Speak

~~Open Date~~
April 10
Thurs.
12:30

Joyce

LAW OFFICES OF

DAVIS & HARMAN

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~~tent~~ April ~~9~~ 10

January 29, 1986

12:00 Lunch
12:30 Speak
(can speak between 12 & 1:00)

The Honorable Robert Dole
Senate Majority Leader
SH-141 Hart Senate Office Building
Washington, D.C. 20510

Dear Mr. Leader:

On behalf of the Washington Tax Seminars, we would like to invite you to speak to our group sometime in the near future here in Washington. Our group meets regularly throughout the year to exchange views with members of the House and Senate about tax policy. A list of our membership is enclosed.

We would like you to make a few informal remarks about pending tax legislation and any other topics of current interest. After your remarks, we would like to ask a few questions.

The luncheon can be arranged to fit your schedule at a location near Capitol Hill. We would be pleased to give you an honorarium of $2,000 for your presentation.

Sincerely,

Tad

Tad Davis

Enclosure: Membership List

DEPRECIATION PROPOSAL

Cosponsors: Senators Roth, Heinz, Dole, Baucus

Proposal on Depreciation

The Chairman's Proposal on Accelerated Cost Recovery would be retained with the following modifications:

1. Computers and telephone central office switching equipment would be moved to 3 years straight-line from 3 years 150 percent declining balance.

2. Rental automobiles and all light trucks would be moved to 3 years straight-line from 5 years 150 percent declining balance.

3. Property qualifying as semi-conductor manufacturing equipment would be moved to 3 years straight-line from 5 years 150 percent declining balance.

4. Property qualifying as "productivity property" would receive 200 percent declining balance depreciation. Productivity property would generally be defined as section 1245 tangible property used as an integral part of manufacturing, production, or extraction, or of furnishing transportation or telephone communications services. Productivity property would not include property in a 3-year class, buildings and their structural components (other than single purpose agricultural structures or facilities for the bulk storage of fungible commodities), utility property, office furniture, fixtures and equipment, information systems, and data handling equipment. A list of qualifying property is attached.

5. The level of expensing available to small business would be reduced to $40,000. In addition, expensing would only be available if the assets were used in an active trade or business and would be limited to taxable income derived from the trade or business in which the assets were used. An unlimited carryover would be permitted.

6. Current law recapture rules (1245 and 1250) would be retained.

7. ACRS deductions would be increased for the full amount of inflation since the second year an asset is placed in service; capped for inflation in excess of 8 percent.

PRODUCTIVITY PROPERTY BY ADR CLASS

I. Section 1245 Property Included in Productivity Property Class

Asset Guideline Class Number	Description or Title of Class or Classes
00.21	Airplanes
00.3	Land improvements (sec. 1245 property only)
01.1 - 01.3	Agriculture
10.0	Mining
13.0 - 13.3	Drilling, petroleum refining
15.0	Construction
20.1 - 20.5	Manufacture of food products
21.0	Manufacture of tobacco and tobacco products
22.1 - 22.5	Manufacture of knitted goods, yarn, fabric, carpets, and medical and dental supplies
23.0	Manufacture of apparel and other finished products
24.1 - 24.4	Timber and manufactured wood products
26.1 & 26.2	Manufacture of pulp, paper, and pulp and paper products
27.0	Printing, publishing, and allied industries
28.0	Manufacture of chemicals and allied products
30.1 - 30.21	Manufacture of rubber products and finished plastic products
31.0	Manufacture of leather and leather products
32.1 - 32.3	Manufacture of glass products, cement, and other stone and clay products
33.2 - 33.4	Manufacture of primary nonferrous metals, foundry products, and steel mill products
34.0 & 34.01	Manufacture of fabricated metal products
35.0	Manufacture of electrical and nonelectrical machinery and other mechanical products
36.0	Manufacture of electronic components, products, and systems
37.11 - 37.42	Manufacture of transportation equipment (motor vehicles, aerospace products, ships and boats, locomotives, and railroad cars)

39.0	Manufacture of athletic, jewelry, and other goods
40.1 - 40.54	Railroad transportation
41.0	Motor transport - passengers
42.0	Motor transport - freight
44.0	Water transportation
45.0	Air transport - commercial and contract
48.11 - 48.14	Telephone communications

II. Section 1245 Property Included in Productivity Property Class If Used in Productive Property "Activity" Classes Described in I, Above

Asset Guideline Class Number	Description or Title of Class or Classes
00.22	Automobiles, taxis (nonrental)
00.23	Buses
00.242	Heavy general purpose trucks
00.25	Railroad cars and locomotives (except those owned by railroad transportation companies)
00.26	Tractor units for use over-the-road
00.27	Trailers and trailer-mounted containers
00.28	Vessels, barges, tugs and similar water transportation equipment

March 27, 1986

Tax Reform Talking Points

- The President's tax plan and the House bill are similar in concept--they both shift more of the tax burden to corporations and reduce the tax burden on individuals. But the bills are very different in how they make the change.

- Both substantially reduce tax rates for individuals (the President to a maximum of 35%; Ways and Means to 38%) and for corporations (President 33%; Ways and Means 36%). But the Ways and Means rates take effect at much lower income levels: the 35% rate clicks in at $43,000 for married couples, as opposed to $70,000 under the Reagan plan.

- Neither plan gets an A+ for the major objectives of tax reform--simplification and fairness, but the President's plan repealed many more of the overly complicated provisions of the tax code than the Ways and Means Committee effort. The House bill just modifies, but leaves in place, many complex tax rules.

- The House bill falls far short of the President's on fairness grounds. Fringe benefits and itemized deductions are major causes of differing tax liabilities, and unlike the President's proposal, the House retained the State and local tax deduction, did less to limit interest-paid deductions, and did nothing on fringe benefits. This means that taxpayers with equal incomes can still have substantially different tax liabilities.

- I have personally long favored income tax reform and, as Chairman of the Senate Finance Committee, led the fight over a number of years to plug unjustified tax loopholes.

- The Senate Finance Committee has begun action on tax reform and will have a full schedule after the Easter recess. A lot of difficult decisions await the Committee if it is to maintain momentum towards the goals the President has outlined: lower tax rates, a $2,000 personal exemption for everyone, and more incentive for saving and capital investment.

- The 'Packwood draft' of tax reform goes a long way toward meeting the President's goals, including a top rate of 35% and a $2,000 personal exemption for all but the wealthiest taxpayers. Still there are many controversial points that will be closely scrutinized.

--the deduction for State and local sales and personal property taxes would be repealed, and that for income taxes would be available only through the first two brackets.

--Interest deductions would be more severely limited than in the House bill, including a $1,000/$2,000 limit on the consumer interest deduction.

--The minimum tax would have a lower rate and a broader base than in the House bill, but is still likely to be controversial.

--Excise taxes would be increased significantly including those on beer and wine.

o On the plus sides, from the viewpoint of many taxpayers--

--The nonitemizer charitable deduction would be made permanent without adopting the floor under the charitable deduction included in the House bill.

--Investment credit repeal would not take effect until March of this year.

--ACRS would remain the basic depreciation system, with a limited inflation adjustment allowed.

--The R&D credit would be made permanent.

--The amount of new equipment costs small businesses can expense would be dramatically increased.

o All in all, the Packwood draft does a better job of lowering tax rates while encouraging new investment and a productive climate for business.

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.

Gramm-Rudman, the Dollar, and Inflation

- Gramm-Rudman should help us meet the commitment we made last September to our trading partners: to reduce the deficit as part of our effort to moderate the value of other dollar.

- By the same token, the risk of inflation should be reduced if we bring down the deficit under Gramm-Rudman, because the pressure to pump up the money supply to keep interest rates down will ease considerably.

Gramm-Rudman: Challenge to the Established Fiscal Order

- The first actions in response to the new Gramm-Rudman deficit control reform will be taken early in 1986. For those of you who missed it, late last year the Congress imposed a new fiscal straightjacket on itself. The new law sets firm deficit targets for each of the new five years, and mandates automatic across the board spending cuts if the deficit exceeds the target. The first round of automatic cuts under the proposal will take effect March 1 unless Congress comes up with a better way to meet the target.

- In addition, President Reagan's budget for fiscal year 1987 is due to Congress by February 5. So we will have reconsideration of the 1986 budget proceeding simultaneously with our first shot at the 1987 budget.

That is a tall order, but is one we ought to be able to fill. Difficult as it seems, we should remember that the Gramm-Rudman law contains new procedures designed to make it easier to meet the deficit targets. We explicitly bring loan programs and other 'off-budget' items into the budget process; set a point of order against legislation from committees that have not met their budget savings allocation; and rule out of order legislation inconsistent with the deficit targets.

Possible Problems. We know there will be a rocky road ahead in implementing Gramm-Rudman. Congressmen Synar and others already have won the first round in their suit claiming it is unconstitutional, and the Reagan Administration also has some problems with the role of the Congress' General Accounting Office in mediating the deficit forecasts. The Supreme Court will have to give us a final ruling on all that in a few months. Even more important, what Congress can legislate, Congress can back out of. That's why we need a constitutional mandate for budgetary restraint, as well as a statutory one.

- o So Gramm-Rudman hasn't made our options any easier: but if it works as planned, it will force us--and the President--to make some decisions and choose among the various deficit-reduction options. That means everyone's cherished spending programs will be put to the test of fiscal responsibility.

Spending the Key. Finally, let me emphasize that Gramm-Rudman is a device for reducing Federal spending. It is not a tax increase plan, or a subterfuge for one. If we fail on the spending front, we can look at other options. But the sooner we entertain any revenue options, you can bet the pressure for spending cuts will drop fast.

The Deficit and the Average American

- o 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.

- o 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 will overspend close to $1,000 for every man, woman, and child in America.

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

April 9, 1986

BUDGET TALKING POINTS

o One piece of good budget news is that on Monday President Reagan signed the budget reconciliation bill that will yield more than $18 billion in savings over the next three years. It was a long time getting here but certain worth it.

OVERVIEW

o The Senate Budget Committee reported out a fiscal 1987 budget by a 13-9 vote. 7 Republicans and 6 Democrats voted for the resolution.

o I salute Chairman Domenici, and the rest of the members of the Budget Committee for their diligence and the speed with which the produced the budget.

o But that was only the first step in the process. This week we began a series of meetings with the President, with the Senate Committee chairmen and with the House GOP leadership to see if we can develop a consensus on budget strategy. There will be more meeting this week and probably next.

o We're already somewhat behind the schedule set out in the Gramm-Rudman-Hollings measure. But we're certainly far ahead of the House, which has chosen to do nothing to date. And in the hope that we can change that, I have written Speaker O'Neill asking that we schedule simultaneous floor action on the budget resolution for both the House and Senate.

IMPLICATIONS OF FAILURE TO MEET DEADLINES

o Missing the April 15 deadline would make it even more questionable that the reconciliation process necessary to achieve savings would be completed by June 15.

o Missing the April 15 deadline would further complicate and delay tax-reform legislation this year, since a major issue of revenue increases or neutrality in tax reform would remain an open issue.

o Procedurally, the failure to adopt a resolution by April 15 means that appropriation bill mark-ups would proceed with no general blueprint for FY 1987 spending.

o Assuming no resolution is adopted by May 15, then House appropriation bills would likely proceed to be reported, passed, and sent to the Senate. No point of order (Section 303) would lie against such bills in the House, but would lie in the Senate. The Senate could waive the point-of-order by a majority vote, voting on a resolution by the SBC. It is not clear that the SBC would be able to report such a resolution and such a resolution would likely be objected to by Minority Leader Byrd if it were reported using a poll.

o For those who argue that we should sit back and do nothing because the healthy economy will take care of the deficit, that just isn't so. Even if the very optimistic economic projections are realized, we won't meet the $144 billion Gramm-Rudman deficit target. And those who argue that we can reach the target merely by trimming appropriations accounts are also wrong. It will take more -- changes in entitlement benfit programs, and maybe even some revenue increases.

DETAILS OF BUDGET RESOLUTION

o From my perspective the resolution approved by the Budget Committee leaves something to be desired. First, I believe that the defense spending authority for next year is too low. And second, that the increase in revenues -- close to $75 billion over three years -- is much too high. I'm not alone in this thinking. Just before Congress adjourned for the Easter recess, I received a letter signed by 24 Republican senators expressing the same concerns.

o However, I understand the problem Senator Domenici faced in getting a resolution out of the committee -- the delicate balance between enough for defense, but not too much, enough cuts in domestic programs, but not too much, and enough revenues to meet the $144 billion deficit figure in Gramm-Rudman-Hollings.

o The total deficit reduction in the resolution is $38.8 billion in fiscal 1987; $58.9 billion in 1988; and $74.4 billion in 1989.

o The Committee's budget resolution contains $18.7 billion in additional revenues in fiscal 1987 and a total of $74.3 billion from fiscal 1987-89. Revenue effects from spending measures assumed in the budget, such as retirement reforms and the sale of CONRAIL, plus revenue from reconciliation would account for $6.1 billion, $22.3 billion over three years. And the president's budget contained $5.9 billion in FY 87 revenue increases, $21.6 over three years.

o Defense spending under the resolution would call for $295.1 billion in FY 87 budget authority and $280 billion in outlays. The President requested $320.4 billion in budget authority, outlays, $282.2 billion. According to the Budget Committee, the amounts included in the resolution allows for 2.8 % growth in budget authority from the FY 86 post-sequester budget authority level. In FY 1988 and 1989 there would be a 1% real growth rate.

o The budget resolution would reduce non-defense spending in FY 87 by $17.3 billion in outlays, and by more than $70 billion from FY 87-89, mostly through freezes and reductions. However, $2.3 billion in additional FY 87 spending would be allocated for critical programs such as embassy security, space shuttle construction, a farm credit initiative ($400 million over 3 years), IRS, Head Start and key education programs.

Social Security, military and civil service pensions and all other indexed programs would receive a cost-of-living adjustment. All civilian and military personnel would receive a 3% pay raise.

o Agriculture: The budget resolution assumes the enactment of the tobacco price support program contained in reconciliation with projected reduced budget authority and outlays of $100 million in fiscal 1987 and $600 million over three years; It assumes $ 300 million in savings over three years from enactment of the 1985 farm bill; and it increases budget authority by $150 million in each of the next three years and $130 million in fiscal 1987 for farm credit programs.

o Committee vote: For the resolution: Andrews, Boschwitz, Danforth, Domenici, Gorton, Grassley, Kassebaum, Chiles, Exon, Hollings, Johnston, Metzenbaum, Riegle.

Against: Armstrong, Hatch, Kasten, Quayle, Symms, Hart, Lautenberg, Moynihan, Sasser.

BOB DOLE
KANSAS

United States Senate

OFFICE OF THE MAJORITY LEADER
WASHINGTON, DC 20510

April 9, 1986

MEMORANDUM

TO: SENATOR DOLE

FROM: RICH BELAS

SUBJECT: FINANCE COMMITTEE TAX REFORM MARKUP, TUESDAY, APRIL 8

Starting Wednesday, Senator Packwood will schedule markup sessions every afternoon, as well as in the morning. However, he will try to limit votes to the morning sessions. There will be a hearing on the Canadian Free-Trade Agreement Friday morning and no afternoon session that day. There will be a hearing on the excise tax provisions on Monday morning, April 21. Senator Packwood still hopes to report a bill by the beginning of May so that it could be scheduled for floor action after Memorial Day.

Unearned Income of Minor Child

Moynihan - Will offer an amendment to adopt the House version of taxing amounts earned on gifts from parents to a child under 14 years old at the parents' marginal tax rate. The Packwood proposal would continue to tax the first $5,000 of unearned income earned on such a gift as the child's income rather than that of the parents.

Chafee - Thinks both the House and Packwood proposals are strange, though the revenue gain ($1.4 billion under the House provision, $0.5 billion under the Packwood provision) is tempting.

Asked why there is no exception for life insurance proceeds received by a minor child since there is an exception for tort claims. Mentz responded that the Administration would exempt transfers at death.

Natural Resources

Bradley - Will probably offer some unspecified amendments on the natural resources provisions tomorrow.

Trusts

Chafee - Wanted to know why Packwood compressed the rate structure for nongrantor trusts to make them less attractive. Packwood said he did not want trusts to be used for tax avoidance.

Armstrong - The nongrantor trust rate structure changes should apply only to new trusts. He asked for a revenue estimate. Brockway said it will be provided. Mentz added that it would be very complicated to have different rules for old and new trusts.

Chafee - Will have amendments to decompress the rate structure for nongrantor trusts. Wants revenue estimates.

Estates

Bradley - Wants to know why the President's proposal raises $400 million more than the Packwood proposal. Brockway will supply.

Generation-skipping Tax

There was no comment on Packwood proposal to retain present law. Senator Symms has advocated repeal or modification in the past.

Special Use Valuation

Grassley - Wants to reduce from 15 to 10 years the period that a taxpayer must hold property in agricultural use to receive the benefit of special use valuation. Congress changed the period prospectively from 15 to 10 years in 1981. Senator Grassley wants to pick up the pre-1981 cases.

Baucus - Wants to have a rule of reasonableness for letting taxpayers correct defective elections for special use valuation. This is a clarification of a 1984 Act provision. There was a similar problem in Kansas that we were able to solve administratively. The IRS is taking a very restrictive view of Congressional intent.

IRA's

Danforth - Concerned about borrowing to invest in IRA's. Asked Mentz if this is consistent with the policy behind the establishment of an IRA. Mentz responded that it is o.k. under present law.

Danforth may have an amendment to deny the IRA deduction where the contribution was made with borrowed funds. (This is in addition to the Packwood proposal to deny an interest paid deduction for interest paid on borrowing to fund an IRA.)

Pensions

Pryor - Is the purpose of these proposals increased revenues or reform? Packwood responded that reform is more important.

Pryor is concerned about 401(k) and 403(b) changes.

The House bill would raise $4.7 billion from 401(k) compared to $4.3 billion under the Packwood proposal.

Matsunaga - Will offer an amendment to retain present law for most of the pension provisions because Congress has changed them so often in recent years. Pryor asked if this includes 403(b). Matsunaga replied that it would retain present law. (This is not precisely accurate. His amendment does not retain present law for the limits on elective deferrals under 403(b) plans.)

Heinz - Commended Packwood for including many of the changes from the Heinz/Chafee bill. Will have one or more unspecified amendments.

Moynihan - Wanted to know why the Administration's 401(k) proposal raises $15.9 billion and the Packwood proposal would lose $0.4 billion. Mentz responded that the Administration proposal, as modified, would have repealed 401(k). Packwood's plan extends 401(k) to state and local government employees.

Bradley - What does the present law IRA benefit cost? Randy Weiss responded that the estimate for FY 1987 is $15.9 billion revenue loss.

Bradley made the point that the spousal IRA proposed by the President might cost more than the $3.6 billion estimated by Joint Tax. (The spousal IRA proposal is not included in the Packwood package.)

Boren - What is the revenue gain from lowering the 401(k) maximum deferral from $30,000 to $7,000? The Joint Tax estimate is $1.7 billion.

Packwood argued that only wealthy people can set aside more than $7,000. It is unfair to base national pension policy on benefiting wealthy employees rather than the majority.

Boren may have amendments on the penalty for early withdrawals from plans and on employer terminations of overfunded pension plans.

Baucus - May have amendment to change the 401(k) limit to a percentage of the social security wage base, perhaps 25 percent of the wage base.

May also have an additional limit for ESOP's in addition to the 401(k) cap.

May also have some nondiscrimination changes from the Packwood proposal.

Heinz - Deferred annuities are purchased with after-tax dollars. Why do we have the same 15 percent penalty for early withdrawals from these plans as is proposed for qualified plans and IRA's which are funded with pre-tax dollars.

Randy Weiss responded that the penalty is only on the inside buildup which is tax deferred. Therefore, the proposal is consistent.

Grassley - May offer an amendment to exempt church organizations from the 403(b) limitations. He is flexible on the specifics.

Boren - Would like exceptions from the early withdrawal penalty for involuntary terminations. Mentz is willing to work with him, but, initially, would prefer generally to lower the age from 59 1/2 before which the penalty would apply, rather than define specific hardship exceptions.

Heinz - Is sympathetic to hardship exceptions from the early withdrawal penalty. Will have an amendment.

Will have an amendment to eliminate the proposed penalty on pension benefits over $112,500.