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SD-106

BOB DOLE
KANSAS

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

May 16, 1986

TO: Senator Dole

FROM: George Pieler

SUBJECT: Talk to Heinz Pennsylvania Tax Seminar

You are scheduled to talk to the group at lunchtime on Monday, May 19.

These are about 200-300 businessmen from Pennsylvania who will be spending most of the day hearing about the Finance tax reform bill (including a presentation Rich will make in the morning).

Attached are current materials on tax, budget, and trade.

Attachments

May 15, 1986

Tax Reform in the Senate

- The Senate Finance Committee has done the country proud by producing the most far-reaching tax reform bill in history: and approving it by an overwhelming 20-0 vote. They said we couldn't beat the special interests--they were wrong.

- Tax reform in the Senate means the lowest income tax rates since 1931. The new rates are 15% up to $29,300 in income (joint returns), and 27% above that income level. On the corporate side, the rate is 33%.

- It also means significant tax reductions for working people in America, particularly the lowest-income wage-earners. 6 million low-income Americans will be taken off the tax rolls completely as a result of tax reform. The personal exemption will go up to $1,900 in 1987 and $2,000 in 1988. The standard deduction will go up to $5,000 for joint returns.

- Taxpayers with incomes of $10,000 or less get a 62% tax reduction; between $10,000 and $20,000, an 18% tax reduction; between $30,000 and $40,000, a 5% reduction; and between $40,000 and $50,000, a 6.5% reduction.

- These low, low tax rates are made possible by a major crackdown on unjustified tax shelters for the rich, and by eliminating many deductions, exemptions, credits, and the like. But mortgage interest, charitable contributions, and State and local income and property taxes remain fully deductible. The casualty loss deduction will remain subject to a 10 percent floor and the medical expenses deduction will be subject to a similar floor.

- A stiff new minimum tax ensures that no wealthy individual or corporation can avoid paying their fair share of tax.

Productive for the economy

- This bill achieves, in a big way, the major economic goal of tax reform: establishing a 'level playing field' by taking the juice out of special tax breaks. If we can get this bill signed into law, people will be able to make their financial and economic decisions without worrying so much about tax consequences--and that's a very healthy thing for the economy.

- In addition, the Senate bill creates a much healthier climate for investment and productivity than the House-passed bill. Depreciation allowances are more realistic, and more neutral among various industries than under the House bill.

- Simply put, lower tax rates for all taxpayers are bound to take the premium out of planning your finances for the purpose of tax avoidance. And getting rid of some long-standing tax differentials--like capital gains rates, deductions for most interest payments, and dropping the investment credit--advances the same goal. From now on, straight marketplace judgment is what counts most--not creative tax accounting.

Last step in the process

- The new high-water mark on tax reform represented in the Finance Committee bill is the culmination of years of hard work in reducing and stabilizing tax rates and broadening the tax base. The groundwork for tax reform was laid in 1981 when, under my Chairmanship, the Finance Committee led the way for President Reagan's tax-rate cuts and initiated tax indexing to keep those lower rates in place, regardless of inflaion.

- The next step was to resort to closing loopholes, improving compliance, and removing special preferences as a way to raise revenue, rather than re-imposing high tax rates on working Americans. That was done in both 1982 and 1984 under the Dole Finance Committee.

- The net effect of this was to point the way to a lower-rate, broader-based, fairer and more productive tax system. Tax indexing and accelerated depreciation were sort of like the Gramm-Rudman of the tax code: they force us to make choices we ought to have been making all along, and to face the fact that our tax code had become a maze of special preferences and privileges that had outlived their usefulness.

- Now let's finish the job: and achieve true tax reform for all Americans.

May 9, 1986

Individual Retirement Accounts

- o Senator Packwood's 25% proposal included repeal of IRA's for everyone. His 27% proposal as it was adopted by the Finance Committee includes my suggestion to retain fully deductible IRA's for people who are not covered by pension plans. This change meant that the proposal would raise $19 billion less over 5 years than full repeal.

- o Senator Chafee's amendment which the Committee adopted broadened IRA's a little more by allowing individuals who are covered by pension plans to make nondeductible IRA contributions. The income earned on these investments would remain tax-deferred until it is withdrawn from the IRA.

- o The Chafee amendment cost $1.6 billion over five years. Of course, since the "inside buildup" will grow over the years, the revenue cost in the future will be substantially greater.

- o These changes, therefore, restored over $20 bilion of the $46 billion that would have been gained by repeal of IRA's altogether.

Misconceptions

- o Individuals who now have IRA's will be able to keep the amounts they have already invested without any change in tax effect. They will also be able to contribute up to $2,000 each year ($2,250 for IRA's with a spousal feature) in the future. The only difference is that only individuals not covered by a pension plan will be able to take a deduction for the contribution. In every case, income earned on amounts invested in an IRA will remain tax-free until they are withdrawn from the IRA.

- o There has been much discussion about the loss of the deduction for some individuals. Two things seem to have been ignored in the debate so far. First, 80 percent of all families will have their tax rate reduced to 15 percent. At this rate, the deduction on a maximum $2,000 contribution is worth only $300. With the low rate, double personal exemption and larger standard deduction, virtually all these taxpayers will have a substantial tax cut despite the loss of an IRA deduction. Of course, many people do not contribute the maximum $2,000 and the deduction is even less important for them.

- Second, the value of the tax-deferral on the income earned in IRA's is the most significant feature from a tax-saving point of view. That feature is still retained in every case.

- In addition, I should point out that more and more employers are adding 401(k) plans as part of the pension package they offer to their employees.

- 401(k) plans are equivalent to IRA's in tax effect except that the maximum annual contribution is $7,000. I expect that, if the Finance Committee's IRA rules are included in the legislation sent to the President, the rate of new 401(k) plans will accelerate.

- If I am right on this, we basically have a fight not about the level of retirement savings, but about who holds these savings. Will it be the banks and insurance companies who administer pension plans or the banks, mutual funds, and other financial institutions who sell IRA's?

Who Takes the IRA Deduction
(Percentages Rounded)

Adjusted Gross Income (1983 figures)	Percent of All Tax Returns	Percent of All IRA Deductions
Below $10,000	36.0%	3.2%
$10,000-$19,999	25.6	11.2
$20,000-$29,999	16.8	18.7
$30,000-$39,999	10.8	21.1
$40,000-$49,999	5.3	17.4
$50,000-$74,999	3.7	18.0
$75,000-$99,999	.8	5.2
$100,000 and up	.8	5.1

May 9, 1986

TAX RATES

- The individual tax rates in the Finance Committee bill are 15 and 27 percent. 80 percent of families will be in the 15 percent bracket.

- To make sure that wealthier taxpayers do not receive a disproportionate tax cut, the benefits of the 15 percent bracket and of the increased personal exemption are phased out for high income taxpayers.

Recapture of Benefit of the 15% Bracket

- The benefit of the 15 percent rate bracket is recaptured for taxpayers filing joint returns who have incomes over $75,000. This is done by a gradual phase-in so that the dollar value of the lower rate is not entirely lost unless the taxpayer has more than $145,320 in income.

- The provision is drafted as a phase-out to avoid what we call a "cliff". We did not think it would be fair to tell taxpayers who have $75,001 of income to pay tax on all of it at the 27% rate, while taxpayers with $74,999 in income pay tax at the 15 percent rate.

- However, the way it is drafted gives commentators an opportunity to say that the "marginal" tax rate for families between $75,000 and $145,320 is 32 percent instead of 27 percent.

- The important thing to remember is that their effective tax rate never will exceed 27 percent and that, even at 32 percent, the rate is below the 38 percent in the House bill and 35 percent in the President's proposals.

(N.B. The phaseout for single taxpayers begins at $45,000.)

Phaseout of Personal Exemption

- The Committee bill phases out the personal exemption for families between $145,320 and $185,320.

- I understand that the effect of this is to raise the marginal rate for these taxpayers to 28 percent, although, as I mentioned earlier, the effective rate never exceeds 27 percent.

o However, for taxpayers in this income range, the rate is significantly less than the 50 percent rate in current law, as well as the rates proposed by the President and passed by the House.

o Some will argue that the Finance Committee bill raises the tax rate on long-term capital gains too much. I can understand their concern, but over 70 percent of the benefit from the capital gains exclusion is taken by individuals making over $250,000 a year. These taxpayers will have a tax rate of 27 percent. That should be sufficient.

May 8, 1986

Real Estate Talking Points

- The tax reform bill reported by the Finance Committee will be very effective in reducing tax considerations as a part of investment decision making.

- With a 27 percent maximum tax rate, individuals will have little incentive to invest in tax shelters. For that reason alone the limitation on the deduction of passive losses will be much less important than it would be if rates were left where they are under present law or under the House bill.

- In addition, with the capital cost recovery period for residential real estate increased to 27 1/2 years and the recovery period for commercial real estate increased to 31 1/2 years, there is little artificial incentive left in depreciation deductions.

- That does not mean that some individuals who have invested in recent years will not be disadvantaged by the new rules.

- Whether it is good policy or not, it has been completely legal for individuals to offset other income by deductions derived from real estate and other investments. It would not be fair to change the rules without giving these individuals some time to rearrange their investments.

- For that reason, although I was a member of the so-called "core group", I refused to support the Chairman's package until a transition rule was included. We were able to convince Senator Packwood to adopt first a 3-year phase-in of the passive loss limitation and later a 4-year phase-in. I tried to extend the phase-in to 5 years, but there were not enough votes for additional relief. Perhaps some additional relief will be possible on the floor, but at least we were able to moderate the immediate short-term effect of the passive loss limitations.

May 9, 1986

PASSIVE LOSS LIMITATION

EXCEPTION FOR OIL AND GAS WORKING INTERESTS

- The Finance Committee bill contains an exception from the passive loss limitation rule for "working interests in oil and gas properties".

- First, I would like to clear up a misconception in the reports by the media. There was no threat to kill the tax reform effort if this modification were not adopted. This modification was included in this bill just like any other modification -- a majority of the Committee thought it was a good idea and voted for it.

- The passive loss limitation rule is the provision that has been described as the "anti-tax shelter" provision. This provision raises approximately $50 billion over five years by telling investors in tax shelters that they can use deductions generated from these investments to offset income generated by these types of investments, but they cannot use these deductions to offset other income such as salary or wages.

- The working interest exception recognizes the economic reality in the way some oil and gas deals are structured differs greatly from real estate or other types of investment.

- Those of us who voted for this exception believe that when an individual enters into a joint venture to drill an oil well and agrees that he will be joint and severally liable for any costs that may result, he is in the business of oil drilling. He is not just a passive investor.

- These individuals receive detailed explanations of proposed expenditures before they are incurred and they have the ability to challenge the specifics and to put up funds or not. They are truly in the business whether or not they actually operate the drilling rig.

- o In contrast, if an individual is a limited partner in a so-called oil fund, he will be treated just like other passive investors and the loss limitations will apply.

- o The working interest exception represents $1.4 billion out of $50 billion attributed to the passive loss limitation. It is clear that the exception does not materially reduce the value of the general rule.

- o In fact, it has almost exactly the same revenue impact as the 3-year extension of the targeted jobs credit which we agreed to the same evening we agreed to the working interest rule. I have not seen any stories about the $1.3 billion loss attributable to these credits.

- o Similarly, the research and development credit was extended for 4 years at $1 billion per year. It is an incentive, not an economic cost, but no one has written about that. No one has discussed the credit for historic and other older buildings which cost $2 billion per year and have been the basis for countless tax shelters.

5/9/86

Handicapping the Tokyo Economic Summit

The U.S. went into the summit with the goals of keeping the dollar down as against the yen (or getting it even lower); encouraging Japan and Germany to speed up their economies (preferably by tax cuts and lower interest); and improving coordination of monetary and fiscal policies among the major developed countries. A corollary is setting the stage for the next GATT round of (hopefully) trade liberalization talks, scheduled to begin in September.

• The dollar. Essentially there is no major change in direction over the G-5 agreement of last September, which aimed at a lower value for the dollar, deficit reduction in the U.S., faster growth in Europe and Japah, and resistance to protectionism on the part of all the major trading nations. Japan failed to win agreement on stabilizing or even increasing the value of the dollar vis-a-vis the yen--a failure that may cause political problems for Nakasone.

(Note--the general consensus is that the Administration would like the dollar down even further against the yen, to keep pressure on Japan to open markets, but that the Fed is wary of a plunge in the dollar that could ultimately mean higher inflation).

• Japanese/German economies. No formal agreement was reached on the question of Japan and Germany stimulating their economies: both are growing at a moderate pace (Japan at around 3% this year, according to the IMF, Germany at about 3.7%). At the same time, there is hope that lower oil prices and lower interest rates will have a stimulative effect in both countries, even without government action.

• Policy coordination. The Reagan administration appears to want to steer a course between strict advocates of floating exchange rates (the present system) and those who want an agreement to fix exchange rates. Japan and Germany like the present system--France prefers fixed rates. From this standpoint, the summit agreement for better coordination and monitoring of each others' economic policies is a win for the U.S. But the proof will be in seeing what the summit participants actually do in a coordinated fashion--it's easier to talk about coordination when the world economy is looking pretty good (like now) than when the threat of recession or high inflation is present.

Big picture. At a minimum, the Tokyo summit brought progress in reducing the risk of renewed inflation or economic downturn in the world economy--because the seven industrial nations at the summit agreed to consider and discuss those risks in setting domestic economic policies. Beyond that, the summit participants continue to give lip service to free trade--but one of the major disappointments was a weak statement acknowledging the 'problem' of overly-protected and subsidized agricultural markets. When it comes to hard cases, the will to pursue a clear course towards more open markets still seems to be lacking.

May 15, 1986

TRADE TALKING POINTS

o While good news on the trade front is slow in coming, exports of U.S. capital equipment and other goods are running about 4% over the pace at the end of 1985. If this trend continues, we should see significant improvement in the trade deficit before the end of this year.

o This positive shift is, in part, the result of past year's decline in the value of the dollar. The dollar has fallen almost 35% from its peak in February 1985 against the yen, and since last September's G-5 meeting it's fallen about 15% against a basket of major currencies.

o I hope this turnabout continues--but there's more to trade trends than exchange rates. Even with the good news, we must face facts: the United States does not have a clearly defined trade strategy or policies to carry it out.

o We Americans believe that trade is an <u>exchange</u> of goods and services -- a two-way street between businesses, states, and countries. However, many countries are only too happy to sell us their goods. But when it comes to buying ours, they say "No thanks."

o The truth is that most of us in Congress, as well as most businesses, don't want to erect protectionist barriers to prevent foreign goods from entering the United States. What we want is access -- the opportunity to sell American products in overseas markets.

o In the past, the United States blinked at other countries' trade barriers even though our markets are among the most open in the world. In view of the current U.S. political and economic climate we can no longer afford this luxury.

CONGRESS AND TRADE POLICY

o I have never seen stronger Congressional sentiment for acting on the trade front. My colleagues, including strong advocates of free trade, are fed up with what they believe to be basic unfairness.

o Trade already is and will continue to be a major political issue in the 1986 and 1988 elections. Many in Congress are already moving to gain early political advantage. Hundreds of trade bills have been introduced to date. The stakes are high -- maybe control of the Senate in 1986.

o Although there is a diversity of opinion among members of Congress on how best to address the trade issue, there seems to be a consensus that Congress must reassert its broad constitutional authority over trade policy. Under Article I of the Constitution, the Congress is expressly vested with the power to regulate commerce with foreign nations and to set tariffs. Over the years, Congress has ceded to the Executive Branch the primary role not only in implementing these policies but also in setting our overall trade policies.

o Last November a bipartisan group of my Senate colleagues joined with me in introducing a major trade initiative which attempts to reestablish our involvement.

Specifically, this bipartisan initiative addresses the following objectives:

To insure systematic enforcement of existing trade laws against foreign unfair trade practices;

To expand trade through market liberalization;

To promote meaningful adjustment of import-impacted industries to new competitive conditions; and

To remedy misalignment of the dollar, developing country debt, and disincentives to U.S. exports.

In addition to this effort there are numerous sector-specific bills which the Congress may consider. Notable among them, the so-called textile bill, which passed overwhelmingly in both the House and Senate and was vetoed by the President.

CANADIAN FREE TRADE AGREEMENT

o One more recent example of congressional determination to become a more active partner on trade is the debate over the Administration's proposal to begin negotiations on a free trade zone agreement with Canada.

o The administration got its way. On a tie vote, the Finance Committee defeated a motion to put the negotiations on a slow track--in effect gutting the initiative. But the Administration came close to losing this one. There were a number of senators unhappy about specific trade issues with Canada, such as timber. But there were others, Republicans included, who are dissatisfied with the administration's failure to be more aggressive overall on the trade front and to take Congress for granted.

o The trade issue is not going to go away. Members of Congress recognize that America's trade policy is in a shambles. And Congress seems prepared to pick up the pieces -- if you can believe all the rhetoric.

May 15, 1986

BUDGET TALKING POINTS

o On May 2, the Senate fulfilled its obligation under Gramm-Rudman-Hollings and approved a spending blueprint for fiscal 1987 that meets the $144 billion deficit target.

o Ours was a bipartisan effort. 38 Republicans and 28 Democrats voted for the revamped Domenici-Chiles budget.

o And the budget we approved is an honest, straightforward attempt to deal with economic realities -- not by making defense a whipping boy and not by tax overkill.

o Unfortunately, the same cannot be said for the House budget, which the House passed yesterday 245-179. The House budget has a $138 billion deficit figure for 1987, but it was achieved by gutting defense spending. This budget decreases 1987 spending authority to $285 billion from the administration's original $320 billion request.

o Many think the Senate went too far when it reduced defense to $301 billion -- but the House's $285 billion level is totally irresponsible and totally unrealistic.

o I hope that the House/Senate budget conferees will get down to work soon, and quickly blow away the bogus defense figures in the House budget so they can agree upon a realistic and responsible national security budget -- one Republicans, Democrats and the American people can accept.

o The Senate faced up to the promise it made to deficit reduction when it passed Gramm-Rudman-Hollings. We did not turn our back on the budget process, we were not willing to roll the dice and hope that the Gods will save us from sequester. Now, it's up to the House to be responsible as well.

o It is in every one's best interest to get a budget resolution in place so that Congress can complete work on all of its fiscal business, from appropriations bills, to deficit reduction, to tax reform.

o The Senate's budget, though far from perfect, is a far superior product than the House plan.

o First, our defense budget though $19 billion below the administration's request, and below the level I would like to see, is at least responsible.

o Second, unlike the House we made substantial reductions in non-defense spending. In 1987 alone, we saved an additional $8.7 billion in these programs -- and over the next three years, these program reforms will yield $25 billion in savings.

o Finally, we reluctantly agreed to revenue increase of $10.6 billion in 1987, $45 billion over three years. These revenue increases could be handled without raising taxes. And there is the possibility we could use a surplus from tax reform for this purpose.

o With the exception of defense, I think the differences between the House and Senate budgets are fairly narrow and should be easy to resolve. The defense issue, is critical. however, and the Senate leadership, including Senate Budget Committee Chairman Domenici, have pledged to the President that we will do everything in our power to hold to the Senate's defense spending level.

The Deficit and the Average American

- Unless we follow a deficit reduction path like that mandated under Gramm-Rudman, 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. That is what the Gramm-Rudman-Hollings initiative is all about.

- Most economists believe that enactment of deficit reduction measures that eliminate the deficit by the end of the decade will produce a drop of at least 1 percent in interest rates over the short run and 2 to 3 percentage 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) would 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.

  -- In 1985, the Federal Government overspent to the tune of $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.

Interest on the Debt

The 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 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.

But if we can adhere to the deficit-reduction goals we've set for ourselves, 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.

May 6, 1986

Finance Committee Tax Reform Bill

- o There will be only two rates for individuals: 15% and 27%. This will cut the top rate almost in half;
- o 80% of Americans will have a top rate no higher than 15%;
- o This will be the lowest individual top rate since 1931.
- o Approximately 6 million of the working poor will be moved off the Federal income tax rolls;
- o A family of four making up to $13,000, $530 above the poverty line, will pay no Federal income taxes;
- o Fairness is restored to the tax system through tough anti-sheltering and minimum tax rules. While significantly reducing Federal income tax rates, the proposal also permits the following deductions:
  - Home mortgage interest;
  - State and local income taxes;
  - State and local property taxes;
  - State and local personal property taxes;
  - Charitable contributions for itemizers.

The following benefits will be retained and/or increased:

- Standard deduction for single, joint and head of household taxpayers--increased;
- Personal exemption--increased to $2,000;
- $600 standard deduction for the elderly and blind;
- Earned income tax credit for lower income taxpayers--increased;
- Child care credits--retained.

How is all of this paid for?

- By closing corporate loopholes and special tax privileges--approximately $105 billion;

- By eliminating the ability of individuals to avoid paying taxes by using tax shelters--$50 billion; A 4-year transition rule applies to alleviate short-term disruption, and working interests are not subject to the passive loss limitations where an individual has unlimited liability.

- By eliminating individual capital gain exclusion--$220 billion; 71% of which is presently claimed by individuals earning over $200,000; (The tax rate on long-term capital gains will still be below the 28 percent maximum rate in effect before 1981.)

- By imposing a stiff minimum tax on individuals and corporations assuring that wealthy individuals and profitable corporations will have to pay some tax--$40 billion.

o Making future IRA contributions available only to those not covered by pension plans (other than social security)--$30 billion. Individuals covered by a pension plan can still make nondeductible IRA contributions and take advantage of tax deferral on the income from his/her investment.

The proposal sets a top corporate rate of 33%, down from a top rate of 46% under current law.

No changes are made to current law excise taxes.

May 19 mon.

Speak

George

ASMMA

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April 17, 1986

9:45 am Speak at Sheraton Wash 2660 Woodley Rd

The Honorable Robert Dole
Majority Leader
141 Hart Senate Office Building
Washington, D.C. 10510

Dear Senator Dole:

On behalf of the Board of Directors of the American Supply & Machinery Manufacturers Association, the National Industrial Distributors Association and the Southern Industrial Distributiors Association, I would like to extend an invitation to you to give the keynote address at the 1986 Triple Industrial Supply Convention at the Sheraton Washington at 9:45 a.m. on May 19, 1986.

This is the major meeting for the manufacturers and distributors who supply America's industrial sector. The Sheraton Washington Ballroom will be filled with 4,000 people making the first time in over two decades that our capital city has hosted this event. The U.S. Marine Band and a Marine Corps Color Guard will open the session.

Our membership is comprised of a cross-section of American manufacturing and distributing companies from the very large corporations to family-owned firms. Regardless of size, all of them represent the entrepreneurial "can do" spirit that has guided our nation. At the same time, they have always recognized their obligation to our country and the communities in which they are located. A highlight of our meeting each year is the presentation of the American Eagle Award to those member companies which have provided their employees and their communities with programs and activities that promote the positive aspects of our free enterprise system.

We know and understand that you can accept a precious few of the many invitations you recieve. We are hopeful, nonetheless, that the importance of the Triple Industrial Convention, will prompt you to accept ours. We are happy to provide a $2,000 honorarium. We will be honored to have you join us at this event.

Cordially,

Sheldon I London

Sheldon I. London