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OUTLINE OF REMARKS

GENERAL MILLS RESTAURANT GROUP

March 19, 1983--8:15 a.m.--Turnberry Island, Miami, Florida

I. The President and the New Congress

A. In his State of the Union message, President Reagan made clear that he and the 98th Congress must work together to deal with an active agenda. That means action on the deficit, on unemployment, on social security, and attention to the shifting patterns of industry and job creation in our economy. At the same time we have to realize there will be major areas where we will not agree. No one is going to compromise away the gains won towards restraining the growth of spending, controlling the tax burden, and beating back inflation. The American people still overwhelmingly support those goals.

B. The President, the House leadership, and the Senate leadership will have to work together to forge a consensus on major decisions if we are to get the job done. On some issues we simply cannot afford to have a legislative stalemate: social security is one of these, and the President and the Speaker have shown a statesmanlike regard for the public interest in supporting the bipartisan social security package, and in agreeing on the basic of a $4 billion-plus jobs package.

C. The President still sets the agenda. On taxes, spending, deficits, employment, and trade the President proposes, and Congress must dispose. Those of us who have ideas of our own will work with the White House to get things done--but leadership still must come from the President. That is why we are unlikely to see any major departure from the principles of government Ronald Reagan has espoused in his first two years in office.

D. There is no coherent alternative to Republican leadership. The people still recognize that our economic problems were a long time in the making, and that the cure will take time too. According to CBS/New York Times voter exit polls in the last election, voters by a 5 to 4 margin blamed our economic problems on past Democratic policies rather than on President Reagan.

II. The Economy

A. Prognosis. We have to realistically assess the state of the economy and the prospects for the next few years. The fact is that the groundwork has been laid for a stable and lasting recovery, without renewed inflation. It is absolutely crucial that we proceed with care at this point, and not throw away the gains already made.

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No one should doubt that we are making progress. In January the index of leading economic indicators jumped 3.6 percent--the biggest one-month rise since 1950, and the ninth increase in the last 10 months. In addition, the "concurrent indicators" of current economic performance rose .6 percent in January, showing we are in recovery.

1. Inflation was cut to 3.9 percent in 1982, from 12.4 percent in 1980. This is the lowest inflation rate since 1972.

2. Interest rates are down and still falling. The prime rate is down to 10 1/2 percent, way down from the 21 percent that prevailed when President Reagan took office. Home mortgage rates are down 3 points since last year. Long-term rates for business loans are off 3 to 4 points from a year ago.

3. Government spending growth rate is down to 11.2 percent this year from 17.4 percent in 1980. The 1983 budget resolution projects the growth rate of government to fall to 7.5 percent by 1985.

4. Lower taxes with major improvements in tax equity will help buoy the recovery, both on the consumer side and on the investment side. The combined effect of the 1981 and 1982 tax bills has been to lower individual taxes over 3 years by $344 billion, as well as improve compliance and tax fairness. Lower individual rates boost personal income and restore incentive, while favorable capital cost recovery rules should spur investment.

5. In January, industrial production was up 0.9 percent; housing starts were up 36 percent; the stock market is up 300+ points over last August. These are tangible evidence of recovery.

B. Unemployment. The January drop in unemployment to 10.4 percent is major good news, and the decline should continue even if there are a few "blips" upward. Unemployment, of course, remains the major negative in the economic picture. High unemployment has to come down and stay down without inflationary stimulus--that is what we have failed to do in the past.

o Clearly there is a bipartisan consensus for more jobs. But resuming the inflationary policies of the past will not create lasting jobs, just an illusion of prosperity that leaves us worse off the next time we try to get "off the wagon."

o That means the most important thing we must do is judge carefully the degree of stimulus the economy can and should take, consistent with a firm anti-inflation policy. The Federal Reserve will play a key role, and has already shown a willingness to adjust its short-term goals based on an assessment of the

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weakness of the economy. We will not allow the recession to continue, but we will not reinflate the economy, either.

o While the main emphasis must remain on the long-term goals of growth with low inflation, there are steps we can take in the short term to deal with the plight of the unemployed. Many things have already been done:

- A new Federal supplemental unemployment compensation program was passed with the 1982 tax bill, providing additional unemployment benefits to about 2 million workers in 38 States. The President has agreed to extend this through December 31, and proposes a tax credit voucher for employers who hire the long-term unemployed

- The President signed into law the new Job Training Partnership Act, which emphasizes training for permanent employment rather than make-work jobs. New initiatives outlined by the President focus on the long-term unemployed, youth, and on training or relocating displaced workers who lost jobs due to plant closures or force reductions

- The targeted jobs tax credit, which was extended for 2 years by the 1982 tax bill, gives employers a real incentive to hire the disadvantaged--about 600,000 workers are certified under the program

- The administration's enterprise zone legislation, reported last fall by the Finance Committee, can provide us with an experiment in private-sector job creation in depressed areas, through a combination of Federal tax incentives and State and local efforts to target an area for development with regulatory and tax relief, neighborhood participation, and capital and other improvements

- The 5¢ per gallon gax tax increase can create over 300,000 jobs by funding much needed repairs and construction of the Federal highway system.

C. The Deficit and Interest Rates.

1. All our economic difficulties are, of course, related--high interest rates and slow growth boost the deficit, and higher deficits create greater uncertainty in the business community as to our future course; will there be more inflation, or less credit available for business expansion?

2. Because of this, it makes sense first of all to chart a path that is most likely to bring stable growth without inflation. Higher growth boosts revenues and cuts unemployment costs, thereby reducing the deficit as well: already, upward

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revisions of growth estimates are being made in light of the economic indicators.

3. In the short term, as the President urges, it makes sense to continue to review every part of the Federal budget in an effort to bring the deficit down. This means both defense and entitlements must be under scrutiny to maximize the efficiency of every dollar spent. A balanced deficit reduction program is still our goal: the Budget Committee will produce a budget resolution in the next few weeks.

4. Continued efforts to restrain the deficit by controlling Federal spending will give the Federal Reserve a bit more room to accommodate the potential for real growth that exists in the economy without inflationary pump-priming. But restraint in both fiscal and monetary policy is crucial if we want to maintain long-term confidence in the economic program. That means long-range goals must be carefully reconciled with efforts to respond to particular weaknesses in the economy. Radical attempts to reverse course would be self-defeating and must be resisted.

III. Taxes and the Budget

A. If we need additional revenues in the out-years, it has to be done consistent with the goal of reducing the deficits as recovery proceeds: a goal that everyone agrees is essential.

B. There are lots of ways to raise revenue, but our job is to choose ways that are fair and consistent with good tax policy. We should resist the temptation to undo the progress that has been made in providing greater incentives for savings, work, and investment: those incentives will become more important as recovery proceeds. There are many base-broadening measures still to be considered that would improve the equity and efficiency of the tax code.

C. Indexing. There seems to be a growing clamor for repeal of the tax indexing provision of the 1981 tax act, which takes effect in 1985. We all know that we have to compromise to get things done, but this is one area that we ought to leave alone if we are interested in sound tax policy and honesty in government. We can raise revenues--but why resort once again to back-door revenue increases generated by inflation? Tampering with indexing further risks sending a signal that we are prepared to reinflate the economy and generate revenues through bracket creep to deal with the deficit. That would mean undoing all the progress we have made over the past two years, and it would be a tremendous mistake.

D. Outyear tax increases. The President's budget recommends a contingency tax to raise $46 billion in FY 1986,

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consisting of a 5% surcharge and an oil tax, to be triggered if the deficit remains too high despite adoption of major spending cuts. It is not clear why we would need to use a "trigger" device to raise taxes based on deficit levels: if we estimate that the revenues will be needed, we can agree that any tax increase we provide for will be temporary, whether it be a surtax or a package of miscellaneous changes. It seems unlikely that a "trigger" mechanism would create the kind of reassurance on the deficit that the country is looking for.

If growth and revenues turn out better than now projected, we can always reduce taxes to the extent that becomes fiscally desirable. One possibility is to enact some additional base-broadening measures--improvements in equity and eliminating tax provisions that are economically inefficient--then provide for further rate reductions if the deficit is brought under control more rapidly than is now expected. This would maintain the momentum for a lower-rate, broader-based tax system that has been built over the last two years. It is also consistent with the administration's consideration of a streamlined and simplified tax structure with lower rates.

E. Tax Issues of Continuing Concern

A number of issues that have been around for some time ought to receive attention from the 98th Congress.

1. 6-month holding period. Efforts to reduce the capital gains holding period to 6 months will continue. There is very strong support for this change, because it can give a boost to capital markets at a time when greater savings and investment is vitally important to sustained economic recovery. This change was approved by the House in 1981 and by the Senate on three separate occasions in 1982, so it is time to get it enacted into law.

2. Education Savings Account. An idea that has been around for several years and may receive attention in the new Congress is to use an IRA-type arrangement to encourage savings for college education or advanced vocational training. Contributions to an account set up for this purpose would be tax-free subject to limits on the use of the funds for the stated purpose. In the area of education of one's children, in particular, the President has proposed a version of this initiative in his FY 1984 budget. It could provide support for education with a free-market approach, which has a lot of appeal.

3. Fringe Benefits. The moratorium on IRS fringe benefit regulations expires on December 31, 1983, having been extended to that date by ERTA. This issue has been with us since 1978, when the moratorium was first imposed, and it may be time to deal with it. The Congressional Budget Office estimates that

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about $500 million could be generated by taxing so-called "nonstatutory" fringe benefits provided to employees--e.g., free airline travel, recreational facilities, etc. While theoretically taxable, these benefits raise difficult issues of valuation and allocation to individual employees. Still, fringe benefits are "compensation" and, to prevent erosion of the revenue base, something may have to be done.

4. Life Insurance Taxation. The temporary life insurance company taxation provisions of TEFRA expire at the end of 1983. The Finance Committee and Joint Committee staffs, as well as GAO, are looking at permanent changes in the taxation of the life insurance and casualty insurance industries. If the temporary rules were simply extended, a substantial revenue loss would result, probably in excess of $1 billion per year.

5. Withholding on Interest and Dividends. The withholding repeal campaign has to be resisted, and the President has indicated he will resist it. Withholding is an equitable compliance measure, not a new tax--without the $4 billion per year from withholding, we will have to raise someone else's taxes. On a $1,000 account, withholding would mean only a 50-cent loss each year on compounding--and banks can help people avoid that by opting for annual withholding.

G. Possible Administration Tax Initiatives

A number of initiatives were not acted on in the 97th Congress, and the administration's 1984 budget proposes action in these areas in the 98th Congress.

1. Tuition Tax Credits. Although the Finance Committee fashioned a compromise tuition tax credit proposal last year after extensive consideration, the bill received no further action last year. But the Committee's efforts could form the basis for legislation in the 98th Congress. Legislation, S. 528, was introduced February 17.

2. Caribbean Basin Initiative. The administration's proposal to provide trade and certain tax incentives for economic development in the Caribbean Basin made substantial progress in the 97th Congress, but still awaits final action. This is likely to be a priority item for the administration; The Finance Committee will hold hearings on April 13.

3. Enterprise Zones. The Finance Committee reported out a modified version of the administration's enterprise zone proposal last September, but no further action was taken. New legislation has been sent up by the President, and the proposal is likely to come up again in connection with discussion of job-creation and economic development proposals, and possibly could be acted on with further refinements. A major question is

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whether the House will take an interest in the idea, which they did not in the 97th Congress.

4. DISC. While no specific DISC proposal was made in the 97th Congress, the issue was extensively discussed--particularly the question of legality under the GATT. The search is clearly on for an alternative way to encourage exports, and the administration is likely to be active.

IV. Social Security

A. Bipartisan cooperation continues to be the key to resolving the social security financing crisis. The National Commission developed a bipartisan package that deserves support. It is not perfect, and everyone had to swallow hard on some items: that is the cost of reaching agreement.

B. The work of the Commission made clear that it is a crisis in social security that we are confronting. The Commission agreed that $150-$200 billion is needed between 1983 and 1989 to ensure the solvency of the system through 1990. This means providing about a 15 percent reserve ratio by 1990 under the pessimistic--some would say realistic--assumptions. This is still a reserve level lower than at any point in history, and does not take into account the medicare program, which will have serious reserve problems by 1990 if nothing is done.

C. The real job is, and always has been, up to Congress. The bipartisan package, including a 6-month delay in cost-of-living adjustments, partial acceleration of scheduled payroll tax increases, coverage of new Federal workers and non-profit organizations, and partial taxation of benefits for higher-income beneficiaries, is now before Congress. The House approved the basic package last week, and the Senate is now considering the Finance Committee version.

D. Long-term changes are also needed, of course, and the work of the commission has helped give us valuable guidance. We cannot forget that the payroll tax burden is already heavy and scheduled to increase, and the confidence of young people is critically low. The long-term deficit can be reduced considerably by very gradually slowing the growth of benefits as people come on to the rolls in the future. The House and Finance Committee bills both involve raising the retirement age, again very gradually, for people retiring some 20 or 30 years from now. Ample time is available for people to adjust their savings and retirement decisions. The Finance Committee bill has the additional virtue of phasing out the retirement earnings test beginning in 1990. This will eliminate the penalty against older Americans who choose to remain in the work force.

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E. Major Features of the Package

1. COLA Delay

Even with the 6-month delay of the cost-of-living increase, benefits for 1984 for the average retired couple will be about $330 higher than their benefits for 1983, assuming an inflation rate of 4 percent.

2. Taxation of Benefits Above Threshhold

Many low and moderate income retired taxpayers are already taxed on their pensions, dividends, interest, and other income. Basic fairness requires that individuals with substantial amounts of other income should at least treat some of their social security benefits as income subject to income tax. One-half is an appropriate amount and should not cause undue hardship.

Taxation of benefits above the threshhold should only affect about 7 percent of all social security beneficiaries, so the great majority of social security recipients will not be affected by this change.

3. Payroll Tax Acceleration

The acceleration of the payroll tax increase will only increase payroll tax revenues by $9 billion between now and 1988. Half of this amount--the employee portion--will be offset by a tax credit. The other half--the employer portion--will be deductible on the employer's income tax return. The net effect will only be to take about $3 billion out of the economy--an insignificant factor in a 3 trillion dollar economy.

By removing the enormous amount of misinformation and uncertainty which has scared the elderly people of the country, the bill will improve confidence, both among the elderly and in the financial markets. These should have significant positive economic effects.

F. Benefits vs. taxes

- Of the $169 billion National Commission financing package, one can view the largest component as being on the benefit side through slowing the rate of future benefit growth and partial taxation of benefits for the highest-income beneficiaries.

- Benefit slowdown and recapture — $70 billion - 41%

  COLA adjustments — ($40 billion)

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	Recapture of benefits through tax systems	($30 billion)
o	<u>Expansion of coverage and repayment of military service obligation</u>	$41 billion - 24%
	Coverage of Federal and nonprofit employees	($23 billion)
	Military service debt	($18 billion)
o	<u>Tax speedup and restructuring of self-employment tax</u>	$58 billion - 34%
	Tax speed up	($40 billion)
	Self-employment restructuring	($18 billion)
		$169 total

o Even though one-third ($58 billion) of the package is comprised of payroll tax changes, the real impact on the economy will be less because of the tax credit to employees, the deductibility of employer payroll taxes and the tax deduction provided for the self-employed will reduce the total tax burden by about $18.5 billion. Thus the real additional payroll tax burden will be slightly below $40 billion over the period 1983-1990.

V. <u>Trade</u>

A. <u>Trade deficit is too large</u>. The size of our trade deficit (which is now projected at $75 billion in merchandise trade and $30 billion in current account) alone means Congress will continue to look hard for ways to reform our trade policy. The system of multilateral arrangements has been called into serious question as many believe it fails to meet our needs. Many voters and members of Congress will want to see us approach more of our trade problems on a bilateral basis. The average American simply does not understand why Japanese cars and TV's sell well here but American cigarettes, beef, baseball bats, and cosmetics cannot be sold in Japan. Remedies for this type of situation are certain to be a major focus of attention in the new Congress.

B. <u>Export issues</u>. Unfortunately, the GATT ministerial failed to make progress on the question of foreign subsidies for agricultural exports. This will continue if pressure from Congress to resolve this situation through negotiation or for

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other export promotion actions like the recent wheat flour sale to Egypt. I will be introducing legislation which will facilitate such activities in the future. This does not mean trade war, but does mean seeking to expand East-West trade, developing a viable substitute for DISC, utilizing Ex-Im Bank resources more adeptly, and moving the trade reciprocity bill that the Finance Committee approved in 1982. Fair access to markets must be a two-way street, and Congress will be under considerable pressure to see that that is so.

C. Import issues. As you know, the House passed "local content" legislation at the end of the last Congress. That is a drastic proposal and likely to be counterproductive in the long run if our goal is to increase access to markets and to gain maximum benefit from the mutual advantages of international trade. There may be other areas, however, where we might make adjustments: in considering extension of the Generalized System of Preferences, there may be an interest on the part of some members of the Finance Committee to restrict the program, particularly in light of the failure of the GATT ministers to agree on a new round of negotiations between developed and developing countries concerning tariffs. Similarly, there may be some objection to the trade provisions of the CBI proposal, and it may be difficult to extend the President's authority to negotiate tariff reductions on a limited basis. It is a good sign that the Japanese have agreed to continue to voluntarily restrain their automobile imports to this market for a third year until the domestic industry has had an adequate time to get back on its feet.

D. Clearly the heat is on when it comes to seeing that American producers get fair treatment under our system of international trade. If we choose our battles carefully to secure an appropriate response from our trading partners, we have an opportunity to making trade freer and fairer, to the advantage of everyone. But we must avoid the two extremes of allowing the world to think only the U.S. will play by the rules of free trade, regardless of disadvantage to our citizens; or, on the other hand, taking extreme unilateral actions that may look good politically but that, in the long run, will provoke severe reaction and deprive us of market opportunities. We need just the right amount of leverage to open more doors, not have them slammed in our face.

VI. Conclusion

The months and years ahead must not be dominated by rigid ideologies on either side--but neither can the President or the Republican leadership be expected to cast aside the principles of Government the American people so soundly endorsed in 1980. Those principles--a more restrained Government, a freer economy, greater accountability to the American people--are as valid today

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as they ever were, and there is no indication that the people have changed their commitment to these same principles. Guided by these principles, we will try to work together to build on the sound foundation for recovery that has already been laid.

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United States Senate

COMMITTEE ON FINANCE

WASHINGTON, D.C. 20510

March 18, 1983

TO: Senator Dole

FROM: George Pieler

SUBJECT: General Mills Restaurant Group talk

Bob Bird with General Mills indicated that their group, in addition to hearing about major legislative issues before Congress, would expect to hear something from you about the tip reporting rules. As you know, there has been some confusion in the industry over the law and I.R.S. regulations. This group is likely to be willing, however, to try to figure out what is being required of them and try to work for changes if necessary to deal with particular problems: they do not have a formal legislative position worked out, however.

Attached in addition to the speech outline are the text of a press release you issued March 3 clarifying the tip problem, and a fact sheet on the tip reporting rules.

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TIP REPORTING

"The new rules require only information reporting, not withholding. Information reports on all allocated tip amounts not declared by the employee are required at yearend. Some employers have withheld income tax on such allocated amounts on the mistaken view that withholding was required," Senator Dole said. "While it is important that we secure a higher compliance level for tip income, it is equally important that we do not cause undue hardship for the hardworking employees of the hospitality industry."

Senator Dole noted that the law requires that restaurant owners should withhold income and social security taxes to the extent tips are reported to them by their employees, but not on tips that are merely allocated.

Beginning April 1, 1983, a bar or restaurant owner generally must allocate to tipped employees the excess of eight percent of gross receipts over the tips reported by the employees to the employer. Tip allocation is not required, however, for establishments with ten or fewer employees. The allocated tip income will appear on the employee's W-2 form. The amount of tips which actually should be included in the employee's gross income, of course, could be higher or lower, depending on the tips actually received. Moreover, employers whose employees require tips at less than an 8 percent rate should write the IRS to receive authority to allocate a lesser amount.

Senator Dole noted that a large percentage of tip income has gone unreported, according to the IRS. This low compliance rate was the reason for the new tip reporting rules. The tip reporting requirements are expected to generate $4.9 billion in additional tax revenue over the next five years.

Employers who have incorrectly withheld taxes on allocated tips should refund the incorrectly withheld amounts to the employee, according to the IRS, and report only the correct amount on IRS Form 941, Employer's Quarterly Federal Tax Return. If the error is discovered after IRS Form 941 has been filed, the employer should correct the error by attaching IRS Form 941c, Statement to Correct Information, to the next Form 941 that is filed.

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FACT SHEET ON NEW TIP REPORTING RULES

Do the new tip reporting provisions impose a new tax?

No, no new tax is imposed by the new reporting rules. Of course, all tips constitute income and are taxable, as under prior law.

Do the new provisions require withholding on tip income?

No. The new provisions revise the prior law rules relating to the yearend reporting of tip income for information purposes, but do not impose any new income tax withholding requirements.

What were the rules for tip income under prior law?

Under the law prior to TEFRA and under present law, any employee who receives tips in excess of $20 a month must report all tips received to the employer on a monthly basis. Tips reported to the employer are treated as wages and as such are subject to income tax withholding and the employee's social security (FICA) tax. In addition, tipped employees must keep records of tips they receive. These rules have not changed.

What are the new tip reporting rules?

The new provisions added in the Tax Equity and Fiscal Responsibility Act require additional information to be reported to the IRS by large food and beverage establishments. In some cases, a "tip allocation" rule will also apply. There is no change in the law with respect to income tax withholding and FICA taxes; these taxes are still to be applied only to tip income voluntarily reported to employers by employees.

What restaurants are covered by the new rules?

Only large food and beverage establishments are covered by the new rules. These are defined as establishments which provide for consumption on the premises, where the employer normally employed more than 10 full time employees (including employees not receiving tips) during the preceding calendar year, and where tipping is customary. Carryout, cafeteria, and fast food establishments are not covered by the new rules.

What is the "tip allocation" rule and when does it apply?

If tipped employees of large food and beverage establishments voluntarily report to the employer tips aggregating 8 percent or more of the establishments's gross recipts, then no allocation rule applies. However, if tipped employees (in the aggregate) report less than 8 percent of gross receipts in tips, the employer must allocate among tipped employees the difference between 8 percent and the tips reported, and he must report these allocations to both the IRS and the employees annually, for

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information purposes only. The allocation is made on the basis of a good faith agreement between the employer and employees or according to IRS regulations.

What if the tipping rate is less than 8 percent?

The new law provides that an establishment can apply to the IRS for a lower percentage to be used in making allocations if it can show that their average tipping rate is less than 8 percent. However, the rate cannot be reduced below 5 percent.

What information must employers report to the IRS?

In addition to the reporting of allocations made among tipped employees, as described above, large food and beverage establishments must now report gross receipts from food and beverage sales, aggregate charge receipts, aggregate tips on charge receipts, and voluntarily reported tip income, all of which are available from the restaurant's records.

How will this information be reported to the IRS and employees?

Employers will file annual information returns with the IRS and will report to each employee, on the W-2 form, his or her tip allocation.

When are the new rules effective?

The new rules apply generally to calendar years after 1982, but the allocation reporting rules are specifically delayed until payroll periods ending after March 31, 1983, to allow employers and employees to learn the new rules. Accordingly, for the first quarter of 1983, large food and beverage establishments will report the items indicated above except that no allocations to employees will be reported.

Do these rules change the end-of-year tax liabilities of restaurant employees?

No. Employees are required under present and prior law to report actual tips received, no more and no less, on their annual income tax returns. (This amount is also subject to FICA tax.) Employees must be able to substantiate the amount of tips they report with adequate records. The IRS may determine upon audit that a tipped employee received more than the amount reported, even if the amount reported equals or exceeds 8 percent.