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REMARKS OF SENATOR DOLE BEFORE

LEAGUE OF WOMEN VOTERS

HYATT REGENCY HOTEL

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## TAX REFORM: BEYOND THE BUDGET BATTLE

It's been said that there are only two kinds of people who dislike paying taxes: Men and Women. As Chairman of the Senate Finance Committee, I can produce a great deal of evidence to corroborate that statement. Indeed, non payment of taxes has become almost as deadly to our economy as the tax rates themselves raised at least in part to cover losses from noncompliance. It seems a classic instance of reversing our horse and our cart -- a position by no means unfamiliar in Washington, D.C. -- for Congress to gnash teeth and lock horns over new taxes without expending -- just a little more effort on collecting a tax bill of \$90 billion or more.

## A VOTE OF THANKS

Of course, nothing is more uncommon in politics than common sense. Except, perhaps, in an organization such as this. So before I tax your public-spiritedness with an appeal for what I call genuine tax reform, let me first render my own gratitude to the League for its efforts to produce a breakthrough on extension of the Voting Rights Act. The service you provided was uncommon indeed.

I speak from both observation and participation when I say that your grass roots organizing and lobbying activities were instrumental in getting the legislation through the House. You and your representative, Sally Laird, played an even more pivotal role as part of the Leadership Conference on Civil Rights, laying the groundwork for a compromise proposal. Once that proposal was finalized, the League was one of the first to endorse it. You all know the outcome. Within hours after the compromise was first revealed publicly, the President gave it his "heartfelt support." The following day, it was adopted as a substitute proposal in the Judiciary Committee by a vote of 14-4, and then favorably reported to the floor by a vote of 14-1. Along with my thanks, I ask that you keep up the good work and keep up the pressure as we now move towards expeditious passage of the entire package on the Senate floor.

## ANOTHER INJUSTICE

In this effort as in so many others in the past, the League has displayed a firm grasp of political realities - without ever once surrendering its own historic faith in political possibilities. In extending government's guarantee of the right to vote, we have transformed reality. We have stood fast for elemental fairness.

And it is that same conviction - the spirit that sees potential where others see only problems - that I want to speak this afternoon about another injustice in America, a retreat from responsibility that if allowed to go on unchecked, will cost us tens of billions of dollars, and quite possibly the moral authority of government itself.

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A few days ago, we celebrated tax freedom day. That's the date each year that divides our income between take-home pay and taxes at all levels of government. Thanks to the recent tax cuts enacted as part of the President's Economic Recovery Package, tax freedom day came three days earlier in 1982. For a lot of Americans, it came earlier still - and their good fortune or bad memories is part of an ominous trend.

Think about it: In 1979, noncompliance with federal taxes cost Uncle Sam \$54 billion. Today, that figure has risen to \$75 billion. And if nothing is done, by 1985, it will have nearly doubled - \$102 billion withheld illegally at a time when the Nation's economy is struggling with the prospect of record high deficits. Non-payment of taxes is growing faster than the GNP and almost as fast as the national debt. A few years ago, it was said that computers had taken the place of taxpayer's consciences, but now, not even the computers can stem the tide of under-reporting, fraudulent exemptions, and just plain concealment that undermines tax collection in this country.

#### REFORMING TAXES BEFORE RAISING THEM

This cost is enormous, both socially and economically. Within the last ten days, the Senate Budget Committee has adopted a budget proposal calling for \$95 billion in additional revenue over the next three years. That money will have to come from somewhere, if we are to bring deficits down, and interest rates to even tolerable levels. In that same period, cumulative unpaid taxes will exceed \$200 billion. In other words, we could collect the taxes proposed by the Budget Committee -- drastically cut the deficit -- and in a stroke eliminate the fears now inhibiting the fall of interest rates - simply by collecting taxes already owed but illegally withheld.

In fact, most American wage earners do pay the taxes they owe. That is, they pay 99% of the taxes they owe, partly because of our withholding system on wages. But there are vast expanses of the U.S. economy -- many underground -- where the IRS barely ventures forth. For instance, 44% of capital gains go unreported. This is income going for the most part to fairly sophisticated people -- people who know the law, but have substantial incomes, not paying tax. In some areas, compliance falls below 20%. That is not acceptable.

Tax compliance is also distressingly low for interest and dividends. The total revenue loss in this area is almost \$8 billion. The compliance rate -- the percentage of tax owed that is actually paid -- is between 85-90%. While the dollar amounts may drop when interest rates fall, the rates of noncompliance will remain high. As more and more honest taxpayers see more and more of their neighbors and co-workers getting away with noncompliance, the temptation to cheat increases in proportion to the penalty their cheating impresses on the rest of us.

Bad as the problem is now, demographic changes suggest that still worse may lie ahead. For as the population grows older, more citizens will be relying on pension income. Pensions are an area where compliance rates are historically low. Meanwhile, the more sophisticated of taxpayers go on playing the costly game known as "audit lottery." In gambling that they won't be audited, or if they are, that they won't pay any penalty, they encourage even more cynicism toward government. They play havoc with the self-assessment principle that lies at the heart of our federal tax system. When they win their gamble, the rest of us lose.

#### SIMPLIFYING THE SYSTEM

To even the odds, we need to simplify a tax system that has grown so complex that only a handful of experts can grasp all its implications -- or exploit all its invitations to greed. The very complexity of the system can lead some honest taxpayers to make honest mistakes.

Part of the problem lies in the efforts of Congress -- usually well-intentioned -- to use the tax system to promote other social and economic goals. This is done by making exceptions from our general rules of taxation, whether by providing a special deduction from income, a tax credit, a differential in tax rates, allowing a special rule of accounting, or whatever.

Many of these exceptions, usually undertaken to promote a particular public policy, have broad support and strong policy justifications. The refusal to tax Social Security benefits, the reduction for mortgage interest, the deduction for reasonable business expenses are obvious examples.

#### THE COST OF PREFERENTIAL TREATMENT

Still, it is hard not to conclude that this practice has gotten out of hand. According to the Congressional Budget Office, in 1967 there were 50 tax expenditure items with a revenue loss totalling less than \$37 billion. By 1981, this list had grown to nearly a hundred items totalling \$228.6 billion. At the same time, tax exceptions nearly doubled as a percentage of GNP. Some exceptions are worthwhile. Others, like safe-harbor leasing and tax breaks for self-employed pensions, are hard to justify.

How have we afforded this growth? First, there are general tax rates themselves. In case you haven't noticed, they've gone up. While Congress hardly ever votes to increase rates, over the past 15 years inflation has done the job for us. Inflation has pushed people into higher marginal rate brackets even when their purchasing power has not increased: That means extra revenues for the government. It also means higher marginal tax rates for individuals of modest income -- an unprogressive result if ever there was one. Indeed, by 1981, over half of all income was received by taxpayers in a rate bracket exceeding 30%. That means every additional dollar of income earned by most Americans is taxed at a rate of 30% or more.

Federal taxes themselves reached a peacetime high of 21% of GNP in 1981. Without last year's tax cuts that percentage would have reached 24% of GNP by 1987.

What does it all mean? Steady growth in federal debt, in federal tax rates and the general tax burden, and at the same time in 'targeted' tax breaks for specific purposes. The combined effect has been to increase taxpayer resentment and frustration over our apparent inability to have a simple system of raising revenue and to match those revenues to the spending levels needed to meet our national goals.

Fortunately, not all the news is bad. The 1981 Tax Act, through rate cuts and indexing, at least stopped the spiraling growth in tax rates that made it easier for Congress to pass tax 'cuts' that were really efforts at redistributing the tax burden with special preferences, 'skewing' tax rates, and the like. And, while we have not yet slowed the growth of tax credits and preferences, we have created considerable pressure to do so by ending bracket creep. From now on it will be clear that any special tax breaks come at the expense of general tax reductions, or at the cost of a higher deficit.

#### A HOPEFUL TREND - AND A SOLUTION

The trend now -- a trend evidenced in the President's budget, and in the most recent budget discussions -- is to work, step by step, to weed out those tax incentives and preferences in the code that narrow the tax base and force us to increase the general tax burden. This will be a slow and careful effort -- it will not happen overnight -- but political and economic facts of life dictate that it must and will be done.

A simpler system with less paperwork and confusion for the taxpayer will reduce concerns that the wealthy or privileged get special tax breaks unavailable to the average guy. We might even be able to move toward lower rates and fewer preferences. That, combined with the greater perception of fairness, should go a long way toward correcting the current gap between taxes owed and taxes paid.

At the same time, we should not expect the tax millenium to suddenly dawn. There are lots of reasons, political, as well as economic, why we provide special tax breaks. Washington is unlikely to rule out the use of tax differentials to, for example, encourage saving or investment or home ownership. But the trend will be in the other direction, and that is good.

To deal with the immediate problem, my Senate Colleague, Charles Grassley, has joined me in introducing legislation that would attack the compliance gap now.

We call our bill the Taxpayer Compliance Improvement Act of 1982. This is the first comprehensive reform of the voluntary compliance system in nearly 30 years. It would give the IRS the ability to do its job better while raising at least \$20 billion over the next 3 years. All this without increasing tax rates or adding new taxes.

#### INFORMATIONAL IMPROVEMENT

First, we would improve reporting of information to the IRS. Information reporting would be extended to federal obligations, bearer bonds, and the highly computerized securities and commodities brokerage industry. State income tax refunds would be reported to taxpayers -- reducing the \$330 million revenue loss associated with such payments. And tips paid over by large employers based upon credit card invoices would be subject to information reporting.

Equally important are the regulatory reform changes we would institute. The IRS would be required to issue promptly regulations interpreting new statutory provisions. And this, in turn, will make it at least a little easier for taxpayers to find the way through the forest of federal tax laws.

Our bill would also give the IRS authority to require persons filing large numbers of returns to file on magnetic tape and related formats, in the hope of processing such returns faster and more efficiently.

#### OVERHAULING PENALTIES AND INTEREST

Beyond improvements in information reporting, we propose an overhaul of the penalty and interest system.

This means compounding interest owed on refunds and deficiencies, thus removing a powerful obstacle to prompt settlements between the IRS and individual taxpayers. It means a frontal assault on the audit lottery -- a 10% penalty in cases of substantial underpayment of tax. This applies essentially to the well-heeled, well-advised taxpayer who not only should know better, but almost always does know better.

#### AUDITS AND ANNUITIES

The third element of our program is increased funding for data processing and auditing to compliment the effects of the additional information required and the stiffer penalties assessed.

Fourth, and last, Senator Grassley and myself would try to clarify what is for many taxpayers a bewildering system of annuities and voluntary withholding.

We believe that taxpayers ought not to be forced into withholding on pensions, but that they should pay their tax. Taxpayers ought to have the option to avoid making estimated tax payments. Thus, we provide a progressive withholding table for pensions, but the taxpayer will be able to elect out of withholding.

Overall, this bill represents a dramatic departure from prior strategies in combating the compliance gap. Without making radical changes it will, nonetheless, substantially increase compliance with the federal tax laws. It weighs taxpayers' interest in limited paper-work and safeguard of privacy with the self-evident need to collect revenues and protect the integrity of fairness of the federal tax system.

I realize that none of this makes for dramatic reporting or sexy television. Tax law is difficult at best to illustrate. And there's undoubtedly a little bit of Robin Hood in each of us. Taxes are oppressive enough, we believe. If we take from our rich Uncle Sam and give to the poor taxpayer -- well, what's really so bad about that?

The problem is that Uncle Sam will collect his revenues one way or another, and that all those who see themselves as crusading Robin Hoods will make the rest of us pay for their crusade. Either that, or they'll soon pay a visit to the Sheriff of Nottingham.

Throughout its history, the League has spoken with a powerful voice on behalf of equality, competence, and the rule of law. You have made government work harder and work better. You've made it reflect your own commitment to excellence -- and when it has failed to meet your standards, you haven't hesitated to educate the public and public officeholder alike. Now, there is a new cause that demands your attention, and new injustices that deserve abolition. Taxes reformed need not be synonymous with taxes raised. Taxes reformed can even play a part in economic renewal -- without becoming the plaything of the rich or an object of suspicion and hostility among middle and lower income Americans. All of this not only can happen -- it must. It will, if we who care about government of the people take the lead in reminding Congress of its responsibility to the people. And so I appeal to you, individually and collectively, to join in a fresh campaign for tax reform that is meaningful and prompt. Some will argue we can't afford to focus our attention on the subject -- not right now anyway. I believe we can't afford not to. I hope you will share my belief, and support the steps I've outlined today.