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June 4
Wed. 1:30
at Bullfeathers

RICHARD T. SCHULZE
5TH DISTRICT, PENNSYLVANIA

WAYS AND MEANS
COMMITTEE

Congress of the United States
House of Representatives • Washington, DC 20515

George

Kay Luther

April 29, 1986

Senator Robert Dole
141 Hart Senate Office Building
Washington, D.C. 20510

Dear Bob:

On Wednesday, June 4, the 5th District (Pennsylvania) Advisory Group will make its annual visit to Washington. The Advisory Group consists of approximately 40 businessmen and women who have, over the years, given me a lot of guidance in matters affecting small businesses -- issues such as taxation, insurance affordability, accounting and banking, pension and health benefits coverage for employees, etc. They are an extremely well informed group, and one of the purposes of their yearly visit to Washington is to listen to a discussion of current issues by Members of the House and Senate as well as industry representatives.

I would be honored if you could take time from your busy schedule to address these individuals on the afternoon of June 4th for about 15 minutes, with a 5 minute question and answer period at the end of your presentation. We will be meeting in Bull-feather's Hunt Room at 410 First Street, S.E. (One block south of the Capitol Hill Club) and would like to schedule your appearance beginning at 1:30 p.m. As I indicated earlier, this group has a wide range of interests and any subject you choose to address will be welcome. Current issues before the Finance Committee would be welcome -- perhaps an update on the tax reform process or predictions on trade policy reform would be possible. In addition, they are a solid Republican constituency who are politically active, and they would be eager to hear your thoughts on the upcoming Senate elections as well as other national political prospects.

Hoping to hear from you soon, with warm regard, I am

Sincerely,

Dick

DICK SCHULZE
Member of Congress

Gloria
x55761

DS/sbh

PLEASE RESPOND TO:

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June 3, 1986

TRADE TALKING POINTS

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

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

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

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

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

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

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CONGRESS AND TRADE POLICY

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

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

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

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

Specifically, this bipartisan initiative addresses the following objectives:

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

To expand trade through market liberalization;

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

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

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

CANADIAN FREE TRADE AGREEMENT

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

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

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

AGRICULTURE AND TRADE

o Agricultural trade is vital to the economic health of rural America and the Nation. 20 million jobs and 20% of our economic activity can be tied to the farm sector. Low farm prices are one of the primary reasons for the low inflation being enjoyed by other Americans as well as foreigners.

o I am especially sensitive to the importance of world markets to U.S. farmers. U.S. agricultural sales have fallen by over one-third in four years: from $43.8 billion in 1981 to $28 billion in 1985.

o Problems facing ag exports have included:

--reduced buying power and increased food production in developing countries. These trends are tied to long-term economic trends, and will not change soon.

--the relatively high value of the dollar in 1981-85. With the 30% decline in the dollar since a year ago, U.S. sales should improve somewhat. However, many of our competitors either trade in dollars or tie their currencies to shifts in the dollar's value to prevent losing market share.

--U.S. price supports have been above world market levels. This has been addressed through the lower loan rates in the 1985 farm bill. However, these 15-25% reductions will not be effective until the 1986 harvest begins (June for wheat; September for feedgrains and soybeans). Current "old crop" prices are significantly higher than "new crop" prices later this year.

--government-assisted competition. The EEC's use of export subsidies is only the most blatant example of government intervention in farm exports. Others have used (and are using) various production, processing, and ocean freight subsidies or allow domestic hyperinflation to underprice their exports.

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--lack of a coherent U.S. trade policy. Food has been used as an economic and political weapon by Administrations of both parties, either by cutting exports off in embargoes or by discriminating in the application of subsidies. U.S. refusal to offer Export Enhancement Program (EEP) bonus commodities across-the-board has cost sales to friends (Korea, Brazil) as well as global adversaries (Soviet Union, PRC).

o The Reagan Administration has launched a more serious effort to counter unfair trade practices. Lyng and Yeutter met their EEC counterparts (Andreissen and de Clerq) in Paris last week to make clear that the U.S. will not accept the new EEC restrictions on farm trade with Spain and Portugal. If restrictions are imposed, the U.S. will offset the value of lost sales of wheat, feed grains and soybean products through parallel restrictions on EEC agricultural exports.

o We do not want to get into a farm trade war. We would like to normalize ag trade by eliminating subsidies now allowed under GATT. The EEC has refused to put ag subsidies on the agenda for the new GATT round ever since the last Ministerial meeting broke down in November 1982. We cannot start new negotiations without ensuring that this issue will be addressed. The President is expected to address this question at the Tokyo Summit next week.

o I have urged the Administration to consider setting annual targets for the volume or value of farm exports in 1986, 1987, and 1988. This would introduce a needed element of accountability into evaluating our export performance, particularly as it relates to the results of our domestic farm programs. It would also be recognition that the U.S. must accept a more active role in competing for agricultural exports as long as other governments continue to actively intervene in international trade.

o When a farmer is threatened by bankruptcy or a processing plant is in danger of closing down, the men and women whose lives are dependent on those ventures are not interested in the comparative advantages of free trade or in how the EEC subsidizes its exports -- they want the Government to protect their jobs.

CONCLUSION

o The clock is ticking. Ticking for our trading partners throughout the world, who need to take some decisive action soon.

o The clock is also ticking here at home. We must do something quickly, on two fronts. We have to get our deficits, and our dollar, under control. And we must set up an effective mechanism to deal with trade issues on a comprehensive basis. If we ignore the problem any longer, we put at risk our own prosperity and our role as the engine of global economic progress.

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May 29, 1986

Tax Reform and Real Estate

- There has been a lot of talk about the impact of tax reform on the real estate industry. The important thing to remember is that tax reform doesn't touch the most important tax breaks that benefit real estate: the mortgage interest deduction for first and second homes, and the capital gains rollover for sale of a principal residence (as well as the capital gains exclusion for those over 55).

- In the period 1986-1990, these tax benefits--together with deductibility of property taxes on owner-occuppied homes--total a revenue loss of $285 billion under current law. None of these benefits is taken away under the Finance Committee tax reform bill.

- Of course, it is true that lowering tax rates dramatically reduces the benefits from existing tax privileges. But that, after all, is the whole point of tax reform: to return to a tax system that is simpler, fairer, and protects the average taxpayer in preference to those who can exploit special tax breaks.

- The much lower rates in the Senate bill--15% and 27%--automatically take a lot of the juice out of tax shelters, by reducing the after-tax benefit of investing in a shelter. All we've done is go one step further, and explicitly limit those tax shelter activities we think lack economic justification.

- That's the new limit on passive losses: we don't let you use losses from inactive investments to offset income from other sources. Why? So we can discourage purely tax-motivated transactions, and ensure that investments are made based on their real economic merit. That's good for the economy as a whole, including the real estate sector.

- The real estate industry itself is divided on the issue of tax reform. A number of major developers--including Oliver Carr, one of the biggest developers in Washington D.C.--have endorsed the Senate tax reform bill, because they hope it will reduce wasteful overbuilding and help target construction to where the marketplace dictates.

- Whenever you make major changes like this tax reform, you are bound to upset a lot of people who have relied on the old rules. Real estate investors are not alone in this. But it was that concern which led me to press for a phase-in of the new passive loss limitations over a 4-year period. The door is not, of course, closed to further changes if an equitable case can be made--we're willing to talk, and everyone expects the conference committee to address many of these concerns.

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• No doubt about it, tax reform will force a lot of people to rearrange their investments. Even the change in depreciation rules for real estate--moving up to 27 1/2 years for residential and 31 1/2 years for commercial--will have some impact. We will try to make the transition as smooth as possible, but remember that if we didn't have to upset some applecarts, we wouldn't be talking about tax reform in the first place.

• Finally, note that the Finance Committee bill keeps in place the credit for rehabilitating older properties (although at a reduced rate) and creates a new credit for low-income housing. No one is closing the door on tax-favored real estate investment.

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May 15, 1986

Tax Reform in the Senate

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

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

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

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

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

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

Productive for the economy

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

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

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

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

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

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

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

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

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May 6, 1986

Finance Committee Tax Reform Bill

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

The following benefits will be retained and/or increased:

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

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How is all of this paid for?

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

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

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

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

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

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

No changes are made to current law excise taxes.

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May 9, 1986

Individual Retirement Accounts

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

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

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

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

Misconceptions

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

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

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

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

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

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

Who Takes the IRA Deduction
(Percentages Rounded)

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

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May 9, 1986

TAX RATES

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

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

Recapture of Benefit of the 15% Bracket

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

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

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

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

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

Phaseout of Personal Exemption

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

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

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- 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.

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SALES TAX DEDUCTION

- The total repeal of state and local taxes would have raised approximately $160 billion over 5 years against the rates in the Finance Committee bill. Repeal of the sales tax raises $17 billion over the same period. Therefore, it is fair to say that substantially all the state and local tax deduction has been retained.

- I strongly supported this historic tax reform bill despite reservations about the loss of the sales tax deduction. Obviously I care a lot about the people of Kansas: and Kansas gets over 23% of its tax revenue from general sales tax.

- But to look only at the sales tax issue would really be letting the tail wag the dog. This tax package provides dramatic relief for individuals, and the potential for a big boost to the economy as a whole. Leaving people with much lower marginal rates, more pocket money, and better job opportunities is bound to make the task of raising revenue at least somewhat easier for State and local governments.

- Also on the plus side for State and local governments, those States that copy the Federal income tax base can get a substantial revenue boost from the extensive base-broadening measures included in the tax reform bill.

- Nearly all individuals use the sales tax table: rather than actually keeping sales tax receipts throughout the year and counting them up when they are ready to prepare their returns. This means that states and localities should not expect any significant change in buying patterns and, therefore, no significant change in sales tax revenue.

- I supported retaining the full state and local tax deduction when we were talking about a maximum rate of 35%. However, with a maximum rate of 27% and 80% of individuals in the 15% bracket, the sales tax deduction is less important.

- To keep that magic 27% top rate, we're going to have to work hard to keep the Finance Committee bill intact. That means anyone who wants to restore the sales tax deduction will have to come up with a credible revenue-raising alternative -- and that's increasingly difficult to do.

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