Kay Luther

July 2 Wed

Speak

United States Department of Agriculture
Rural Electrification Administration
Office of the Administrator
Washington, D.C. 20250

Joyce (copy to Mark S)

APR 2 1986

OK. 8:15 Speak

Honorable Robert Dole
United States Senate
Washington, D.C. 20510

Dear Senator Dole:

The 1986 National Conference of the Rural Electrification Administration will be held here in the Washington area from July 21-25 at the Hyatt Regency Hotel in Bethesda, Maryland.

The national conference brings together REA field staff in 47 states as well as key personnel in the Washington office representing the Electric, Telephone, and Accounting Divisions. These government employees are very interested in the state of agriculture and other timely national issues such as the deficit and tax reform.

in Bethesda

On behalf of the REA organization, we would consider it a great honor if you could take a few minutes to keynote our conference on Monday, July 21, 1986, at 8:15 a.m., at the Hyatt, or perhaps your schedule would better accommodate a talk to all REA personnel on Wednesday morning, July 23, 1986, in the Jefferson Auditorium (South Building) of the Department of Agriculture. 8:15 am

4th Wing - South USDA Bldg.

Your presence on our program will enhance the overall success of the conference. As Majority Leader in the United States Senate with close ties to agriculture and in-depth knowledge of the REA program, including the stress that some of the G&T plants are experiencing at the present time, your message would be of keen interest.

I am taking the liberty of enclosing a copy of the program for the 1985 conference, which marked the 50th year of rural electrification. The agency is now in its 51st year; changes are sorely needed, as you know, to modernize the Program to bring it into line with the times. The basic mission has been accomplished, with 98.8 percent of rural America electrified and 96 percent having telephone service. There are borrowers with real need, but one cannot justify the overall Program as it currently exists.

REA has not had any RIFs or furloughs since I have been Administrator and has returned money to the United States Treasury.

Please consider this invitation an opportunity to address an audience close by to the Senate chamber -- an audience which would welcome hearing from one of our country's most respected and knowledgeable lawmakers.

With high regards.

Sincerely,

382-9540 Ruth Ann Mason

Harold V. Hunter

HAROLD V. HUNTER
Administrator

Enclosure

Speak

July ~~Mon. at~~ 23 Wed.

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382-9540

Ruth Ann Mason

basic talking points

update

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general farm
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budget

Enclosure

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June 27, 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 take some of the juice out of the tax rate reduction for wealthier taxpayers, the tax breaks from 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 cut back for taxpayers filing joint returns who have incomes over $75,000. This is done by a gradual phase-in, so the dollar benefit of the lower rate doesn't disappear completely until 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 <u>effective</u> tax rate never will exceed 27 percent and that, even at 32 percent, the rate is well below the 38 percent in the House bill and 335 percent in the President's proposals. Still, I hope we can work out some of these anomalies in conference.

(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.

- 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.

- 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.

June 27, 1986

Tax Reform in the Senate

o The U.S. Senate has done the country proud by producing the most far-reaching tax reform bill in history: the Senate approved it by an overwhelming 97-3 vote. They said we couldn't beat the special interests--they were wrong.

o 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%.

o 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.

o Taxpayers with income 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.

o 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.

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

o In addition, the Senate has voted to do everything possible in Conference to restore some deductions for all IRA contributions and for State sales taxes.

Productive for the economy

o 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.

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

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

<u>Last step in the process</u>

o The new higher-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, regarless of inflation.

o 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.

o 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 soret 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.

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

<u>Issue for Conference</u>

o There are many good features in both the Senate and House bills. We can draw on both to achieve true tax reform, so long as we keep our eye on the goal of getting rates as low as possible.

o In addition to IRA's and State sales taxes, there will be interest in smoothing out the revenue impact of the bill over 5 years, the treatment of capital gains in 1987, and the distribution of benefits from tax reform.

o Even more important, I think we should stop the "stagger effect" that delays rate cuts for 6 months after loopholes are closed. In addition, we need to address the so-called "phantom rate" in excess of 27% that's caused by the upper-income phase out of some tax benefits.

June 25, 1986

TAX REFORM

MAJOR FLOOR AMENDMENTS

STATE AND LOCAL TAXES

The Senate agreed to allow a deduction for 60 percent of excess state and local sales tax payments over income tax payments, rather than repealing the sales tax deduction as the Finance Committee proposed. The provision aids the handful of states with little or no revenue from income taxes. The Senate also agreed to a sense-of-the-Senate resolution declaring that the final tax bill developed by the House and Senate conferees should contain full deductions for all state and local taxes.

FARMERS

Farmers would be exempt from the bill's repeal of income averaging. Also, unused investment tax credits could be carried back over the prior 15 years allowing farmers up to $750 in refunds in years when the taxpayers had enough tax liability to be offset by the credit. (This is a more limited version of the steel company rule.)

LOW-INCOME HOUSING

Low-income housing projects utilizing federal or state and local housing subsidies would still qualify for the proposed low-income housing credit in the bill. The Finance Committee bill would have prevented "double-dipping" of the credit and direct housing subsidies.

INDIVIDUAL RETIREMENT ACCOUNTS

The Senate agreed to a sense-of-the-Senate resolution directing conferees to restore the IRA deduction, but without altering the tax rates in the bill or the distribution of individual tax cuts.

FIRPTA

The Senate reversed the committee's decision to repeal the Foreign Investment in Real Property Tax Act.

DEFICIT

The Senate agreed to ignore, for purposes of meeting the Gramm-Rudman balanced budget targets, the revenue surpluses created in the first two years of what is expected to be a revenue-neutral bill over five years.

MIDDLE-INCOME TAXPAYERS

The Senate, after defeating two amendments aimed at providing more tax relief for middle-income taxpayers than the committee will would have provided, agreed to a sense-of-the-Senate resolution calling on conferees to increase tax benefits for these taxpayers.

PASSIVE LOSSES

The five-year phase-in of the passive loss restrictions in the bill would be limited to existing investments at the time the new law takes effect. (Part of Mitchell low-income housing amendment.)

MUTUAL FUNDS

New rules governing the taxation of mutual funds, among other things, would expand the types of income mutual funds are allowed to have and still keep their status as being taxed as a conduit so that interest, dividends, and capital gains are passed to shareholders. The amendment adopted by the Senate also would tax separately a series of funds within each mutual fund, thus codifying recent Internal Revenue Service private letter rulings.

TAX AMNESTY

The Senate deleted a provision of the Finance Committee bill codifying IRS' practice of eliminating criminal penalties against taxpayers who voluntary disclose tax violations and fully pay any past-due taxes and penalties.

EFFECTS OF TAX REFORM ON AGRICULTURE

1. Limitation of losses for tax purposes

* "Passive" investors who have no material role in managing a farm cannot deduct losses resulting from the investment against other income. Thus, the investors can shelter all income from farm operations by using paper losses generated by the farm operations, but they cannot shelter any income from other sources such as professional income from a dental practice.

* Current law sets no such limits.

* 1982 farm proprietorship profits were $7.7 billion while farm losses for tax purposes were $19 billion - benefiting high income investors with large off-the-farm incomes.

* The provision would be phased in over a 5-year period, fully effective by 1991.

* This could impact persons who cash-rent land to tenant farmers, according to some. Those who rent land on a crop-share basis probably would qualify for the loss deduction.

2. Special farm debt restructuring

* Heavily indebted farmers could restructure debt with lenders without having to treat the cancelled portion of the loan as income subject to taxation, provided a farmer has a debt-to-equity ratio of 70-30. This means that a bank could write down the principal of a farm loan without the writedown being considered income to the indebted farmer.

* Current law taxes as income cancelled debt if the taxpayer is technically solvent.

3. Limitation of "prepaid" expenses

* With certain exceptions, farmers could deduct no more than 50-percent of expenses such as feed and fertilizer not used or consumed during the year.

* Under current law, expenditures may not be deductible in the year paid if they do not clearly reflect income.

* Prepayment shelters are especially used in farming contexts such as cattle feeding since investers use "cash accounting" in figuring taxes; thus sheltering other income earned during the year.

* Committee bill makes no change in current rules covering eligibility for the use of cash accounting.

(more)

4. Slower depreciation for single-purpose farm structures

* Single-use buildings - such as chicken coops, hog confinement sheds, etc. - could be depreciated over a 10 year period.

* Current law allows for 5-year depreciation.

* Rapid depreciation as we have now is widely acknowledged to be a key factor in encouraging large-scale farm operations, giving a competitive advantage over family run farms.

* Example: Combined with the tax credit, rapid depreciation gives an investor in the 50-percent bracket who builds a 500 sow farrowing barn a federal tax break of nearly $8 for every pig sold; Kansas ranks in the top 10 states for hog production.

5. Limitation of industrial development bonds for agriculture

* No more than $250,000 worth of tax-free bonds could be issued for agricultural projects.

* Current law has no such limitation.

* Some express concern over the use of industrial bonds for large scale farming operations, again giving a competitive edge over family farms.

* Example: An Irish-owned corporation recently announced plans to use such bonds to build a 10,000 dairy cow operation in Georgia; another has used bonds to build a hog "factory" in Michigan.

6. Two-year extension of "Aggie" bonds

* Extends to 1988 the authority for small issue bonds, limited to $250,000, to help first-timne farmers.

* Current law authorizing such bonds is due to expire this year.

7. Health insurance deductions for self-employed farmers

* Farmers and other self-employed individuals not covered by company plans could deduct 50-percent of health insurance premiums.

* Current law does not allow such a deduction, although some farmers are able to treat premiums as a business expense.

# # #

22 July 1986

TALKING POINTS/GRAMM-RUDMAN-HOLLINGS

o I don't think anyone was surprised with the Supreme Court's decision to rule the automatic spending cut provisions of Gramm-Rudman-Hollings unconstitutional.

o But it is already very clear that Congress is not going to ignore the deficit targets set out by Gramm-Rudman-Hollings. Just this Thursday, the House and Senate both reaffirmed the first round of $11.7 billion in spending cuts made under GRH last March.

o When we take up the debt ceiling extension this week, probably today, Senators Gramm, Rudman and Hollings will offer an amendment to meet the objections raised by the Supreme Court about the separation of powers. Their remedy, which is fairly straightforward, will give the Office of Management and Budget the authority to lay out the spending cuts if the automatic trigger is pulled.

o Senator Gramm characterizes OMB's fall-back function as merely a "Green Eyeshade" operation. But knowing the Democrats' distrust of OMB, I'm certain that there will be objections raised. The legislation is pretty narrowly drawn. But there may be attempts to guarantee that the administration will have no discretion, that its function will indeed be purely ministerial.

o Although we could and probably will spend more time than necessary on this the bottom line is that Congress should fix Gramm-Rudman-Hollings as quickly as possible so the threat of the automatic spending cuts stays alive. And in the end, I think we will do this.

o Right now, however, our main mission should be to implement the budget resolution we adopted in late June -- a budget resolution that was designed to meet the $144 billion GRH deficit target. If slower than expected economic growth worsens the deficit situation, as apparently it will, then we may have to find more savings.

o But I think Congress has the will to do that as well -- to meet its obligations. Because the alternative is automatic spending cuts that would literally cripple the defense budget -- taking $20-25 billion out of defense outlays -- and show no discrimination or sense of priority among a host of federal programs. That's no way to run the federal government.

July 17, 1986

INTEREST RATES AND THE ECONOMY

o On June 12 I called for the Federal Reserve to take the lead in lowering interest rates by further reductions in the discount rate (which then stood at 6 1/2%). After that, others indicated they agreed. Business Week called for Fed Leadership in lowering interest rates, and the June 27 Wall Street Journal cited several bank economists and market analysts as predicting another discount rate cut very soon. The Federal Open Market Committee met July 8 and 9 to review money supply targets and credit strategy, and on July 10 the Fed responded: cutting the discount rate to 6%. The prime rate came down, too, to 8%.

o I called for lower interest rates because rates are still too high, considering everything that is going on in the real-world economy. For one thing, inflation is way, way down. In the first quarter of 1986 prices actually fell at a 1.9% rate. For all of 1986, prices are expected to rise at a 2% or 3% rate at worst. Yet the prime rate is still at 8.0%, which means real interest rates are hovering around 5 to 6%.

o In April the Fed cut the discount rate after Chairman Volcker secured agreement on coordinated action with the Germans and Japanese. Most everyone agrees that was a good move for the world economy. This time the Fed acted on its own, and we hope others will follow.

o Further steps may yet be needed. Even though the economy grew at 2.9% in the first quarter--no great shakes in any event--unemployment has crept back up to 7.3%. Lower inflation, disappointing growth rates, and plenty of unused productive capacity all point to the need for a lower interest rate environment.

o World impact. Lower rates and faster growth can help cut our deficit, which we have pledged to do as part of our agreement with Europe and Japan to moderate the value of the dollar. That's our most important weapon in the battle to cut the trade deficit. And lower world rates can help relieve the debt burdens of many of our friends in the third world, and help produce a better-balanced system of world trade and finance.

- Lower rates are also a key part of any effort to stave off protectionism and keep the doors open to the free flow of goods and services around the world. Nothing is more important to the American farmer than open export markets.

- Right now lower rates can help fight inflation as well, by helping us rally support for the kinds of changes that boost productivity--tax reform and lower tax rates, deregulation, privatization, restraint on government spending, and ending wasteful subsidies.