BOB DOLE
KANSAS

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United States Senate
OFFICE OF THE MAJORITY LEADER
WASHINGTON, DC 20510

October 8, 1985

TO: SENATOR DOLE

FROM: GEORGE PIELER

SUBJECT: TALK TO INTERNATIONAL COUNCIL OF SHOPPING CENTERS
Wednesday, October 9, 1985-8:00 a.m. at the Regent Hotel

The ICSC has particular concerns about tax reform.

Also, the ICSC appreciates your help on the 1984 bankruptcy bill. You sponsored provisions included in that bill to protect lessors from unreasonable actions by bankrupt commercial (non-residential) tenants. For example, under the legislation you sponsored, such tenants could not refuse to pay on space they still occupy, or refuse to vacate space they no longer operate, or alter their use of shopping center space in a way that violates the lease.

Attachment

Tax Reform Concerns

ICSC supports the concept of tax reform, but generally, anything that reduces tax breaks for real estate--including limits on syndicated tax shelter deals--will be of concern to ICSC. In particular--

- **At-risk rules**

  The Reagan plan would extend at-risk rules to real estate: that is, limit the deductible loss a taxpayer may claim on an investment to the amount the taxpayer has at risk. Current law allows real estate investors to shelter income from other sources. ICSC opposes changing the law on the ground that many developers would be unable to get financing, since their debt-equity ratios would look too high to lenders.

- **Depreciation**

  ICSC argues that the Reagan plan is not neutral as applied to structures when compared with other depreciable assets. Obviously that is a subjective judgment: since Reagan would index depreciation, the value of his new system would depend, to some extent on the relative impact of inflation on different types of depreciable assets. But the Reagan plan is intended to be neutral among types of assets, so ICSC agrees in principle.

- **Recapture**

  ICSC opposes the so-called recapture provision of the Reagan plan as it applies to depreciation deductions for structures.

- **Capital gains**

  ICSC opposes the provision in the Reagan plan that would deny capital gains treatment for depreciable assets. They worry about 'locking in' investment in depreciable property and discourage investment in real property. The administration argues this change makes sense when we index depreciation, preventing taxation of an illusory gain on sale of depreciable property.

Also, attached are general talking points on tax reform and the deficit.

Taxes

- The President and the American people have sworn off tax increases as a deficit solution, and no one in Congress seems to want to suggest otherwise. So as far as taxes are concerned, the focus will be on tax reform and ways to improve the distribution of the tax burden.

- There have been a lot of reports and analyses of inequities in the tax code, including one of Joe Pechman on who pays taxes, and one by Ralph Nader's Public Citizen group on corporate loopholes. Despite all the headlines, the bottom line conclusion is one we have known for a long time--payroll taxes and bracket creep raised the tax burden on working people, while the proliferation of tax loopholes cut taxes for the upper income and corporations. There, in a nutshell, is the source of most of the momentum for tax reform.

- Working people have legitimate concerns in the tax debate: protection of the tax free status of fringe benefits that workers have bargained for, including health insurance--greater equity for the average taxpayer through lower rates and larger personal exemptions. Businesses and workers who don't benefit from rich fringe benefits have legitimate concerns, too, which is why we expect a long and lively debate.

- Clearly tax reform is important, because we must have a tax system that our people believe in and will support without coercion. But unless we deal with the deficit, initiatives such as tax reform will fall by the wayside--because our fiscal crisis will demand all our energy if it gets worse.

- Republicans led the effort to reduce and index tax rates, close corporate loopholes, shut off some upper-income benefits, and improve tax compliance over the past four years. Taken together these changes are the best improvements in tax policy for working people in many years. And without them, scheduled increases in the payroll tax would be pinching workers much more severely than they are.

- The latest report by the Joint Committee on Taxation shows that tax loopholes and preferences will amount to about $424 billion in 1986. Tax loopholes are on a rapid growth path--which is why people are troubled by the unfairness of a "swiss cheese" tax base.

Reagan's Tax Reform

- The President has proposed a striking and historic revision of the income tax laws. His plan would make the system both simpler and fairer.

- The present 14 brackets would be replaced by just three: 15%, 25%, and 35%. The maximum corporate rate would drop to 33% (with graduated rates for small business).

- The plan as a whole would shift the tax burden away from working people and toward businesses that have a lot of income but haven't paid their share of tax. Total taxes paid by individuals would drop 7 percent, while corporate tax payments would rise about 9 percent.

- Distributional Offset. Under the Reagan plan, families with incomes of $10,000 or less would get a 35.5% tax cut; $10,000 to $15,000, a 22.8% tax cut; $15,000 to $20,000, a 13.5% tax cut; $20,000 to $30,000, an 8.7% tax cut; $30,000 to $50,000, a 6.6% tax cut; $50,000 to $100,000, a 4.2% tax cut; $100,000 to $200,000, a 4.1% tax cut; and $200,000 or more, a 10.7% tax cut (the larger-than-average break for the top income group results from the lower top rate of 35% and the lower top capital gain tax rate of 17.5%).

- Return Free System. Under the Reagan plan, only 33% of taxpayers are expected to itemize. In addition, more than half of all taxpayers would be able to get their tax bill or refund without filing a return (if they so choose).

- Protection for Low Income. The plan would remove from the tax rolls virtually all families, married couples, single heads of households, and older Americans at or below the poverty line. This would result from the combination of increasing the personal exemption, zero bracket, earned income credit, and the new consolidated credit for the blind, elderly, and disabled.

- Indexing Protection. The plan retains the indexing protection for rate brackets, the personal exemption, and the zero bracket which we pioneered in 1981. Most plans that claim to do more for middle incomes (like Bradley-Gephardt) do not protect taxpayers against inflation and would do less for them in the long run. President Reagan also expands the indexing concept to the earned income credit, protecting the working poor, to depreciation and to capital gains (in 1991).

- Business and Growth. President Reagan proposes a system of business taxation that is more neutral and will reduce tax-motivated distortions that skew economic decisions. Repealing the ITC and revising depreciation schedules mean greater neutrality among different investment categories. Other changes that will limit economic distortions include limiting real estate tax breaks to the amount at risk, and tightening the minimum tax with regard to oil and gas tax breaks (intangible drilling costs).

- Issues to Watch. Congress is giving the President's plan a very close look, and no doubt many Members have particular changes they want to propose. In particular, there will be focus on:

  - Distribution of Tax Burden. Some are concerned about the break for the top income class--but to address that would require changing the rate structure on the capital gains exclusion, both very sensitive issues. Secretary Baker's proposals to drop inventory indexing, eliminate 401(k)s, and restore the child care credit will help make the case this is a revenue-neutral plan.

  - Neutrality/Investment. Any perceived deviation from "neutral" tax treatment for different industries will bring demands for change from other industries. In addition, those industries most heavily subsidized by the current code--like those which benefit from the ITC because they are capital-intensive--will want to minimize the effect of the plan.

  - State and Local Taxes. Secretary Baker has said that eliminating the deduction for State and local taxes is a sort of "acid test" for serious tax reform. This is a $40 billion item over the projected phase-in period, and that amount would be difficult to make up. If high-tax States can fight off this change--even in the context of much lower tax rates and other benefits that ease the tax take on their citizens--progress may be difficult. A compromise that doesn't lose much revenue may be necessary.

THE DEFICIT AND THE AVERAGE AMERICAN

- Unless we enact a massive deficit reduction measure, American families will face either higher interest rates or higher inflation: not to mention the risk of a disastrous new recession throwing millions of breadwinners out of work.

- Most economists believe that enactment of the deficit reduction package as large as the Senate offer will produce a drop of at least 1 percent in interest rates over the short run and 2 to 3 pecentage points over the long term: relative to what they otherwise would be.

- With a 2% drop in interest rates, the monthly payment on a median priced home ($80,000) will go down by about $100 a month.

- Conversely, if we don't reduce the deficit to keep rates as low as they are now, homeowners could face that large an increase-or-more in monthly payments.

- A 2% drop in interest rates would mean an additional $4,000 in income for the average wheat farmer with a 1,000 acre operation.

- This year alone, the Federal government will overspend close to $1,000 for every man, woman and child in America.

- This $1,000 per head of additional Federal debt will be one more burden for our children to repay in higher taxes or higher inflation in the future.

- I don't believe we can let this budget negotiation fail. If we don't act now on major deficit reduction, the American people will pay the price. By 1989, interest on the debt alone would take up half of all individual income tax payments. The interest cost would be $250 billion or $1,100 for each American.

- If we can get something like this package I am very, very optimistic about the course of the economy. I think we take too much for granted what we have achieved so far: strong growth without inflation. We can keep that going if we reduce the deficit substantially. The way is open to economic performance unprecedented in the postwar period if we have the will to find it.

ESCALATING DEFICIT

The main threat to continued economic expansion is run-away Federal spending.

- Since 1940, the Federal Government has run deficits in 37 out of the last 45 years. Since 1960, we've run deficits in 24 out of 25 years.

- In 1985, the gross Federal debt will total $1,841 trillion, an increase of 533% over 1960, 238% over 1975, and 101% over 1980. The total debt in 1985 now stands at 48% of our GNP.

- With no changes in Federal spending policy, CBO projects that Federal outlays will rise from $950 billion in 1985 to $1,378 trillion in 1990--an increase of $428 billion in five years.

- If no changes are made, the budget deficit will increase from $214 billion in FY 85 to $300 billion in 1990 and the National debt will increase to $2,786.

INTEREST ON THE DEBT

This massive increase in debt has itself created one of the largest and fastest growing components of Federal spending--interest on the debt. Constant deficits have put fiscal policy on an endless treadmill of paying for the irresponsibility of previous decades:

- In 1965, interest on the National debt cost $9 billion and consumed 1.4% of GNP. By 1980, annual interest costs rose to $52 billion--2% of GNP. But the worst was yet to come.

- In 1985, interest on the National debt will cost taxpayers $130 billion--almost three times the level of five years ago. This represents 3.8% of GNP, 13.5% of the entire 1985 budget, and a 1,450% increase in costs over 1965.

- $130 billion is equal to the sum total of all Federal spending from 1789--the founding of the Republic--to 1936. It also equals total Federal outlays in 1966, the entire defense budget in 1980, and twice the level of medicare funding today.

- To put it in even simpler terms, about 40% of all revenue collected by the Federal Government from personal income taxes ($330 billion in 1985) will go to pay interest costs and no Federal services at all.

GRAND HOTEL
REGENT #5

Intl Council of
Shopping Ctrs
10/9/85

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