Kay Luther
June 19, 1986
Sheraton Grand
Ballroom Center

INDEPENDENT BAKERS ASSN (Agriculture)

IBA IS PRIMARILY INTERESTED IN TAX REFORM, GRAMM-RUDMAN-HOLLINGS (IBA STRONGLY SUPPORTS BOTH) AND LILABILITY INSURANCE. MR. BOB PYLE, PRESIDENT OF IBA, STATES THAT 98% OF THE MEMBERSHIP IS REPUBLICAN. HE REMEMBERS WORKING FOR CONGRESSMAN PERKINS BASS WHEN YOU WERE IN THE HOUSE.

* I UNDERSTAND IBA MEMBERS PRODUCE OVER HALF OF THE NATION'S BAKED GOODS. THE NEW FARM BILL SHOULD BE A HELP TO BAKERS SINCE THE LOWER LOAN RATES SHOULD REDUCE THE COST OF FLOUR TO DOMESTIC PURCHASERS. THE TREND OF GOVERNMENT DICTATED HIGH SUPPORT PRICES SET ABOVE MARKET CLEARING LEVELS HAS BEEN REVERSED IN HOPES FARMERS AND THOSE IN AGRIBUSINESS AND RELATED INDUSTRIES WILL MAKE THEIR PRODUCTION AND MARKETING DECISIONS BASED ON MARKET FUNDAMENTALS INSTEAD OF POLITICAL TINKERING.

* THE NEW BILL LOWERED WHEAT LOAN RATES FROM $3.30 FOR THE 1985 CROP YEAR TO A $2.40 ADJUSTED RATE THIS YEAR. THE SECRETARY HAS AUTHORITY TO ADJUST LOAN RATES DOWNWARD BY FIVE PERCENT PER YEAR. IF LOWER LOAN RATES DO INCREASE EXPORTS AS EXPECTED THEN THE MARKET PRICE SHOULD EVENTUALLY RISE ABOVE THE LOAN RATE.

* THE PURPOSE IS TO GET AGRICULTURE ON A MARKET-ORIENTED FOOTING WHICH MANY BELIEVE WILL HELP INCREASE EXPORTS AND HELP INCREASE NET FARM INCOME. I BELIEVE THAT LESS GOVERNMENT INVOLVEMENT WOULD BE HELPFUL FOR ALL OF AGRICULTLURE, INCLUDING THE INDEPENT BAKERS ASSOCIATION.

* AND ALTHOUGH WE DIDN'T REDUCE THE SUGAR SUPPORT PRICE WITH THE NEW FARM BILL, WE DID DISCONTINUE THE ANNUAL INCREASE IN THE SUGAR SUPPORT PRICE CONTAINED IN THE 1981 FARM BILL BY FREEZING THE PRICE AT THE 1985 LEVEL (18 CENTS) FOR FIVE YEARS.

* ((THE SUGAR PROGRAM MAY BE A GOOD EXAMPLE OF A COMMODITY WITH PRICES SET HIGH ENOUGH TO MAINTAIN DOMESTIC PRODUCTION WHILE AT THE SAME TIME ENCOURAGING SUBSTITUTION OF ALTERNATE SWEETNERS SUCH AS HIGH FRUCTOSE CORN SYRUP (HFCS) RESULTING IN LOSS OF THE SUGAR MARKET SHARE.))

June 13, 1986

Tax Reform in the Senate

- The U.S. Senate is about to do the country proud by producing the most far-reaching tax reform bill in history: the Finance Committee approved 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.
- In addition, the Senate has voted to do everything possible in Conference to restore some deductions for all IRA contributions and for State sales taxes.

Productive for the economy

- 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.

- o Simply put, lower tax rates for all 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.

Last step in the process

- o 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 keep those lower rates in place, regardless of inflaion.

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

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

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

Issues for Conference

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

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

June 13, 1986

Tax Rates

o 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.

o To take some of the juice out of the tax rate reduction for wealthier taxpayers, the tax breaks from the 15 percent bracket and of the increased personal exemption are phased out for high income taxpayers.

Recapture of Benefit of the 15% Bracket

o The benefit of the 15 percent rate bracket is cut back for taxpayers filing joint returns who have incomes over $75,000. This is done by a gradual phase-in, so the dollar benefit of the lower rate doesn't disappear completely until the taxpayer has more than $145,320 in income.

o 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.

o 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.

o 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 well 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

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

o 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.

o 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.

o 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.

CAPITAL GAINS TAX

- I understand the intense interest in the tax rates paid on capital gains income. I have long supported lower rates on capital gains, in the interest of encouraging investment, saving, and entrepreneurial activity. But in the context of overall tax reform, the issue demands a thorough reevaluation.

- Let no one doubt this Senator's conviction that capital gains taxes should not be allowed to interfere with productive economic activity. Since 1978 I have consistently worked for lower capital gains rates: One of my first major challenges as Chairman of the Finance Committee was to win approval of the 1981 Economic Recovery Tax Act, which cut the top capital gains rate to the present 20%. And I led the fight to reduce the holding period for long-term capital gains to 6 months, a battle we finally won in 1984.

- Why is the situation different now? Quite simply, the overriding goal of this tax reform bill is to reduce tax rates dramatically for all types of taxpayers--and all types of economic activity. With the maximum tax rate down to 27%, as opposed to the 50% rate we now have, providing a differential for capital gains becomes much less urgent than it used to be. The key is to get tax rates as low as possible for everyone, including taxpayers who have capital gains. To achieve that, many tax preferences have to go: including, in this case, the preference we gave to capital gains.

NEW ERA

- In an era of high tax rates we have little choice but to provide special protection for income-producing activities that we believe are essential to the health of the economy. Investment is one of those essential activities, and that's why we've excluded a portion of capital gains income from tax up to now.

- But let's face it--the need for such differentials just illustrates why a high-tax policy is a bad policy. We finally seem to have learned the lesson that if lower tax rates are good for capital gains, they're good for every type of income-generating activity. That is the basic thrust of the Packwood tax reform bill.

● It's important to maintain the principle of progressivity as we move to a lower-rate system. We want to build popular support for a fairer tax system. That's much easier to do if we eliminate tax preferences that largely benefit the very wealthy. In dollar terms, 60% of the benefit of the capital gains preference goes to taxpayers with incomes over $100,000. When those taxpayers will be getting the benefit of a 27% tax rate, I'm not sure we need to give a capital gains preference as well.

June 13, 1986

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.

- The top rate of 27% is so important, Senators have to find other revenue-raisers to pay for restoring any deduction. No one in the Senate found a way to do that for the sales tax deduction--it's not easy. But we did pledge to work in conference for a better deal for State sales taxes.

June 13, 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. In addition, the full Senate has pledged its conferees to work for further restoration of IRA deductions in conference with the House.

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.

- 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

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.

• 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.

May 9, 1986

PASSIVE LOSS LIMITATION

EXCEPTION FOR OIL AND GAS WORKING INTERESTS

- The Finance Committee bill contains an exception from the passive loss limitation rule for "working interests in oil and gas properties".

- First, I would like to clear up a misconception in the reports by the media. There was no threat to kill the tax reform effort if this modification were not adopted. This modification was included in this bill just like any other modification -- a majority of the Committee thought it was a good idea and voted for it.

- The passive loss limitation rule is the provision that has been described as the "anti-tax shelter" provision. This provision raises approximately $50 billion over five years by telling investors in tax shelters that they can use deductions generated from these investments to offset income generated by these types of investments, but they cannot use these deductions to offset other income such as salary or wages.

- The working interest exception recognizes the economic reality in the way some oil and gas deals are structured differs greatly from real estate or other types of investment.

- Those of us who voted for this exception believe that when an individual enters into a joint venture to drill an oil well and agrees that he will be joint and severally liable for any costs that may result, he is in the business of oil drilling. He is not just a passive investor.

- These individuals receive detailed explanations of proposed expenditures before they are incurred and they have the ability to challenge the specifics and to put up funds or not. They are truly in the business whether or not they actually operate the drilling rig.

- In contrast, if an individual is a limited partner in a so-called oil fund, he will be treated just like other passive investors and the loss limitations will apply.

- The working interest exception represents $1.4 billion out of $50 billion attributed to the passive loss limitation. It is clear that the exception does not materially reduce the value of the general rule.

- In fact, it has almost exactly the same revenue impact as the 3-year extension of the targeted jobs credit which we agreed to the same evening we agreed to the working interest rule. I have not seen any stories about the $1.3 billion loss attributable to these credits.

- Similarly, the research and development credit was extended for 4 years at $1 billion per year. It is an incentive, not an economic cost, but no one has written about that. No one has discussed the credit for historic and other older buildings which cost $2 billion per year and have been the basis for countless tax shelters.

Gramm-Rudman and the Budget

- o In light of the uncertainty about the fate of provisions of the Gramm-Rudman-Hollings law, completing action on the fiscal 1987 Budget Resolution before the July 4th recess, scheduled to start a week from Friday, becomes even more important.

- o If Congress adopts a budget resolution now, and completes work on reconciliation-savings legislation, we will have fulfilled our responsibilities -- met the deficit-cutting obligations we assumed when we passed Gramm-Rudman-Hollings, -- without having to pass the buck to someone else.

- o In the absence of a budget resolution, if the letter of the balanced budget law is followed, the House of Representatives would not be able to recess for more than three days in July unless all regular 1987 appropriations bills and reconciliation legislation were approved. That in and of itself should provide the kick in the pants we all seem to need to get the resolution out of conference and adopted by both Houses.

- o What's more, further delay in adopting a budget resolution will throw our entire Congressional agenda out of whack. Without the budget resolution we cannot draft appropriations bills that are in sync with the final set of Congressional spending priorities. The Appropriations Committees will do their very best to reflect the wishes of each chamber as expressed in its version of the budget -- but that will not be the final word.

- o Besides, without a budget, authorizing committees can't begin drafting deficit-reduction legislation that will be mandated by reconciliation instructions included in the budget resolution. Reconciliation is, after all, the teeth in the budget -- the mechanism for enforcing deficit-reduction. According to Gramm-Rudman-Hollings, reconciliation legislation should have passed by June 15.

- o Last year when we approved the Gramm-Rudman-Hollings law we all made eloquent speeches about the dire consequences of big deficits, and Congress' inability to come to terms with those deficits. Today we realize anew that no matter what mechanism is in place, we have to make the tough choices about how we reduce that deficit.