SAVINGS INCENTIVES

HEARING

BEFORE THE

SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY

OF THE

COMMITTEE ON FINANCE UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

FIRST SESSION

ON

S. 12

A BILL TO AMEND THE INTERNAL REVENUE CODE OF 1954 TO ALLOW A RETIREMENT SAVINGS DEDUCTION FOR PERSONS COVERED BY CERTAIN PENSION PLANS

S. 24

A BILL TO AMEND THE INTERNAL REVENUE CODE OF 1954 TO PROVIDE FOR THE ESTABLISHMENT OF, AND THE DEDUCTION OF CONTRIBUTIONS TO, EDUCATION SAVINGS ACCOUNTS AND HOUSING SAVINGS ACCOUNTS

S. 243

A BILL TO AMEND THE INTERNAL REVENUE CODE OF 1954 TO INCREASE THE ALLOWABLE CONTRIBUTIONS TO INDIVIDUAL RETIREMENT PLANS AND TO ALLOW EMPLOYEES A DEDUCTION FOR SAVINGS CONTRIBUTIONS TO EMPLOYER RETIREMENT PLANS OR TO INDIVIDUAL RETIREMENT ACCOUNTS

FEBRUARY 24, 1981

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SAVINGS INCENTIVE TAX BILLS

TUESDAY, FEBRUARY 24, 1981

U.S. SENATE,
SUBCOMMITTEE ON SAVINGS, PENSIONS,
AND INVESTMENT POLICY,
COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:10 a.m., in room 2221, Dirksen Senate Office Building, Senator John H. Chafee (chairman of the subcommittee) presiding.

Present: Senators Chafee, Byrd, and Mitchell.

[The press release announcing these hearings, the bills S. 12, S. 24, S. 243, and the description of same follow:]

Press Release #81-105

PRESS RELEASE

FOR IMMEDIATE RELEASE
February 12, 1981

COMMITTEE ON FINANCE
UNITED STATES SENATE
Subcommittee on Savings, Pensions, and Investment Policy
2227 Dirksen Senate Office Bldg.

FINANCE SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY SETS HEARING ON THREE SAVINGS INCENTIVE TAX BILLS

Senator John H. Chafee, Chairman of the Subcommittee on Savings, Pensions, and Investment Policy of the Senate Committee on Finance announced today that the Subcommittee will hold hearings on February 24, 1981 on three tax bills designed to provide important new incentives for savings.

The hearing will begin at 10:00 a.m. in Room 2221 of the Dirksen Senate Office Building.

The following pieces of legislation of general application will be considered on February 24, 1981.

S. 12 -- Introduced by Senator Dole for himself and others. Would permit an individual to make a tax-deductible contribution of not more than $1,000 to an individual retirement account even if that individual is covered by an employer-sponsored retirement plan.

S. 24 -- Introduced by Senator Dole for himself and others. Would permit individuals to establish tax-deductible savings accounts for the purchase of a home (up to $1,500 per year) and for higher education (up to $1,000 per child per year).

S. 243 -- Introduced by Senator Chafee. Would permit increased tax-deductible contributions to an individual retirement account of up to $2,000 per year as well as nondeductible contributions up to $8,000 plus $2,000 per year and would permit withdrawals in amounts up to $10,000 from such account for the purchase of a home, higher or vocational education or on retirement under existing law. S. 243 would also make permanent the current $200 ($400 on a joint return) exclusion of interest and dividends and increase that exclusion to $500 ($1,000 on a joint return) when an individual or spouse attains age 65.

Witnesses who desire to testify at the hearing on February 24, 1981 must submit a written request to Robert E. Lighthizer, Chief Counsel, Committee on Finance, Room 2227 Dirksen Senate Office Building, Washington, D.C. 20510, by no later than the close of business on February 19, 1981.

Legislative Reorganization Act. -- Senator Chafee stated that the Legislative Reorganization Act of 1946, as amended, requires all witnesses appearing before the Committees of Congress "to file in advance written statements of their proposed testimony, and to limit their oral presentations to brief summaries of their argument."

Witnesses scheduled to testify should comply with the following rules:

(1) A copy of the statement must be filed by noon the day before the day the witness is scheduled to testify.

(2) All witnesses must include with their written statement a summary of the principal points included in the statement.

(3) The written statements must be typed on letter-size paper (not legal size) and at least 100 copies must be submitted by the close of business the day before the witness is scheduled to testify.

(4) Witnesses should not read their written statements to the Subcommittee, but ought instead to confine their oral presentations to a summary of the points included in the statement.

Written statements. - Witnesses who are not scheduled to make an oral presentation, and others who desire to present their views to the Subcommittee, are urged to prepare a written statement for submission and inclusion in the printed record on the hearings. These written statements should be typewritten, not more than 25 double-spaced pages in length, and mailed with five (5) copies to Robert E. Lighthizer, Chief Counsel, Committee on Finance, Room 2227, Dirksen Senate Office Building, Washington, D.C. 20510, not later than Tuesday, March 10, 1981.

P.R. #81-105

II

97TH CONGRESS
1ST SESSION

S. 12

To amend the Internal Revenue Code of 1954 to allow a retirement savings deduction for persons covered by certain pension plans.

IN THE SENATE OF THE UNITED STATES

JANUARY 5, 1981

Mr. DOLE (for himself and Mr. COCHRAN) introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To amend the Internal Revenue Code of 1954 to allow a retirement savings deduction for persons covered by certain pension plans.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That the Internal Revenue Code of 1954 is amended to
4 provide for the limited Employee Retirement Account as
5 follows:
6 (a) DEDUCTION FOR CERTAIN EMPLOYEE RETIRE-
7 MENT SAVINGS CONTRIBUTIONS.—

1 (1) IN GENERAL.—Part VII of subchapter B of
2 chapter 1 (relating to additional itemized deductions for
3 individuals) is amended by redesignating section 221 as
4 222 and by inserting after section 220 the following
5 new section:

6 "SEC. 221. DEDUCTION FOR CERTAIN EMPLOYEE RETIRE-
7 MENT SAVINGS CONTRIBUTIONS.

8 "(a) DEDUCTION ALLOWED.—In the case of an eligible
9 employee, described in subsection (c), there is allowed as a
10 deduction amounts paid in cash for a taxable year by such
11 individual for the benefit of himself—

12 "(1) to a plan described in section 401(a) which
13 includes a trust exempt from tax under section 501(a),

14 "(2) to an annuity plan described in section
15 403(a),

16 "(3) to a qualified bond purchase plan described in
17 section 405(a),

18 "(4) to an individual retirement account described
19 in section 408(a), individual retirement annuity de-
20 scribed in section 408(b), or for a retirement bond de-
21 scribed in section 409, or

22 "(5) to a group retirement trust maintained by a
23 labor organization described in section 501(c)(5) which
24 is financed exclusively by assessments of individuals
25 who are members of such labor organization, which

1 was established prior to January 1, 1974, and in which
2 the assessments paid to the trust by any participant
3 are 100 percent nonforfeitable.
4 "(b) LIMITATION AND RESTRICTIONS.—
5 "(1) MAXIMUM DEDUCTION.—The amount allow-
6 able as a deduction under subsection (a) to an eligible
7 employee for any taxable year may not exceed an
8 amount equal to 15 percent of the compensation in-
9 cludible in his gross income for such taxable year, or
10 $1,000, whichever is less.
11 "(2) ADDITIONAL LIMITATION.—No deduction is
12 allowed for any amount paid to an account, annuity, or
13 for a bond described in paragraph (4) of subsection (a)
14 except to the extent of the excess of the amount deter-
15 mined under subsection (b) over any amount paid by
16 the eligible employee to a plan or trust described in
17 paragraph (1), (2), (3) or (5) of subsection (a).
18 "(3) ALTERNATIVE DEDUCTION.—No deduction
19 is allowed under subsection (a) for the taxable year if
20 the individual claims the deduction allowed by sections
21 219 or 220 for the taxable year.
22 "(c) DEFINITIONS AND SPECIAL RULES.—
23 "(1) ELIGIBLE EMPLOYEE.—For purposes of this
24 section, the term 'eligible employee' shall mean an in-
25 dividual who is an employee without regard to section

1 401(c)(1) or is a member of a labor organization re-
2 ferred to in subparagraph (D) and who is an active
3 participant for any part of the taxable year in—
4 "(A) a plan described in section 401(a) which
5 includes a trust exempt from tax under section
6 501(a),
7 "(B) an annuity plan described in section
8 403(a),
9 "(C) a qualified bond purchase plan described
10 in section 405(a), or
11 "(D) a group retirement trust maintained by
12 a labor organization described in section 501(c)(5)
13 which is financed exclusively by assessments of
14 individuals who are members of such labor organi-
15 zation, which was established prior to January 1,
16 1974, and in which the assessments paid to the
17 trust by any participant are 100 percent
18 nonforfeitable,
19 but not if such plan is established or maintained by
20 the United States, by a State or political subdivision
21 thereof or by agency or instrumentality of any of the
22 foregoing.
23 "(2) REPORTS.—The Secretary shall promulgate
24 regulations which prescribe the time and manner re-
25 ports shall be filed by an employer receiving contribu-

1 tions deductible under this section and by any eligible
2 employee making any such deductible contribution.
3 "(3) RECONTRIBUTED AMOUNTS.—No deduction
4 shall be allowed under this section with respect to a
5 rollover contribution described in section 402(a)(5),
6 402(a)(6), 402(a)(7), 403(a)(4), 403(a)(5), 403(b)(8),
7 408(d)(3), or 409(b)(3)(C).
8 "(4) AMOUNTS CONTRIBUTED UNDER ENDOW-
9 MENT CONTRACT.—In the case of an endowment con-
10 tract described in section 408(b), no deduction shall be
11 allowed under this section for that portion of the
12 amounts paid under the contract for the taxable year
13 which are properly allocable, under regulations de-
14 scribed by the Secretary, to the cost of life insurance.
15 "(5) MARRIED INDIVIDUALS.—The maximum de-
16 duction under subsection (b) shall be computed sepa-
17 rately for each individual, and this section shall be
18 applied without regard to any community property
19 laws.".
20 (2) DEDUCTION ALLOWED IN ARRIVING AT AD-
21 JUSTED GROSS INCOME.—Section 62 (defining ad-
22 justed gross income) is amended by inserting after
23 paragraph (13) the following new paragraph:
24 "(14) DEDUCTION FOR CERTAIN CONTRIBU-
25 TIONS.—The deduction allowed by section 221 (re-

1 lating to certain employee retirement savings
2 contributions).".
3 (b) TAX TREATMENT OF CERTAIN DEDUCTIBLE EM-
4 PLOYEE CONTRIBUTIONS.—Subpart A of part I of sub-
5 chapter D of chapter 1 (relating to retirement plans) is
6 amended by inserting after subsection (l) of section 414 the
7 following new subsection:
8 "(m) DEDUCTIBLE EMPLOYEE CONTRIBUTIONS.—For
9 purposes of this title other than for purposes of sections
10 401(a) (4) and (5), 404, 410(b), 411, and 412, any amount
11 which an employer is required to report pursuant to regula-
12 tions promulgated under subsection (c)(2) of section 221, with
13 respect to an amount paid by an eligible employee, as defined
14 in subsection (c)(1) of section 221, as an employee retire-
15 ment savings contribution, shall be treated as an employer
16 contribution.".
17 (c) CONFORMING AMENDMENTS.—
18 (1) So much of section 72(f) as precedes para-
19 graph (1) thereof is amended to read as follows:
20 "In computing, for purposes of subsection (c)(1)(A), the
21 aggregate amount of premiums or other consideration paid
22 for the contract, for purposes of subsection (d)(1), the consid-
23 eration for the contract contributed by the employee, and for
24 purposes of subsection (e)(1)(B), the aggregate premiums or
25 other consideration paid, amounts which an employer is re-

1 quired to report, pursuant to regulations promulgated under
2 subsection (c)(2) of section 221, with respect to an amount
3 paid by an eligible employee, as defined in subsection (c)(1) of
4 section 221, as a retirement savings employee contribution
5 shall be excluded, and amounts contributed by the employer
6 shall be included, but only to the extent that—".
7 (2) Section 414(h) (tax treatment of certain contri-
8 butions) is amended by inserting after "any amount
9 contributed" the following: "other than an amount de-
10 scribed in subsection (m)".
11 (3) So much of section 4973(b) as follows para-
12 graph (1)(A) thereof is amended to read as follows:
13 "(B) the amount allowable as a deduction
14 under section 219, 220, or 221 for such contribu-
15 tions, and
16 "(2) the amount determined under this sub-
17 section for the preceding taxable year, reduced by
18 the sum of—
19 "(A) the distributions out of the account
20 for the taxable year which were included in
21 the gross income of the payee under section
22 408(d)(1),
23 "(B) the distributions out of the account
24 for the taxable year to which section
25 408(d)(5) applies, and

1 "(C) the excess (if any) of the maximum
2 amount allowable as a deduction under sec-
3 tion 219, 220, or 221 for the taxable year
4 over the amount contributed (determined
5 without regard to sections 219(c)(5) and
6 220(c)(6)) to the accounts or for the annuities
7 or bonds for the taxable year.

8 For purposes of this subsection, any contribution which is
9 distributed from the individual retirement account, individual
10 retirement annuity, or bond in a distribution to which sec-
11 tion 408(d)(4) applies shall be treated as an amount not
12 contributed.".

13 (d) EFFECTIVE DATE.—The amendments made by this
14 Act shall apply to taxable years beginning after the date of
15 the enactment of this Act.

II

97TH CONGRESS
1ST SESSION

S. 24

To amend the Internal Revenue Code of 1954 to provide for the establishment of, and the deduction of contributions to, education savings accounts and housing savings accounts.

IN THE SENATE OF THE UNITED STATES

JANUARY 5, 1981

Mr. DOLE (for himself, Mr. CHAFEE, Mr. DANFORTH, Mr. GARN, Mr. HATFIELD, and Mr. WALLOP) introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To amend the Internal Revenue Code of 1954 to provide for the establishment of, and the deduction of contributions to, education savings accounts and housing savings accounts.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 **SECTION 1. EDUCATION SAVINGS ACCOUNTS.**
4 (a) IN GENERAL.—Part VII of subchapter B of chapter
5 1 of the Internal Revenue Code of 1954 (relating to addi-
6 tional itemized deductions for individuals) is amended by re-

1 designating section 221 as 222 and by inserting after section
2 220 the following new section:
3 "SEC. 221. EDUCATION SAVINGS ACCOUNT.
4 "(a) DEDUCTION ALLOWED.—In the case of an individ-
5 ual, there is allowed as a deduction the sum of—
6 "(1) amounts paid in cash, and
7 "(2) the fair market value at time of transfer of
8 stock, bonds, or other securities, which are readily
9 tradeable on an established securities market, trans-
10 ferred,
11 during the calendar year which ends with or within the tax-
12 able year by such individual to an education savings account
13 established for the benefit of an eligible individual.
14 "(b) LIMITATIONS.—
15 "(1) ACCOUNT MAY NOT BE ESTABLISHED FOR
16 BENEFIT OF MORE THAN 1 INDIVIDUAL.—An educa-
17 tion savings account may not be established for the
18 benefit of more than 1 individual.
19 "(2) INDIVIDUAL MAY NOT BE BENEFICIARY OF
20 MORE THAN 1 ACCOUNT.—An individual who is the
21 beneficiary of more than 1 education savings account
22 during any calendar year shall not be treated as an eli-
23 gible individual for that calendar year.
24 "(3) MAXIMUM DEDUCTION PER ACCOUNT.—The
25 amount allowable as a deduction under subsection (a)

1 to an individual for amounts paid or transferred to an
2 account for any calendar year shall not exceed $1,000.
3 "(4) CONTRIBUTIONS BY MORE THAN 1
4 PERSON.—If more than 1 individual makes contribu-
5 tions to an education savings account during a calendar
6 year, the $1,000 amount under paragraph (3) shall be
7 allocated proportionately among all individuals contrib-
8 uting to the account during that year on the basis of
9 the amounts contributed by each such individual.
10 "(5) ADJUSTMENT OF LIMIT FOR INFLATION.—
11 "(A) IN GENERAL.—Beginning in 1982, the
12 dollar amounts in paragraph (3), paragraph (4),
13 and subsection (c)(2)(A) shall each be adjusted by
14 multiplying such amounts by the inflation adjust-
15 ment factor for the 12-month period ending on
16 July 31 of the preceding calendar year and, as
17 adjusted, shall be substituted for such amounts for
18 taxable years ending with or within the calendar
19 year next beginning after such 12-month period.
20 "(B) COMPUTATION OF INFLATION ADJUST-
21 MENT FACTOR.—
22 "(i) DETERMINATION AND PUBLICA-
23 TION.—The Secretary shall, not later than
24 October 1 of each calendar year (beginning
25 in 1981), determine and publish in the Fed-

1 eral Register the inflation adjustment factor
2 for the immediately preceding 12-month
3 period ending on July 31 in accordance with
4 this paragraph.

5 "(ii) INFLATION ADJUSTMENT
6 FACTOR.—The term 'inflation adjustment
7 factor' means, with respect to a calendar
8 year, a fraction the numerator of which is
9 the average monthly Consumer Price Index
10 (all items—United States city average) pub-
11 lished by the Bureau of Labor Statistics of
12 the Department of Labor for the most recent
13 12-month period ending on July 31 and the
14 denominator of which is the average monthly
15 Consumer Price Index (all items—United
16 States city average) for the 12-month period
17 ending on July 31, 1980.

18 "(c) DEFINITIONS AND SPECIAL RULES.—

19 "(1) ELIGIBLE INDIVIDUAL.—The term 'eligible
20 individual' means the taxpayer or a child of the tax-
21 payer (within the meaning of section 151(e)(3)) unless
22 the taxpayer or child—

23 "(A) has attained the age of 21 before the
24 close of the calendar year for which the contribu-
25 tion is made, or

1 "(B) is enrolled as a full-time student at an
2 eligible educational institution for more than 4
3 weeks during that calendar year.
4 "(2) EDUCATION SAVINGS ACCOUNT.—For pur-
5 poses of this section, the term 'education savings ac-
6 count' means a trust created or organized in the
7 United States exclusively for the purpose of paying the
8 educational expenses of an eligible individual, but only
9 if the written governing instrument creating the trust
10 meets the following requirements:
11 "(A) No contribution will be accepted unless
12 it is in cash, stocks, bonds, or other securities
13 which are readily tradeable on an established se-
14 curities market, and contributions will not be ac-
15 cepted for the taxable year in excess of $1,000.
16 "(B) The trustee is a bank (as defined in sec-
17 tion 401(d)(1)) or another person who demon-
18 strates to the satisfaction of the Secretary that
19 the manner in which that person will administer
20 the trust will be consistent with the requirements
21 of this section.
22 "(C) No part of the trust assets will be in-
23 vested in life insurance contracts (other than con-
24 tracts the beneficiary of which is the trust and the
25 face amount of which does not exceed the amount

1 by which the maximum amount which can be con-
2 tributed to the account exceeds the sum of the
3 amounts contributed to the account for all taxable
4 years).
5 "(D) The assets of the account may be in-
6 vested in accordance with the direction of the in-
7 dividual contributing to the account, but, if more
8 than one individual has made contributions to the
9 account, the consent of all such individuals shall
10 be required for any such direction.
11 "(E) The assets of the trust will not be com-
12 mingled with other property except in a common
13 trust fund or common investment fund.
14 "(F) Any balance in the account on the day
15 before the date on which the individual for whose
16 benefit the trust is established attains age 26 will
17 be distributed on that date to each of the individ-
18 uals who have contributed to the trust in an
19 amount which bears the same ratio to such bal-
20 ance as such individual's contributions bear to the
21 sum of all such contributions.
22 "(3) TIME WHEN CONTRIBUTIONS DEEMED
23 MADE.—For purposes of this section, a taxpayer shall
24 be deemed to have made a contribution on the last day
25 of a calendar year if the contribution is made on ac-

1 count of such calendar year and is made not later than
2 the time prescribed by law for filing the return for the
3 taxable year (including extensions thereof) with or
4 within which the calendar year ends.

5 "(4) STOCK, ETC., TO BE VALUED AS OF TRANS-
6 FER DATE.—The fair market value of stocks, bonds,
7 and other securities shall be determined as of the date
8 on which they are transferred to the account. If the
9 date of transfer falls on a Saturday, Sunday, or public
10 legal holiday, then the fair market value shall be deter-
11 mined by reference to the last preceding day on which
12 they could have been traded on an established securi-
13 ties market.

14 "(5) EDUCATIONAL EXPENSES.—The term 'edu-
15 cational expenses' means—

16 "(A) tuition and fees required for the enroll-
17 ment or attendance of a student at an eligible
18 educational institution,

19 "(B) fees, books, supplies, and equipment re-
20 quired for courses of instruction at an eligible edu-
21 cational institution, and

22 "(C) a reasonable allowance for meals and
23 lodging.

24 "(6) ELIGIBLE EDUCATIONAL INSTITUTION.—
25 The term 'eligible educational institution' means—

1 "(A) an institution of higher education, or
2 "(B) a vocational school.
3 "(7) INSTITUTION OF HIGHER EDUCATION.—The
4 term 'institution of higher education' means the institu-
5 tions described in section 1201(a) or 491(b) of the
6 Higher Education Act of 1965.
7 "(8) VOCATIONAL SCHOOL.—The term 'voca-
8 tional school' means an area vocational education
9 school as defined in section 195(2) of the Vocational
10 Education Act of 1963 which is in any State (as de-
11 fined in section 195(8) of such Act).
12 "(d) TAX TREATMENT OF DISTRIBUTIONS.—
13 "(1) IN GENERAL.—Except as otherwise provided
14 in this subsection, any amount paid or distributed out
15 of an education savings account shall be included in
16 gross income by each individual who has contributed to
17 the account, in an amount which bears the same ratio
18 to such payment or distribution as the amount contrib-
19 uted by that individual for all taxable years bears to
20 the amounts contributed by all individuals for all tax-
21 able years, for the taxable year in which the payment
22 or distribution is received, unless such amount is used
23 exclusively to pay the educational expenses incurred by
24 the individual for whose benefit the account is estab-
25 lished.

"(2) EXCESS CONTRIBUTIONS RETURNED BEFORE DUE DATE OF RETURN.—Paragraph (1) does not apply to the distribution of any contribution paid during a taxable year to an education savings account to the extent that such contribution exceeds the amount allowable as a deduction under subsection (a) if—

"(A) such distribution is received on or before the day prescribed by law (including extensions of time) for filing such individual's return for such taxable year,

"(B) no deduction is allowed under subsection (a) with respect to such excess contribution, and

"(C) such distribution is accompanied by the amount of net income attributable to such excess contribution.

Any net income described in subparagraph (C) shall be included in the gross income of the individual for the taxable year in which it is received.

"(3) QUALIFIED DISTRIBUTIONS INCLUDED IN BENEFICIARY'S INCOME OVER 10-YEAR PERIOD.—The gross income of an individual for whose benefit an education savings account was established for the taxable year in which that individual attains age 25 and

1 for each of the 9 succeeding taxable years shall be in-
2 creased by 10 percent of the sum of the amounts paid
3 or distributed out of the account which were used ex-
4 clusively to pay the educational expenses incurred by
5 that individual.
6 "(e) TAX TREATMENT OF ACCOUNTS.—
7 "(1) EXEMPTION FROM TAX.—An education sav-
8 ings account is exempt from taxation under this subti-
9 tle unless such account has ceased to be an education
10 savings account by reason of paragraph (2) or (3). Not-
11 withstanding the preceding sentence, any such account
12 is subject to the taxes imposed by section 511 (relating
13 to imposition of tax on unrelated business income of
14 charitable, etc. organizations).
15 "(2) LOSS OF EXEMPTION OF ACCOUNT WHERE
16 INDIVIDUAL ENGAGES IN PROHIBITED TRANSAC-
17 TION.—
18 "(A) IN GENERAL.—If, during any taxable
19 year of an individual who contributes to an educa-
20 tion savings account, that individual engages in
21 any transaction prohibited by section 4975 with
22 respect to the account, the account ceases to be
23 an education savings account as of the first day of
24 that taxable year.

1 "(B) ACCOUNT TREATED AS DISTRIBUTING
2 ALL ITS ASSETS.—In any case in which any ac-
3 count ceases to be an education savings account
4 by reason of subparagraph (A) on the first day of
5 any taxable year, paragraph (1) of subsection (d)
6 applies as if there were a distribution on such first
7 day in an amount equal to the fair market value
8 (on such first day) of all assets in the account (on
9 such first day).
10 "(3) EFFECT OF PLEDGING ACCOUNT AS SECU-
11 RITY.—If, during any taxable year, the individual for
12 whose benefit an education savings account is estab-
13 lished uses the account or any portion thereof as secu-
14 rity for a loan, the portion so used is treated as distrib-
15 uted to that individual.
16 "(f) ADDITIONAL TAX ON CERTAIN AMOUNTS IN-
17 CLUDED IN GROSS INCOME.—
18 "(1) DISTRIBUTION NOT USED FOR EDUCATION-
19 AL EXPENSES.—If a distribution from an education
20 savings account is made, and not used in connection
21 with the payment of educational expenses of the indi-
22 vidual for whose benefit the account was established,
23 the tax liability of each of the individuals who has con-
24 tributed to the account for the taxable year in which
25 such distribution is received shall be increased by an

1 amount equal to 10 percent of the amount of the distri-
2 bution which is includable in his gross income for such
3 taxable year.

4 "(2) DISQUALIFICATION CASES.—If an amount is
5 includable in the gross income of an individual for a
6 taxable year under subsection (d), his tax under this
7 chapter for such taxable year shall be increased by an
8 amount equal to 10 percent of such amount required to
9 be included in his gross income.

10 "(3) DISABILITY CASES.—Paragraphs (1) and (2)
11 do not apply if the payment or distribution is made
12 after the taxpayer becomes disabled within the mean-
13 ing of section 72(m)(7).

14 "(g) COMMUNITY PROPERTY LAWS.—This section
15 shall be applied without regard to any community property
16 laws.

17 "(h) CUSTODIAL ACCOUNTS.—For purposes of this sec-
18 tion, a custodial account shall be treated as a trust if the
19 assets of such account are held by a bank (as defined in sec-
20 tion 401(d)(1)) or another person who demonstrates, to the
21 satisfaction of the Secretary, that the manner in which he
22 will administer the account will be consistent with the re-
23 quirements of this section, and if the custodial account would,
24 except for the fact that it is not a trust, constitute an educa-
25 tion savings account described in subsection (c). For purposes

1 of this title, in the case of a custodial account treated as a
2 trust by reason of the preceding sentence, the custodian of
3 such account shall be treated as the trustee thereof.

4 "(i) REPORTS.—The trustee of an education savings ac-
5 count shall make such reports regarding such account to the
6 Secretary and to the individual for whose benefit the account
7 is maintained with respect to contributions, distributions, and
8 such other matters as the Secretary may require under regu-
9 lations. The reports required by this subsection shall be filed
10 at such time and in such manner and furnished to such indi-
11 viduals at such time and in such manner as may be required
12 by those regulations.".

13 (b) DEDUCTION ALLOWED IN ARRIVING AT ADJUSTED
14 GROSS INCOME.—Paragraph (10) of section 62 of such Code
15 (relating to retirement savings) is amended—

16 (1) by inserting "or education" after "Retire-
17 ment" in the caption of such paragraph, and

18 (2) by inserting before the period at the end there-
19 of the following: "and the deduction allowed by section
20 221 (relating to deduction of certain payments to edu-
21 cation savings accounts)".

22 (c) TAX ON EXCESS CONTRIBUTIONS.—Section 4973
23 of such Code (relating to tax on excess contributions to indi-
24 vidual retirement accounts, certain section 403(b) contracts,

1 certain individual retirement annuities, and certain retirement
2 bonds) is amended—
3 (1) by inserting "EDUCATION SAVINGS AC-
4 COUNTS," after "ACCOUNTS," in the caption of such
5 section,
6 (2) by redesignating paragraphs (2) and (3) of sub-
7 section (a) as (3) and (4), and by inserting after para-
8 graph (1) the following:
9 "(2) an education savings account (within the
10 meaning of section 221(c)),", and
11 (3) by adding at the end thereof the following new
12 subsection:
13 "(d) EXCESS CONTRIBUTIONS TO EDUCATION SAV-
14 INGS ACCOUNTS.—For purposes of this section, in the case
15 of an education savings account, the term 'excess contribu-
16 tions' means the amount by which the amount contributed for
17 the taxable year to the account exceeds the amount allowable
18 as a deduction under section 221(b) for such taxable year.
19 For purposes of this subsection, any contribution which is
20 distributed out of the education savings account and a distri-
21 bution to which section 221(d)(2) applies shall be treated as
22 an amount not contributed.".
23 (d) CONTRIBUTION NOT TO BE TREATED AS A GIFT
24 FOR GIFT TAX PURPOSES.—Section 2503 of such Code (re-

1 lating to taxable gifts) is amended by adding at the end there-
2 of the following new subsection:
3 "(e) EDUCATION SAVINGS ACCOUNTS.—For purposes
4 of subsection (b), any payment made by an individual for the
5 benefit of his child to an education savings account described
6 in section 221(c), shall not be considered a gift of a future
7 interest in property to the extent that such payment is al-
8 lowed as a deduction under section 221.".
9 (e) TAX ON PROHIBITED TRANSACTIONS.—Section
10 4975 of such Code (relating to prohibited transactions) is
11 amended—
12 (1) by adding at the end of subsection (c) the fol-
13 lowing new paragraph:
14 "(4) SPECIAL RULE FOR EDUCATION SAVINGS
15 ACCOUNTS.—An individual for whose benefit an educa-
16 tion savings account is established shall be exempt
17 from the tax imposed by this section with respect to
18 any transaction concerning such account (which would
19 otherwise be taxable under this section) if, with respect
20 to such transaction, the account ceases to be an educa-
21 tion savings account by reason of the application of
22 section 221(e)(2)(A) to such account.", and
23 (2) by inserting "or an education savings account
24 described in section 221(c)" in subsection (c)(1) after
25 "described in section 408(a)".

1 (f) FAILURE TO PROVIDE REPORTS ON EDUCATION
2 SAVINGS ACCOUNTS.—Section 6693 of such Code (relating
3 to failure to provide reports on individual retirement account
4 or annuities) is amended—
5 (1) by inserting "OR EDUCATION SAVINGS AC-
6 COUNTS" after "ANNUITIES" in the caption of such
7 section, and
8 (2) by adding at the end of subsection (a) the fol-
9 lowing: "The person required by section 221(i) to file a
10 report regarding an education account at the time and
11 in the manner required by such section shall pay a
12 penalty of $10 for each failure unless it is shown that
13 such failure is due to reasonable cause.".
14 (g)(1) The table of sections for part VII of subchapter B
15 of chapter 1 of such Code is amended by striking out the item
16 relating to section 221 and inserting in lieu thereof the
17 following:

"Sec. 221. Education savings accounts.
"Sec. 222. Cross references.".

18 (2) The table of sections for chapter 43 of such Code is
19 amended by striking out the item relating to section 4973
20 and inserting in lieu thereof the following:

"Sec. 4973. Tax on excess contributions to individual retirement accounts, education savings accounts, certain 403(b) contracts, certain individual retirement annuities, and certain retirement bonds.".

1 (3) The table of sections for subchapter B of chapter 68
2 of such Code is amended by striking out the item relating to
3 section 6693 and inserting in lieu thereof the following:

"Sec. 6693. Failure to provide reports on individual retirement accounts or annuities or on education savings accounts.".

4 (h)(1) Part III of subchapter B of chapter 1 of such
5 Code (relating to items specifically excluded from gross
6 income) is amended by redesignating section 128 and 129
7 and by inserting after section 127 the following new section:
8 **"SEC. 128. EDUCATION SAVINGS ACCOUNT DISTRIBUTIONS.**
9 "In the case of an individual, and except as is provided
10 in section 221(d)(1), gross income does not include distribu-
11 tions from an education savings account used exclusively for
12 the payment of educational expenses of that individual
13 (within the meaning of section 221(c)(5)).".
14 (2) The table of sections for such part III is amended by
15 inserting after the item relating to section 127 the following
16 new items:

"Sec. 128. Education savings account distributions.
"Sec. 129. Cross references to other Acts.".

17 (i) Subsection (b) of section 152 of such Code (relating
18 to definition of dependent) is amended by adding at the end
19 thereof the following new paragraph:
20 "(6) A payment to an individual for whose benefit
21 an education savings account (as defined in section
22 221(c)) is established from that account which is ex-

1 cluded from the gross income of that individual under
2 section 128 shall not be taken into account in deter-
3 mining support for purposes of this section.".
4 (j) The amendments made by this section shall take
5 effect with respect to taxable years beginning after December
6 31, 1981.
7 **SEC. 2. HOUSING SAVINGS ACCOUNTS.**
8 (a) IN GENERAL.—Part VII of subchapter B of chapter
9 1 of the Internal Revenue Code of 1954 (relating to addition-
10 al itemized deductions for individuals) is amended by redesig-
11 nating section 222 as 223 and by inserting after section 221
12 the following new section:
13 **"SEC. 222. HOUSING SAVINGS ACCOUNT.**
14 "(a) DEDUCTION ALLOWED.—In the case of an individ-
15 ual, there is allowed as a deduction the sum of—
16 "(1) amounts paid in cash, or
17 "(2) the fair market value of stocks, bonds, or
18 other securities, readily tradeable on an established se-
19 curities market, transferred,
20 during the taxable year by such individual to a housing sav-
21 ings account.
22 "(b) LIMITATIONS.—
23 "(1) MAXIMUM ANNUAL DEDUCTION.—The
24 amount allowable as a deduction under subsection (a)
25 to an individual for any taxable year may not exceed

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1 $1,500 ($3,000 in the case of married individuals filing
2 a joint return).
3 "(2) MAXIMUM LIFETIME DEDUCTION.—The
4 amount allowable as a deduction under subsection (a)
5 to an individual for all taxable years may not exceed
6 $15,000 ($30,000 in the case of married individuals
7 filing a joint return).
8 "(3) STOCK, ETC., TO BE VALUED ON TRANSFER
9 DATE.—The fair market value of stock, bonds, and
10 other securities is to be determined as of the date on
11 which it is transferred to the account, or, if the trans-
12 fer occurs on a Saturday, Sunday, or other public legal
13 holiday, on the last preceding day on which it could
14 have been traded.
15 "(4) ADJUSTMENT OF LIMIT FOR INFLATION.—
16 "(A) IN GENERAL.—Beginning in 1982, the
17 dollar amounts in paragraph (1), paragraph (2),
18 and subsection (c)(1)(A) shall each be adjusted by
19 multiplying such amounts by the inflation adjust-
20 ment factor for the 12-month period ending on
21 July 31 of the preceding calendar year and, as
22 adjusted, shall be substituted for such amounts for
23 taxable years ending with or within the calendar
24 year next beginning after such 12-month period.

1 "(B) COMPUTATION OF INFLATION ADJUST-
2 MENT FACTOR.—
3 "(i) DETERMINATION AND PUBLICA-
4 TION.—The Secretary shall, not later than
5 October 1 of each calendar year (beginning
6 in 1981), determine and publish in the Fed-
7 eral Register the inflation adjustment factor
8 for the immediately preceding 12-month
9 period ending on July 31 in accordance with
10 this paragraph.
11 "(ii) INFLATION ADJUSTMENT
12 FACTOR.—The term 'inflation adjustment
13 factor' means, with respect to a calendar
14 year, a fraction the numerator of which is
15 the average monthly Consumer Price Index
16 (all items—United States city average) pub-
17 lished by the Bureau of Labor Statistics of
18 the Department of Labor for the most recent
19 12-month period ending on July 31 and the
20 denominator of which is the average monthly
21 Consumer Price Index (all items—United
22 States city average) for the 12-month period
23 ending on July 31, 1980.
24 "(c) DEFINITIONS AND SPECIAL RULES.—

1 "(1) HOUSING SAVINGS ACCOUNT.—For purposes
2 of this section, the term 'housing savings account'
3 means a trust created or organized in the United
4 States for the exclusive benefit of an individual, or in
5 the case of a married individual, for the exclusive bene-
6 fit of the individual and his spouse jointly, but only if
7 the written governing instrument creating the trust
8 meets the following requirements:

9 "(A) No contribution will be accepted unless
10 it is in cash or in stocks, bonds, or other securi-
11 ties readily tradeable on an established exchange,
12 and contributions will not be accepted for the tax-
13 able year in excess of $1,500 on behalf of any in-
14 dividual ($3,000 in the case of a trust for an indi-
15 vidual and his spouse), or in excess of $15,000 on
16 behalf of an individual for all taxable years
17 ($30,000 in the case of a trust for an individual
18 and his spouse).

19 "(B) The trustee is a bank (as defined in sec-
20 tion 401(d)(1)) or another person who demon-
21 strates to the satisfaction of the Secretary that
22 the manner in which that person will administer
23 the trust will be consistent with the requirements
24 of this section.

1 "(C) No part of the trust assets will be in-
2 vested in life insurance contracts.
3 "(D) The assets of the trust will not be com-
4 mingled with other property except in a common
5 trust fund or common investment fund.
6 "(E) The entire interest of an individual or
7 married couple for whose benefit the trust is
8 maintained will be distributed to him, or them,
9 not later than 120 months after the date on which
10 the first contribution is made to the trust.
11 "(F) The assets of the trust shall be invested
12 in accordance with the directions of the individual
13 contributing to the trust, but, if more than 1 indi-
14 vidual makes contributions to the trust the con-
15 sent of all such individuals shall be required with
16 respect to such direction.
17 "(d) TAX TREATMENT OF DISTRIBUTIONS.—
18 "(1) IN GENERAL.—Except as otherwise provided
19 in this subsection, any amount paid or distributed out
20 of a housing savings account shall be included in gross
21 income by the payee or distributee for the taxable year
22 in which the payment or distribution is received, unless
23 such amount is used exclusively in connection with the
24 purchase of the first dwelling purchased by the payee

1 or distributee which constitutes his principal residence.
2 The basis of any person in such an account is zero.
3 "(2) EXCESS CONTRIBUTIONS RETURNED
4 BEFORE DUE DATE OF RETURN.—Paragraph (1) does
5 not apply to the distribution of any contribution paid
6 during a taxable year to a housing savings account to
7 the extent that such contribution exceeds the amount
8 allowable as a deduction under subsection (a) if—
9 "(A) such distribution is received on or
10 before the day prescribed by law (including exten-
11 sions of time) for filing such individual's return for
12 such taxable year,
13 "(B) no deduction is allowed under subsec-
14 tion (a) with respect to such excess contribution,
15 and
16 "(C) such distribution is accompanied by the
17 amount of net income attributable to such excess
18 contribution.
19 Any net income described in subparagraph (C) shall be
20 included in the gross income of the individual for the
21 taxable year in which it is received.
22 "(3) TRANSFER OF ACCOUNT INCIDENT TO DI-
23 VORCE.—The transfer of an individual's interest in a
24 housing savings account to his former spouse under a
25 divorce decree or under a written instrument incident

1 to a divorce is not to be considered a taxable transfer
2 made by such individual notwithstanding any other
3 provision of this subtitle, and such interest, at the time
4 of the transfer, is to be treated as a housing savings
5 account of the spouse, and not of such individual. After
6 the transfer, the account is to be treated, for purposes
7 of this subtitle, as maintained for the benefit of the
8 spouse.
9 "(e) TAX TREATMENT OF ACCOUNTS.—
10 "(1) EXEMPTION FROM TAX.—Any individual
11 housing account is exempt from taxation under this
12 subtitle unless such account has ceased to be a housing
13 savings account by reason of paragraph (2) or (3). Not-
14 withstanding the preceding sentence, any such account
15 is subject to the taxes imposed by section 511 (relating
16 to imposition of tax on unrelated business income of
17 charitable, etc., organizations).
18 "(2) LOSS OF EXEMPTION OF ACCOUNT WHERE
19 INDIVIDUAL ENGAGES IN PROHIBITED TRANSAC-
20 TION.—
21 "(A) IN GENERAL.—If, during any taxable
22 year of the individual for whose benefit a housing
23 savings account is established, that individual en-
24 gages in any transaction prohibited by section
25 4975 with respect to the account, the account

1 ceases to be a housing savings account as of the
2 first day of that taxable year. For purposes of this
3 subparagraph the individual for whose benefit any
4 account was established is treated as the creator
5 of the account.

6 "(B) ACCOUNT TREATED AS DISTRIBUTING
7 ALL ITS ASSETS.—In any case in which any ac-
8 count ceases to be a housing savings account by
9 reason of subparagraph (A) on the first day of any
10 taxable year, paragraph (1) of subsection (d) ap-
11 plies as if there were a distribution on such first
12 day in an amount equal to the fair market value
13 (on such first day) of all assets in the account (on
14 such first day).

15 "(3) EFFECT OF PLEDGING ACCOUNT AS SECU-
16 RITY.—If, during any taxable year, the individual for
17 whose benefit a housing savings account is established
18 uses the account or any portion thereof as security for
19 a loan, the portion so used is treated as distributed to
20 that individual.

21 "(f) ADDITIONAL TAX ON CERTAIN AMOUNTS IN-
22 CLUDED IN GROSS INCOME.—

23 "(1) DISTRIBUTION NOT USED TO PURCHASE
24 RESIDENCE.—If a distribution from a housing savings
25 account to an individual for whose benefit such account

1 was established is made, and not used in connection
2 with the purchase of a principal residence for such in-
3 dividual, the tax liability of such individual under this
4 chapter for the taxable year in which such distribution
5 is received shall be increased by an amount equal to
6 10 percent of the amount of the distribution which is
7 includable in his gross income for such taxable year.
8 "(2) DISQUALIFICATION CASES.—If an amount is
9 includable in the gross income of an individual for a
10 taxable year under subsection (e), his tax under this
11 chapter for such taxable year shall be increased by an
12 amount equal to 10 percent of such amount required to
13 be included in his gross income.
14 "(3) DISABILITY CASES.—Paragraphs (1) and (2)
15 do not apply if the payment or distribution is attributa-
16 ble to the taxpayer becoming disabled within the mean-
17 ing of section 72(m)(7).
18 "(g) COMMUNITY PROPERTY LAWS.—This section
19 shall be applied without regard to any community property
20 laws.
21 "(h) CUSTODIAL ACCOUNTS.—For purposes of this sec-
22 tion, a custodial account shall be treated as a trust if the
23 assets of such account are held by a bank (as defined in sec-
24 tion 401(d)(1)) or another person who demonstrates, to the
25 satisfaction of the Secretary, that the manner in which he

1 will administer the account will be consistent with the re-
2 quirements of this section, and if the custodial account would,
3 except for the fact that it is not a trust, constitute a housing
4 savings account described in subsection (c). For purposes of
5 this title, in the case of a custodial account treated as a trust
6 by reason of the preceding sentence, the custodian of such
7 account shall be treated as the trustee thereof.

8 "(i) REPORTS.—The trustee of a housing savings ac-
9 count shall make such reports regarding such account to the
10 Secretary and to the individual for whom the account is
11 maintained with respect to contributions, distributions, and
12 such other matters as the Secretary may require under regu-
13 lations. The reports required by this subsection shall be filed
14 at such time and in such manner and furnished to such indi-
15 viduals at such time and in such manner as may be required
16 by those regulations.

17 "(j) REDUCTION OF BASIS.—The basis of any residence
18 acquired with funds withdrawn from a housing savings ac-
19 count shall be reduced by an amount equal to the amount of
20 expenditures made in connection with the acquisition of the
21 residence out of such funds.".

22 (b) DEDUCTION ALLOWED IN ARRIVING AT ADJUSTED
23 GROSS INCOME.—Paragraph (10) of section 62 of such Code
24 (relating to adjusted gross income) is amended to read as
25 follows:

1 "(10) RETIREMENT, HIGHER EDUCATION, AND
2 HOUSING SAVINGS.—The deductions allowed by sec-
3 tions—
4 "(A) 219 (relating to retirement savings),
5 "(B) 220 (relating to retirement savings for
6 certain married individuals),
7 "(C) 221 (relating to education savings), and
8 "(D) 222 (relating to housing savings).".
9 (c) TAX ON EXCESS CONTRIBUTIONS.—Section 4973
10 of such Code (relating to tax on excess contributions to indi-
11 vidual retirement accounts, certain section 403(b) contracts,
12 certain individual retirement annuities, and certain retirement
13 bonds) is amended—
14 (1) by inserting "HOUSING SAVINGS ACCOUNTS,"
15 after "EDUCATION SAVINGS ACCOUNTS," in the cap-
16 tion of such section,
17 (2) by redesignating paragraphs (3) and (4) of sub-
18 section (a) as (4) and (5), and by inserting after para-
19 graph (2) the following:
20 "(3) a housing savings account (within the mean-
21 ing of section 222(c)),", and
22 (3) by adding at the end thereof the following new
23 subsection:
24 "(e) EXCESS CONTRIBUTIONS TO HOUSING SAVINGS
25 ACCOUNTS.—For purposes of this section, in the case of a

1 housing savings account, the term 'excess contributions'
2 means the amount by which the amount contributed for the
3 taxable year to the account exceeds the amount allowable as
4 a deduction under section 222(b)(1) for such taxable year.
5 For purposes of this subsection, any contribution which is
6 distributed out of the housing savings account and a distribu-
7 tion to which section 222(d)(2) applies shall be treated as an
8 amount not contributed.".

9 (d) TAX ON PROHIBITED TRANSACTIONS.—Section
10 4975 of such Code (relating to prohibited transactions) is
11 amended—

12 (1) by adding at the end of subsection (c) the fol-
13 lowing new paragraph:

14 "(4) SPECIAL RULE FOR HOUSING SAVINGS AC-
15 COUNTS.—An individual for whose benefit a housing
16 savings account is established shall be exempt from the
17 tax imposed by this section with respect to any trans-
18 action concerning such account (which would otherwise
19 be taxable under this section) if, with respect to such
20 transaction, the account ceases to be a housing savings
21 account by reason of the application of section
22 222(e)(2)(A) or if section 222(e)(4) applies to such ac-
23 count.", and

1 (2) by inserting "or a housing savings account de-
2 scribed in section 222(c)" in subsection (e)(1) after
3 "described in section 408(a)".
4 (e) FAILURE TO PROVIDE REPORTS ON HOUSING SAV-
5 INGS ACCOUNTS.—Section 6693 of such Code (relating to
6 failure to provide reports on individual retirement account or
7 annuities) is amended—
8 (1) by inserting "OR HOUSING SAVINGS AC-
9 COUNTS" after "EDUCATION SAVINGS ACCOUNTS," in
10 the caption of such section, and
11 (2) by adding at the end of subsection (a) the fol-
12 lowing: "The person required by section 222(i) to file a
13 report regarding a housing savings account at the time
14 and in the manner required by such section shall pay a
15 penalty of $10 for each failure unless it is shown that
16 such failure is due to reasonable cause.".
17 (f) ADJUSTMENT OF BASIS OF RESIDENCE PUR-
18 CHASED THROUGH USE OF AMOUNTS IN ACCOUNT.—Sec-
19 tion 1016(a) of such Code (relating to adjustments to basis) is
20 amended by inserting after paragraph (20) the following new
21 paragraph:
22 "(21) in the case of a residence the acquisition of
23 which was made in whole or in part with funds from a
24 housing savings account, to the extent provided in sec-
25 tion 222(j);".

1 (g) REDUCTION OF ONE-TIME EXCLUSION.—Subsec-
2 tion (b) of section 121 of such Code (relating to limitations) is
3 amended by adding at the end thereof the following new
4 paragraph:

5 "(4) REDUCTION OF EXCLUSION FOR HOUSING
6 SAVINGS AMOUNT.—The $100,000 amount in para-
7 graph (1) shall be reduced by any amount paid or dis-
8 tributed out of a housing savings account of the tax-
9 payer which was not included in gross income of the
10 taxpayer for the year in which it was paid or distrib-
11 uted to the taxpayer (one-half of such amount in the
12 case of a separate return by a married individual).".

13 (h) CLERICAL AMENDMENTS.—

14 (1) The table of sections for part VII of sub-
15 chapter B of chapter 1 of such Code is amended by
16 striking out the item relating to section 222 and insert-
17 ing in lieu thereof the following:

"Sec. 222. Housing savings accounts.
"Sec. 223. Cross references.".

18 (2) The table of sections for chapter 43 of such
19 Code is amended by striking out the item relating to
20 section 4973 and inserting in lieu thereof the following:

"Sec. 4973. Tax on excess contributions to individual retirement accounts, education savings accounts, housing savings accounts, certain 403(b) contracts, certain individual retirement annuities, and certain retirement bonds.".

21 (3) The table of sections for subchapter B of chap-
22 ter 68 of such Code is amended by striking out the

1 item relating to section 6693 and inserting in lieu
2 thereof the following:

"Sec. 6693. Failure to provide reports on individual retirement accounts or annuities, education savings accounts, or housing savings accounts.".

3 (i) EFFECTIVE DATE.—The amendments made by this
4 section apply to taxable years beginning after December 31,
5 1980.

II

97TH CONGRESS
1ST SESSION

S. 243

To amend the Internal Revenue Code of 1954 to increase the allowable contributions to individual retirement plans and to allow employees a deduction for savings contributions to employer retirement plans or to individual retirement accounts.

IN THE SENATE OF THE UNITED STATES

JANUARY 23 (legislative day, JANUARY 5), 1981

Mr. CHAFEE introduced the following bill; which was read twice and referred to the Committee on Finance

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A BILL

To amend the Internal Revenue Code of 1954 to increase the allowable contributions to individual retirement plans and to allow employees a deduction for savings contributions to employer retirement plans or to individual retirement accounts.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 **SECTION 1. SHORT TITLE.**
4 This Act may be cited as the "Savings and Retirement
5 Income Incentive Act of 1981".

1 **SEC. 2. AMENDMENTS TO MAKE PERMANENT CURRENT INTER-**
2 **EST AND DIVIDEND EXCLUSION AND TO IN-**
3 **CREASE SUCH EXCLUSIONS FOR PERSONS OVER**
4 **AGE 65.**

5 (a) Section 404(c) of the Crude Oil Windfall Profit Tax
6 Act of 1980 is amended to read as follows:

7 "(c) EFFECTIVE DATE.—The amendments made by
8 this section shall apply with respect to taxable years begin-
9 ning after December 31, 1980.".

10 (b) Paragraph (1) of section 116(b) of the Internal Reve-
11 nue Code, as amended by section 404(a) of the Crude Oil
12 Windfall Profit Tax of 1980, is amended to read as follows:

13 "(1) MAXIMUM DOLLAR AMOUNT.—

14 "(A) GENERAL EXCLUSION.—Except as
15 provided in subparagraph (B), the aggregate
16 amount excluded under subsection (A) for any
17 taxable year shall not exceed $200 ($400 in the
18 case of a joint return under section 6013).

19 "(B) In the case of an individual who has at-
20 tained age 65 before the close of the taxable year
21 or who is married as of the close of the taxable
22 year to an individual who has attained age 65
23 before the close of the taxable year, the aggregate
24 amount excluded under subsection (a) for any tax-
25 able year shall not exceed $500 ($1,000 in the
26 case of a joint return under section 6013)".

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1 SEC. 3. INCREASE IN PERMISSIBLE CONTRIBUTIONS TO INDI-
2 VIDUAL RETIREMENT ACCOUNTS.
3 (a) Section 219(b) of the Internal Revenue Code of 1954
4 (relating to retirement savings) is amended—
5 (1) by deleting the words "an amount equal to"
6 from paragraph (1), by striking out "15 percent" wher-
7 ever it appears and inserting in lieu thereof "the
8 amounts", and by striking out "$1,500" wherever it
9 appears and inserting in lieu thereof "$2,000"; and
10 (2) by deleting paragraph (2) and redesignating
11 paragraphs (3) through (7) as paragraphs (2) through
12 (6).
13 (b) Section 4973(b) of such Code is amended to read as
14 follows:
15 "(b) EXCESS CONTRIBUTIONS.—For purposes of this
16 section, in the case of individual retirement accounts, individ-
17 ual retirement annuities, or bonds, the term 'excess contribu-
18 tions' means the sum of—
19 "(1) the excess (if any) of—
20 "(A) the amount contributed for the taxable
21 year to the accounts or for the annuities or bonds
22 (other than a rollover contribution described in
23 section 402(a)(5), 403(a)(4), 403(b)(8), 408(d)(3),
24 or 409(b)(3)(c)), over

1 "(B) $2,000 plus the amount allowable as a
2 deduction under section 219 for such contribu-
3 tions, and
4 "(2) the amount determined under this subsection
5 for the preceding taxable year, reduced (but not below
6 zero) by the sum of—
7 "(A) the distributions out of the account for
8 the taxable year which were included in the gross
9 income of the payee under section 408(d)(1),
10 "(B) the distributions out of the account for
11 the taxable year to which section 408(d)(5) ap-
12 plies, and
13 "(C) the excess (if any) of—
14 "(i) $2,000 plus the maximum amount
15 allowable as a deduction under section 219
16 for the taxable year over
17 "(ii) the amount contributed (determined
18 without regard to section 219(c)(5)) to the
19 accounts or for the annuities or bonds for the
20 taxable year.
21 The amount determined under the preceding sentence
22 shall be reduced (but not below zero) by the excess (if
23 any) of $8,000 over the aggregate of the amounts con-
24 tributed for each prior taxable year in excess of the

1 sum of $2,000 and the amount allowable as a deduc-
2 tion under section 219 for such prior taxable year.".
3 (c) Section 408 of such Code is amended—
4 (1) by striking out "$1,500" wherever it appears
5 and inserting in lieu thereof "$4,000";
6 (2) by adding to paragraph (1) of subsection (a)
7 the following sentence: "For purposes of the preceding
8 sentence if contributions for any taxable year exceed
9 $4,000 on behalf of any individual, they shall not be
10 taken into account except to the extent that such
11 excess contributions, when aggregated with any similar
12 excess contributions for prior taxable years, exceed
13 $8,000.";
14 (3) by amending paragraphs (1) and (2) of subsec-
15 tion (d) to read as follows:
16 "(1) In general.—Except as otherwise provided
17 in this subsection, any amount or annuity contract paid
18 or distributed out of an individual retirement account
19 or under an individual retirement annuity to any distri-
20 butee shall be taxable to him in the year in which so
21 distributed under section 72 (relating to annuities).
22 "(2) Computation of employees' contribu-
23 tions.—For purposes of this paragraph and section
24 72, any amounts for which a deduction is allowed

1 under section 219 shall be treated as an employer con-
2 tribution.";
3 (4) by deleting the words "or 220" from para-
4 graphs (4) and (5) of subsection (d) wherever they
5 appear;
6 (5) by amending subsection (f)—
7 (A) by inserting before the period at the end
8 of paragraph (1) thereof "unless such distribution
9 is a qualified withdrawal as defined in paragraph
10 (4)", and
11 (B) by adding at the end thereof new para-
12 graphs (4) and (5) to read as follows:
13 "(4) QUALIFIED WITHDRAWAL.—Paragraphs (1)
14 and (2) shall not apply to any withdrawal during a tax-
15 able year in which the individual has made no prior
16 qualified withdrawals—
17 "(A) which is used—
18 "(i) to pay the qualified educational ex-
19 penses of a child of the individual for whose
20 benefit the trust is maintained, or
21 "(ii) in connection with the purchase of
22 the first dwelling purchased by the individual
23 for whose benefit the account is maintained
24 which constitutes his principal residence,

1 "(B) which is not less than $2,000, but
2 which when aggregated with all qualified with-
3 drawals in prior taxable years does not exceed
4 $10,000, and
5 "(C) which will not cause the fair market
6 value of the account immediately after the with-
7 drawal to be less than $2,000.
8 "(5) DEFINITIONS.—
9 "(A) QUALIFIED EDUCATIONAL EX-
10 PENSE.—The term 'qualified educational ex-
11 penses' means—
12 "(i) tuition and fees required for the en-
13 rollment or attendance of a student at an eli-
14 gible educational institution,
15 "(ii) fees, books, supplies, and equip-
16 ment required for courses of instruction at an
17 eligible educational institution, and
18 "(iii) a reasonable allowance for meals
19 and lodging.
20 "(B) ELIGIBLE EDUCATIONAL INSTITU-
21 TION.—The term 'eligible educational institution'
22 means—
23 "(i) an institution of higher education,
24 or
25 "(ii) a vocational school.

1 "(C) INSTITUTION OF HIGHER EDUCA-
2 TION.—The term 'institution of higher education'
3 means the institutions described in section 1201(a)
4 or 491(b) of the Higher Education Act of 1965.
5 "(D) VOCATIONAL SCHOOL.—The term 'vo-
6 cational school' means an area vocational educa-
7 tion school as defined in section 195(2) of the Vo-
8 cational Education Act of 1963 which is in any
9 State (as defined in section 195(8) of such Act).".
10 (d) Section 72 of the Internal Revenue Code of 1954
11 (relating to annuities; certain proceeds of endowments and
12 life insurance contracts) is amended by redesignating subsec-
13 tion (o) as subsection (p) and by inserting after subsection (n)
14 the following new subsection:
15 "(o) TREATMENT OF DISTRIBUTIONS FROM INDIVIDU-
16 AL RETIREMENT ACCOUNTS.—For purposes of subsections
17 (c)(1)(A) and (e)(1)(B), any contribution made by an individual
18 to an individual retirement account which is allowed as a
19 deduction under section 219 shall be treated as an amount
20 contributed by an employer which is not includible in the
21 gross income of such employee.".
22 (e) Section 2039 of the Internal Revenue Code of 1954
23 (relating to the estate tax) is amended by repealing subsec-
24 tion (e) thereof and redesignating subsection (f) as subsection
25 (e).

1 (f) Section 2517(b) of the Internal Revenue Code of
2 1954 (relating to the gift tax) is amended by striking the
3 parenthetical phrase "(other than paragraphs (4) and (5))"
4 and substituting "(other than paragraph (4))".

5 **SEC. 4. ALLOWANCE OF RETIREMENT SAVINGS DEDUCTION.**

6 Part VII of subchapter B of chapter 1 of such Code
7 (relating to additional itemized deductions for individuals) is
8 amended by repealing section 220 and by substituting there-
9 for the following new section:

10 **"SEC. 220. DEDUCTION FOR CERTAIN EMPLOYEE RETIRE-**
11 **MENT SAVINGS CONTRIBUTIONS.**

12 "(a) GENERAL RULE.—In the case of an eligible em-
13 ployee, described in subsection (c)(2), there shall be allowed
14 as a deduction the qualified retirement savings contributions
15 of such individual for the taxable year.

16 "(b) LIMITATIONS AND RESTRICTIONS.—

17 "(1) MAXIMUM DEDUCTION.—The amount allow-
18 able as a deduction under subsection (a) to an eligible
19 employee for any taxable year may not exceed the
20 lesser of—

21 "(A) the amount of the compensation includi-
22 ble in the eligible employee's gross income for
23 such taxable year, or

24 "(B) $2,000.

1 "(2) ALTERNATIVE DEDUCTION.—No deduction
2 shall be allowed under subsection (a) for the taxable
3 year if a deduction is allowed under section 219 for the
4 taxable year.
5 "(c) DEFINITIONS AND SPECIAL RULES.—
6 "(1) QUALIFIED RETIREMENT SAVINGS CONTRI-
7 BUTION.—For purposes of this section, the term 'quali-
8 fied retirement savings contribution' means any contri-
9 bution in cash, other than a mandatory contribution,
10 made by an individual as an employee to or under—
11 "(A) a plan described in section 401(2) which
12 includes a trust exempt from tax under section
13 501(a),
14 "(B) an annuity plan described in section
15 403(a),
16 "(C) a qualified bond purchase plan described
17 in section 405(a), or
18 "(D) a plan described in section 805(d)(3).
19 "(2) ELIGIBLE EMPLOYEE.—For purposes of this
20 section, the term 'eligible employee' means any indi-
21 vidual who is an active participant for any part of the
22 taxable year in a plan described in paragraph (1).
23 "(3) RECONTRIBUTED AMOUNTS.—No deduction
24 allowed under this section with respect to a rollover

1 contribution described in section 402(a)(5), 403(a)(4),
2 403(b)(8), 408(d)(3), or 409(b)(3)(C).
3 "(4) AMOUNTS CONTRIBUTED TO AN INSURANCE
4 CONTRACT.—No deduction shall be allowed under this
5 section for that portion of the amounts paid which are
6 properly allocable, under regulations prescribed by the
7 Secretary, to the cost of life insurance.
8 "(5) MARRIED INDIVIDUALS.—In the case of an
9 individual who is married (as determined under section
10 143(a)), the maximum deduction under subsection (b)
11 shall be computed separately for each individual, and
12 this section shall be applied without regard to any
13 community property laws.
14 "(6) TIME WHEN CONTRIBUTIONS DEEMED
15 MADE.—For purposes of this section, a taxpayer shall
16 be deemed to have made a contribution on the last day
17 of the preceding taxable year if the contribution is
18 made on account of such taxable year and is made not
19 later than the time prescribed by law for filing the
20 return for such taxable year (including extensions
21 thereof).
22 "(7) COMPENSATION.—For purposes of this sec-
23 tion, the term 'compensation' includes earned income
24 as defined in section 401(c)(2).

1 "(8) MANDATORY CONTRIBUTIONS.—For pur-
2 poses of this section, the term 'mandatory contribu-
3 tions' means amounts contributed to the plan by the
4 employee which are required as a condition of employ-
5 ment, as a condition of participation in such plan, or as
6 a condition of obtaining benefits under the plan attrib-
7 utable to employer contributions.
8 "(d) SIMPLIFIED REPORTS.—The Secretary shall issue
9 regulations which prescribe the time and manner in which
10 simplified reports shall be filed by the employer or plan ad-
11 ministrator of a plan receiving contributions deductible under
12 this section.".
13 SEC. 5. TREATMENT OF DISTRIBUTIONS FROM PLAN TO
14 WHICH EMPLOYEE MADE DEDUCTIBLE CONTRI-
15 BUTIONS.
16 (a) Subpart A of part I of subchapter D of chapter 1 of
17 such Code (relating to retirement plans) is amended by in-
18 serting after subsection (l) of section 414, the following new
19 subsection:
20 "(m) DEDUCTIBLE EMPLOYEE CONTRIBUTIONS.—For
21 purposes of this title, other than for purposes of section
22 401(a) (4) and (5), 404, 410(b), 411, and 412, any amount
23 which is allowed as a deduction under section 220 as a quali-
24 fied retirement savings contribution shall be treated as an
25 employer contribution.".

1 (b) Section 414(h) of such Code (relating to tax treat-
2 ment of certain contributions) is amended by inserting after
3 "any amount contributed" the following: "(other than an
4 amount described in subsection (m))".

5 **SEC. 6. TECHNICAL AND CONFORMING AMENDMENTS.**

6 (a) ESTATE AND GIFT TAX EXCLUSION.—

7 (1) ESTATE TAX.—Subsection (c) of section 2039
8 of such Code (relating to exemption of annuities under
9 certain trusts and plans) is amended by adding at the
10 end thereof the following new sentence: "For purposes
11 of this subsection, any contribution allowed as a deduc-
12 tion under sections 219 or 220 shall be considered as
13 made by a person other than the decedent.".

14 (2) GIFT TAX.—Subsection (b) of section 2517 of
15 such Code (relating to transfers attributable to employ-
16 ee contributions) is amended by adding at the end
17 thereof the following new sentence: "For purposes of
18 this subsection, any contribution allowed as a deduc-
19 tion under sections 219 or 220 shall be considered as
20 made by a person other than the employee.".

21 (b) OTHER AMENDMENTS.—

22 (1) Paragraph (10) of section 62 of such Code (de-
23 fining adjusted gross income) is amended by striking
24 out "(relating to retirement savings for certain married
25 individuals)" and inserting in lieu thereof "(relating to

1 deduction for certain employee retirement savings con-
2 tributions)".

3 (2) So much of section 72(f) of such Code as pre-
4 cedes paragraph (1) thereof is amended to read as fol-
5 lows: "In computing, for purposes of subsection
6 (c)(1)(A), the aggregate amount of premiums or other
7 consideration paid for the contract, for purposes of sub-
8 section (d)(1), the consideration for the contract con-
9 tributed by the employee, and for purposes of subsec-
10 tion (e)(1)(B), the aggregate premiums or other consid-
11 erations paid, amounts which an employer is required
12 to report, pursuant to regulations promulgated under
13 section 220(d) with respect to an amount paid by an
14 eligible employee (as defined in section 220(c)(2)) as a
15 qualified retirement savings contribution shall be ex-
16 cluded, and amounts contributed by the employer shall
17 be included, but only to the extent that—".

18 (3) Section 415(a) of such Code is amended by re-
19 pealing paragraph (3) thereof.

20 (4) The table of sections for part VII of sub-
21 chapter B of chapter 1 is amended by striking out the
22 item relating to section 220 and inserting in lieu there-
23 of the following:

"Sec. 220. Deduction for certain employee retirement savings contributions.".

1 **SEC. 7. EFFECTIVE DATES.**

2 (a) GENERAL RULE.—Except as provided in subsection
3 (b), the amendments made by this Act shall apply to taxable
4 years beginning after December 31, 1980.

5 (b) ESTATE AND GIFT TAX PROVISIONS.—

6 (1) ESTATE TAX.—The amendments made by
7 section 4(a)(1) shall apply to the estates of decedents
8 dying after December 31, 1980.

9 (2) GIFT TAX.—The amendment made by section
10 4(a)(2) shall apply to transfers after December 31,
11 1980.

DESCRIPTION OF TAX BILLS

(S. 12, S. 24, AND S. 243)

ON FEBRUARY 24, 1981

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

INTRODUCTION

This pamphlet provides a description of three Senate bills (S. 12, S. 24, and S. 243) which are scheduled for a public hearing on February 24, 1981, by the Senate Finance Subcommittee on Savings, Pensions, and Investment Policy. The bills relate to the tax treatment of savings accounts of individuals for retirement, education, and housing, and to the partial exclusion of dividends and interest from income.

The first part of the pamphlet is a summary. This is followed by a description of the bills, including a discussion of present law, the issues involved, an explanation of the provisions of the bills, effective dates, and estimated revenue effects.

I. SUMMARY

1. S. 12—Senators Dole, Cochran, and Symms: Certain Employee Retirement Savings Contributions

Under the bill, employees who are active participants in a private qualified pension plan would be allowed to make deductible contributions to the plan, to a group retirement trust or to an individual retirement account. The annual deduction would be limited to the lesser of $1,000 or 15 percent of compensation.

2. S. 24—Senators Dole, Chafee, Danforth, Wallop, Garn, Hatfield, Goldwater, and DeConcini: Deduction of Amounts Deposited in Education and Housing Savings Accounts

Under the bill, individuals would be allowed a deduction of up to $1,000 per year, per beneficiary, for amounts transferred to an education savings account. Distributions from the account for education purposes would be taxed to the beneficiary over a 10-year period, in 10 equal parts, beginning when the beneficiary reaches age 25. The limit on contributions would be indexed for inflation.

A deduction of up to $1,500 ($3,000 in the case of a joint return) per year would be allowed for amounts contributed to a housing savings account. There would be a lifetime maximum deduction of $15,000 ($30,000 in the case of a joint return). The annual contributions and lifetime maximum contributions would be indexed for inflation. The basis of the dwelling would be reduced by the amount distributed for the purchase of the first dwelling of the taxpayer which is to be used as his principal residence.

3. S. 243—Senators Chafee, Warner, and Thurmond: Savings and Retirement Income Income Incentive Act of 1981

a. Sec. 2. Permanent interest and dividend exclusion

Under present law, effective for 1981 and 1982, individuals generally may exclude from gross income up to $200 ($400 in the case of a joint return) of dividends and interest income (Code sec. 116). The bill would make permanent the exclusion for dividends and interest income, and individuals who are 65 or older would be permitted an exclusion of up to $500 ($1,000 in the case of a joint return).

b. Secs. 3–6. Individual retirement accounts and retirement savings deductions

Under the bill, the allowable deduction for a contribution to an individual retirement account would be increased to $2,000 per year. Deductions would be allowed for contributions to a qualified plan in which the taxpayer is a participant or to an individual retirement

account (IRA). Benefits generally would be taxable when distributed, except when there is a tax-free rollover into another qualified plan or IRA.

Nondeductible contributions also could be made, subject to a $2,000 annual limit plus an $8,000 lifetime limit. Withdrawals could be made under present rules affecting such plans. In addition, withdrawals could be made from IRAs for educational expenses or for the purchase of a first dwelling of the taxpayer, if it is used as that individual's principal residence.

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II. DESCRIPTION OF THE BILLS

1. S. 12—Senators Dole, Cochran, and Symms Certain Employee Retirement Savings Contributions

Present law

An individual generally is entitled to deduct the amount contributed to an individual retirement account or annuity, or used to purchase retirement bonds (referred to collectively as "IRAs"). The limitation on the deduction for a taxable year is generally the lesser of 15% of compensation for the year or $1,500. Under a spousal IRA, the $1,500 contribution limit is increased to $1,750 for a year if (1) the contribution is equally divided between an individual and the spouse of the individual, and (2) the spouse has no compensation for the year. However, no IRA deduction is allowed for a taxable year to an individual who is an active participant during any part of the taxable year in a qualified pension, profit-sharing or stock bonus plan, a tax-sheltered annuity maintained by a tax-exempt organization for an educational institution, or a government plan (whether or not qualified). Except for tax-free rollovers and certain amounts paid for life insurance, nondeductible contributions are not permitted to be made to an IRA. Income and gain on amounts held under an IRA are not taxed until distributed. All distributions from IRAs are includable in gross income. Distributions may be made from an IRA without penalty after age 59½ or in the event of disability or death. Amounts held in an IRA can qualify for exclusions under the estate tax and gift tax rules.

Many qualified plans provide for contributions by both the employer and the employee. In many cases, the employee contributions are mandatory (i.e., required as a condition of employment, a condition of participation in the plan, or a condition of obtaining additional employer-derived benefits). In other cases, employee contributions are voluntary, and the amount, within limits, is left to the discretion of the employee. A plan can provide for both mandatory and voluntary employee contributions. In any case, neither employer nor employee contributions to a qualified retirement plan may discriminate in favor of employees who are officers, shareholders, or highly compensated. Generally, in the case of voluntary employee contributions within certain limits, there is presumed to be no discrimination so long as there is an equal opportunity for all employees to make such contributions. Income allocable to an employee's contributions to a qualified plan is generally not taxed to the plan or to the employee before the income is distributed or made available to the employee or the employee's beneficiary. However, the employee is not entitled to a deduction or exclusion for employee contributions to the plan. Benefits held in a qualified plan can qualify for exclusions under the estate tax and

gift tax rules to the extent the benefits are not attributable to employee contributions.

In the case of tax-sheltered annuities (including custodial accounts investing in shares of a regulated investment company) purchased by certain tax-exempt institutions for their employees or purchased by schools for teachers, employees are entitled to an exclusion, within limits, from gross income for amounts paid by the employer on a salary reduction basis. Amounts invested in a tax sheltered annuity purchased by a tax-exempt organization can qualify for exclusions under the estate tax and gift tax rules.

Issue

The issue is (1) whether the present tax incentives for individual retirement savings should be expanded and (2) what safeguards are appropriate.

Explanation of the bill

In the case of an employee who is an active participant in a private qualified plan, a deduction would be allowed for contributions by the employee to the plan, to a group retirement trust,[1] or to an IRA. The annual deduction is limited to the lesser of $1,000 or 15 percent of compensation includible in gross income and is first assigned to any employee contributions to a plan.

Under the bill, benefits attributable to deductible employee contributions to a qualified plan would be taxed under the same rules that apply to benefits attributable to employer contributions. Accordingly, these benefits generally would be taxed only when distributed or made available to the employee or a beneficiary unless rolled over, tax free, to another qualified plan or to an IRA. Such benefits could also qualify for exclusion under the estate and gift tax provisions.

Deductible employee contributions to a plan would be treated as employee contributions, however, in testing whether the plan meets the requirements for tax-qualified status and whether the plan meets the requirements of ERISA.

The bill provides for reports to be filed with the Secretary of the Treasury with respect to deductible employee contributions received by plans.

Effective date

The provisions of this bill would apply to taxable years beginning after the date of enactment.

Revenue effect

It is estimated that this bill will decrease budget receipts by $948 million in fiscal year 1982, $2,066 million in 1983, $2,400 million in 1984 and $2,728 million in 1985.

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[1] Under the bill, a trust is a group retirement trust if (1) it was established before January 1, 1974, (2) it is maintained by a tax-exempt labor organization described in section 501(c)(5), (3) it is financed exclusively by assessments of members of the organization, and (4) the right of any participant in the trust to assessments paid to the trust is fully nonforfeitable.

2. S. 24—Senators Dole, Chafee, Danforth, Garn, Hatfield, Wallop, Goldwater, and DeConcini Deduction of Amounts Deposited in Education and Savings Accounts

Present law

Education expenses

Under present law, there is no general provision which permits deductions for amounts contributed to a trust to pay education expenses of the taxpayer or a child of the taxpayer. However, educational expenses which qualify as trade or business expenses under section 162 may be deducted. In addition, an employer may provide educational assistance to employees as a tax-free fringe benefit under an educational assistance program (sec. 127). Expenditures made by an individual for his own education generally are deductible if they are for education which (1) maintains or improves skills required by the individual's employment or other trade or business, or (2) meets the express requirements of the individual's employer or the requirements of applicable law or regulations imposed as a condition to the retention by the individual of an established employment relationship, status, or rate of compensation. These types of education are commonly called "job-related education."

A taxpayer is permitted to claim an exemption for a child over age 18 who is a full-time student, even though the child may claim a personal exemption on his own return (Code sec. 151).

Housing expenses

There is no general provision which permits deductions for amounts contributed to a savings account to be used for the acquisition of a personal residence of the contributor. However, present law does permit deductions for interest and real property taxes paid by the taxpayer relating to the taxpayer's personal residence (Code secs. 163 and 164). In addition, present law permits the limited use of tax-exempt bonds to finance the acquisition of a principal residence by a first-time homebuyer subject to certain purchase price limitations (Code sec. 103A).

Present law also permits a one time exclusion for taxpayers who are age 55 or older of up to $100,000 of gain derived from the sale of the taxpayer's principal residence (Code sec. 121). In order to qualify for the exclusion, the taxpayer generally must have owned and occupied the residence as the taxpayer's principal residence for a period aggregating 3 out of the 5 years which precede the sale.

Issues

The bill raises the issues of (1) whether education and housing expenditures should be specifically encouraged through tax deductible contributions to special saving accounts for these purposes, and (2) what safeguards are appropriate.

Explanation of the bill

The bill would provide tax incentives for amounts saved for the vocational or higher education of the taxpayer and his children and for amounts saved for the purchase of a dwelling by a first-time homebuyer.

Education savings account

In general.—The bill generally would allow a deduction to individuals of up to $1,000 per year, per beneficiary, for amounts transferred to an education savings account. The account generally would be tax-exempt. Amounts distributed out of the account for education expenses would be taxed to the beneficiary of the account ratably over a 10-year period beginning in the year the beneficiary reaches age 25.

Deduction allowed.—An individual would be allowed a deduction for contributions of cash and the fair market value at the time of transfer of stocks, bonds, or other readily tradeable securities to an education savings account. The deduction would be allowed whether or not the individual itemizes deductions.

Limitation on maximum deduction.—The maximum amount allowed as a deduction for transfers to an education savings account for any one beneficiary would be $1,000 per year. The $1,000 amount would be indexed to account for the effects of inflation, as measured by annual changes in the Consumer Price Index after July 31, 1980. Where more than one individual makes contributions to the account of a particular beneficiary, the $1,000 would be allocated proportionally among all contributors. A penalty tax would be imposed upon excess contribution to the account.

Eligible beneficiary.—An education savings account would be a trust established for no more than one eligible individual. Moreover, only one eligible education savings account could be created for any one individual. An eligible individual would be either the taxpayer or a child of the taxpayer so long as the taxpayer or child is either under age 21 or is not enrolled as a full-time student at an eligible educational institution for more than 4 weeks during that calendar year.

Requirements of account.—The governing instrument of the trust must provide that (1) the trust can only accept contributions of cash, stock, bonds or other readily tradeable assets, (2) contributions cannot be accepted that exceed $1,000 per year, (3) a bank (or other qualified person) must be the trustee, (4) no part of the trust's assets may be invested in life insurance contracts (other than contracts the beneficiary of which is the trust and the face amount of which does not exceed the amount by which the maximum amount which can be contributed to the account exceeds the sum of the amounts contributed to the account for all taxable years), (5) the assets of the trust may be invested in accordance with the directions of the contributors to the trust, (6) the assets of the trust may not be commingled with the other property except in a common trust or investment fund, and (7) any unspent amount must be returned to the contributors when the beneficiary attains age 26.

Taxation of distributions for educational purposes.—Distributions out of the trust to pay for educational expenses of the beneficiary would be taxed to the beneficiary in 10 equal parts over a 10-year period beginning when the beneficiary reaches age 25. Education expenses in-

clude tuition and fees at an eligible educational institution, fees, books, supplies, and equipment required for courses of instruction at an eligible eductaional institution, and a reasonable allowance for meals and lodging. An eligible educational institution would be either an institution of higher education or a vocational school.

Taxation of distribution for noneducational purposes.—Amounts distributed out of the education savings account that are not for the educational expenses of the beneficiary would be includable in the gross income of the contributors to the account in the year of distribution. However, there would be a special rule which allows removal of excess contributions and related income before the due date of the return for the year of contribution. Pledging of the account or any portion thereof would be treated as a distribution to the person pledging the account. In addition, a penalty tax would be imposed equal to 10 percent of all distributions not used for educational expenses of the beneficiary. The penalty tax would not apply if the contributor is disabled.

Taxation of account.—The education savings account would be exempt from Federal income taxes other than the tax on unrelated trade or business income. The exemption of the account would be lost if any contributor engages in a prohibited transaction with the account. In such a case, the account would be treated as distributing all of its assets on the first day of the year when the prohibited transaction occurred.

Gift tax treatment of contributions.—Deductible contributions to the account would be treated as gifts of a present interest in property and, thus, would be eligible for the $3,000 per year, per donee gift tax exemption.

Housing savings account

In general.—The bill also would allow a deduction of up to $1,500 ($3,000 in the case of a joint return) for amounts contributed to a housing savings account. The account would be generally exempt from tax. Distributions out of the account for use in connection with the purchase of the first dwelling purchased by the payee or distributee which constitutes his principal residence would not be taxed to the payee but would reduce the basis of the dwelling and would reduce the taxpayer's one time $100,000 exemption for gain on a principal residence.

Deduction allowed.—An individual would be allowed a deduction for contributions of cash and the fair market value of stocks, bonds, or other readily tradeable securities to a housing savings account. The deduction would be allowed whether or not the individual itemizes his deductions.

Limitation on maximum deduction.—The maximum amount allowed as a deduction for transfers to a housing savings account would be $1,500 per year ($3,000 in the case of a joint return). In addition, there would be a lifetime maximum deduction of $15,000 ($30,000 in the case of a joint return). These amounts would be indexed to account for the effects of inflation, as measured by annual changes in the Consumer Price Index after July 31, 1980.

Requirements of account.—A housing savings account would be a trust established for the exclusive benefit of an individual and his

spouse (if any). The governing instrument of the trust must provide that (1) the trust can only accept contributions of cash or stock, bonds, or other readily tradeable assets, (2) contributions cannot be accepted that exceed $1,500 per year ($3,000 if the individual is married), (3) total contributions in excess of $15,000 ($30,000 if the individual is married and filing a joint return) cannot be accepted, (4) a bank (or other qualified person) must be trustee, (5) no part of the trust's assets may be invested in life insurane contracts, (6) the assets of the trust may be invested in accordance with the directions of the contributors to the thrust, (7) the assets of the trust may not be commingled with other property except in a common trust or investment fund, and (8) the entire corpus of the trust is to be distributed to the contributors not later than 10 years from the date on which contributions were first made to the trust.

Taxation of distributions to purchase first principal residence.—Distributions out of a housing savings account that are used in connection with the purchase of a first dwelling by the payee, which becomes the principal residence, would not be taxed to the payee. However, the basis of the dwelling would be reduced by such distributions. In addition, the $100,000 one-time exclusion for persons aged 55 or older on the gain from the sale of a principal residence would be reduced by the amount of these distributions.

Taxation of other distributions.—Amounts distributed out of the housing savings account that are not used for the purchase of a first dwelling of the beneficiary would be includible in the gross income of the contributors to the account in the year of distribution. However, there would be a special rule which allows removal of excess contributions and related income before the due date of the return for the year of contribution. Pledging of the account or any portion thereof would be treated as a distribution to the person pledging the account. The bill contains a special rule that allows transfer of all or a portion of the account incident to a divorce. In addition, a penalty tax would be imposed equal to 10 percent of all distributions not used for the purchase of a first dwelling of the beneficiary. The penalty tax would not apply if the contributor is disabled.

Taxation of accou t.—The housing savings account would be exempt from Federal i ome taxes other than the tax on unrelated trade or business incor The exemption of the account would be lost if any contributor en ges in a prohibited transaction (within the meaning of Code sec 75) with the account. In such a case, the account would be trea is distributing all of its assets on the first day of the year when th pi hibited transaction occurred.

Effective ate

The section o the b relating to education savings accounts would be effective wit respec to taxable years beginning after December 31, 1981.

The section of the bill relating to housing savings accounts would be effective with respect to taxable years beginning after December 31, 1980.

Revenue effect

It is estimated that this bill will decrease budget receipts by $309 million in fiscal year 1981, $5,698 million in 1982, $5,640 million in 1983, $6,781 million in 1984 and $7,847 million in 1985.

3. S. 243—Senators Chafee, Warner, and Thurmond Savings and Retirement Income Incentive Act of 1981

a. Permanent interest and divided exclusion (sec. 2 of the bill)

Present law

Individuals may exclude from gross income up to $200 ($400 on a joint return) of dividends and interest income received from domestic sources (Code sec. 116). This provision is effective for taxable years beginning after December 31, 1980, and before January 1, 1983. After 1982, the exclusion reverts to prior law, under which the exclusion applied only to dividends and was limited to $100 ($200 in the case of a joint return). This is reflected in the revenue estimates (below) for 1983 and later.

Issues

This section of the bill specifically raises the issue (1) whether the partial exclusion for dividends and interest should be made permanent, and (2) whether the amount of the exclusion should be increased for individuals who are age 65 and older.

Explanation of provision

Section 2 of S. 243 would make permanent the partial exclusion of dividends and interest by individuals.

In addition, the provision would increase the aggregate amount excludible to $500 ($1,000 in the case of a joint return) for an individual who attains age 65 before the close of the taxable year or who is married, at the close of the taxable year, to an individual who is at least 65 years old.

Effective date

The provisions of section 2 of S. 243 would be effective for taxable years beginning after December 31, 1980.

Revenue effect

Fiscal year budget receipts would be reduced by $105 million in 1981, $771 million in 1982, $1,742 million in 1983, $4,278 million in 1984, and $4,391 million in 1985.

b. Individual retirement and savings accounts (secs. 3–6 of the bill)

Present law

An individual generally is entitled to deduct the amount contributed to an individual retirement account or annuity, or used to purchase retirement bonds (referred to collectively as "IRAs"). The limitation on the deduction for a taxable year is generally the lesser of 15% of compensation for the year or $1,500. Under a spousal IRA, the $1,500 contribution limit is increased to $1,750 for a year if (1) the contribution is divided equally between an individual and the spouse

of the individual, and (2) the spouse has no compensation for the year. However, no IRA deduction is allowed for a taxable year to an individual who is an active participant during any part of the taxable year in a qualified pension, profit-sharing, or stock bonus plan, a tax-sheltered annuity maintained by a tax-exempt organization or educational institution, or a governmental plan (whether or not qualified). Except for tax-free roll-overs and certain amounts paid for life insurance, nondeductible contributions are not permitted to be made to an IRA. Income and gain on amounts held under an IRA are not taxed until distributed. All distributions from IRAs are includible in gross income. Distributions may be made from an IRA without penalty after age 59½ or in the event of disability or death. Amounts held in an IRA can qualify for exclusions under the estate tax and gift tax rules.

Many qualified plans provide for contributions by both the employer and the employee. In many cases, the employee contributions are mandatory (i.e., required as a condition of employment, a condition of participation in the plan, or a condition of obtaining additional employer-derived benefits). In other cases, employee contributions are voluntary, and the amount, within limits, is left to the discretion of the employee. A plan can provide for both mandatory and voluntary employee contributions. In any case, neither employer nor employee contributions to a qualified retirement plan may discriminate in favor of employees who are officers, shareholders, or highly compensated. Generally, in the case of voluntary employee contributions, within certain limits, there is presumed to be no discrimination so long as there is an equal opportunity for all employees to make such contributions. Income allocable to an employee's contributions to a qualified plan is generally not taxed to the plan or to the employee before the income is distributed or made available to the employee or the employee's beneficiary. However, the employee is not entitled to a deduction or exclusion for employee contributions to the plan. Benefits held in a qualified plan can qualify for exclusions under the estate tax and gift tax rules to the extent the benefits are not attributable to employee contributions.

In the case of tax-sheltered annuities (including custodial accounts investing in shares of a regulated investment company) purchased by certain tax-exempt institutions for their employees or purchased by schools for teachers, employees are entitled to an exclusion, within limits, from gross income for amounts paid by the employer on a salary reduction basis. Amounts invested in a tax sheltered annuity purchased by a tax-exempt organization can qualify for exclusions under the estate tax and gift tax rules.

Issue

The issues are whether the present tax incentives for individual retirement savings accounts should be expanded and whether distribution from the accounts also should be allowed for educational purposes and for the purchase of the first principal residence.

Explanation of the bill

Deductible contributions

The bill would increase the annual limit on deductible retirement savings contributions to 100 percent of the first $2,000 of compensation includible in gross income. In addition, the bill would extend eligibility for deductible retirement savings contributions to individuals who are active participants in qualified plans, tax-sheltered annuity programs, or governmental plans. The bill would delete the special $1,750 deduction limitation for spousal IRAs.

Under the bill, deductible retirement savings contributions could be made by an individual to (1) a qualified plan in which the individual is an active participant or (2) to an IRA. No deduction would be allowed, however, for mandatory employee contributions to a plan. Contributions to a qualified plan or to an IRA made before the time for filing the tax return for a year could be taken into account as if made on the last day of the year for which the return is filed.

Under the bill, benefits attributable to deductible employee contributions to a plan would be taxed under the same rules that apply to benefits attributable to employer contributions. Accordingly, these benefits would generally be taxed only when distributed or made available to the employee or a beneficiary, unless rolled over tax-free to another qualified plan or to an IRA. Such benefits could also qualify for exclusion under the estate and gift tax provisions.

Deductible employee contributions to a plan would be treated as employee contributions, however, in testing whether the plan meets the requirements for tax-qualified status and whether the plan meets the requirements of ERISA.

The bill provides for simplified reports with respect to deductible employee contributions received by plans.

Nondeductible contributions

The bill would allow nondeductible contributions to be made to an IRA. Although no deduction would be allowed for the contributions and they would not be excluded from estate or gift tax under the usual rules applicable to IRAs, the earnings attributable to nondeductible contributions would not be taxed until distributed. Nondeductible contributions would be subject to an annual limit of $2,000. Nondeductible contributions of up to $8,000 could be made over an individual's lifetime in addition to the amount contributed under the $2,000 annual limit for nondeductible contributions. Under the bill, the limits for nondeductible contributions would be applied only after the limit on deductible contributions for a year is exceeded.

Distributions for education and housing purposes

Where nondeductible contributions have been made to an IRA, distributions from the IRA would be allocated under the usual annuity rules to determine the taxable portion, so that the part of each distribution consisting of nondeductible contributions would not be taxed. The bill would permit distributions to be made from an IRA without penalty to pay for certain educational expenses and would

permit distributions in connection with the purchase of the first dwelling purchased by the owner of the IRA if the dwelling is used as that individual's principal residence. Withdrawals for educational expenses or the purchase of a dwelling could not be less than $2,000 and could not reduce the amount held in the IRA below $2,000. Also, total withdrawals for these purposes could not accumulate to more than $10,000.

Under the bill, withdrawals for educational expenses could be made to pay for (1) tuition and fees at an educational institution, (2) fees, books, supplies, and equipment for courses of instruction, and (3) a reasonable allowance for meals and lodging. An institution would qualify as an educational institution if it is an institution of higher education [2] or a vocational school.[3]

Effective dates

Generally, the amendments made by the bill would apply to taxable years beginning after 1980. The estate and gift tax amendments would apply to estates of decedents who die after 1980 and to transfers made after 1980 (respectively).

Revenue effect

It is estimated that this bill will decrease budget receipts by $118 million in fiscal year 1981, $2,754 million in 1982, $2,992 million in 1983, $3,620 million in 1984 and $3,907 million in 1985.

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[2] As defined in section 1201(a) or 491(b) of the Higher Education Act of 1965.

[3] As defined in section 195(2) of the Vocational Education Act of 1963 in any State (as defined in section 195(8) of that Act).

Senator CHAFEE. Good morning. I want to welcome you all to this first meeting of the Finance Subcommittee on Savings, Pensions, and Investment Policy.

The fact that this, our first hearing, concerns tax incentives to promote increased individual savings is an indication of the priority that I give to this issue, and I believe that other members of the committee will agree with the thrust of the various measures which have been introduced.

Our tax code is long on incentives for people to borrow money, and to borrow for virtually any purpose, but it is discouragingly short on incentives for the average worker in this country to save and plan for the future.

In the face of 25 percent inflation during the last 2 years, people have kept their saving levels low and incurred record levels of consumer debt at the same time.

I am sure some of our witnesses will testify to the fact that the savings rate in the United States is the lowest of any industrial nation in the world, and indeed has fallen drastically in the past 5 years.

People who are retired have become more and more dependent on social security and on some occasions, unfortunately, have to rely on public assistance programs as they have seen the value of whatever savings they have had diminish.

The shortage of loanable funds resulting from the drain on savings is causing persistently high interest rates, at least it is certainly a contributing factor to that, which make the purchase of a home or the education of a child extremely expensive.

The tight money markets are making it harder for business to expand and to create new jobs for our 8 million unemployed Americans.

To help return growth and stability to our economy, President Reagan has already proposed major tax cuts for individuals and business. His tax cuts for individuals alone in 1982 will leave an additional $44 million of spendable income in the hands of our taxpayers. A portion of this amount is likely to be saved and invested, but the vast majority of it, I expect, will be spent for current consumption.

It is my hope that when Congress deals with the President's economic proposals and tax cuts it will pass legislation to encourage a larger share of the tax cut to be saved. Not only will this be beneficial to individual savers, but it will help offset any potential inflationary effects such a large tax cut might have.

In January, Congressman Henson Moore and I introduced a bill, S. 243 and H.R. 1250, intended to accomplish the goal of encouraging savings. This is called the Savings and Retirement Income Incentive Act of 1981.

Our proposal has several features which combine to reduce taxes on individual savings and investment and to make the Individual Retirement Act, the IRA, a more effective long-term savings vehicle.

Our bill contains the following features:

First, it makes permanent the $200 individual or $400 married couple interest and dividend exclusion. This would expire in 1982 unless something is done.

Two, it would allow a $500 individual or $1,000 married couple interest and dividend exclusion for senior citizens 65 years or older.

Three, it makes all persons with earned income eligible to establish an IRA, including Government and military employees and workers who are already participants in qualified pension plans. As you can see, that is a very dramatic departure from where we are now. It increases the potential use of the IRA's very substantially.

Four, it increases the maximum deductible IRA contribution to $2,000 a year.

Five, it permits a tax deduction up to $2,000 a year to individuals who make voluntary contributions, in excess of any mandatory contributions, to a pension plan in lieu of an IRA.

Six, it allows additional nondeductible contributions—mind you, these additional contributions are nondeductible—up to $2,000 a year into an IRA. However, the interest earned on this amount would be tax deferred.

Next, it allows an account holder the privilege of making five withdrawals without penalties up to a total amount of $10,000 if the funds are used for the purchase of a first home or for higher education expenses.

In working out the details of our bill we have given top priority to incentives for increasing individual savings rather than simply giving tax benefits to people who are saving anyway. That was one of the concerns last year when we offered the $200 to $400 exclusion. The question was whether we were adding to the amount of savings in the Nation or simply giving a tax break to those already saving.

Senator Dole, who unfortunately could not be here this morning, also has introduced bills S. 12 and S. 24, which have the same objectives, and some features are similar to the bill that Congressman Moore and I have.

Senator Dole is extremely interested in this entire project. We will be working together to establish a strong savings incentive which will help millions of individuals plan for their most important family goals, which are a home and education for their children and a financially secure retirement.

[Opening statements of Senators Dole and Chafee follow:]

Opening Statement of Senator Dole

Mr. Chairman, today we have the opportunity to hear the views of members of the public on three bills which could be of substantial interest to many of our taxpayers, many businesses seeking to make substantial capital investments and thus of potentially great importance for the econcmic recovery of the republic.

THE DECLINE OF THRIFT

Although the three bills vary in scope and in other important respects, all three address the critical need to increase the level of capital investment in the United States, Current figures show that the level of investment—and the rate of productivity growth—in the United States have fallen far below that of our principal economic competitors. The most recent figures available from the Department of Commerce show that in 1980 personal savings amounted to only 3.5 percent of total income. By contrast, as recently as 1975 the comparable percentage was approximately 7.7.

SHOULD WE BORROW ABROAD

To fund the needed investment for our new plant and equipment, we must either borrow overseas or we must make savings for our citizens more attractive and so reduce consumption. In the public sector foreign borrowing has increased enormous-

ly in the recent past. Nearly 22 percent of the privately held national debt is now owned by foreigners. Yet this accelerating trend is, at the least, deeply troubling. America's only genuine option is to finance its own economic recovery.

POSSIBLE SOLUTIONS

S. 12, the first of these measures, provides an additional form of tax-deferred savings for retirement. The goal of this bill is to encourage employees who are nominally covered by an employer's retirement plan but who may never be entitled to benefits under that plan, to save for their own retirement. Thus, we not only provide the funds American industry needs to revitalize our economy but we once more encourage that classic American virtue, thrift.

S. 24, the second bill, provides similar IRA-type accounts for accumulating savings for a down payment for a home and for college education. Again, taxpayers can make tax-deferred contributions for such purposes to a restricted account. As under S. 12, no taxes are lost, but instead such taxes are only deferred.

S. 243, the most sweeping and complex of these bills, addresses many of the same problems but provides somewhat different solutions. While I may differ slightly from the esteemed Senator from Rhode Island as to the mechanics of savings incentive, I believe that we are fully in agreement on the problem and the general directions we must move for solutions. S. 243 will extend the maximum deductible IRA accounts as well as permit contribution to such accounts to be used for saving for higher education or a first home. Additionally, the bill will make permanent the increase in the dividend and interest exclusion approved last year. Like S. 12 and S. 24, this bill will sharply reduce disincentives for saving and for thrift.

We hope to hear today what funds could be saved and invested that would otherwise have been spent on personal consumption as well as how those funds would be used. We look forward to hearing from the individuals, representative organizations and financial institutions, who together represent a broad range of the players in any enhanced savings program.

STATEMENT BY SENATOR JOHN H. CHAFEE

Welcome to the first meeting of the Subcommittee on Savings, Pensions and Investment Policy. As Chairman of this subcommittee, I am pleased that our first hearing concerns tax incentives to promote individual savings.

Our tax code is long on incentives for people to borrow money, and to borrow for virtually any purpose; but it is discouragingly short on incentives for the average worker in this country to save and plan for the future.

In the face of 25 percent inflation during the last two years, people have kept their saving levels low, and incurred record levels of consumer debt at the same time.

People who are retired have become more and more dependent on Social Security and public assistance programs as the value of their savings income diminishes.

The shortage of loanable funds resulting from the drain on savings is causing persistently high interest rates—which make the purchase of a home or the education of a child prohibitively expensive.

At the same time, tight money markets are making it harder for businesses to expand and create new jobs for eight million unemployed Americans.

To help return growth and stability to our economy, President Reagan has already proposed major tax reductions for individuals and business. His tax cut for individuals alone in 1982 will leave an additional $44 billion spendable income in the hands of taxpayers. A portion of this amount in likely to be saved and invested, but the vast majority of it will be spent for current consumption.

It is my hope that after Congress deals with the President's economic proposals, it will pass legislation to encourage a larger share of the tax cut to be saved. Not only will this be beneficial to individual savers, but it will also help offset any potential inflationary effect such a large tax cut might have.

In January, Congressman Henson Moore and I introduced a bill (S. 243, H.R. 1250) intended to accomplish this goal, the Savings and Retirement Income Incentive Act of 1981.

Our proposal has several features which combine to reduce taxes on individual savings and investment, and to make the individual retirement act a more effective long-term savings vehicle. It contains the following provisions:

Makes permanent the $200/$400 interest and dividend exclusion (under current law, this expires after 1982).

Allows a $500/$1,000 interest and dividend tax exclusion for senior citizens (65 years of age and older).

Makes all persons with earned income eligible to establish an IRA (including government and military employees, and workers who are also participants in qualified pension plans).

Increases the maximum tax deductible IRA contribution to $2,000 a year.

Permits a tax deduction up to $2,000 a year to individuals who make voluntary contributions (in excess of any mandatory contributions) to a pension plan in lieu of an IRA.

Allows additional non-deductible contributions up to $2,000 a year. However, interest earned on this amount would be tax-deferred.

Allows account holder the privilege of making five withdrawals without penalty up to a total of $10,000 if the funds are used for the purchase of a first home or for higher education expenses.

In working out the details of our bill, Representative Moore and I have given top priority to incentives for increasing total individual savings, rather than simply giving tax benefits to people who are saving anyway.

Senator Dole, who unfortunately cannot be here with us this morning, has also introduced bills, S. 12 and S. 24, which have the same objectives and some features similar to S. 243. We will be working together this year to establish a strong savings incentive which will help millions of individuals plan for their most important family goals: A home of their own, education for their children, and a financially secure retirement.

We are honored to have with us as the lead-off witness Congressman Henson Moore, the sponsor of H.R. 1250, the Savings and Retirement Income Incentive Act, and the leading advocate of savings legislation in the House of Representatives.

Brief Summary of the Provisions of the Savings and Retirement Income Incentive Act of 1981

The "Savings and Retirement Income Incentive Act of 1981" is designed to increase the incentives for individual savings and investment in the following ways:

(1) The bill makes permanent the exclusion from tax of the first $200 ($400 on a joint return) of dividend and interest income and increases that amount to $500 ($1000 on a joint return) when an individual or spouse attains the age of 65.

(2) The bill permits the use of individual retirement accounts (IRA's) by employees, including government employees and military personnel, who are covered by employer-sponsored retirement plans and increases the maximum allowable deductible contributions to these accounts from $1,250 per year under existing law to $2,000 per year or the total amount of the employee's earned income, whichever is less.

(3) In lieu of a contribution to a separate IRA, the bill permits an employee to make a $2,000 per year tax-deductible, voluntary contribution to his employer-sponsored retirement plan, if the plan so permits.

(4) The bill permits additional voluntary non-deductible contributions of $2,000 per year plus an additional $8,000 over the employee's lifetime to either an IRA or an employer-sponsored plan thereby increasing the size of the accounts so that the expense of managing and promoting such savings plans will be more easily absorbed. Tax is deferred on earnings from all moneys contributed to the account to that the employee's total savings are also enhanced by such contributions. This provision is similar to existing law regarding corporate pension plans and Keogh plans for the self-employed. Thus, for example, in one year an individual could make a deductible contribution to an IRA of $2,000 and a non-deductible contribution of $10,000; thereafter, he could make annually a deductible contribution of $2,000 and a non-deductible contribution of $2,000.

(5) Finally, the bill permits an employee to withdraw without penalty up to $10,000 from the account in order to purchase a first home or to pay for the higher education of his children. (The amounts so withdrawn are subject to income tax in the year of withdrawal). This provision will make IRA's attractive to younger employees who are hesitant to invest funds for retirement savings which may still be needed for major family commitments.

[From the Congressional Record, Jan 23, 1981]

Savings and Retirement Income Incentive Act of 1981

Mr. Moore. Mr. Speaker, as individual taxes climb, disposable income dwindles and personal savings become a necessary income supplement to meet costs imposed by inflation instead of an investment reserve to which regular deposits were once

made. As a result, personal savings rates in this Nation are pitifully low especially when compared to those of other major industrial nations.

On the average, Japanese workers save four times as much as we do, West German savings are triple our rate, and Canadians save twice our level. In the last decade our savings rates have fallen while each of theirs has risen.

It is no mystery why Americans save so little today or why Japan, West Germany, Canada, and other countries have a comparative abundance of savings capital upon which to draw for economic expansion and competition with us.

In Japan interest earned on the first $23,000 of individual savings is tax free. In West Germany, families with children and with low- to moderate-incomes are given sufficient tax cuts for long-term saving to cause 94 percent of blue collar workers to establish and regularly add to their savings accounts. In Canada, employee contributions to employer-sponsored pension plans are tax deferred in amounts up to $3,300 per year and individuals having their own retirement plans can defer taxes on up to $5,500 in annual additions. This is by no means an inclusive list of their savings incentive or nations offering them.

By comparison, we are pikers in the savings game and, for this reason, we are losing it. Until language I initiated in the House won approval as part of the Windfall Profit Tax Act approved in the last Congress, this Nation fully taxed every dollar of interest income received by individuals. The $400 maximum annual exclusion granted last year for interest and dividend income in 1981 and 1982 tax years appears paltry when compared to savings incentives in Japan, West Germany, or Canada, but it is a step in the right direction and one that should have been taken long ago.

Much more needs to be done to give a favorable real after-tax rate of return on savings to track or hopefully stay ahead of inflation. Foreign experience shows savings can best be built by reducing the tax imposed on it. Our tax on savings is particularly onerous as interest income is taxed at the highest rate an individual must pay and commonly it puts a taxpayer into a higher tax bracket when added atop earned income as our tax policy instructs.

To counter this built-in tax bias against savings, Senator John Chafee and I are jointly introducing a bill to build upon the present interest and dividend exclusion and expand individual retirement account eligibility and benefits. Our Savings and Retirement Income Incentive Act of 1981 is a natural extension of guidance given by the Senate Finance Committee late last year in its omnibus tax cut bill. It embraces desired objectives of simple yet functional design, tax adjustment to account for interest and dividend income damage caused by inflation, self-reliance in retirement income management, first-time home ownership, new savings formation, and vocational or college education for the account holder's children. It has won approval by more than 25 national organizations representing investment and financial communities, the Nation's largest retirement organizations, and national military organizations. Initial estimates put its static revenue cost at some $4 billion in the first year with savings formation encouraged by its terms giving an early cost recovery. Econometric tests are underway. In view of recent surges in personal debt growth, and record low rates of personal savings, it is extremely timely. It also only rewards retirement savings beyond activity already provided under mandatory employer-sponsored plans.

Many notions on savings formation are being offered these days. Senator Chafee, who serves as chairman of the subcommittee on Savings, Pensions, and Investment Policy, and I are convinced this bill gets highest marks when all objective tests are applied, especially in terms of the wide range of worthy purposes served on an equal basis and at a reasonable cost.

For this reason, we have recommended its inclusion in the forthcoming tax cut recommendations of the administration and Senator Chafee intends to begin hearings on it at an early date.

A summary of the bill, a list of organizations supporting or in most cases endorsing it, as well as the measures full text follow:

BILL SUMMARY

The "Savings and Retirement Income Incentive Act of 1981" is designed to increase the incentives for individual savings and investment in the following ways:

(1) The bill makes permanent the exclusion from tax of the first $200 ($400 on a joint return) of dividend and interest income and increases that amount to $500 ($1,000 on a joint return) when an individual or spouse attains the age of 65.

(2) The bill permits the use of individual retirement accounts (IRA's) by employees, including government employees and military personnel, who are covered by employer-sponsored retirement plans and increases the maximum allowable deductible contributions to these accounts from $1,500 per year under existing law to

$2,000 per year or the total amount of the employee's earned income, whichever is less.

(3) In lieu of a contribution to a separate IRA, the bill permits an employee to make a $2,000 per year tax-deductible, voluntary contribution to his employer-sponsored retirement plan, if the plan so permits.

(4) The bill permits additional voluntary non-deductible contributions of $2,000 per year plus an additional $8,000 over the employee's lifetime to either an IRA or an employer-sponsored plan thereby increasing the size of the account so that the expense of managing and promoting such savings plans will be more easily absorbed. Tax is deferred on earnings from all moneys contributed to the account so that the employee's total savings are also enhanced by such contributions. This provision is similar to existing law regarding corporate pension plans and Keogh plans for the self-employed. Thus, for example, in one year an individual could make a deductible contribution to an IRA of $2,000 and a non-deductible contribution of $10,000; thereafter, he could make annually a deductible contribution of $2,000 and a non-deductible contribution of $2,000.

(5) Finally, the bill permits an employee to withdraw without penalty up to $10,000 from the account in order to perchase a first home or to pay for the higher education of his children. (The amounts so withdrawn are subject to income tax in the year of withdrawal.) This provision will make IRA's attractive to younger employees who are hesitant to invest funds for retirement savings which may still be needed for major family commitments.

ENDORSEMENTS OR STATEMENTS OF SUPPORT

American Association of Retired Persons.
National Retired Teachers Association.
National Association of Retired Federal Employees.
Merrill Lynch, Pierce, Fenner & Smith, Inc.
National Association of Federal Credit Unions.
Credit Union National Association, Inc.
Investment Company Institute.
U.S. League of Savings Associations.
National Savings and Loan League.
National Consumer Finance Association.
National Association of Mutual Savings Banks.
Independent Bankers Association.
Chief Warrant and Warrant Officers Association, U.S. Coast Guard.
U.S. Army Warrant Officers Association.
American Security Council.
Reserve Enlisted Association.
National Association for Uniformed Services.
Veterans of Foreign Wars of the United States.
Marine Corps League.
Non Commissioned Officers Association.
Disabled Officers Association.
Association of the United States Army.
Navy League of the United States.
Army Mutual Aid Association.
Retired Officers Association.
Military of the World Wars.

H.R.1250

A bill to amend the Internal Revenue Code of 1954 to increase the allowable contributions to individual retirement plans and to allow employees a deduction for savings contributions to employer retirement plans or to individual retirement accounts

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE

This Act may be cited as the "Savings and Retirement Income Incentive Act of 1981".

SEC. 2. AMENDMENTS TO MAKE PERMANENT CURRENT INTEREST AND DIVIDEND EXCLUSION AND TO INCREASE SUCH EXCLUSIONS FOR PERSONS OVER AGE 65.

(a) Section 404(c) of the Crude Oil Windfall Profit Tax Act of 1980 is amended to read as follows:

"(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to taxable years beginning after December 31, 1980."

(b) Paragraph (1) of Section 116(b) of the Internal Revenue Code, as amended by Section 404(a) of the Crude Oil Windfall Profit Tax of 1980, is amended to read as follows:

"(1) MAXIMUM DOLLAR AMOUNT.—

"(A) GENERAL EXCLUSION.—Except as provided in subparagraph (B), the aggregate amount excluded under subsection (A) for any taxable year shall not exceed $200 ($400 in the case of a joint return under section 6013).

"(B) In the case of an individual who has attained age 65 before the close of the taxable year or who is married as of the close of the taxable year to an individual who has attained age 65 before the close of the taxable year, the aggregate amount excluded under subsection (a) for any taxable year shall not exceed $500 ($1,000 in the case of a joint return under section 6013)."

SEC. 3. INCREASE IN PERMISSIBLE CONTRIBUTIONS TO INDIVIDUAL RETIREMENT ACCOUNTS.

(a) Section 219(b) of the Internal Revenue Code of 1954 (relating to retirement savings) is amended—

(1) by deleting the words "an amount equal to" from paragraph (1), by striking out "15 percent" wherever it appears and inserting in lieu thereof "the amounts", and by striking out "1,500" wherever it appears and inserting in lieu thereof "$2,000".

(2) by deleting paragraph (2) and redesignating paragraphs (3) through (7) as paragraphs (2) through (6).

(b) Section 4973(b) of such Code is amended to read as follows:

"(b) EXCESS CONTRIBUTIONS.—For purposes of this section, in the case of individual retirement accounts, individual retirement annuities or bonds, the term 'excess contributions' means the sum of—

"(1) the excess (if any) of—

"(A) the amount contributed for the taxable year to the accounts or for the annuities or bonds (other than a rollover contribution described in section 402(a)(5), 403(a)(4), 403(b)(8), 408(d)(3), or 409(b)(3)(c)), over

"(B) $2,000 plus the amount allowable as a deduction under section 219 for such contributions, and

"(2) the amount determined under this subsection for the preceding taxable year, reduced (but not below zero) by the sum of—

"(A) the distributions out of the account for the taxable year which were included in the gross income of the payee under section 408(d)(1).

"(B) the distributions out of the account for the taxable year to which section 408(d)(5) applies, and

"(C) the excess (if any) of—

"(i) $2,000 plus the maximum amount allowable as a deduction under section 219 for the taxable year over

"(ii) the amount contributed (determined without regard to section 219(c)(5)) to the accounts or for the annuities or bonds for the taxable year.

The amount determined under the preceding sentence shall be reduced (but not below zero) by the excess (if any) of 8,000 over the aggregate of the amounts contributed for each prior taxable year in excess of the sum of $2,000 and the amount allowable as a deduction under section 219 of such prior taxable year.

(c) Section 408 of such Code is amended—

(1) by striking out "$1,500" wherever it appears and inserting in lieu thereof "$4,000".

(2) by adding to paragraph (1) of subsection (a) the following sentence: "For purposes of the preceding sentence if contributions for any taxable year exceed $4,000 on behalf of any individual, they shall not be taken into account except to the extent that such excess contributions, when aggregated with any similar excess contributions for prior taxable years, exceed $8,000."

(3) by amending paragraphs (1) and (2) of subsection (d) to read as follows:

"(1) IN GENERAL.—Except as otherwise provided in this subsection, any amount or annuity contract paid or distributed out of an individual retirement account or under an individual retirement annuity to any distributee shall be taxable to him in the year in which so distributed under section 72 (relating to annuities).

"(2) COMPUTATION OF EMPLOYEES' CONTRIBUTTIONS.—For purposes of this paragraph and section 72, any amounts for which a deduction is allowed under section 219 shall be treated as an employer contribution."

(4) by deleting the words "or 220" from paragraphs (4) and (5) of subsection (d) wherever they appear.

(5) by amending subsection (f)—

(A) by inserting before the period at the end of paragraph (1) thereof "unless such distribution is a qualified withdrawal as defined in paragraph (4)", and

(B) by adding at the end thereof new paragraphs (4) and (5) to read as follows:

"(4) QUALIFIED WITHDRAWAL.—Paragraphs (1) and (2) shall not apply to any withdrawal during a taxable year in which the individual has made no prior qualified withdrawals—

"(A) which is used—

"(i) to pay the qualified educational expenses of a child of the individual for whose benefit the trust is maintained, or

"(ii) in connection with the purchase of the first dwelling purchased by the individual for whose benefit the account is maintained which constitutes his principal residence,

"(B) which is not less than $2,000, but which when aggregated with all qualified withdrawals in prior taxable years does not exceed $10,000, and

"(C) which will not cause the fair market value of the account immediately after the withdrawal to be less than $2,000.

"(5) DEFINITIONS.—

"(A) QUALIFIED EDUCATIONAL EXPENSE.—The term 'qualified educational expense' means—

"(i) tuition and fees required for the enrollment or attendance of a student at an eligible educational institution,

"(ii) fees, books, supplies, and equipment required for courses of instruction at an eligible educational institution, and

"(iii) a reasonable allowance for meals and lodging.

"(B) ELIGIBLE EDUCATIONAL INSTITUTION.—The term 'eligible educational institution' means—

"(i) an institution of higher education, or

"(ii) a vocational school.

"(C) INSTITUTION OF HIGHER EDUCATION.—The term 'institution of higher education' means the institutions described in section 1201(a) or 491(b) of the Higher Education Act of 1965.

"(D) VOCATIONAL SCHOOL.—The term 'vocational school' means an area vocational education school as defined in section 195(2) of the Vocational Education Act of 1963 which is in any State (as defined in section 195(8) of such Act)."

"(d) Section 72 of the Internal Revenue Code of 1954 (relating to annuities; certain proceeds of endowments and life insurance contracts) is amended by redesignating subsection (o) as subsection (p) and by inserting after subsection (n) the following new subsection:

"(o) TREATMENT OF DISTRIBUTIONS FROM INDIVIDUAL RETIREMENT ACCOUNTS.—For purposes of subsections (c)(1)(A) and (e)(1)(B), any contribution made by an individual to an individual retirement account which is allowed as a deduction under section 219 shall be treated as an amount contributed by an employer which is not includible in the gross income of such employee."

(e) Section 2039 of the Internal Revenue Code of 1954 (relating to the Estate Tax) is amended by repealing subsection (e) thereof and redesignating subsection (f) as subsection (e).

(f) Section 2517(b) of the Internal Revenue Code of 1954 (relating to the gift tax) is amended by striking the parenthetical phrase "(other than paragraphs (4) and (5))" and substituting "(other than paragraph (4))."

SEC. 4. ALLOWANCE OF RETIREMENT SAVINGS DEDUCTION

Part VII of subchapter B of chapter 1 of such Code (relating to additional itemized deductions of individuals) is amended by repealing section 220 and by substituting therefor the following new section:

"SEC. 220. DEDUCTION FOR CERTAIN EMPLOYEE RETIREMENT SAVINGS CONTRIBUTIONS

"(a) GENERAL RULE. In the case of an eligible employee, described in subsection (c)(2), there shall be allowed as a deduction the qualified retirement savings contributions of such individual for the taxable year.

"(b) LIMITATIONS AND RESTRICTIONS.—

"(1) MAXIMUM DEDUCTION.—The amount allowable as a deduction under subsection (a) to an eligible employee for any taxable year may not exceed the lesser of—

"(A) the amount of the compensation includible in the eligible employee's gross income for such taxable year, or

"(B) $2,000.

"(2) ALTERNATIVE DEDUCTION.—No deduction shall be allowed under subsection (a) for the taxable year if a deduction is allowed under section 219 for the taxable year.

"(c) DEFINITIONS AND SPECIAL RULES.—

"(1) QUALIFIED RETIREMENT SAVINGS CONTRIBUTION.—For purposes of this section, the term 'qualified retirement savings contribution' means any contribution in cash, other than a mandatory contribution, made by an individual as an employee to or under—

"(A) a plan described in section 401(2) which includes a trust exempt from tax under section 501(a).

"(B) an annunity plan described in section 403(a).

"(C) a qualified bond purchase plan described in section 405(a), or

"(D) ELIGIBLE EMPLOYEE.—For purposes of this section, the term 'eligible employee' means any individual who is an active participant for any part of the taxable year in a plan described in paragraph (1).

"(3) RECONTRIBUTED AMOUNTS.—No deduction allowed under this section with respect to a rollover contribution described in section 402(a)(5), 403(a)(4), 403(b)(8), 403(d)(3), or 409(b)(3)(C).

"(4) AMOUNTS CONTRIBUTED TO AN INSURANCE CONTRACT.—No deduction shall be allowed under this section for that portion of the amounts paid which are properly allocable, under regulations prescribed by the Secretary, to the cost of life insurance.

"(5) MARRIED INDIVIDUALS.—In the case of an individual who is married (as determined under section 143(a)), the maximum deduction under subsection (b) shall be applied without regard to any community property laws.

"(6) TIME WHEN CONTRIBUTIONS DEEMED MADE.—For purposes of this section, a taxpayer shall be deemed to have made a contribution on the last day of the preceding taxable year if the contribution is made on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof).

"(7) COMPENSATION.—For purposes of this section, the term 'compensation' includes earned income as defined in section 401(c)(2).

"(8) MANDATORY CONTRIBUTIONS.—For purposes of this section, the term 'mandatory contributions' means amounts contributed to the plan by the employee which are required as a condition of employment, as a condition of participation in such plan, or as a condition of obtaining benefits under the plan attributable to employer contributions.

"(d) SIMPLIFIED REPORTS.—The Secretary shall issue regulations which prescribe the time and manner in which simplified reports shall be filed by the employer or plan administrator of a plan receiving contributions deductible under this section."

SEC. 5. TREATMENT OF DISTRIBUTIONS FROM PLAN TO WHICH EMPLOYEE MADE DEDUCTIBLE CONTRIBUTIONS

(a) Subpart A of part I of subchapter D of chapter I of such code (relating to retirement plans) is amended by inserting after subsection (1) of section 414, the following new subsection:

"(m) DEDUCTIBLE EMPLOYEE CONTRIBUTIONS.—For purposes of this title, other than for purposes of section 401(a)(4) and (5), 404, 410(b), 411, and 412, any amount which is allowed as a deduction under section 220 as a qualified retirement savings contribution shall be treated as an employer contribution."

(b) Section 414(h) of such Code (relating to tax treatment of certain contributions) is amended by inserting after "any amount contributed" the following: "(other than an amount described in subsection (m))".

SEC. 6. TECHNICAL AND CONFORMING AMENDMENTS

(a) ESTATE AND GIFT TAX EXCLUSION.—

(1) ESTATE TAX.—Subsection (c) of section 2039 of such code (relating to exemption of annuities under certain trusts and plans) is amended by adding at the end thereof the following new sentence: "For purposes of this subsection, any contribution allowed as a deduction under sections 219 or 220 shall be considered as made by a person other than the decedent."

(2) GIFT TAX.—Subsection (b) of section 2517 of such code (relating to transfers attributable to employee contributions) is amended by adding at the end thereof the

following new sentence: "For purposes of this subsection, any contribution allowed as a deduction under sections 219 or 220 shall be considered as made by a person other than the employee."

(b) OTHER AMENDMENTS.—

(1) Paragraph (10) of section 62 of such Code (defining adjusted gross income) is amended by striking out "(relating to retirement savings for certain married individuals):" and inserting in lieu thereof "(relating to deduction for certain employee retirement savings contributions)".

(2) So much of section 72(f) of such code as precedes paragraph (1) thereof is amended to read as follows: "In computing, for purposes of subsection (c)(1)(A), the aggregate amount of premiums or other consideration paid for the contract, for purposes of subsection (d)(1), the consideration for the contract contributed by the employee, and for purposes of subsection (e)(1)(B), the aggregate premiums or other considerations paid, amounts which an employer is required to report, pursuant to regulations promulgated under section 220(d) with respect to an amount paid by an eligible employee (as defined in section 220(c)(2)) as a qualified retirement savings contribution shall be excluded, and amounts contributed by the employer shall be included, but only to the extent that—".

(3) Section 415(a) of such Code is amended by repealing paragraph (3) thereof.

(4) The table of sections for part VII of subchapter B of chapter 1 is amended by striking out the item relating to section 220 and inserting in lieu thereof the following:

"Sec. 220. Deductions for certain employee retirement savings contributions."

SEC. 7. EFFECTIVE DATES

(a) GENERAL RULE.—Except as provided in subsection (b), the amendments made by this Act shall apply to taxable years beginning after December 31, 1980.

(b) ESTATE AND GIFT TAX PROVISIONS.—

(1) ESTATE TAX.—The amendments made by section 4(a)(1) shall apply to the estates of decedents dying after December 31, 1980.

(2) GIFT TAX.—The amendment made by section 4(a)(2) shall apply to transfers after December 31, 1980.

Senator CHAFEE. We are honored to have with us this morning as the leadoff witness Congressman Henson Moore, who is the sponsor of H.R. 1250, the Savings and Retirement Income Incentive Act, and who has been a leading advocate in this area for several years. He has taken the chief role in the House. Not only that, but he has spoken out and been one of the true leaders in this field.

Congressman Moore, we are delighted to have you with us this morning and look forward to hearing your testimony.

STATEMENT OF HON. HENSON MOORE OF LOUISIANA

Mr. MOORE. Thank you.

First, congratulations on being chairman of this subcommittee. I think we may get a more favorable light on these measures than we have in past years.

Senator CHAFEE. There was some malice aforethought in my going on this subcommittee. It is not sheer coincidence.

Mr. MOORE. I also thank you for sponsoring S. 243 as being a substantial and first piece of legislation in this area of doing something to stimulate savings, something I hope we can emulate on the House side. Certainly those of us in the House will be following the work of your subcommittee as a guiding light.

I think there are six things that cause you and me and others as public servants to consider we have a problem today, and something must be done in the form of attracting savings to solve those problems.

First, we need look only at the problems of thrift institutions today, mutual savings banks and savings and loans. These institu-

tions in my State and in many other States are losing money steadily. Something has to be done.

One of the things that needs to be done is to put more money into their deposits, increase their deposits to make loans.

Second, we know the individual saver today is pretty smart. The individual saver today has figured out with inflation at 12.4 percent, at 6 percent on a passbook savings account and paying taxes on that 6 percent it does not take much of a mathematician to figure out you are losing money in trying to save money.

Evidence we have from the CATO Institute, a San Francisco economic research group, indicates our tax system, as you pointed out, essentially taxes savings almost twice as heavily as it taxes consumption.

An individual earning $30,000 in 1978 taxable income paid 40 percent more in Federal taxes. If they saved $7,500 of that $30,000 income, they paid 40 percent more in taxes than if they spent it. That is a bad situation.

Third, social security was meant to be an income supplement. We know the problems of the social security system. Something must be done to encourage people to save on their own to prepare for their retirement years and not depend just on social security for those retirement years.

A fourth factor is the fact that today we have very much in evidence a national psychology to spend as a hedging against inflation rather than to save. We must do something to get young people particularly, but also all Americans, out of the idea of buying something now that will cost more money next year instead of saving that money, and they are consciously making that decision daily.

Fifth, the median average of a saver today in the United States is 55 years of age. That means if we don't begin to reverse that trend someday our savers are going to be up in age and someday there will be no savers left. What kind of situation will the country be in then?

Sixth and last, traditionally one-third of the U.S. capital investment in this country has come from savings accounts. I repeat, one-third of all the available capital of this country traditionally has come from savings accounts. Our savings rate as a percentage of disposable income was 7.7 percent a decade ago. Now it is half that.

It is interesting to note during that same decade the productivity of the United States, the growth of productivity in this country, was less than that of any of our major trading partners except Great Britain. There is a definite connection between low savings, availability of capital, and productivity.

The point remains we are not doing enough today to attract capital to be able to improve our productivity. Let's look at some of our opposition, people in the trading wars we are involved in internationally.

In Japan they save 21 percent of the disposable income, three times our current rate in the United States. Why? They exempt all interest income on the first $23,000 of income, among other reasons.

In Germany, 12.6 percent of their disposable income is saved, three times our rate. They have such tax incentives to save that

nearly 94 percent of all the blue collar workers in Germany have savings accounts and regularly contribute to them.

In Canada, 11 percent of disposable income twice our rate, is saved. I will mention Canada more in a moment as to why they have that rate.

Basically, I think we, as lawmakers, need to try to address some kind of legislation that will increase deposits at thrifts, make it profitable to save, prepare people for retirement, give an incentive to save to break the spending psychology, get our younger population into the habit of saving, and then form capital to be able to improve productivity and lower the inflation rate. That is precisely what S. 243 does. The bill was drafted to attack those very problems.

The bill, I think most importantly, opens up to 44 million Americans who are presently excluded the opportunity to have an individual retirement account. Those people will take advantage of this, we believe. I have more evidence on that in a few moments.

We increase the amount from $1,500 to $2,000 to make it profitable. Many people don't take it out today because there is not enough money involved to make it worthwhile and the cost of maintaining and servicing the account eats up too much, so it is not attractive enough to the saver.

Third, we attract more income into individual retirement accounts than is currently possible.

Fourth, we allow flexibility of letting them take out without penalty a certain amount of that money from their individual retirement account to buy their first home or educate their children, which brings about needed flexibility to attract a young saver who today is scared to put his money into an account which he cannot take out without paying a heavy penalty until he is 59 years of age.

There are three pieces of evidence we have already developed which say this bill will work, that this bill will do what we think it will do.

First, the Canadian experience. Perhaps that is our best piece of evidence. In Canada in 1971 their savings totaled 5.9 percent of disposable income. Shortly after they passed their individual retirement act that savings rate began to improve to the point it is now running at 11 percent.

During the same time period in the United States, ours used to be 7 percent in 1971. It is now half that. Essentially, then, the Canadians doubled their savings rate by passing an individual retirement act and we were halving ours during the same time period.

Senator CHAFEE. How much is exempt in the Canadian plan?

Mr. MOORE. $3,300 if you have a pension plan. In the United States under existing law you cannot have an IRA if you have an existing pension plan. The Canadians allow $5,500 to be deductible if you don't have one.

Our bill is modest in talking about a mere $2,000. It should be higher. If Treasury can stand it, we should consider that.

A second piece of evidence that I think indicates this bill will work and will accomplish our desired goals is a recent attitudinal survey taken by one of our groups supporting this bill, working

with us, the American Council for Life Insurance, taken in February of this year, a survey of 1,000 working Americans all across the country by Roger Seasonwein and Associates of New Rochelle, N.Y. They asked questions of 1,000 working adults and the answers that came back I thought were surprising.

Sixty-three percent of those polled indicate they know they are not saving enough money. Seventy-two percent felt their savings for retirement were too little. Forty-four percent indicated they weren't saving anything for their retirement.

Seventy-two percent indicated that a deduction for retirement income savings by employees covered by pension plans was favored by them. Forty-seven percent indicated that they—those already covered by pension plans—47 percent of those polled already covered by pension plans indicated they would initiate an individual retirement account if this bill were passed, that they would contribute to it on an annual figure of about $617 per person polled.

That alone will raise a potential of $11 billion in new savings just from the limited people who already are covered by pension funds. It does not take into consideration those people who do not have IRA's today.

We have an econometric study underway being done by Professor Boskin at Stanford University which will hopefully have some information later this week as additional evidence of what this poll is trying to say.

Interestingly enough, 89 percent of the people polled indicated the reason they are not saving money is because of the current income tax laws of this country.

The people are telling us something in that poll, Mr. Chairman. They understand what is going on and they are telling us something has to be done to encourage them to save.

A third item of proof, I think, that this bill will work is the groups which worked with us in drafting it and the groups which have lent their names. Many of them are here to testify today in support of this bill, groups which know something about the financial markets of this country, know something about savings incentives in this country, have studied it, have worked with us and have endorsed it.

Included are groups such as the American Association of Retired Persons; National Retired Teacher Association; National Association of Retired Federal Employees; American Society of Civil Engineers; Merrill Lynch, Pierce, Fenner and Smith. I believe our current Secretary of the Treasury had some connection with that association.

Senator CHAFEE. No question about that.

Mr. MOORE. National Association of Federal Credit Unions; Credit Union National Association; Investment Company Institute; U.S. League of Savings Associations; National Savings and Loan League; National Consumer Finance Association; National Association of Mutual Savings Banks; Independent Bankers Association; Louisiana Bankers Association; and many others.

There are also about 20 groups of veterans' organizations because for the first time we allow anybody, including a serviceman or Government employee, to have the opportunity to save.

Therefore, Mr. Chairman, if you look at the problems facing us as lawmakers, facing the economy today, those problems cry out for something being done to encourage people to save money.

If you look at the plan we drafted, it does that. If you look at the evidence already being generated, it shows it will work. We have additional evidence forthcoming.

Last, I would like to comment on the political ability to pass this bill as opposed to some other ideas.

On the Ways and Means Committee, when we talk about exempting $1,000 or $2,000 of interest income, immediately what I hear from my colleagues on that committee is the fact you are helping rich people. Figure out how many thousands you have to have on deposit at 6 percent to get $1,000 or $2,000 of interest income. The committee will not pass such a bill, I feel.

Second, when you talk about such programs as a general cut across the board, that is good. We support that. However, there are people who do not believe that will work and they don't believe that will go into savings.

This morning's editorial in The Washington Post indicates that very thought. It concludes at the end by saying this should be considered by the administration, by the Senate Finance Committee and the House Ways and Means Committee, putting something in the President's bill that will directly encourage savings such as we are dealing with.

Additionally, this bill will help every working American. Every working American who takes home a paycheck can have payroll deductions to start a modest savings program. This is not a program to benefit the rich. This is a program which should be like the Canadian experience, ought to be like the German experience. It ought to be something to get Americans saving money again.

Mr. Chairman, I believe this bill is one of the most necessary things that your subcommittee and the Ways and Means Committee on which I serve will address in this Congress to turn the problems we face today.

It is high time we stop subsidizing spending and penalizing saving. That is exactly what we have been doing.

I congratulate you for these hearings. I very much appreciate your sponsorship of S. 243. I encourage you to move forthrightly, as I think you can believe the evidence you will hear in these hearings will show this bill will in fact work, and it is the best bill anybody has come up with that we can find to take care of all of these six problems I mentioned at the outset of my testimony.

Thank you for allowing me the honor of being here.

Senator CHAFEE. Thank you very much for that excellent testimony. Again I want to congratulate you for the leadership you have taken on this measure.

In your opening remarks you mentioned the difficult times that thrift institutions are having.

In that same vein, I noticed yesterday on the front page of The New York Times that the 10 leading thrift institutions in New York City, savings banks, everyone of them lost money in 1980.

Mr. MOORE. That is a perilous situation. It has not reached the peril point, but it is an alarming situation for those institutions which are so important to millions of savers.

Senator CHAFEE. Let me ask you a question with which I am frequently confronted in connection with this legislation. One of the real attractions to the measure is not only the ability to save for a first home but also for the tuition expenses in higher education for a child.

Yet, for people who save about $10,000, where will that get you in the way of a college education nowadays when some of the institutions are charging $10,000 a year? Under this bill it will be a total withdrawn of $10,000 which would cover 1 year out of 4 for a young person. If you have two or three children, how much help will it be?

Can you give us some assistance in answering that question?

Mr. MOORE. It is a very difficult question to answer satisfactorily. Let me try by saying this: When we drew up this bill we called in all these organizations. There are about a half dozen other well-known organizations, well-versed in financial matters, which have not yet had it cleared by their national boards to endorse the bill, but they will do so in the next several weeks.

These organizations told us what was wrong with the current individual retirement account law, why it was not working, why more Americans were not taking it out.

One of the things they mentioned was the fear of young people locking up that money and not being able to get it out for these two major expenses they know they will face in their lifetimes—a home and education.

We tried to address that without doing damage to having this money put away for long-term investment which is needed for the economy and needed by the thrift institutions for existence.

Ten thousand dollars will not by itself be a down payment for a home nor will it by itself educate all your children, but it will help. It will be encouragement to get people to save for that purpose and know that money can be taken out for that purpose.

One of the problems we simply have is that this piece of legislation cannot solve all the problems of our economy, all the problems facing people, but only make measured steps toward that.

I would suggest as we get into this, if hearings indicate it should be higher, let's consider it.

After we pass this legislation, if experience indicates it ought to be higher, let's perhaps raise the $2,000 amount of money people can put into these plans and likewise raise the amount that can be taken out for these purposes.

The basic purpose of the plan still must be long-term savings. If we destroy that concept, then we are not getting the maximum impact out of this device that its framers and drafters indicated it should do.

Senator CHAFEE. That is very helpful.

I think another important point which perhaps has not been stressed as much is that under the existing IRA's one is permitted to set aside only 15 percent up to $1,500, whereas you can take the first $2,000 of earnings into this bill and set it into a thrift account and a savings account, which it seems to me is an extremely important point, because for somebody to work their way up to, say, the $2,000 into the 15-percent limitation they would have to have fairly substantial earnings.

Mr. MOORE. Mr. Chairman, I agree fully.

In trying to draft this bill we tried to look at all the present encumbrances that keep this plan from being a success and remove them. That was one of them.

We think we were able to withdraw that in this bill. We leave it up to the individual saver to figure out whether he can afford that $2,000. If so, there is no reason to put an arbitrary restriction of 15 percent.

We don't know yet how many millions of dollars we will be opening up in additional savings by that one feature alone. As soon as we get our report back from Prof. Michael Boskin, I think we will know.

Senator CHAFEE. Thank you for joining us today. Again we appreciate all you have done for this legislation.

Now we will have a series of panels. The first panel will consist of Dr. Terry Sanford, president of Duke University and chairman of the Association of American Universities; Michael P. McCarthy, National Affairs Office, Deloitte, Haskins & Sells; Frederick J. Napolitano, first vice president, National Association of Home Builders; and Robert N. Kelly, executive director, Kansas Independent College Association.

Gentlemen, we have other panels present as well.

Is Dr. Carlson here?

[No response.]

Gentlemen, I will ask you to restrict your statements to 5 minutes, please. In speaking to the rest of the panelists here, we have a very full agenda this morning. It is important that the panelists stay within their time restrictions or we will not be able to reach everybody, and we want to reach everybody.

Governor Sanford, if you would proceed, we will be delighted to hear you. We are glad to have you here.

STATEMENT OF DR. TERRY SANFORD, PRESIDENT, DUKE UNIVERSITY, AND CHAIRMAN, ASSOCIATION OF AMERICAN UNIVERSITIES

Dr. SANFORD. Thank you. I appreciate the opportunity to be here.

I have been here before presenting testimony as a public governor of the American Stock Exchange on capital formation. It is very interesting that this bill is primarily aimed at that objective.

However, I am here today as president of Duke University to talk about thc aspects of your legislation as it relates to higher education. In order to do so, I need to comment that people in higher education generally are very well pleased with the pattern of aid to students in higher education which has been put together by Congress. It is working very well. It is working here, and while there is a flaw here and there, and perhaps an abuse, those can easily be corrected.

The higher education community generally strongly supports a continuation of the present legislation, the present aid procedures and proposals and funding which we now have. We think this has accomplished the purpose of Congress of making, first of all, access to higher education available and, in addition, making a choice available on behalf of the student.

The purpose of Congress, then, in enacting higher education legislation I think has been very successful in meeting its objectives.

I do not appear now to endorse the concept of Senate bill 24 and Senate bill 243 with a view that these are designed to take the place of this very fine accumulation of legislation which we already have. I personally and as president of Duke University want to endorse the concepts of these two bills because I think there are a great many good reasons for endorsing them. An increase in savings is apt to have a salutary effect on the Nation's savings rates, as already has been very clearly set forth, and certainly the capital formation, which perhaps is the best answer to inflation and to unemployment, the best way to reach the level of productivity that this Nation needs. Therefore, I think all citizens can look to this kind of legislation with a great sense of support.

As a separate issue, savings incentives certainly have a great appeal for the college community because there is no question that an encouragement of families to save money with a bill enabling families to save money certainly will be of assistance in getting students properly financed in higher education.

I would hope that you could blend into S. 243 some of the aspects of S. 24 which more aptly fit the higher education needs. To mention two or three, contributions to the account in S. 24 can be made by individuals outside of the immediate family. The contribution would be indexed to inflation. Substantial savings can accrue for educational purposes without limitation of other than the maximum annual contribution. Those are aspects, I think, which would be very, very helpful.

I cannot help but mention one other consideration for a tax benefit for higher education, and that is the tuition tax credit proposals. I speak to that as it applies to higher education.

Most of us who have looked at it feel it would do more harm than good. It would cost the Treasury far more than it would bring in the way of benefits to either families or students, and that it would take away from the Treasurer about as much money as is now proposed to be taken away from the various grant and loan programs which mean so much to higher education. Therefore, I would like to go on record as saying that the tuition tax credit proposals for higher education simply do not meet the mark.

Senate bills 24 and 243 do meet the mark, not as a substitute for the very fine accumulation of legislation but as an additional way to propose making it possible for students to go to higher education.

I thank you, Senator, for giving me this opportunity for being here in the U.S. Senate which is taking charge of this.

Senator CHAFEE. Thank you very much, Governor. Those are good points. The points you brought out about S. 24 were helpful.

I am also glad to hear your comments on the tuition tax credit. I have always opposed the tuition tax credit for a host of reasons. I am glad to hear your comments, particularly as you see them as applied to higher education.

We have been working on this legislation for some time. We are not proposing it as a substitute for existing legislation. As to basic educational grants and student loans—of course, as you know, the

President has proposed that the total amounts under that be reduced substantially. However, we are proposing this regardless of what happens in that area. We intend to press ahead.

Thank you.

Mr. McCarthy from Deloitte, Haskins & Sells.

STATEMENT OF MICHAEL P. McCARTHY, NATIONAL AFFAIRS OFFICE, DELOITTE HASKINS & SELLS, ACCOMPANIED BY ALEXANDER ZAKUPOWSKY, JR.

Mr. McCARTHY. Good morning, Mr. Chairman.

My name is Michael McCarthy. I am a partner in the national affairs office of Deloitte, Haskins & Sells. Accompanying me today is Alex Zakupowsky, who also is a partner in our firm.

Deloitte, Haskins & Sells serves over 750 financial institutions in the United States as well as a lot of industry trade groups and the regulatory agencies here in Washington and elsewhere.

We strongly support the savings incentive legislation before this committee and the whole tenor of the bill. Our purpose here today, Mr. Chairman, is to talk a little bit about the the impact of the proposed legislation on thrift industries. What we particularly would like to point out is the result of some significant studies we have done for three groups involved in financial institutions here in the United States—the American Bankers Association, the Independent Bankers Association of America, and the Federal Home Loan Bank Board.

These studies were all directed at different perspectives of capital. In essence each one seems to indicate to us a clear, distinct problem that there was an ever-coming capital shortage for financial institutions in the United States.

Another thing that the studies particularly have pointed out is the fact that some institutions are infinitely greater impacted than other institutions. The characteristics we have identified in those institutions are institutions where the assets side of the balance sheet is less interest-sensitive, and that is fixed-rate loans with long-term repayment; institutions which have an asset liability maturity imbalance, and that is institutions which borrow in short-term markets and lend long-term markets; and institutions located in States that have maintained usury ceilings far below market rates as well as institutions which previously were saddled with Federal interest ceilings below market rate.

From all those profiles it is clear to see the institutions we are talking about which primarily have been impacted over these past few years are thrift institutions. Thrift institutions have been seriously affected by this crisis.

We were employed by the Federal Home Loan Bank Board at one point in time, approximately a year and a half ago, to evaluate the different characteristics of risk which are inherent in savings and loans. While we evaluated these levels of risk in the savings and loan industry we found that most of the risk they really face are not risks that result from the particular types of assets they invest in but rather are risks which come about by the nature of the types of assets that they have and the types of liabilities they have.

What I am talking about there is the fact they have been lending long and they have been borrowing short. Their assets are not interest-sensitive and their liabilities are.

For example, in the past 12 months alone money market certificates and 30-month CD's have increased by $102 billion, $60 billion of which has been invested in 6-month money market certificates. Seventy billion dollars has gone out of longer-term certificates of deposit. Passbooks have declined in the meantime another $10 billion.

With these types of changes it is impossible for people in the thrift industry to make that type of spread management which we refer to in the financial institutions area. That type of planning is impossible in that kind of environment. I am sure some of the other individuals representing the savings and loan industry will again emphasize that.

This past year institutions recorded $950 million in net operating earnings for the whole industry. If in fact you took out $1 billion of penalty income, and if in fact you took out the additional dividends that the Federal Home Loan Bank system got, you would see the industry is clearly in trouble.

In other words, we feel that these bills will give thrift institutions in the United States a longer-term type of deposit that they require to make the adjustments necessary until their assets part of their balance sheet can be adjusted to these interest rate sensitivity problems.

That is the conclusion. We appreciate this opportunity, Mr. Chairman.

Senator CHAFEE. Thank you very much, Mr. McCarthy.

Let me ask you a question. In representing the thrift institutions, is it the feeling of the thrifts that if you are going to have a deposit it has to be a long-term deposit and thus permitting, say, a greater withdrawal than $10,000 for the college tuition would be too much of a wrench and destroy the purpose of the legislation we have here, the objective of it?

Mr. McCARTHY. At first, Mr. Chairman, let me say there are other people here today representing the thrift industry as a whole who I hope would answer that question.

For my own part, as far as good financial planning, it is impossible to be in the long-term real estate mortgage market and have the types of liabilities which they have today because they are so short term that it is impossible to make any type of long-term commitments.

Many people say, "Well, what you do is commit. You make loans and you sell those to the secondary mortgage market."

However, that is not so easy because we have geographical interest differences throughout these United States. In some areas there are higher interest rates than others. Therefore, in areas where the interest rates are more modest it is impossible for these people to go to the secondary markets and be able to market their loans. Consequently, they cannot make long-term real estate mortgage loans.

Senator CHAFEE. I see. Thank you very much.

STATEMENT OF FREDERICK J. NAPOLITANO, FIRST VICE PRESIDENT, NATIONAL ASSOCIATION OF HOME BUILDERS, ACCOMPANIED BY ROBERT D. BANNISTER, SENIOR STAFF VICE PRESIDENT FOR GOVERNMENTAL AFFAIRS, AND JAMES SCHUYLER, LEGISLATIVE COUNSEL

Mr. NAPOLITANO. Mr. Chairman, in keeping with your wishes, we would like to enter the full text of my remarks for the record.

Senator CHAFEE. Certainly.

Mr. NAPOLITANO. I will try to be brief.

My name is Frederick J. Napolitano. I am a home builder from Virginia Beach, Va.

I am testifying today on behalf of the more than 120,000 members of the National Association of Home Builders who employ over 3 million workers. NAHB is the trade association of the Nation's home building industry, of which I am first vice president.

Accompanying me today are Robert D. Bannister, senior staff vice president for governmental affairs, and James Schuyler, legislative counsel.

Mr. Chairman, I appreciate the opportunity to appear here today and am grateful to you for scheduling these most timely hearings. Before I begin my statement, I would like to express my personal pleasure to appear before you in your new capacity as chairman of this most important subcommittee. I wish you well as you assume this new responsibility, particularly since the state of the economy is so precarious and the road to recovery does not appear to be a straight or a simple path. Our future depends on the wise and judicious leadership of this committee and this Congress.

Senator CHAFEE. Thank you very much, Mr. Napolitano. I appreciate those kind remarks.

If you are going to be able to get through this statement, I think you are going to have to abbreviate.

Mr. NAPOLITANO. I will, sir.

Senator CHAFEE. As I stated, it will be in the record.

Mr. NAPOLITANO. Thank you, sir.

My written statement contains a capsule summary of the current conditions of the housing industry and a short-term outlook.

As you are aware, our industry is in severe trouble and this has meant a significant loss of jobs, loss of revenue to the economy, and limited opportunity for homeownership, especially for the first-time homebuyers.

Our economics department projects only a slight increase in housing production for 1981 over the 1980 level, which was the second-worst year since World War II.

The impact of inflation on a potential homebuyer has been dramatic. Those who were fortunate enough to have purchased a home prior to the rapidly escalating prices of the late 1970's have been able to use their inflation equity to move up to more comfortable homes with very little increase in monthly payments. However, their younger brothers and sisters who are seeking to buy a home today are being priced out of the homeownership market. The results are already beginning to be demonstrated.

According to a U.S. League of Savings Associations report, only 18 percent of all homebuyers in 1979 were first-time homebuyers compared to 36 percent in 1977. A major hurdle facing the first-

time buyer is accumulating cash for the downpayment. Over 80 percent of them count on household savings exclusively for the downpayment.

This serious problem is addressed by bills which you are considering today. Mr. Chairman, what this country needs is a return to the old 8.5, 30-year, fixed-rate mortgage, but that is unlikely. Therefore, the Chafee and Dole bills represent a necessary positive action.

Both S. 24 and S. 243 properly focus on the needs of the first-time buyer. They would assist in restoring a long-term source of funding which could be made available for residential mortgages. These bills help to encourage savers which will result in productive growth in the economy.

As I state in my written testimony, I believe that a comprehensive analysis of the economic impact of these bills is needed to determine which proposal would have the greatest impact on savings and housing production. I am pleased to offer the resources of our economics division to work with your highly competent professional staff in such an analysis.

Mr. Chairman, we support the concept of the legislation before you and stand ready to work with you to refine the specifics of this legislation.

I strongly believe that a housing savings incentive program should be a key element in the first round of tax legislation which is developed by this committee.

I sincerely appreciate the opportunity to appear before you. I will be happy to respond to any questions.

Senator CHAFEE. Thank you very much, Mr. Napolitano.

In the absence of Chairman Dole, feel free to refer to it as the Chafee-Dole bill. [Laughter.]

Mr. NAPOLITANO. I think I did, sir.

Senator CHAFEE. I hate to think we have to set aside the dream of returning to 8.5, 30-year, fixed-rate mortgages. I just like to think we can continue to shoot for it although it seems a little distant at the present time.

Mr. NAPOLITANO. Mr. Stockman in the morning paper seems to indicate we might get back to it.

Senator CHAFEE. Let me ask you this, and it relates to the same question that I asked Congressman Moore and a bit to Governor Sanford: Will the $10,000 really do much good?

Mr. NAPOLITANO. Sir, it will help. No; it is not enough, if that is your question.

A downpayment today takes more than that. However, we have to start somewhere. I would like to see it as high as we can possibly get it. Obviously, it will have an impact on Treasury and that will be taken into consideration.

No; it is not enough. They will have to get funds from other sources.

One thing I would encourage in looking at this bill is whether or not others can make contributions into the funds such as a grandfather or parent so that a child or younger person who is a first-time buyer can get the funds that are necessary in a shorter period of time.

Senator CHAFEE. Governor Sanford mentioned that, too. That is a good point.

The person would be able to take the deduction, say the grandfather, but put it in the fund that the grandson or granddaughter, whoever it is, is accumulating.

Mr. NAPOLITANO. Yes.

Senator CHAFEE. Thank you very much.

Mr. NAPOLITANO. Thank you, sir.

Senator CHAFEE. Mr. Kelly? We are glad you are here.

STATEMENT OF ROBERT N. KELLY, EXECUTIVE DIRECTOR, KANSAS INDEPENDENT COLLEGE ASSOCIATION

Mr. KELLY. Thank you, Mr. Chairman.

I am Robert Kelly, executive director of the Kansas Independent College Association.

Our association favors the concept of education savings accounts contained in S. 24 and S. 243. These bills address many of the concerns of independent higher education, and I would like to list some of these.

First, it will provide an incentive for middle income families to save for their education. These families will be those most hurt by reduced Federal programs of student grants and loans.

Second, substantial savings accounts will allow middle income students to consider higher cost independent colleges. Our colleges have been very successful in attracting lower income students because of State and Federal student grants and loan programs, but we are afraid that we may have difficulty attracting middle income students in the next decade unless there are some types of programs that would allow some funds to be available for these students so that they are more able to consider our schools.

Third, the education savings accounts complement student assistance programs for the needy. The accounts induce the middle class to save for future educational benefits, while the needy continue to receive the direct Federal assistance they require. In no way can education savings accounts be considered as a substitute for present student aid programs because the present student aid programs have an entirely different beneficiary. The needy do not have the disposable income that would be necessary to take advantage fully of these types of programs. The middle and upper income students who can take advantage and do have a disposable income will have trouble getting student grants and loans. Therefore, the programs are very complementary.

Fourth, parental responsibility for the children's education will be restored through inducing educational savings. At this time many students are taking out loans and borrowing for their education and are looking into the marketplace at the time when they go to school to see which is the best deal and which is the best price. We believe if you set up savings accounts in advance earmarked for education the student will look; parents and students will sit down and have time to think about the various educational alternatives facing them in the future. We believe this will lead to better educational quality and could help to better educational institutions, both private and public, throughout the country.

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Fifth, and most important, education savings accounts aid capital formation and should reduce inflation. Inflation is a very serious problem for independent higher education. We have to raise our tuitions to keep up with inflation. It tends to spread the gap between the public-subsidized tuitions in public universities and our tuitions on a widening basis. Anything that can reduce inflation will be a very great help to us.

Those are my comments.

Senator CHAFEE. Thank you very much, Mr. Kelly.

That is a good statement and you make some good points.

I am amazed that the tuition differential between the Kansas public and independent colleges is only $1,600. I am surprised at that.

Mr. KELLY. We have taken the opposite side. Rather than try to keep up with inflation and raising our tuitions, we have really taken it out of the hides of our faculty. We really have kept deferred maintenance. It has not been a pleasant situation.

We just feel that is one of the best ways we can compete.

Senator CHAFEE. In passing, it is extraordinary the way parents and young people are prepared to go to the private institutions, the independent ones, even though the price is considerably more. The quality ones seem to be keeping up their strength.

I suppose your applications, Governor Sanford, are what—as high as ever?

Governor SANFORD. Yes.

Senator CHAFEE. It is extraordinary. People are willing to pay for quality—not that the public ones do not have quality, but the particular programs that the young people or their families see in the private institutions cause them to attend. That has been true in our area at Brown University and places such as that.

Your view, Mr. Kelly, again is that the $10,000 will be helpful?

Mr. KELLY. It would be helpful. Of course, we would prefer things in S. 24 which earmark the account because we think that would aid planning. We also would like removal of the limit because costs are going to be rising considerably. A $10,000 limit would be somewhat of a disincentive.

Senator CHAFEE. I will be asking members of the other panels representing the thrifts whether they would be so shaken if we increased that amount somewhat.

It seems to me one of the great selling points is to attract the young people, that and the mortgage portion. Those are the things to sell the younger people in this program, get them into savings.

That completes this panel's presentation. Thank you for coming. We appreciate your attendance.

[The statements of the preceding panel follow:]

EXECUTIVE SUMMARY

Terry Sanford
President, Duke University

Statement on Educational Savings Accounts Before
Senate Finance Subcommittee
on Pensions, Savings and Investment Policy

1. Higher education is very concerned regarding reports of impending deep cuts in direct federal aid and loan programs to students. These have been very effective in providing access to and choice in Higher Education.

2. There appears to be a broad consensus in the higher education community that any tax proposal to provide relief to taxpayers for educational costs should only be considered a supplement, not replacement, for direct aid and loan programs.

3. As a separate issue, savings incentives proposals have great appeal. They could provide some financial relief for families that may be foreclosed from participation in the direct aid/loan programs, due to budget cuts. The savings would be available for both graduate and undergraduate education. An increase in savings is apt to have a salutary effect on the nation's savings rate and capital formation. The proposals would also provide a vehicle to encourage self-help in planning to meet the costs of attending higher education.

4. Of the two proposals under consideration today each has great merit, although S. 24 appears to offer the taxpayer additional features of flexibility. Contributions to the account can be made by individuals outside the immediate family, the contribution would be indexed for inflation, and substantial savings can accrue for educational purposes without limitation of other than the maximum annual contribution.

5. In light of current budgetary constraints and past Congressional debate, tuition tax credit proposals must be viewed as a part of this discussion. On balance it appears that such proposals are not a cost effective means of providing relief for educational costs at the postsecondary level. Educational savings accounts provide the better approach to supplemental tax-based relief from the high parental and student costs of postsecondary education.

6. Again, however, in my opinion the most cost effective way to supply aid to students attending institutions of higher education is to retain full funding of direct aid and loan programs. If neither education savings incentives nor tuition tax credits are enacted, it appears there may well be sufficient revenues to continue full funding, with some adjustments, of traditional direct aid and loan programs.

STATEMENT

by

Terry Sanford

President, Duke University

February 24, 1981

I am Terry Sanford, President of Duke University and current Chairman of the Association of American Universities. I am pleased to come before this Subcommittee in my capacity as President of Duke, to express my support for the concepts embodied in the educational savings account proposals. I wish to extend my congratulations to the sponsors of these bills for offering what could be an important piece of the puzzle known as student aid - a puzzle of central concern to higher education today.

Although it may sound facetious to call student aid a puzzle, in many ways it is quite an apt description of the process through which financial aid packages, representing the best distillation of scarce and still insufficient resources to meet total requirements, are allocated and tailored to fit the needs of candidates for higher education.. The pieces of this puzzle have thus far been carefully crafted by Congress to allow students from all economic brackets in this country to attend, regardless of cost, the institutions of higher education that will best prepare them for a productive later life.

Thus, it is with grave concern that we in higher education greet suggestions of deep cuts in direct federal spending programs for student aid. These programs have been developed over the last decade to give students not only access to post-secondary institutions, but also, to a large extent, their choice of institutions should they otherwise qualify for admission. These programs have worked and been demonstrably successful in serving their twin goals of access to higher education and choice of institutions. Recent studies conducted by the National

Institute of Independent Colleges and Universities (NIICU) show that enactment of the Middle Income Student Assistance Act (MISAA) in 1978 has been extremely effective in providing financial assistance to students who wish to attend schools of higher education. MISAA was designed to increase grants to lower income students and to relieve lower and middle income families from the increasing burden of education costs. That these objectives have been served is borne out by the research studies of NICCU and the data compiled in them. I recommend that research study to the attention of this subcommittee.

These kinds of data compiled by NICUU help explain what appears to be an almost unanimous consensus in the higher education community that any tax-based proposals designed to provide relief to students and/or their parents should properly be considered only as a supplement to the highly effective traditional student aid programs that offer both access and choice. We have seen these programs work the way Congress intended them to work; and if we seem to move with caution in support of the educational savings account proposals, it is only from concern that in such perilous economic times any tax-based relief targeted to students and their parents may well be viewed as a trade-off for direct aid funding. This displacement effect of one upon the other is a spectre we view with alarm.

I must add that it is this same concern for the continued vitality of direct Federal aid to students that colors our views of the tuition tax credit for postsecondary education, an issue that has been in vogue in the Congress for some years. Although it may seem that by reference

to a tuition tax credit concept I am moving far afield from the express purpose of this hearing, I believe the perceived digression is in fact quite pertinent to this discussion since tuition tax credits have the vocal support of many members of Congress and share a common frame of reference with direct student aid programs and educational savings proposals. In addition it appears that the role and viability of direct aid/loan programs, savings incentive for education, and tuition tax credits must be politically intertwined. Consequently, I find it necessary to discuss all three issues in order to fully discuss one - education savings incentives. Without commenting on the efficacy or merit of tuition tax credit proposals for other levels of education, I generally oppose them as a mechanism to provide relief to taxpayers for postsecondary educational costs. I will go into this subject in further detail later in my testimony.

The much publicized Stockman "black book" indicates that the Administration is considering reductions in federally supported student aid programs that could reach 3 billion dollars in two to three years. This figure includes: a cut in Social Security education benefits of 1.2 billion dollars, a decrease in the cost of the Guaranteed Student Loan Program of more than 1.5 billion dollars by limiting eligibility through a need-based formula, and more than a 300 million dollars combined reduction in the Pell Grants (formerly known as BEOG's) and the National Direct Student Loan Program. The BEOG reductions are to be achieved by placing a $25,000 income cap on eligibility. Proposed cuts in Social Security benefits for dependent students will likely have a sharp effect. Although Social Security assistance is designed to aid in meeting general

family need, most funds received under this program are, in fact, used for student aid purposes. In light of the cuts already recommended in Title IV direct aid/loan programs it seems unlikely that funds from that source will be available to replace the significant loss of funds provided through the Social Security system.

In summary then, it appears likely that established programs of aid for higher education students and their parents are facing significant retrenchment prospects. Although I would prefer to see continued full funding of these direct aid and loan programs, I understand and to some extent accept our President's contention that inflation is our worst enemy. Thus, one must be prepared to see some adjustments forthcoming and hope that any reductions in student aid funding will share the President's view of the importance of protecting those students and families in greatest need. It is important, for example, that Congress at least continue the interest forgiveness on loans to students with demonstrated need. I do believe that a student who has enough confidence in his future to borrow to finance his education should be able to expect this limited government subvention of the interest costs while in school.

Generally it appears that the cuts properly will be targeted to protect the low income bracket family. However mid-range bracket tax payers will be left to their own resources and resourcefulness in finding funds to send their children to college. If you would permit a return to the metaphor of the puzzle, a very important piece, one that aids choice of institution - between in-state and out-of-state schools, between public and private institutions, and among private institutions - will be missing.

Fortunately, it appears that this endangered part of the puzzle perhaps can be, in part and over a period of time, supplemented with a new configuration known as an educational savings account, or an expanded IRA account that allows early withdrawals for educational assistance. But again I want to remind you that this concept should only be viewed as a supplement to existing aid programs.

It is important to keep in mind that the average cost of tuition, room and board at a public university is now reported to be $4,000, which does not include the cost of the state student subsidy for resident students, an amount well in excess of $3,000 in the case of my own state of North Carolina. The average cost of a private institution is projected to be $8,000. The Chafee-Moore bill, S. 243 provides incentives to save up to $2,000 per year. S. 24, the Dole-Conable proposal, provides incentives to save $1,000 per year indexed for inflation. Assuming a taxpayer could afford to save the maximum, it would take at least 2 years (under Chafee) for the taxpayer to have saved enough to pay for half of one year of a private college education, 4 years under the Dole proposal.

The problem of the short fall of funds that will be faced by mid-range to upper income families if the Administration cuts are enacted is illustrated by the proposed reductions in the Guaranteed Student Loan Program. Currently a family can anticipate borrowing for each enrolled child up to $5,500 per year through the GSL and the Parent Loan Program. It now appears that forward cuts in the GSL program cost of 2 billion dollars will be requested. Assuming an average $2,000 student loan ($2,500 per year is the maximum available), approximately one million

students would then be unable to borrow through this program. Even though the Administration may support continuation of the Parent Loan Program with a maximum loan limit of $3,000 borrowed at market interest rates, the increased demands on family income are severe. Suddenly families will be forced to find (presumably through private loans) up to $2,500 more each year at substantially higher interest rates, just to stay even. If an income cap is placed on the GSL, mid-range families could, if other loans or assets are not available, face expenditures of 1/5 or more of the gross family income for each child, to pay just the current average cost of a private education.

Those mid-range income individuals are ones that could find some valuable relief from tax incentives to encourage savings for educational purposes. I would guess that generally, mid to higher bracket taxpayers would be responsible for a major part of the revenue impact of these proposals. I understand that the estimated revenue reduction in 1980, due to enactment of the 1980 version of the Dole bill, would have been $2 billion with an increase to $4 billion by 1985. Please note that these reductions in revenue are in the same range as the direct aid and loan cuts mentioned in the "black book". The revenue loss would be less if the plan were phased in over a three year period.

I assume mid to higher bracket taxpayer participation for several reasons. The concept, by definition, requires the possession of discretionary income that can be placed in savings accounts. In addition, because both proposals allow deductions from gross income rather than credits, the value of the deduction to the taxpayer will

depend on the taxpayer's marginal tax rate. Thus the incentive to save for education will increase as the parents' tax bracket increases.

Under the current budgetary demands, and with the likelihood of cuts in direct Federal aid available for students from the middle to higher income brackets, such a targeted inducement for these tax payers may in fact be highly desirable. Tax relief would stimulate another source of funds, parental and personal savings, for those portions of the student population that are apt to be resigned to the harsh reality of depleting family resources and heavy borrowing of substantial funds at high market rates. These savings would be made possible, in part, due to Federal tax incentives in the form of deductions, deferrals and/or repayment at a lower tax rate (that of the student).

At the same time the placement of these funds in savings institutions (and the penalties for early withdrawal) should have a salutary effect on the nation's savings rate which is currently at a very low level. An increase in the savings rate should in turn make more capital available for investment. I will not dwell on this issue, since it is really out of my area of expertise. But I am sure that the capital formation aspects of these proposals are already quite clear to the members of this panel. From my own perspective the educational savings account concept promotes in happy combination the important national economic policy objectives of capital formation and the educational needs of middle income parents and their children, who increasingly are threatened to be crowded out from the rich diversity and promise of our higher education system.

Another aspect of these proposals that I find particularly appealing is the incentive they would provide to encourage the American family to plan for its future. It is basically a self-help plan that, when used to supplement direct aid programs and loans, might continue the promise of both access and choice to the American student.

I do have several specific comments on the proposals under consideration by the Committee. One in particular is the $10,000 limit in the Chafee bill. A single year at one of several of our higher priced private institutions already costs that amount. Depending on the severity of the direct cuts in student aid, I would recommend increasing this maximum. Otherwise by the time plan participants save $10,000 (5 years for the Chafee bill) and if inflation continues unabated, prospective students may not be able to afford more than a sharply limited number and kind of schools. Although I am not generally a proponent of indexing, I would think, for the reasons cited above, that the amount of income that can be deducted and deferred by the taxpayer should somehow be linked to external economic conditions. Perhaps this is a regulatory adjustment that could be left to the discretion of the Secretary of the Treasury or to the Federal Reserve Board.

Generally, the Dole proposal S. 24 appears to be a more flexible instrument and more specifically targeted to educational needs. It allows a larger maximum account and appears to be structured in a way that might more easily allow the inclusion of other levels of education should such a course be found desirable. Also of note, the Dole plan cushions the tax burden on withdrawal for educational purposes by charging tax ratably to the student at his then lower tax rate over a 10 year period, while S.

243 would place that burden on the higher bracket parent entirely in the year of withdrawal, presumably when the parent is least able to pay because of the converging educational costs. In addition, I am somewhat concerned about placing both education and retirement funds in one account as is required in S. 243. Withdrawals for purposes of educating one's child at the expense of retirement plans seems a harsh choice, particularly for older parents.

In considering the desirability of education savings accounts, I found it instructive to consider the New York State PASS Program. The PASS Program is quite similar to the Dole proposal. The results in New York State for parents whose children plan to attend private colleges and universities is reportedly positive. Initially public participation was low (due in part to low yield interest rates of 5 1/2%) until participants were allowed to invest the same amounts in term accounts and get money market rates. I believe the experience in New York with the PASS Program could prove to be a happy bellwether for a national educational savings account plan.

If the Subcommittee could spare me several more minutes, I would like to explain in brief why tuition tax credits for tuition paid to postsecondary education are not a desirable option for providing relief to families for higher education costs.

First, in light of the budget cuts currently under discussion, it seems that tuition tax credits would provide little assistance to those middle-income groups that would no longer be eligible for government subsidy. Frankly, $250 to $500 would mean very little to a family currently facing average costs ranging between $4,000 and $8,000 per

year. At the postsecondary level these tuition tax credits would likely soon be seen to be hollow benefits.

Second, tuition tax credit proposals generally lack income sensitivity. Affluent families would be eligible for the full credit (even if of negligible value) while lower income families with either little or no taxable income would receive little or no benefit. Efforts to make the concept income-sensitive will add either to the "cost" and controversy (refundability) or to complexity in computing the amount of the credit. The concept also moves away from the traditional "need" requirement built into student aid programs. What we have seen so far indicates that the Reagan Administration shares Higher Education's view of the desirability of a "need" requirement for Federal aid.

In addition it appears that the cost of tuition tax credits will be complex and difficult to administer. Factors which would impose administrative burdens far beyond a simple line item on the tax form include:

--Which students would be eligible? Part-time students? If so, for how much? What about students who drop out during the year? What about students not making satisfactory progress? What about students at low or no-tuition schools whose parents may still be bearing other substantial "costs of attendance"? What about graduate students; parents who are students? How many years are students eligible? Who will monitor these matters?

-- What criteria will be used to determine which institutions a student can attend and be eligible to receive a tuition tax credit? How would separate governmental agencies in the Department of Education and IRS be able to coordinate activities and avoid duplicate monitoring machinery?

Tax credits will not generally help the student. The credit goes to the tax paying parent. In addition, the credit is received in April - timing that is out of synch with the financial demands for the school year. It seems that any benefit received in mid-semester might more likely be spent to finance the month's groceries than educational expenses that will occur later in the year.

Finally, and very importantly, please let me remind you that the cost estimates for most tuition tax credit proposals range between approximately 2 to 4.5 billion dollars even in their initial years. If those revenues were collected and applied instead to direct aid and loans to students, the lion's share of direct aid and loan programs could be retained with some adjustments to hold down cost.

In sum then -- the best way to help Americans afford college is to retain existing direct student aid and loan programs. Any trade-off in this area for tax relief would not be cost effective. As a separate issue, the educational savings account concept could be very useful as a supplement to those direct aid and loan programs, at the same time that the incentive to save fosters other important national goals. As to tuition tax credits, I cannot foresee any major contribution to the

student, to the parent, to the institution or to the economic solvency of this country that such a scheme might offer.

Thank you.

bsw

Statement of

Michael P. McCarthy

on behalf of

Deloitte Haskins and Sells

on

Amendments to the Internal Revenue Code of 1954
to Provide Tax Incentives for Savers
(S. 12, S. 24, and S. 243)

before the

Subcommittee on Savings, Pensions, and Investment Policy
Committee on Finance
United States Senate

February 24, 1981

Mr. Chairman and Members of the Committee, I am Michael P. McCarthy, a partner in the firm of Deloitte Haskins & Sells. I have primary responsibility for policy analysis of regulations and legislation affecting financial institutions. Accompanying me is my partner, Alexander Zakupowsky, Jr. who is responsible for tax policy matters for our firm.

Deloitte Haskins & Sells serves over 750 financial institution clients in the United States. We also serve most of the financial institution regulatory agencies and industry groups.

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We appreciate this opportunity to express our views on the savings incentive legislation before this subcommittee. We strongly support the tenor of these bills. Our testimony today is primarily focused on the need for savings incentives and the probable impact of the proposed legislation on the thrift industry. We will leave for others to discuss the macro-economic and individual saver advantages to be derived from tax incentives to increase savings. Many of these advantages have been well chronicled in Western Europe and Japan.

We believe that there are substantial ramifications for financial institutions in these bills. Many of these institutions would normally be providing mortgage credit for the estimated 43 million people who will reach 30 during the 1980s.

Our views are predicated upon three significant studies we have recently conducted and our continuous surveillance of the financial institution environment. The three studies involved issues affecting the declining capital levels in U.S. financial institutions.

The first study for the Federal Home Loan Bank Board (FHLBB) was to develop an asset risk index to determine capital standards for insured savings and loan associations. The second study was for the American Bankers Association (ABA) and required us to assess the impact of the use of capital

as a regulatory tool. The third study was for the Independent Bankers Association of America (IBAA) and required us to develop a spread management strategy to be used by smaller independent banks as a tool to enhance earnings and preserve capital.

All of these studies pointed to a critical capital problem in the future for financial institutions in the United States. The principal cause of the problem is inflation. Inflation has eroded capital levels, forced interest rates paid for funds to record highs, and reduced interest spreads, that is, the difference between interest income and interest expense, to dangerously low and sometimes negative levels. This has produced a capital crisis for much of the financial institution segment of our economy.

The most critically affected institutions are:

- Institutions where the asset side of the balance sheet is less interest sensitive - that is, fixed rate loans with a long repayment term.

- Institutions that have an asset-liability maturity imbalance - that is, they borrow in the short term markets and lend in the long term markets.

- Institutions located in states that have maintained usury ceilings far below market rates.

- Institutions which were previously saddled with federal interest ceilings below market rates - for example, federally insured credit unions.

From the above profiles you will notice that the thrift institutions (mutual savings banks, savings and loan associations, and credit unions) have been the most seriously affected by this current crisis. Accordingly, we will direct the balance of our statement to these financial institutions.

Let me recap briefly the nature of the study for the FHLBB and the conclusions derived.

The study required us to assess asset risk from a number of perspectives. Our study indicated that various types of assets in which savings and loan associations invest have various types of risk. We measured default, interest rate, market, and fiduciary risks. The significant finding we made was that while it was clearly true that various types of assets carry different elements of risk the greater current risk to the industry results from asset/liability mismatch or borrowing short and lending long. This conclusion is also supported by other studies.

The mismatch problem for thrifts has been around for sometime except the current situation presents an entirely different perspective. Historically, in high interest periods funds would pour out of thrifts to seek higher yields. This process has been termed "disintermediation". To combat this problem regulators developed money market certificates of deposit (MMCs). Unfortunately the MMCs success in combating disintermediation has carried a price for the thrift industry. For example, in the case of savings and loan associations over the past 12 months MMCs and 30 month Certificates of Deposit (CDs) have increased $102 billion, $60 billion of which is invested in MMCs, while longer term certificates have declined $70 billion and passbook accounts are down by $10 billion. This is an indication of the change in the liability structure of thrifts. Overall the term of their deposits has become significantly shorter.

During the past year savings and loan earnings have shrunk to an estimated $950 million or a return on assets of .16%. These numbers would be even worse if it were not for approximately $1 billion in penalty income from premature withdrawals and an extremely high dividend from the Federal Home Loan Banks of $140 million. The problem appears to be getting worse as maturing MMCs carrying 9% rates are being replaced by 13% to 15% MMCs. As a result, the average cost of funds at June 30 1980 accelerated to 8.77%while mortgage rates stood at 9.18% - a critically low spread.

Clearly savings and loan associations are the victim of forces beyond their control, inflation and related monetary policies. An important tool for survival will be a source of longer term reliable funds. Many of the provisions of the legislation you consider today will help create longer term deposits.

Specifically, the proposals to help individuals save for retirement through IRA's or for purchases of homes or education will provide incentives for longer term savings.

Longer term savings will permit thrifts to lend funds at determinable spreads. They will also be in a better position to make longer term loans at favorable margins. Ultimately this change coupled with other legislative initiatives should give thrifts an opportunity for improvements in net income and enhancement of their capital position.

Thank you for the opportunity to appear before you today.

Summary of Principal Points
Contained in
Statement of Michael P. McCarthy

- Our Position. We support proposals included in the proposed legislation designed to encourage individuals to provide for retirement, purchase homes, pay for education, and save for other long-term objectives.

- Benefits to be Derived. In addition to the probable favorable impact on the economy and the individual savers, there are substantial benefits that should inure to financial institutions, particularly thrift institutions and the millions of Americans who rely on thrift institutions for mortgage credit.

- Nature of the Problem.

    - Individual demands for mortgage credit in the 1980's will be at record highs. An estimated 43 million people will reach age 30 during the 1980's. A large number of these people will be purchasing homes and will need mortgage financing. This need has been unsurpassed in our history.

    - The capital of thrift institutions is rapidly declining. Net earnings can only regain strength with some reliable source of longer term funds and time to adjust portfolios.

    - Studies we have conducted indicate that the primary problems of thrifts are (1) asset/liability maturity imbalance and (2) lack of interest sensitive assets.

- Conclusion. In addition to the substantial macroeconomic and individual saver benefits that should result from the proposals, we believe that the proposals will provide thrift institutions with a type deposit more stable in quality to the extent these proposals focus on long-term financial goals of savers. As a result, thrift institutions will be given an opportunity to engage in meaningful financial planning and meet the mortgage credit needs of Americans.

National Association of Home Builders
15th and M Streets, N.W., Washington, D.C. 20005
Telex 89-2600 (202) 452-0200

STATEMENT OF

THE NATIONAL ASSOCIATION OF HOME BUILDERS

before the

SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY

SENATE FINANCE COMMITTEE

UNITED STATES SENATE

on

TAX INCENTIVES FOR SAVINGS

(S. 12, S. 24, S. 243)

February 24, 1981

SUMMARY OF PRINCIPAL POINTS

- 1980 has been the second worst year for housing production since World War II. NAHB projects only a 5 to 6 percent increase in housing starts in 1981.
- Inflation has significantly reduced the percentage of first-time homebuyers in the housing market.
- Single major obstacle to homeownership for first-time home-buyer is obtaining cash for the downpayment.
- Changes in the savings patterns and powers of thrift institutions have raised serious questions about their ability to continue as primarily mortgage lenders.
- NAHB endorses the concept of tax-free treatment for all interest earned on savings which is used for residential mortgages.
- Both the Dole and Chafee bills would produce a needed source of assistance for first-time homebuyers.
- An analysis of the economic impact of these bills is needed to determine their impact on savings rate and housing production.
- NAHB supports immediate tax cuts which are targeted to encourage savings and improve productivity.

Mr. Chairman and Members of the Subcommittee:

My name is Frederick J. Napolitano and I am a home builder from Virginia Beach, Virginia. I am testifying today on behalf of the more than 120,000 members of the National Association of Home Builders (NAHB), who employ over 3 million workers. NAHB is the trade association of the nation's home building industry, of which I am First Vice President. Accompanying me today are Robert D Bannister, Senior Staff Vice President for Governmental Affairs and James Schuyler, Legislative Counsel.

Mr. Chairman, I appreciate the opportunity to appear here today and am grateful to you for scheduling these most timely hearings. Before I begin my statement, I would like to express my personal pleasure to appear before you in your new capacity as Chairman of this most important Subcommittee. I wish you well as you assume this new responsibility, particularly since the state of the economy is so precarious and the road to recovery does not appear to be a straight or a simple path. Our future depends on the wise and judicious leadership of this Committee and this Congress.

Outlook for Housing

Before I discuss the specifics of the legislative proposals being considered today, I would like to briefly review the status of the housing industry and its short-term outlook. I believe that an understanding of the current condition of our industry, the second largest in the nation, is essential to determine the need for a tax incentive for savings directed toward housing.

As you are aware, the housing industry is in a severe slump due to record high interest rates and uncertainty in the mortgage

markets.

The facts are:

- o 1980 has been the second worst year for housing production since World War II, with production dropping by 57 percent from the peak of the housing cycle in November, 1978.

- o Total negative impact to the economy of the housing downturn from 1978 to 1980 was $88 billion.

- o Total housing production for 1980 was down 28 percent from 1979 - with 1,292,000 units actually started or over 450,000 units less than the 1,745,100 started in 1979.

- o Housing production under government programs are comprising a larger segment of total starts. In 1980, the number of units under government programs totalled 43.3 percent of total starts, compared to 34.5% in 1979, and 22.8% in 1976.

- o Our Builders Economic Council survey shows a substantial decline in sales and "traffic". For December, only 3 percent of the single-family builders surveyed reported sales to be "good to excellent" -- the lowest ever recorded in this category. Regarding traffic of prospective buyers, only 2 percent of the respondents in December told us that traffic was "high to very high."

- o The failure rate in construction is up sharply. For the first nine months of 1980, there was a 140 percent increase in business failure dollar volume for building contractors and a 230 percent increase for subcontractors.

- o Net inflows of loanable funds into thrift institutions continue to be low. For 1980, the thrifts only received $5.7 billion in net new money, down 29 percent from 1979 and down 75 percent from 1978.

- o The unemployment rate in construction in January reached 13.3% -- almost twice the national unemployment rate for all workers.

What about 1981? The latest projections of the NAHB Econometric Model forecast only a 5 to 6 percent increase in housing starts over the depressed starts rate of 1980 - about 1.36 million units. Although a gradual decline in interest rates is assumed in the projection, we still believe that mortgage rates will remain high - probably in the 13 percent range this year. Our industry faces at least another six months of dismal performance, with a slight improvement by the second

half of the year. I am deeply troubled that this near-term outlook is not optimistic. But I feel strongly that this Committee should recognize that fact when you are considering the appropriate mix of tax and spending policies to revive this ailing economy.

First-Time Home Buyer

The demand for housing is very strong and will grow substantially through the decade of the 1980's. Projections indicate that during the 1980's, 41 million Americans will reach the prime homebuying age of 30. This compares with about 31 million who reached the age of 30 during the 1970's. The rate of new household formation will be 25 percent higher in the 1980's than during the last decade. This increased rate of family formation is largely the result of the postwar baby boom and the number of increased single person households.

The impact of rapidly escalating housing costs on the potential homebuyer is dramatic. At the current median sales price of $67,900, and assuming all families to be first-time buyers who devote 25 percent of tneir income to housing costs, only 4.5 million or less than 8 percent of the 57 million American families can afford to buy a median-priced new home at today's 14.5 percent interest rates.

All of us are affected by increased costs of home purchase and maintenance and operation. Those who bought their homes prior to the recent dramatic price increases in the 1970's have been least adversely affected. The equity appreciation in their homes has allowed many to move up to more comfortable homes with very little increase in monthly mortgage payments. Those harmed most by the acceleration in housing costs are those who do not have the "ticket of admission" to the homeownership market -- young families who are potential first-time homebuyers. For these individuals, the rapid increase in the cost of

housing has quickly outstripped their own modest increases in income.

As Harry Schwartz, former chief economist of Federal National Mortgage Association, stated in an article on the "fading dream" of homeownership in the Wall Street Journal last Tuesday, on the ladder of homeownership, "it's going to be a hell of a lot harder to get on at that bottom rung."

A United States Savings Associations report on "Homeownership: Coping with Inflation" has made a number of significant findings regarding the first-time homebuyer. First, inflation has significantly reduced the percentage of first-time buyers in the market. Only 18% of all homebuyers in 1979 were first-time purchasers, compared to 36% of the total in 1977. Second, first-time buyers had to stretch their budgets, even with two incomes, to afford a home. In two-thirds of first-time buyer households with two adults, a second income contributed more than 10% of income. Less than 50% of repeat buyer households had two incomes. Third, the old "25% of income" rule of thumb for housing expenses has been shattered. About 46% of all buyers spent more than one-fourth of their income on housing expenses.

Regarding downpayments, an earlier U.S. League report in 1978 made a number of significant findings regarding the first-time buyer. First, at least one-half of all first-time homebuyers make a downpayment of less than 20%. However, with the high price of housing today, even a low downpayment may require a substantial amount of money. A low downpayment represents a mixed blessing for the average buyer because a lower downpayment means a higher monthly mortgage payment. Second, "the single biggest hurdle facing the first-time homebuyer attempting to buy a home is obtaining cash for the downpayment." Over 4 out of 5

first-time buyers use only household savings to accumulate the downpayment. And, as I have stated earlier, most of these buyers need two incomes to generate the savings needed for the downpayment. The availability of low downpayments (through FHA, VA and private mortgago insurance companies) is essential because, as the U.S. League report found, 4 out of 5 buyers who made less than a 20% downpayment could not have afforded to purchase their home if a 20% downpayment had been required.

There is no doubt that first-time homebuyers have been hardest hit by the impact of inflation on home prices.

Mortgage Finance

While this area could be the basis for an entirely different set of hearings, I feel that the recent trends in mortgage finance are relevant to a discussion of the kind of tax incentives needed for savings. Obviously, major changes are occurring in the cost and availability of mortgage finance. Many of these changes were precipitated by the Depository Institutions Deregulation and Monetary Control Act of 1980. The Act phases out Regulation Q and the interest rate differential for thrifts. Within six years, there will no longer be any maximum ceilings on the interest rates which banks and thrifts can pay their depositors. While this is unquestionably important to the depositors, it will certainly mean a higher cost of funds to the financial institutions which will be translated into much higher mortgage interest rates for housing consumers.

New powers granted to thrift institutions regarding checking accounts and consumer loans have raised serious questions about the continuation of savings and loans as primary residential mortgage

lenders. The tremendous shift of funds from passbook savings to higher-rate short-term money market certificates has all but eliminated the long-term savings needed to make standard long-term mortgages. As of December, 1980, over one-third of the savings funds in thrift institutions are in money market certificates. These short-term funds are not likely to be used to make long-term mortgages. Therefore, we have witnessed the growth of variable and adjustable rate mortgages which are intended to compensate for inflation and the shift of available funds to short-term deposits.

Finally, the "siphoning-off" of billions of dollars of potential deposits to unregulated money market funds which do not invest in residential mortgages will continue to restrict the availability of mortgage credit, even at higher interest rates.

The Solution

What this country needs, Mr. Chairman, is a return to the old 8 1/2%, 30-year fixed-rate mortgage.

In the absence of that simple solution, I believe that the legislative proposals embodied in the Dole, Dole-Chafee, and Chafee bills being discussed today represent a strong positive step.

We applaud the intent of these bills which is to help restore a long-term source of funding which can be made available for residential mortgages. We believe that the emphasis on the first-time homebuyer is right on target. (And as a parent who has had to support two children in college, in my unofficial capacity as chief wage earner of my family, I can't complain about a tax-deferred savings plan for higher education.) Finally, these bills help to encourage savings and growth in productivity which is beneficial to the national economy

and to the homebuilding sector of the economy.

Mr. Chairman, let me add that I am deeply concerned about the low rate of savings in the United States today. As will be said many times today, our country currently has the lowest personal savings rate of all of the major industrial nations. Our savings rate as a percent of disposable income has declined steadily from a level of 8.6 percent in 1975 to 5.6 percent today. One of the major reasons for the decline in productivity growth has been due to the fact that Americans tend to consume -- rather than save -- too large a portion of their income. One of the most important benefits of this legislation is that it will encourage people to channel funds into savings -- which can then be used for productive purposes such as housing production and business capital formation.

Our Association has endorsed the concept of legislation which would give tax-free treatment to all interest earned on savings deposits which are used for residential mortgages. Because of the revolutionary changes now occurring at thrift institutions which threaten their viability as the principal suppliers of mortgage finance, we are concerned that funds which are deposited in an expanded IRA or Housing Savings Account may not result in increased funds for long-term mortgages. However, both the Dole and Chafee bills provide a needed source of assistance for first-time buyers to accumulate the downpayment on a home. Mr. Chairman, if we were forced to make a judgment today, I believe that we would accept on faith the belief that additional inflow into thrift institutions would result in lower interest rates which would allow more potential homebuyers to qualify for loans. The impact of the housing savings account on

first-time buyers would probably not be felt for at least three to four years, because it would take savers that long to accumulate a downpayment.

Economic Impact

I am aware that a number of estimates have been made regarding the tax revenue impact of funds invested in an individual housing account. Canadian experience with a similar savings program has shown that about 55 percent of the eligible households take advantage of the program. However, a definitive means of measuring the impact on new housing starts activity which would offset the direct revenue cost has not yet been developed. I would be pleased to offer the resources of the NAHB Economics Division to work with your highly competent staff and the Joint Tax Committee professionals to perform such an analysis. Such a study should measure the net increase in savings, tax revenue impact in a steady-state mode and if possible the impact on the economy due to increased housing production and net tax revenues. This kind of analysis would offer a better basis for determining which particular proposal would be most beneficial in terms of stimulating savings and promoting increased housing production.

Conclusion

Mr. Chairman, I am heartened that this Subcommittee chose the issue of tax incentives for savings as its first topic for discussion this year. Our Association strongly believes that tax cuts should be targeted to stimulate savings and business investment by increasing production in vital sectors of the economy if we are to achieve the results we all desire. This Congress could make no greater contribution to housing the American people in the 1980's than by putting the economy on a steady, predictable growth path which will create jobs

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and help hold down price increases by allowing us to produce sufficient housing to meet the growing demand. President Reagan has often spoken of getting the country back to work. I believe that this legislation is perfectly consistent with that objective. I know that a number of members of this Committee as well as recent reports by the Joint Economic Committee have long urged enactment of a supply stimulus for businesses and individuals to encourage savings, improve productivity and enhance economic growth. In fact, had that advice been heeded, I think we could have avoided the worst of our current economic crisis and would have built a solid base for growth.

Mr. Chairman, we support the concept of these bills and would be willing to work with you to refine the specific provisions of the legislation. Increased savings and investment are essential to a more stable flow of mortgage finance and growth in productivity in the significant housing sector of the economy.

One final issue - timing. My answer can be simple and direct -- the sooner the better. With the condition of the housing industry and its dismal short-term outlook, a housing savings incentive program would represent a glimmer of hope for our hard-pressed homebuyers and builders. As Chairman Dole has said, when you are hitchhiking, you take the first available ride. We think that the first available legislative vehicle should include a variant of the housing savings incentive program presented today. I appreciate this opportunity to present our views, and look forward to the opportunity to respond to any questions you may have.

NATIONAL ASSOCIATION OF HOME BUILDERS

housing news service

National Housing Center 15th and M Streets, N.W., Washington, D.C. 20005 (202) 452-0200

FOR IMMEDIATE RELEASE

Contact: Jay Shackford
(202)452-0406

NAHB SUPPORTS TAX EXEMPT SAVINGS PLAN FOR FIRST TIME HOME BUYER

WASHINGTON, Feb. 24 -- To help stimulate a housing recovery and to aid hard pressed young families priced out of the market, the National Association of Home Builders today called on Congress to consider legislation that would allow for tax-free or tax deferred treatment on interest earned on savings targeted for home mortgage loans.

Fred Napolitano, first vice president of NAHB and a home builder from Virginia Beach, VA., made the statement during testimony before the Senate Finance Subcommittee on Savings, Pensions and Investment Policy.

"With the condition of the housing industry and its dismal short-term outlook, a housing savings incentive program would represent a glimmer of hope for our hard-pressed homebuyers and builders," Napolitano said.

Napolitano said the additional inflow of funds into thrifts resulting from tax-exempt savings would result in lower interest rates, which in turn would allow more potential homebuyers to qualify for loans.

Last year was one of the worst for housing production since World War II, according to Napolitano, with production dropping 57 percent from the peak rate of new home building set in November, 1978. But, he cautioned, the 1981 forecast shows only a 5 to 6 percent increase in housing starts over last year -- about 1.36 million units -- following "at least another six months of dismal performance."

While housing production is plodding along at a depressed rate, "the rate of new household formations will be 25 percent higher in the 1980s than during the last decade," largely as the result of the 41 million postwar baby boom Americans reaching prime homebuying age and the number of increased single person households, he said. The growing imbalance between housing production and household formation rates will have an inflationary impact upon already dramatically escalating housing costs.

"Those harmed most by the acceleration in housing costs are those who do not have the 'ticket of admission' to the home-ownership market -- young families who are potential first-time buyers," he added. As rises in housing costs have outstripped modest increases in income, the share of first-time buyers in the housing market has declined, from 36 percent in 1977 to only 18 percent in 1979.

"The single biggest hurdle facing the first-time buyer attempting to buy a home is obtaining cash for the downpayment," Napolitano said.

Napolitano pointed to factors that have joined forces to imperil the continuation of savings and loan associations as primary residential mortgage lenders. The eventual phase-out of ceilings on the interest rates which banks and thrifts can pay their depositors, enacted last year under the Depository Institutions Deregulation and Monetary Control Act, will result, he said, in "a higher cost of funds to the financial institutions which will be translated into much higher mortgage interest rates for housing consumers.

Thrifts are already paying a significantly higher price for funds obtained at the deposit window. Low yielding passbook accounts, which in the past have provided the bulwark for low interest mortgage loans, now account for less than 20 percent of all S&L deposits. As of December, 1980, more than one-third of S&L funds have shifted from passbook accounts into high yielding money market certificates, Napolitano said.

Separate legislation introduced by Sen. Robert Dole and Sen. John Chafee would allow for IRA type housing and educational savings accounts, in which the interest earned would be tax exempt as long as the money accumulated eventually went for the purchase of a first home or to pay for higher education.

In general, Napolitano said NAHB backs tax cuts targeted to stimulate savings and business investment by increasing production in vital sectors of the economy.

STATEMENT

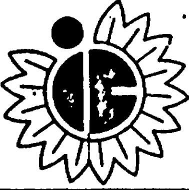
before the

Senate Finance Subcommittee on Savings, Pensions, and Investment Policy

by

Robert Kelly, Executive Director
Kansas Independent College Association

February 24, 1981



KANSAS INDEPENDENT COLLEGE ASSOCIATION
Capitol Federal Building, Room 515, Topeka, Kansas 66603
Telephone (913) 235-9877

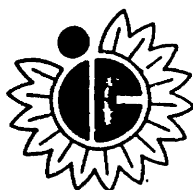
ROBERT N. KELLY, *Executive Director*

February 24, 1981

Summary of Statement

Our association favors the concept of education savings accounts contained in S.24. This bill addresses many of the concerns of independent higher education. First, it will provide an incentive for middle-income families to save for their education. These families will be those most hurt by reduced federal programs of student grants and loans. Second, substantial savings accounts will allow middle-income students to consider higher-cost independent colleges. Third, the education savings accounts complement student assistance programs for the needy. The accounts induce the middle class to save for future educational benefits, while the needy continue to receive the direct federal assistance they require. Fourth, parental responsibility for their children's education will be restored through inducing educational savings. Fifth, more parental responsibility and involvement will lead to more long-term educational planning and presumably better educational quality. Sixth, and most important, education savings accounts aid capital formation and should reduce inflation, truly the most dangerous threat to the survival of independent higher education.

BAKER UNIVERSITY / BENEDICTINE COLLEGE / BETHANY COLLEGE / BETHEL COLLEGE / CENTRAL COLLEGE / DONNELLY COLLEGE / FRIENDS UNIVERSITY / HESSTON COLLEGE / KANSAS NEWMAN COLLEGE / KANSAS WESLEYAN / MARYMOUNT COLLEGE / McPHERSON COLLEGE / MID-AMERICA NAZARENE COLLEGE / OTTAWA UNIVERSITY / ST JOHN'S COLLEGE / SAINT MARY COLLEGE / ST. MARY OF THE PLAINS COLLEGE / SOUTHWESTERN COLLEGE / STERLING COLLEGE / TABOR COLLEGE



KANSAS INDEPENDENT COLLEGE ASSOCIATION
Capitol Federal Building, Room 515, Topeka, Kansas 66603
Telephone (913) 235-9877

ROBERT N. KELLY, *Executive Director*

Mr. Chairman and Members of the Committee, I am Robert Kelly, Executive Director of the Kansas Independent College Association. Our association, which includes all twenty independent accredited liberal arts colleges in Kansas, wholeheartedly supports the concept of education savings accounts such as embodied in Senator Robert Dole's S. 24. We also note our comments on the approach Senator Chaffee has suggested in S. 243. We would like to restrict our comments to the educational benefits of these bills. The concept addresses some of our major long-range concerns as follows:

1. Attracting Students from Middle-Class Families. Federal and state student grant programs have been very successful in meeting the objective of providing choice among institutions. In Kansas, our independent college enrollments have grown annually since 1973, and the composition of our student bodies has changed dramatically. We now educate a higher percentage of students from families with incomes below $20,000 than do the state universities. Over 60 percent of our full-time students receive student assistance grants. We are very pleased with these developments but still have one major concern. As federal grant funds are earmarked toward lower income levels, we will find it increasingly harder to compete for middle-income students because of the lower tuitions at public universities. At the present time, the tuition differential between Kansas public and independent colleges exceeds $1,600 and increases annually. Without some governmmental financial incentives, we will have difficulty attracting students from middle-class families. The education savings account concept addresses this problem directly because it provides an opportunity for middle-class parents and students to save the sums necessary to be able to consider our colleges as financially-sound alternatives. We will be better equipped to compete for these students.

2. Reasserting Parental Responsibility. The trend in higher education has been to increase the burden placed on the middle-income student (family income above $24,000) to fund a larger portion of his or her education. The substantial increase in student indebtedness among such students is of increasing concern to educators. Over time, the educational savings plans, by encouraging greater parental preparation for college expences, could provide a useful means to lower this debt burden, and restore a balance between parental and student contribution to the student's higher education.

3. Complementing the Guaranteed Student Loan (GSL) Program. The GSL program has been criticized because there are no limits on loan availability, and students without financial need have borrowed under the program. If Congress places carefully constructed need-based limitations on GSL eligibility, there could be numerous upper- and middle-income families left without access to the program. This could be damaging as most independent college families with incomes over $24,000 borrow a substantial portion of their expected parental

contribution. The education savings accounts in the long-term could be a useful complement to a carefully constructed need-based GSL program. Upper- and middle-income families would be the msot likely to participate in education savings accounts as they would receive the most tax benefits and possess the most discretionary income.

4. Reducing Inflation. Independent colleges are very vulnerable to inflation. Their principal competition, public colleges and universities, receive state subsidies which allow them generally to avoid raising tuitions at the rate of inflation. The independent college is placed in the dilemma of either holding prices (tuitions) at less than the inflation rate, which results in reduced maintenance and faculty compensation, or to keep up with inflation and run the danger of being priced out of the market. We are very much in favor of programs that appear to be non-inflationary, such as the education savings accounts. Unlike most tax reduction proposals, the danger of inducing over consumption is not applicable because the money would have to be placed in savings accounts.

5. Encouraging Earlier Educational Planning. A survey by the National Institute of Independent Colleges and Universities of the distribution of student and parent loan burdens at independent colleges indicates that most families with incomes over $24,000 must borrow a substantial portion of the expected parental contribution as well as cause their children to assume a larger than average debt burden. For example, in academic year 1978-79, a family with an adjusted gross income between $30,000-36,000 is on the average expected to contribute $3,830 to their child's education. The survey indicates that on the average, parents are borrowing $1,053 to meet this expected parental contribution. In addition, the student is borrowing on the average $771 for his or her education. In total, the loan burden for this family each college year averages $1,824. Because of this dependence on loans, higher education decisionmaking has been moved to the immediate market place. Deliberate planning is becoming uncommon. Students look at price and other non-educational inducements, and the parent goes along. The education savings account can change this. Holding a substantial education "nest egg", parents will work with their children in considering educational and personal benefits as much as price. We believe that this could improve educational quality and be of aid to the better educational institutions, in both the public and independent sectors.

6. Maintaining Present Programs for the Needy. The education savings account should not have a negative effect on present existing student assistance programs. In recognition of the new political climate, student assistance programs should be fine-tuned but will undoubtedly be continued as the principal means of providing needier students the opportunity to choose among all postsecondary education options. Because the benefits of the education savings accounts will be utilized by the more affluent and will not be felt in higher education for several years, it is impossible to perceive the accounts as a substitute for student aid programs. They are clearly complementary.

Technical Comments

S. 24 has two favorable provisions which assist colleges in allowing for inflation. First, the bill indexes the maximum deduction to the Consumer Price Index. Second, the bill does not include a limit on the amount which can be placed in an education savings account. With increasing costs of independent higher education, these components of S. 24 are essential because they allow the amount to be saved to become substantial enough to provide for choice among colleges.

We are less in favor of the provision in S. 243 which limits to $10,000 the amount which can be withdrawn for education from an individual retirement account. Moreover, we believe that the education planning benefits of education savings accounts are mitigated in S. 243 which does not require separate accounts.

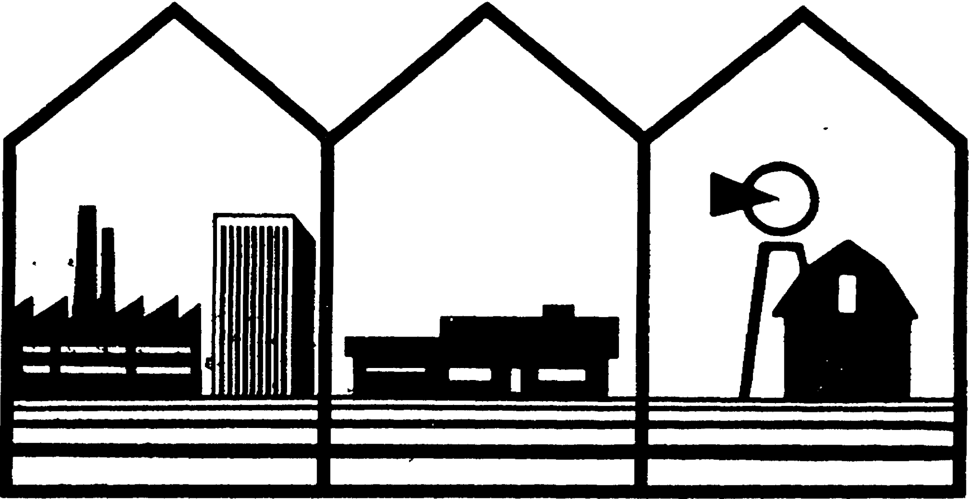
The provision in S. 24 which provides for the students to assume the tax liability for the savings accounts is good. It places the burden on the beneficiary of the education, and it places this burden at a time of life in which it should be least onerous. We believe this is preferable to the repayment provision contained in S. 243. There the parent/taxpayer is required to take into taxable income sums withdrawn from the account in that year. The net result is a substantial increase in taxpayer liability in the very years -- college years -- the parent is least able to afford it. We believe this feature would provide a substantial disincentive for educational withdrawals.

It should also be noted that present student assistance programs discourage student savings by including them as a student resource in calculating student need. Savings often remove students from eligibility for assistance. Clearly, some thought should be given to eliminating education savings accounts for these calculations so that the student would not be penalized.

Finally, independent colleges are very concerned with the dual-pricing system which exists in higher education. Tuitions are significantly lower in the public sector because of subsidies. Therefore, we would favor provisions to increase the amounts which could be placed in an education savings account and provisions which would limit the education expense items for which these accounts could be used. An example would be the obvious additional expenses of tuition, fees, books, supplies, and on-campus room and board charges.

Conclusion

We believe that the education savings account plan is an excellent devise to enhance savings, reduce tax burdens, foster parental responsibility, emphasize educational quality, provide for educational choice for the middle class, and encourage long-range educational planning and commitment. It is not an answer to the immediate pressing needs of higher education occasioned by the proposed budget cuts. The educational benefits will be felt later. Its principal beneficiary is society, which will receive in the future increased economic production and a better educated citizenry.



Statement of the

NATIONAL ASSOCIATION OF REALTORS®

TO THE:	SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY, SENATE FINANCE COMMITTEE
ON:	TAX INCENTIVES FOR SAVERS
BY:	DR. JACK CARLSON
DATE:	FEBRUARY 24, 1981

STATEMENT
on behalf of the
NATIONAL ASSOCIATION OF REALTORS®
regarding
TAX INCENTIVES FOR SAVERS
to the
SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY
of the
SENATE COMMITTEE ON FINANCE
by
DR. JACK CARLSON
February 24, 1981

I am Jack Carlson, Executive Vice President and Chief Economist of the NATIONAL ASSOCIATION OF REALTORS®.

On behalf of the more than 750,000 members of the National Association, we greatly appreciate the opportunity to present our views on tax policies to encourage savings to be available for investment in industry and housing.

There is inadequate savings and investment in the U.S. economy today and forecast for the future as shown by the historically low 5% savings rate for individuals compared with 8% during the early 1970s, and the decline in investment and capital per worker, the slow growth of productivity because of adequate investment, increasing requirements for savings for key sectors short of investment, such as energy, defense and housing.

President Reagan's proposal to slow spending and taxing growth provides the essential basis for a response to this inadequate savings and investment. With reference to the particular concerns of this subcommittee, we believe that the Administration's program needs improvement to increase and make more reliable the savings by individuals to provide funds needed for investment in industry

and housing. Attachment 1 to my written statement includes our recommendations to improve the Administration's total economic program and the expected results if these recommendations are accepted.

To improve the President's proposal for savings, we strongly recommend that tax relief be designed so that all Americans are directly encouraged to save.

First, we recommend expanding interest and dividend excludibility from $200 for individuals and $400 for joint returns to $500 for individuals and $1,000 for joint returns, effective July 1, 1981. This would generate additional savings which would be available for increased investment. (See Table 2, $500/1,000 Impact.)

The gross tax loss would be about $6 billion but would net to $3 billion after taking into account (supply side response) the additional growth in the economy, investment and in productivity.

This type of tax cut, in addition to being uniformly available to all taxpayers whether using the short form 1040 or the long form, would particularly benefit lower income taxpayers because the incentive would represent a larger percentage increase in their after-tax income when compared with middle and upper income groups. Also the elderly would benefit more because that group receives approximately 25% of their income from dividend and interest.

In future years, 1982-1985, we recommend increasing the amount from $500/1,000 to $1,000/2,000.

Second, we recommend excluding larger amounts from gross income through Individual Retirement Accounts from $1,500 now to $7,500

phased in during the next five years. Also people with inadequate pension programs should be eligible up to one-half of the maximum exclusion amounts. This proposal would also generate additional savings available for increased investment. (See Table 2.)

The gross tax loss would be about $4 billion and the net loss about $3 billion. The higher ceiling proposed would encourage middle income workers to save to supplement inadequate private pension plans.

These proposals would overcome a fundamental weakness of the Administration's broad economic program by providing a reliable basis for the needed increase in savings.

BACKGROUND

Two of the major factors behind the recent acceleration in inflation have been the emerging shortage of housing and the slow growth in worker productivity (even after allowing for the impact of cyclical downturns in output and employment).

As much as half of this slowdown in productivity growth in the United States is attributable to the virtual stagnation in capital per worker. During the current period of very rapid growth in the labor force, rapidly rising energy prices and high environmental investing, it is vital that the rate of capital formation be increased in order to restore the growth in productivity to normal levels and fight inflation.

Residential investment also needs to increase to alleviate the emerging housing shortage and hold down future rent and housing price increases.

The United States has the lowest rate of capital investment among the major industrial powers. The United States presently invests less than 17% of its gross national product in capital (including housing), whereas West Germany and Japan invest 25 percent and 35 percent respectively. Growth in capital per worker has been high or at least positive among industrialized countries in recent years, except for the United States.

Moreover, residential investment has fallen to only 3.5% of national output under pressure from high inflation and interest rates. This inadequate investment in housing below the post war average is also showing up in the very low rental vacancy rates experienced over the last 15 months.

Business investment within the United States has been low mainly because of higher interest rates and because after tax profits from current production have fallen to less than 4¢ on each sales dollar and are forecast to drop below 3¢ after adjusting for corporate taxes, inadequate depreciation and overstatement of profits from inventories. High federal taxes are a major cause of this decline in investment incentive - federal taxes will siphon away more than 56% of profits from current production during 1981.

U.S. savings performance ranks the lowest of major industrial countries - only 5 percent of personal disposable income was saved by households in 1979 compared with 13% in West Germany and 20% in Japan. Although some modest increase in the savings rate in the U.S. occurred during 1980 as a result of the recession, without effective efforts to boost personal savings it is unlikely that the savings rate will rise significantly above 7 percent over the next five years.

One of the major reasons for our poor savings performance has been the relatively heavy reliance on personal income taxes as a source of government revenue in the United States together with steadily rising effective personal income tax rates.

Overall, at least 50 percent of any tax relief provided over the next few years should be devoted specifically to stimulating savings and investment, and at most 50 percent in the form of general relief in individual income tax for stimulating consumption.

This is in contrast with composition of the tax relief package advocated by the new administration. The new administration

has supported a 10 percent reduction in individual tax rates during each of the next three years beginning July 1, 1981, accompanied by a very inadequate package of investment incentives. Over the next few years, this tax package would involve 5 dollars in consumption oriented tax relief to every one dollar of relief specifically directed at savings and investment. This is the most anemic proportion of tax relief to stimulate savings and investment in twenty years.

More importantly, tax relief must be tied to a slowdown in federal spending growth. Otherwise consumption-stimulating tax relief, such as general reductions in individual income tax rates could increase rather than decrease inflation, drive up interest rates and reduce new housing starts by over 200,000 units a year.

S.12, S.24, and S.243

The real earnings for wage earners over the recent past have seriously declined as a result of the high rate of inflation, slow productivity growth and unlegislated increases in effective tax rates on individuals. Even though wage earners may have received higher gross incomes, the decline in the value of the dollar as a result of inflation has caused real incomes to decline.

To add insult to injury, any wage increases received to reduce the effects of inflation have forced these workers into higher tax brackets, resulting in automatic tax increases despite the fact that real incomes may have declined.

In keeping with our view that tax relief must be non-inflationary and encourage investment and economic growth, we strongly support legislation that would provide tax incentives for savers.

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We congratulate the Congress for recognizing the need to encourage savings and appreciate the legislation recently passed by the Congress by initiating the first step -- $200 interest and dividend excludibility for individuals and $400 for a joint return. Now, second steps should be enacted to provide an adequate stimulus to savings. We strongly support increased tax incentives to encourage more savings.

S.12, S.24, and S.243 would all provide tax incentives to encourage savings and we applaud the sponsors of these bills for recognizing that savings and investment must be encouraged. We are concerned, however, that each of these bills would encourage savings only by particular taxpayers interested in saving for a particular purpose. S.12 would encourage retirement savings by persons covered by employer-sponsored pension plans; S.24 would provide incentives to save for college education costs or the purchase of a first home; and S.243 would, in essence, encourage savings for retirement, education, and first home purchases.

Each of these is an admirable goal, but in our view the problems of the economy are such that increased savings by all individuals in all sectors of the economy and in all income groups should be encouraged.

In consequence, although all of the bills discussed here today are clearly positive steps headed in the right direction, the NATIONAL ASSOCIATION OF REALTORS® would prefer legislation that would not only raise the ceiling on Individual Retirement Accounts and expand the number of persons who can take advantage of such an account and raise the ceiling on KEOGH retirement plans, but also increase the

exclusion of interest and dividend income from gross income to at least $500 for a single taxpayer ($1,000 for a joint return.) Table 1 indicates how many Americans have already established IRA's and also indicates the percentage of people eligible to establish the retirement savings plan who have done so. Further increases in the exclusion level to $1,000/$2,000 should be phased-in by 1985 to maintain adequate savings incentives in future years. The interest/dividend exclusion would generally benefit lower income and elderly people and the IRA expansion would help provide more adequate pensions for one-half of the people that do not now have adequate private pension plans and who are primarily middle-income. Both would provide for more planned savings to match the need for productivity-increasing investment. These incentives, in order to provide the most savings stimulus with the least effect on federal revenues, should be effective July 1, 1981.

The increase in the exclusion level to $500/$1,000 with an increase to $1,000/$2,000 by 1985 would result in significant improvements in many sections of the economy. The estimated economic cost to the U.S. Treasury is set forth in Table 2 in our testimony. Table 2 sets forth the average increases in investment, savings, employment, and other items as a result of the enactment of such legislation.

As is evident from the Table, the increase in savings that would occur results in substantial increases in productivity and economic growth. Table 2 indicates that as the increased savings are invested, private investment would increase by 5.5 percent in 1984, with corresponding increases in employment of 150,000 jobs and a rise in household spendable income of $450. Table 2 also provides the same data for IRA expansion and for $500/1,000 without

the increase to $1,000/$2,000.

This increased economic activity is vitally necessary at a time when the high rate of inflation is rapidly bringing the economy to a halt. The increased level of savings brought about by the higher interest/dividend exclusion would serve to help control inflation because individuals would save rather than spend a greater proportion of their disposable income. In addition, increased investment would bring our nation's economy back on track after the downturn we have experienced over the last year and, as a result of newer and more efficient equipment, output per man hour would increase by 0.4 percent per worker. And yet, all of this necessary and vital economic growth would only cost the U.S. Treasury the relatively modest net amount of $9 billion in the fifth year after enactment of the bill. The total cost to the Treasury would be a fraction of the rise in GNP that would occur if such legislation were enacted.

The NATIONAL ASSOCIATION OF REALTORS® particularly supports this form of tax incentives for savers because of the effect on interest rates and residential and non-residential housing. As the members of this Committee may know, the rate of interest on home mortgages is presently about 15%. Table 2 indicates that this legislation would decrease long-term interest rates by 0.7% due to the higher rate of savings inflow into lending institutions. Concurrently, residential construction would likely increase by approximately 150,000 starts per year over current levels to accommodate the anticipated increase in housing demand.

Table 3 breaks down interest income by type of return and income group, clearly illustrates that any net cost to the Treasury as a result of tax incentives for savers legislation

would in reality be tax relief to low and middle income tax payers, since more than 80% of all tax returns on which interest income is reported are filed by taxpayers earning less than $25,000. In fact, when computed as a percentage change in taxable income, the lower the income level the greater the tax relief that would accrue as a result of this legislation. This would be particularly helpful, therefore, to the elderly who are generally in a low tax bracket and whose interest income comprises approximately one quarter of all income they receive in any given taxable year.

CONCLUSION

The NATIONAL ASSOCIATION OF REALTORS® strongly supports legislation to provide tax incentives for savings as a means to help reduce interest rates, control inflation, and encourage vitally needed capital formation.

The legislation we have proposed would serve to accomplish these goals by providing a meaningful tax incentive to increase the low rate of savings we are experiencing today. The increased flow of savings into lending institutions will be invested in new housing, structures and equipment and will serve to increase productivity and real economic growth. We urge this Committee to favorably report such legislation at the earliest opportunity.

We thank the Committee for the opportunity to present our views on this important matter. We will be happy to answer any questions the Committee may have.

TABLE I

PERCENTAGE OF PEOPLE WHO ARE ELIGIBLE
WHO HAVE INDIVIDUAL RETIREMENT ACCOUNTS
BY INCOME CLASS, 1977

Family Adjusted Gross Income (In Dollars)	Percentage of People Who Are Eligible	Contributors 1978	
		Percent	Numbers (000s)
0 - 5,000	85.0	1.5	36.9
5,000 - 10,000	70.0	8.7	206.8
10,000 - 15,000	60.0	12.8	305.0
15,000 - 20,000	45.4	13.8	328.1
20,000 - 50,000	24.9	52.3	1,245.8
Over 50,000	28.6	10.9	260.1

Source: President's Commission on Pension Policy, 1979 Household Survey, Internal Revenue Service and NATIONAL ASSOCIATION OF REALTORS®' estimates.

TABLE II

IMPACT OF PROPOSED TAX INCENTIVES FOR SAVERS ON THE ECONOMY IN 1984

	Increased Exclusion of Interest and Dividend Income			Increased Ceilings from $1,500 to $7,500 and Increased Participation in Individual Retirement Accounts
	$500/$1000	From $500/$1000 to $1000/$2000	$1000/$2000	
Gross National Product (Percent Difference in Levels)	0.4	0.6	0.9	0.3
Consumer Prices (Percent)	-0.2	-0.3	-0.4	-0.1
Long Term Interest Rates (Percentage Points)	-0.4	-0.6	-0.9	-0.3
Average Spendable Income per Household with Interest Income and/or IRA ($, 1981 Prices)	230	450	670	600
Employment (Jobs)	100,000	150,000	220,000	100,000
New Housing Starts (Units)	120,000	170,000	230,000	90,000
Non-Residential Investment (Percent Difference in Levels)	4.0	5.5	8.5	2.7
Productivity (Percent Difference in Levels)	0.3	0.4	0.7	0.2
Gross Revenue Reductions	7.2	12.6	19.0	8.0
Net Revenue Reductions (Including Feedback Effects of a Stronger Economy)	5.0	9.3	13.9	6.3

Source: NATIONAL ASSOCIATION OF REALTORS®, Forecasting and Policy Analysis Division.

TABLE III

EFFECTS OF $500/$1,000
INTEREST AND DIVIDEND EXCLUSION
BY INCOME GROUP
(Dollars)

Gross Adjusted Income	Number of Returns with Interest Income (Millions)		Average Interest Payment per Return		Tax Reduction from $500/$1,000 at Typical Marginal Tax Rate 1/ (Dollars)		As a Percent of Average Taxable Income	
	Joint	Individual	Joint	Individual	Joint	Individual	Joint	Individual
Less than 6,000	2.13	6.59	1,120	680	-	-	-	-
6,000-11,999	4.13	5.08	1,130	1,100	108	54	1.7	0.7
12,000-15,999	3.59	2.24	946	1,230	114	57	1.0	0.5
16,000-19,999	4.35	1.24	800	1,350	126	78	0.9	0.5
20,000-24,999	4.94	0.68	830	2,080	144	90	0.8	0.5
25,000-29,999	3.19	0.28	1,130	2,790	168	102	0.7	0.4
30,000-49,999	3.91	0.29	1,690	4,350	222	132	0.7	0.4
Over 50,000	1.24	0.11	5,280	9,980	384	204	0.5	0.3

1/ Relative to current law including $200/$400 interest and dividend exclusion.

Source: Based on 1977 IRS data. Calculations by NATIONAL ASSOCIATION OF REALTORS®.

ATTACHMENT 1

RECOMMENDATIONS FOR IMPROVEMENT

We recommend the following concerning the President's program:

(1) The Congress should accept the magnitude of the President's spending slowdown (which generally coincides with our own petitions to the Federal government during the last 13 months and published most recently in the newspapers on January 19, 1981, found in Attachment 5.)

(2) The Congress should insist on trimming most programs except the truly needy. Equal sacrifice for a better future is appropriate for all Americans. We continue to offer to do our share by supporting cuts in budget proposals for programs affecting our industry (see Attachment 6.) We have written to every major trade and professional association to recommend they do likewise.

(3) Slower spending and tax relief should be tied together so that the Federal deficit will trend downward each year towards balance by at least 1984. Because of the need for keeping spending reductions and tax relief linked, we recommend limiting across-the-board personal income tax relief to 5 percent annually, which is large enough to offset higher personal income tax receipts caused solely by inflation. Both tax relief for individuals and business should not begin prior to July 1, 1981. This recommendation reflects the view of several industries, including bankers, savings and loans, mutual savings banks, mortgage bankers, home builders, and REALTORS®.

(4) Tax relief should be provided to directly stimulate savings, such as raising interest and dividend excluded from taxable income from the current $200 for individuals and $400 for joint returns to $500/$1,000 effective July and expanding to $1,000/$2,000 during the next four years. Also raise the ceiling on Individual Retirement Accounts from $1,500 to $7,500 during the next five years and extend eligibility at half the ceiling to people with inadequate private pension plans. The larger interest/dividend exclusion would generally benefit lower income and elderly people; and the increase in the IRA ceiling and eligibility would benefit middle income people and help provide a retirement "safety net" for about one-half of workers who do not have private pension programs. Both would provide for more planned savings to match the need for expanded investment.

(5) Depreciation lives for similar long-lived structures should be the same: 15 years straight line depreciation for commercial, industrial and rental residential structures regardless of whether owner-occupied, investor-provided, work place, or home place. (The phase-in of a five-year depreciation life for machinery and three-year depreciation life for vehicles appears appropriate and will greatly stimulate investment and productivity.)

(6) The Congress should allow current expensing of interest and taxes incurred during construction and remove the $10,000 investment interest limitation on individuals which are not imposed on corporations.

RESULTS OF RECOMMENDATIONS

If these recommendations are accepted, inflation will be

lower, more jobs will be created, the average American will be ensured of more adequate food, clothing and shelter, interest rates will be lower, investment in industry and housing will be higher and countries around the world will be better off.

ATTACHMENT 2

CHANGES IN ECONOMIC OUTLOOK IN 1984
PRESIDENT'S PROGRAM PROPOSED AND LIKELY
COMPARED WITH REALTORS®' RECOMMENDATIONS

	President's Proposal		REALTORS®' Modifications
	Full Spending Cuts	Half Spending Cuts	
Real U.S. Output (GNP)	0.5%	2.1%	3.2%
Real Consumption	1.1%	2.6%	2.0%
Consumer Inflation (CPI)	Zero	0.8%	-1.8%
Mortgage Interest Rates (Percentage Points)	Zero	0.5	-2.0
Real Investment			
Non-Residential Structures	11.1%	14.0%	19.0%
Equipment	12.7%	16.0%	23.0%
New Housing:			
Starts (Units)	27,000	-164,000	500,000
1981-84	Zero	-125,000	1,950,000
Net Exports	-10.5%	-17.9%	-5.0%
Jobs	200,000	800,000	1,200,000
Productivity	0.3%	1.3%	2.0%
Average Household Income:			
Annual	$790	$1,360	$1,770
1981-84	$1,600	$3,000	$3,990

ATTACHMENT 3

ADVANTAGE OF SHORTER DEPRECIATION LIVES
(Straight Line, $100,000 Structures,
20% Discount Rate)

Depreciation Life	First Year	Present Value of All Years	% of Original Cost
18	$5,555	$26,734	27%
15	6,667	31,170	31%
12	8,333	36,992	37%
10[1/]	10,000	41,924	42%

The 10-year life effectively lowers the cost of the building about 10% or $10,000 compared with a depreciation life of 15 years and by about 15% or $15,000 compared with a depreciation life of 18 years.

1/ Accelerated depreciation schedules faster than straight line for plant and equipment would make the comparison even more favorable.

ATTACHMENT 4

COMPARISON OF THE ECONOMIC IMPACT OF THE REAGAN ADMINISTRATION'S ECONOMIC PROGRAM POLICIES AND OF THE REALTORS®' MODIFICATIONS DURING THE NEXT FOUR YEARS

State	Increase(+) or Decrease(-) in Employment After Four Years ('000 Jobs)		Increase(+) or Decrease(-) in Average Household Income (Dollars)		Increase(+) or Decrease(-) in Housing Starts (Units)	
	Administration	Realtor	Administration	Realtor	Administration	Realtor
Alabama	11.8	17.7	2,300	3,100	-2,100	32,400
Alaska	1.6	2.4	4,100	5,300	-400	6,100
Arizona	9.2	13.8	2,900	3,700	-4,000	62,700
Arkansas	6.6	9.9	2,400	3,100	-1,700	26,900
California	88.4	132.5	3,400	4,500	-15,500	241,600
Colorado	11.5	17.3	3,100	4,100	-3,000	46,000
Connecticut	12.6	18.9	3,500	4,500	-1,000	15,900
Delaware	2.3	3.4	3,300	4,300	-300	4,100
Florida	31.8	47.7	3,000	3,900	-11,800	183,700
Georgia	19.0	28.5	2,600	3,400	-4,000	62,600
Hawaii	3.6	5.4	3,200	4,200	-600	9,500
Idaho	3.1	4.6	2,500	3,300	-900	13,900
Illinois	42.1	63.2	3,400	4,400	-3,200	49,500
Indiana	19.5	29.3	3,000	3,900	-2,100	32,900
Iowa	9.8	14.7	3,000	3,900	-1,600	24,900
Kansas	8.3	12.4	3,100	4,000	-1,200	19,100
Kentucky	10.8	16.2	2,500	3,200	-1,800	28,200
Louisiana	13.8	20.7	2,700	3,500	-2,700	42,000
Maine	3.7	5.5	2,400	3,200	-600	9,500
Maryland	14.2	21.4	3,100	4,100	-1,900	29,500
Massachusetts	23.8	35.6	3,100	4,100	-1,400	22,200
Michigan	30.0	45.0	3,000	4,000	-3,100	48,000
Minnesota	15.7	23.5	3,000	3,900	-2,400	36,800
Mississippi	7.3	11.0	2,100	2,800	-1,100	17,900
Missouri	17.5	26.2	2,800	3,700	-2,100	33,100
Montana	2.6	3.8	2,600	3,400	-400	6,200
Nebraska	5.5	8.3	2,800	3,700	-1,000	14,900
Nevada	3.9	5.9	3,400	4,400	-1,[illegible]00	21,800
New Hampshire	3.4	5.1	2,800	3,700	-600	9,800
New Jersey	26.7	40.0	3,400	4,400	-1,900	29,700
New Mexico	4.4	6.7	2,500	3,300	-900	14,500
New York	60.7	91.0	3,100	4,100	-2,000	31,700
North Carolina	21.6	32.4	2,600	3,400	-4,300	67,100
North Dakota	2.2	3.3	2,800	3,600	-600	8,700
Ohio	38.6	57.9	3,000	3,900	-3,200	49,200
Oklahoma	10.3	15.5	2,900	3,800	-2,500	39,700
Oregon	9.2	13.8	3,000	3,900	-2,400	36,900
Pennsylvania	41.5	62.2	2,900	3,800	-3,000	46,900
Rhode Island	3.4	5.1	2,800	3,700	-300	5,200
South Carolina	10.6	15.9	2,500	3,200	-2,200	34,200
South Dakota	2.1	3.2	2,600	3,400	-500	8,300
Tennessee	15.7	23.6	2,500	3,300	-2,500	39,300
Texas	53.1	79.7	3,000	3,900	-12,500	195,500
Utah	5.2	7.7	2,400	3,100	-1,300	20,600
Vermont	1.8	2.7	2,500	3,300	-600	10,000
Virginia	18.9	28.3	3,000	3,900	-3,400	53,400
Washington	15.3	23.0	3,200	4,200	-3,800	59,200
West Virginia	5.6	8.3	2,600	3,300	-500	7,800
Wisconsin	17.7	26.5	2,900	3,800	-2,100	33,400
Wyoming	2.2	3.3	3,400	4,400	-500	7,300
United States	800.0	1200.0	3,000	3,900	-125,000	1,950,000

Modelling and Assumptions By The NATIONAL ASSOCIATION OF REALTORS® and Policy Analysis Division. Assumes Federal spending growth slows proportionately across all states.

ATTACHMENT 5 20.

Appeared on January 19, 1981 in: The Washington Post, The Wall Street Journal, The New York Times, The Washington Star, Christian Science Monitor, Los Angeles Times, REALTOR® News and Washington Report.

THE AMERICAN PEOPLE DEMAND ACTION TO ATTACK INFLATION AND HIGH INTEREST RATES. AND THEY WANT IT NOW!

That was the message the American people delivered on November 4, 1980. It was so persuasive that it elected 18 new Senators, 74 new Representatives and one new President - Ronald Reagan - and gave them a strong directive for immediate action.

To the new administration and Congress the American people said, "We need help! Reduce inflation and the burden of government by slowing deficit spending and providing tax relief."

There was no mistaking the message... or its urgency. The American people want evidence that policymakers heard their message and felt its urgency.

Restoring prosperity.

Inflation, recession and excessive government are the major problems each of us faces.

The price we pay for inflation is staggering. It has eaten away the life savings of millions of hard-working people.

Inflation, recession and slow growth have caused the living standards of the average worker to decline.

Inflation and bad government policies have skyrocketed interest rates to the point that many people cannot afford to purchase homes or cars.

Money for modern buildings and equipment has disappeared, thus shrinking jobs, productivity and income.

And the American people have said, "Enough!" The more than 700,000 individual members of the NATIONAL ASSOCIATION OF REALTORS® also have said, "Enough!"

The 2% Solution to a healthier economy.

We have proposed specific ways to fight inflation and help restore our standard of living.

Here is what the new President and Congress should do:

1. Slow federal spending by at least 2% in the current 1981 fiscal year from a likely $665 billion to $650 billion.
2. Slow federal spending in future years to a rate 2% less than the growth of people's income. Even then the government will spend as much as $715 billion in fiscal year 1982.
3. Insure that by 1984, the cost of federal government will shrink to less than 21% of people's income—a drop of more than two percentage points.
4. Direct one-half of any tax relief specifically to encourage savings and investment.
5. Stimulate savings by allowing $500 for individuals and $1,000 for couples of interest and dividends to be excluded from taxable income. Allow more funds to be set aside for Individual Retirement Accounts.
6. Through tax relief, encourage investment to overcome the rental housing shortage and to improve worker productivity.
7. Provide tax relief to offset the effect of inflation on personal income taxes.
8. Achieve a balanced budget at high employment by the end of fiscal year 1983.
9. Provide lower and more stable interest rates through Federal Reserve Board policies that mandate steadier growth of money supply and somewhat higher and more realistic money growth targets.
10. Reduce unnecessary and costly government regulations and repeal the President's authority to allocate credit.

How this platform will improve our lives.

If our government adopts these recommendations, here's what we can expect:

☐ **This Year**
Inflationary expectations and interest rates would drop and continue to decline during the next 12 months.

☐ **Within Two Years**
The rate of inflation and long-term interest rates would decrease two percentage points. This would lower the average homebuyer's monthly payment by $150—and allow two million additional families to afford their own homes.

☐ **Within the Next Four Years**
Home construction would accelerate, and the shortage in housing would be reduced by two million units. An additional four million families would upgrade their housing.

New plant and equipment investment would increase by 20%, increasing output by more than 2%.

One million more jobs would be created. Inflation would decrease from 13.5% in 1980 to less than 8%, and the average family would have $4,000 more in spendable income.

Why we're speaking out.

The NATIONAL ASSOCIATION OF REALTORS® represents professionals involved in all phases of real estate. Obviously, we have an important stake in our nation's economic health—as do America's 55 million homeowners, several million would-be homeowners, 25 million renters, and owners of commercial, industrial and agricultural real estate. All have been hurt badly by the economic policies of the past few years.

As a result of these policies, people are required to work in out-of-date buildings with obsolete equipment, and live in less-than-adequate housing. Home construction declined 52% from the fall of 1979 to the spring of 1980 and has not recovered yet. Existing home sales dropped 41%. Mortgage commitments fell 33%. Rental housing shortages exist in most cities.

Little wonder that the American people, who spend one-third of their income on housing (businesses spend more than one-half of their income on improving workplaces and productivity)—voted for a change!

Americans will be watching for actions and results.

Americans expect new policies and new priorities. And their mandate is for action now.

They will back tough decisions and actions that must be initiated in the days immediately ahead by the new administration and Congress.

That is the message of November 4, 1980.

NATIONAL ASSOCIATION OF REALTORS®
Working for America's property owners.™

REALTOR®

ATTACHMENT 6.1

REALTORS®' PROPOSALS FOR REDUCTIONS IN BUDGET PROPOSALS FOR PROGRAMS AFFECTING THEIR INDUSTRY

A program of slowing the growth of federal spending does not have to be synonymous with a program that impacts negatively on the needy. We have reviewed HUD's budget and have found that:

- There are many areas in which the elimination of programs would not impact on the poor.
- There are also several areas in which the program funds proposed by the Carter Administration could be reduced without any reduction in services.
- Additionally, there are program funds which could be administered more efficiently resulting in the recapture and reprogramming of funds appropriated in prior years.
- Finally, there is at least one program in the HUD budget which could be suspended for a time in order to rebuild the nation's economy -- a goal which is more advantageous in the long run than the program itself.

The changes outlined below will impact significantly on HUD's budget but will not affect the services currently being provided to house the low-income families in our nation.

- The Carter Administration has requested fiscal 1982 funding for its Community Development Block Grant programs in the amount of $3.997 billion in Outlays and $3.96 billion in Budget Authority. This is an increase of $60 million in Outlays and $266 million in Budget Authority over funding for fiscal

ATTACHMENT 6.2

year 1981. In this era of economic instability we would recommend that this increase be eliminated and that funding for this program remain at its current level.

- Another program used to revitalize our nation's distressed cities is HUD's Urban Development Action Grant program. The Carter Administration recommended $610 million in Outlays and $675 million in Budget Authority for fiscal 1982. Again, while this program has proven beneficial in many areas, we believe that the overall economy would experience greater benefits by less federal spending. As a result we recommend that a moratorium be placed on this program and that we should rely on Community Development Block grants instead.
- One very real possibility also exists for substantial savings -- perhaps billions -- by a change in HUD's procedures for renewing commitments. While we acknowledge the need to renew some commitments that have not yet been activated by project developers and sponsors, we also know that HUD, for many years, has continued to routinely renew unfulfilled commitments without regard to the reasons for renewal or timetable for realization of the commitments. This practice has imposed a costly burden on the federal budget and should be reviewed. The action would involve commitments for Section 236, Section 235, Section 8, GNMA Tandem programs and others.
- Public Housing Agencies Operating Subsidies were originally authorized to cover unexpected costs in expenses for Public Housing projects. These funds, however, have become a band-aid approach to mounting expenses and should be phased out with adequate emphasis on HUD's Comprehensive Modernization program for

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ATTACHMENT 6.3

Public Housing. This action would cure many of the basic structural problems of public housing projects with less emphasis on continuing funds which provide only stop-gap remedies.

- Another program which could be eliminated without significant impact is HUD's new Solar Energy and Energy Conservation Bank. The Carter Administration's budget for this program in FY 1981 reflects $47 million in Outlays and $121.2 million in Budget Authority. For fiscal 1982 the budget request of the previous Administration was $134.25 million in Outlays and $125 million in Budget Authority. Again, we recommend no start-up for this program since the results of the program can be obtained through other means. The people served through the Solar Energy and Energy Conservation Bank are currently able to receive assistance through HUD's Community Development Block Grants funds or funds administered by other federal agencies.

- On government-assisted housing programs, spending could be reduced by changing the ratio of New/Substantial Rehabilitation Section 8 units to Existing/Moderate Rehabilitation units. In its Section 8 requests, the Carter Administration requested $1.133 billion in Contract Authority and $21.158 billion in Budget Authority for fiscal 1982 with an equal mix between New/Substantial Rehabilitation units and Existing/Moderate Rehabilitation units. By placing greater emphasis on the Existing/ Moderate Rehabilitation components of the program, greater use of the program funds could be realized. While

we acknowledge that there currently exists a critically low vacancy rate in rental dwellings across the country, we also recognize that some 3 million units exist which could be put into use if HUD's Section 8 Moderate Rehabilitation funds were emphasized to a greater extent. This change in ratio is a possible alternative to decreasing the Carter Administration's request to subsidize 260,000 Section 8 and Public Housing units to 225,000 as requested by the Reagan Administration.

- The Reagan Administration has committed that it will implement a currently/existing statute authorizing HUD to <u>increase tenant contributions for rents</u> in subsidized housing from 25 percent to 30 percent of their incomes. This is another action that could be taken to curtail the amount of subsidies that HUD must pay, and we would endorse this step taken by the new Administration. According to the Congressional Budget Office, implementation of this statute would save approximately $69 million in Outlays and $38 million in Budget Authority for fiscal year 1982. While this change in policy would affect low-income recipients of HUD's housing programs, it would not place a disproportionate burden on them in contrast to the more affluent segment of our population.

One obvious example of regulations and statutes that impose excessive costs that surpass the benefits to society is the requirement that <u>Davis-Bacon labor standards</u> be applied in all federal construction. The Congressional Budget Office estimates that the elimination of Davis-Bacon requirements would save $179 million in Outlays and $160 million in Budget Authority for fiscal year 1982.

ATTACHMENT 6.5

- The HUD Budget proposed by the Carter Administration called for Fiscal 1982 spending of $9.8 million in Outlays and $10 million in Budget Authority for the Housing Counseling program. Funding for this program for FY 1981 was set at $9.4 million in Outlays and $10 million in Budget Authority. Housing counseling for homebuyers and renters is a very important tool in terms of logical budget planning and proper care of property. The line item in HUD's budget, however, is one which could be eliminated because the funds, in many cases, duplicate the efforts of civic organizations and the efforts of managers in HUD-assisted projects. Additionally, in many cases, Community Development Block Grants funds are already being used for this purpose. Elimination of this program from the HUD budget would encourage greater participation of local entities but would not stifle the services provided.

- Among the programs that could be eliminated is funding for the Community Housing Resource Boards. This program grew out of an agreement between the Department and the NATIONAL ASSOCIATION OF REALTORS. It was never envisioned, however, that funding by HUD would be necessary since the talent and facilities of REALTORS in local communities were to be used. The Carter Administration proposed fiscal 1982 Budget Authority and Outlays of $2.0 million.

- Another program that may be eliminated because of its duplication with other federal funds is HUD's Neighborhood Self Help Development program. In fiscal 1981 HUD has been allocated Outlays

ATTACHMENT 6.6

of $15.4 million and Budget Authority of $9.0 million. For fiscal 1982, HUD's budget request was for $8.8 million in Outlays and $9.0 million in Budget Authority. While, again, we do not argue with the intent of this program, its primary benefit was in encouraging the organization of community groups. After the first few years of this program, we see consortiums that have been established -- but not always as the result of HUD's Neighborhood Self Help Development Program. New private non-profit groups have been founded and are active in their respective communities, and older, well-established non-profit groups have also been working toward the same goals of revitalization. Additionally, where the need still exists, Community Development Block Grant funds can be used to provide needed monies for technical assistance

- While we acknowledge the need for research by HUD we recognize that in previous years, the Department has frequently conducted research efforts with the goal of rationalizing a predetermined conclusion. One obvious example may be cited in the studies funded by HUD regarding the extent of discrimination practices in housing. The subjective tests used and the results of the study demonstrated preordained conclusions that were based on opinion rather than fact. With tighter administration of HUD's research programs and more oversight by Congress, we recommend a 10 percent cut in HUD's budget for fiscal 1982 as proposed by the Carter Administration. From a budget request of $48.6 million in Outlays and $50 million in Budget Authority this 10 percent budget reduction would save $4.86 million in Outlays and $5 million in Budget Authority.

ATTACHMENT 6.7

- The previous Administration's request for an increase in HUD staff of 315 slots should also be denied, which would lead to a savings of approximately $9 million in fiscal 1982. While we realize that many program areas are operating without adequate staffing, we are also aware that other offices have a surplus of employees. Human nature dictates and past experience has shown that because staffing is a symbol of status, program supervisors will not recommend staffing cuts, but do frequently recommend staff increases. It is possible, therefore, to review the overall staffing in HUD and transfer employees and slots from one program area to another. This is especially needed if the budget for fiscal 1982 includes the elimination of specific programs as envisioned by the Reagan Administration and as proposed by the NATIONAL ASSOCIATION OF REALTORS®.
- Additionally, in terms of HUD's administrative costs, non-essential travel should be eliminated. Rather than curtailing spending for travel, the Carter Administration requested an increase in travel funds for fiscal year 1982 in the amount of $2.6 million. Eliminating non-essential travel would result in at least that amount.
- President Reagan, in his Executive Order dated February 17, 1981, stated that: "Regulatory action shall not be undertaken unless the potential benefits to society for the regulation outweigh the potential costs to society ..."

We envision that as a result of the actions outlined above, federal expenditures by the Department of Housing and Urban Development will be cut by at least 10 percent in terms of Outlays and Budget Authority.

The NATIONAL ASSOCIATION OF REALTORS® is comprised of more than 1,806 local boards of REALTORS® located in every state of the Union, the District of Columbia, and Puerto Rico. Combined membership of these boards is over 750,000 persons actively engaged in sales, brokerage, management, counselling, and appraisal of residential, commercial, industrial, recreational and farm real estate. The activities of the Association's membership involve all aspects of the real estate industry, such as mortgage banking, home building, and commercial and residential real estate development, including development, construction and sales of condominiums. The Association has the largest membership of any association in the United States concerned with all facets of the real estate industry.

Elected Officers are: President John R. Wood, Naples, Florida; First Vice President Julio S. Laguarta, Houston, Texas; Treasurer Budd Krones, Tucson, Arizona.

The Chief Administrative Officer is Jack Carlson, Executive Vice President and Chief Economist.

The Senior Vice President, Government Affairs is Albert E. Abrahams and the Vice President & Legislative Counsel, Government Affairs is Gil Thurm.

Headquarters of the Association are at 430 North Michigan Avenue, Chicago, Illinois 60611. The Washington office is located at 925 15th Street, N.W., Washington, D.C. 20005. Telephone 202/637-6800.

Senator CHAFEE. The next panel consists of Mr. Stephen L. Skardon, Jr., legislative representative, National Association of Retired Federal Employees; James M. Hacking, assistant legislative counsel for the associations, National Retired Teachers Association/American Association of Retired Persons; C. A. (Mack) McKinney, senior vice president of the Noncommissioned Officers Association of the United States of America; John P. Sheffey, executive vice president, National Association for Uniformed Services; Dr. David C. Lewis, chairman of the Pension Task Force, The Institute of Electrical & Electronics Engineers, Inc.; and Morton A. Harris, president, Small Business Council of America, and Mr. Nissi Grossman, Northeastern Retail Lumbermens Association.

I would urge you to keep your remarks within 3 minutes. We will start off with Mr. Skardon.

STATEMENT OF STEPHEN L. SKARDON, JR., LEGISLATIVE REPRESENTATIVE, NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES

Mr. SKARDON. Thank you, Mr. Chairman.

In the interest of time, I will submit my statement in full for the record.

Senator CHAFEE. Fine. That will be included following your oral presentation.

For the information of everyone here, your statements will all be inserted in the record. Therefore, there is no reason even to ask about that.

Mr. SKARDON. Mr. Chairman, our association has long been an advocate of improving the tax status of retirement income, not only to provide a measure of relief for those presently retired but also to offer incentives to all Americans to invest in their own retirement during their working years.

Our association supports your bill, S. 243, because we believe its provisions meet these dual goals in a responsible and reasonable manner.

Presently the retirement income of most Americans originates from three sources—pensions and annuities, savings and investments, and social security.

As already has been mentioned here today, there is a marked trend among Americans to rely exclusively on social security as the primary component of their retirement income. We believe this is a dangerous trend and that social security is not designed to fulfill such a need.

Your bill, Mr. Chairman, would restore much needed emphasis on pensions and savings as key components of retirement income.

We welcome the provision of your bill which would extend favorable tax treatment to interest income from savings accounts. The temporary tax exclusion which Congressman Moore so effectively pursued last year is an important step.

However, unless that exclusion is made permanent, I seriously doubt it will have much of a long-term impact in encouraging greater reliance on savings as a component of retirement income.

Mr. Chairman, I feel compelled to wind up these remarks with one final note of concern. As I mentioned, retirement income is

based on three components—pensions, savings and investment, and social security.

In the opinion of our association it would be most counterproductive for Congress to emphasize the savings and investment component while at the same time welching on its commitments to social security and pensions, and annuities. Yet, there seems to be a substantial contingent in Congress intent on doing just that.

I am told that the budget committees of Congress are contemplating a plan to rewrite the calculations for determining the monthly Consumer Price Index to artificially produce a low rate of inflation. Such a plan would have a devastating effect on millions of Americans whose incomes depend on that CPI.

In addition, President Reagan has proposed elimination of certain social security benefits and at the same time has proposed reducing the present cost-of-living formula for Federal retirees.

Should Congress go along with these proposals, it would be a clear signal to present and future retirees that they cannot depend on the Federal Government to live up to commitments it has made to assure them of an adequate retirement.

Any benefit elderly persons might receive through the passage of S. 243 or similar measures would be more than wiped out by enactment of any of the kinds of proposals I have just outlined.

Mr. Chairman, I thank you for the opportunity to appear before your committee.

Senator CHAFEE. Thank you very much, Mr. Skardon. I took note of your remarks and I suspect we can assume that any of the following people who testify will amplify on your concern about the elimination of the double COLA.

Mr. SKARDON. I am sure.

Senator CHAFEE. Which I voted for twice last year.

Mr. SKARDON. I think you will get another opportunity this year.

Senator CHAFEE. I voted to eliminate it. I will get another opportunity this year, I think.

However, we will not get into that. That is not the subject of this hearing.

We appreciate your testimony.

Now we will ask Mr. Hacking from the National Retired Teachers Association and the American Association of Retired Persons for his statement.

STATEMENT OF JAMES M. HACKING, ASSISTANT LEGISLATIVE COUNSEL FOR THE ASSOCIATIONS, NATIONAL RETIRED TEACHERS ASSOCIATION/AMERICAN ASSOCIATION OF RETIRED PERSONS

Mr. HACKING. Thank you, Mr. Chairman.

I am here today representing the National Retired Teachers Association and the American Association of Retired Persons. These are affiliated organizations which currently have a membership in excess of 12.5 million older persons.

I would just like to make a few brief remarks in view of the time constraint.

Let me start by saying that I am sure it comes as no surprise to you that the elderly themselves identify inflation as their chief and primary concern. It is rapidly eroding their standard of living,

rapidly eroding the value of their privately accumulated assets, and increasing their dependence on Government programs—the programs that provide them with income support and health care protection.

At the same time, however, this inflation trend, in conjunction with other related economic trends like declining rates of savings, declining rates of growth in worker productivity and in real GNP is undermining the financial strength of many of these same Government programs on which the elderly have come to rely.

In view of this, our associations have long advocated that a comprehensive anti-inflation program be developed which would include a number of important and essential elements. Some of these are well known and widely supported, like bringing the Federal budget into balance over the business cycle and bringing the rate of growth in the supply of money and credit in line with the rate of growth in real GNP.

Other elements in the package are less well supported or less widely known. We think there is still a need for a strong but selectively applied income policy to complement the fiscal and monetary policy restraint and dampen inflationary expectations.

It is also important to allow for tax cuts. We think the ultimate objectives of tax reduction legislation ought to be to stimulate productivity, to stimulate savings, and in the process bring down the inflation rate and help keep it down.

In this respect I would like to make two main points. First, any tax cut legislation developed this year should be modest in terms of its revenue loss and that revenue loss should bear some reasonable relation to the net reduction achieved on the expenditure side of the Federal budget.

The second point is that any tax cut developed this year ought to be focused primarily on encouraging savings and investment. Therefore, we support S. 243. Our associations have long been identified with this legislation.

We were strong supporters of the provisions enacted last year as part of the windfall profits tax to provide some modest tax relief with respect to interest and dividend income.

At the same time our associations rule out any support for the much discussed Kemp-Roth tax cut bill. We think it would simply stimulate aggregate demand and generate a lot of short-term inflationary pressure without encouraging the kind of savings and investment we think is absolutely essential.

That concludes my remarks, Mr. Chairman. Thank you.

Senator CHAFEE. Thank you very much, Mr. Hacking. I think there is a lot of merit in what you say.

Let me ask you and Mr. Skardon a question. By representing retired people, those now retired—this bill will not do a great deal for them except for the $500-$1,000 feature. Is that the feature most appealing or are you looking forward to people who are currently teachers or Federal employees who can use this to assist in their retirement in the future?

Mr. HACKING. When I say we hope the tax cut bill will focus primarily on encouraging savings and investment, we are looking not only at the currently retired population but also those who will be retired in the future.

Your bill will encourage retirement planning. We think that is essential. Your bill will help encourage people who can save to do so, and at the same time it will afford to those who did save when the incentives were less some compensation for the effects that inflation is having on the interest income they derive from those assets.

Senator CHAFEE. The $500-$1,000?

Mr. HACKING. Yes.

Senator CHAFEE. Mr. Skardon, that is your view, too?

Mr. SKARDON. Yes.

I might add that I think sooner or later we will get to the point where we face a major overhaul in retirement policy in this country. That is going to include restructuring social security. The more people can depend on individual retirement accounts or supplemental annuities or savings, or whatever, the better off I think they will be.

Senator CHAFEE. We have with us the very distinguished Senator from Maine, Senator Mitchell.

Senator, any time you wish to break in, please do so, or you may want to wait until we finish with the panel presentations.

Senator MITCHELL. Thank you.

Senator CHAFEE. Mr. Mack McKinney, senior vice president of the Noncommissioned Officers Association of the United States.

STATEMENT OF C. A. (MACK) McKINNEY, SENIOR VICE PRESIDENT, NONCOMMISSIONED OFFICERS ASSOCIATION OF THE UNITED STATES OF AMERICA

Mr. McKINNEY. Thank you, Mr. Chairman.

I am also here today representing the Marine Corps League.

Senator CHAFEE. That is one up for you.

Mr. McKINNEY. I retired as a Marine sergeant major.

Senator CHAFEE. You are picking up speed every minute.

Mr. McKINNEY. I have a prepared statement which I have submitted and I will make my remarks as brief as possible.

The regular military retirement system offers absolutely no vested interest to the participant until he or she has reached the magical number of 20 years of honorable service. In addition to having no vested interest, enlisted personnel, unlike their Federal employee brethren and many civilian employees, are not entitled to any payment if not permitted to remain in the military service to complete the necessary years to be eligible for retired pay.

This has been brought out by the Court of Claims in its ruling and decision that military personnel have no vested interest or a contractual right to military retired pay.

Basically what they are saying is that it is up to Congress as to whether or not they want to give any retired pay to a military retiree and in increments of how much.

In the past years many recommendations have been made to change the military retirement system to include a vested interest. This vested interest would give military personnel a portion of a pay or a deferred payment providing they serve *x* number of years but less than 20 for retirement purposes.

However, it is believed by many, including this association, that providing a vested interest before serving 20 years would weaken

considerably the retention factor in the Armed Forces, so we endorse the IRA participation by military personnel, applaud the chairman for his bill S. 243, and say unequivocably we endorse it for our military members.

Thank you, sir.

Senator CHAFEE. Thank you, Mr. McKinney. I am delighted at the interest you have shown in this as well as that of your organization. We appreciate your coming.

Mr. MCKINNEY. Thank you, sir.

Mr. Sheffey of the National Association for Uniformed Services.

STATEMENT OF JOHN P. SHEFFEY, EXECUTIVE VICE PRESIDENT, NATIONAL ASSOCIATION FOR UNIFORMED SERVICES

Mr. SHEFFEY. It is a pleasure to be here. I want to express once more my pleasure in sharing a name that sounds like yours. It sure helps get my phone calls answered on Capitol Hill. [Laughter.]

I represent not only the National Association for Uniformed Services, but also the Naval Enlisted Reserve Association and the Disabled Officers Association.

My fellow service member, Mack McKinney, has covered one of the most critical points. However, I would like to elaborate a little on it.

There is a general feeling that all service people are locked into a retirement system which is very generous. The actual fact is that only 1 out of 10 who enter the armed services succeeds in staying or is willing to stay long enough to qualify for retirement.

Therefore, under the present IRA laws they are denied the privilege of having IRA's, because they are theoretically in a retirement system when they really aren't. Until they serve 20 years, as Mack McKinney said, they have no vested interest.

I would also like to point out to the committee that uniformed services retired pay, even when augmented by social security, usually is insufficient for retirees and their families to live on. It must be supplemented by other employment or another type of retirement plan, such as an IRA.

It is usually not understood nor well known that minimum service retired pay is 50 percent of active duty base pay only. Most career members retire at this level, after 20 years or a little more.

The actual retired pay is closer to 37 percent of their active duty compensation, which includes allowance for quarters, rations, and various other special pay. Military retired pay for most people is not very great. That is why IRA's would be an extremely valuable addition in planning for their future.

I would like to close by pointing out that this bill will encourage every worker, young and old, to practice thrift, a practice too long neglected in our society, and it will add to self-reliance. It will make people look more to their own efforts for security in their old age rather than only to the Government.

We and the associations that join with me thoroughly endorse your bill, S. 243, and wish you the greatest good fortune in getting it through the Senate.

Senator CHAFEE. Thank you, Mr. Sheffey.

It seems to me there is another plus to it which pertains particularly to the military services, and that is it gives an outlet for

judicious investment of re-enlistment bonuses or special bonuses paid in a lump sum that are received in military service.

Mr. SHEFFEY. I couldn't agree more. In fact, that is in my prepared statement.

The bonuses are often fairly large, particularly for people whose skills we are particularly trying to reenlist. As you well know, the large income tax for that increase in a single year, decreases that value very much.

It would be a very useful arrangement for even the lower ranking service member who has no large income and no big income tax in ordinary years.

Senator CHAFEE. Can those bonuses be spread over a couple years?

Mr. SHEFFEY. No, sir. I believe they are taken in cash. Is that correct, Mack?

Mr. MCKINNEY. They can take them right away, lump sum, or they can take them through a series of payments.

Senator CHAFEE. Thus deferring the income tax.

Mr. MCKINNEY. This is why the IRA would be ideal for many of them.

Senator CHAFEE. If somebody has a $6,000 bonus of some nature, he can spread it over 3 years and have $2,000 each year?

Mr. MCKINNEY. That is right.

Senator CHAFEE. He would end up, in effect, with no tax on it until withdrawn?

Mr. MCKINNEY. That is right.

Senator CHAFEE. Thank you.

Mr. Lewis, chairman of the pension task force, Institute of Electrical and Electronics Engineers, Inc.

STATEMENT OF DR. DAVID C. LEWIS, CHAIRMAN OF THE PENSION TASK FORCE, THE INSTITUTE OF ELECTRICAL AND ELECTRONICS ENGINEERS, INC.

Mr. LEWIS. Thank you.

I am appearing here today as chairman of the Institute of Electrical and Electronics Engineers pension task force. My testimony has also been endorsed by the National Society of Professional Engineers, the American Institute of Aeronautics and Astronautics, and the American Society of Civil Engineers.

In addition, I am also IEEE's representative to, and vice chairman of, the Engineers and Scientists Joint Committee on Pensions, an organization representing the pension concerns of the half a million technical and professional members of 17 scientific and engineering societies.

I appreciate this opportunity to appear before the subcommittee today.

In the time that is available I cannot hope adequately to discuss the pension concerns of the engineers and scientists throughout the country, indeed Americans everywhere. Some of the pension aspects of the present legislation have been presented in the written testimony. I hope that you and/or your staff will take the time to peruse the written testimony. It is very short and I hope lucid.

I would be happy to respond to any questions you might have regarding the written testimony. Within my remaining time I simply would like to touch upon the highlights of that testimony.

First, Mr. Chairman, we endorse the features of most of the legislation before the subcommittee today. We feel that the legislation will greatly assist in capital formation and it will correct what we perceive to be a gross inequity in the Nation's pension structure. In particular, persons enrolled in poor corporate pension plans, pension plans in which they may never vest, and many people never vest in a pension plan, will for the first time have the opportunity to establish tax-sheltered retirement savings.

We are concerned that the amounts which can be set aside should be tied directly to IRA limits so that as IRA limits rise the limits allowed under the current savings plans will rise. With this in mind, we are particularly concerned about S. 12, which has limits of $1,000 or 15 percent, whichever is less.

We would prefer to see the limits be at least $1,500 or more and tied directly to whatever limits are specified in ERISA.

Senator CHAFEE. You appreciate in my bill you go up to the $2,000 and there is no percentage. If you make only $2,000, you can put that all in?

Dr. LEWIS. Right. That is fine. We certainly endorse that. However, we have a little concern with the $1,000, which is another bill.

We also would like to see the funding limits tied to the ERISA limits so that if the IRA limits rise we do not have to come back here and worry about auxiliary legislation to raise the limits in whatever bill results from today's hearings.

Senator CHAFEE. You mean under the regular IRA legislation, if they raise that, say, to $3,000.

Dr. LEWIS. Right. Just rationalize the whole code.

Senator CHAFEE. That is a challenge.

Dr. LEWIS. Last, Mr. Chairman, we realize that many pressures surface during enactment of legislation and compromise often is necessary. However, we feel strongly that individuals should be provided the means to help themselves.

In this regard we want to encourage the subcommittee not to compromise on equity to the individual. It is important that individuals enrolled in poor pension plans or who may never vest in a pension plan have the opportunity to take care of their own needs by setting aside adequate funds.

I appreciate the opportunity to have presented our views regarding the bills being considered today. I would be pleased to answer any questions the subcommittee may have.

Senator CHAFEE. As I understand your last point, what you say is don't compromise. In other words, you want us to be sure that our legislation will continue to apply to those already in pension plans. In other words, do not go to the exception that now pertains to existing IRA's.

Dr. LEWIS. That is part of it, a big part of it.

The offsetting feature of this type of legislation, of course, is that there is a tax loss to the Treasury. At some point it can't be borne.

We have been pursuing this for a number of years and at times we have encountered situations where there is a temptation to go for a very simple bill by simply scaling back on the proposed limits.

For example, instead of letting individuals set aside $1,500, or 15 percent each year, limit the amount to $1,000 or 15 percent and let the legislation apply to everyone, whether or not they are vested in a corporate pension plan.

There are more complicated approaches for people who are in awkward pension situations, where they are in pension plans where they will never vest——

Senator CHAFEE. Like the military, for example.

Dr. LEWIS. Right. Exactly. It is important they be allowed to set aside adequate income, and maybe not let the person already enrolled and vested in a good pension plan, set aside quite so much.

It is a more complicated bill. We are suggesting you might want to go for the complications and be sure that individuals who really need this kind of legislation can take advantage it.

Senator MITCHELL. Is your concern with S. 12 that the limitation might be unfair with respect to those persons whose interest never vest? S. 12 extends to people who already are covered the opportunity to get into IRA's but places a limit on it, whereas S. 243 does not make a distinction.

Dr. LEWIS. The concern with S. 12 is with the limits. We don't think $1,000 is enough.

Senator MITCHELL. These are people already covered under some other private plan.

Dr. LEWIS. But covered means a lot of things to a lot of people. You can be covered; you can be actively enrolled; and you can be a participant in a pension plan and get nothing. Most people are in that situation.

Senator MITCHELL. If someone were assured of getting something——

Dr. LEWIS. If they are vested it is a different ball game. They are in a separate category. However, most people are not in that category. Most people need the kind of protection that this legislation would provide.

It is important that protection be afforded to people who are not vested in a pension plan.

Senator MITCHELL. Of course, this gives two opportunities to those who are already covered to invest in private IRA's.

Dr. LEWIS. That is right. That is why it might not be so important to them if they are already protected.

Senator MITCHELL. It is not available to a person who is not part of a private plan, a separate plan?

Dr. LEWIS. That is right.

Senator MITCHELL. Does that give one category more than the other?

Dr. LEWIS. It might. In fact, it probably will in certain cases. There are ways of getting around that situation.

For example, in the last session of Congress there was a bill, H.R. 628, which was introduced which would allow individuals to contribute to what was very much like an IRA. It was called a limited employee retirement account. It was established just like an IRA. Individuals could make contributions to it as an IRA until they became vested.

When individuals became vested and had protection of this corporate pension plan, they would go back and recompute earnings,

and taxes, for prior years. In the event an individual never vested, they would take this IRA-like lump sum of money and that would be their pension plan.

Senator CHAFEE. Thank you, Dr. Lewis.

Mr. Morton Harris, president, Small Business Council of America.

STATEMENT OF MORTON A. HARRIS, PRESIDENT, SMALL BUSINESS COUNCIL OF AMERICA

Mr. HARRIS. The Small Business Council of America is a national organization composed of men and women who primarily are interested in representing the interests of small business corporations, specifically in the area of Federal tax legislation.

As I am sure you have heard from time to time, there are over 13 million small business people in the United States.

Senator CHAFEE. You are not limited to small corporations, are you?

Mr. HARRIS. We primarily are interested in small corporations. There are in excess of 2 million of those types of corporations in the country today.

Based on statistics presented 2 years ago, there are over 500,000 qualified retirement plans in the United States. Of those plans, 90 percent of them cover 25 or less participants. In other words, over 450,000 cover less than 25 participants.

That does not mean they cover that many of the overall-covered employees, which is in excess of 45 million. It is estimated about 15 percent of all of the covered participants are in 90 percent of the plans.

Nevertheless, there is a significant number of small business corporations in this country which have qualified plans and which have participants who are very much interested in your legislation.

The Small Business Council is a nationwide organization. We have membership at this point—we are only 2 years old—in over 43 States. Unfortunately, Rhode Island is not one of them.

We are growing at a very rapid rate at this point and are primarily a voluntary organization of tax attorneys, consultants, accountants, and leading business people from around this country, a list of which is on that brochure you have.

Included among them is the national tax director of Touche, Ross. The gentleman, Mr. William Raby, writes for the National Law Journal, who very much is involved in much of the legislation which has been presented from time to time in the tax area.

First let me say that we have for a long time been very much interested in legislation of this type. If you will note on the SBCA brochure, item 3 of Legislation and Issues, we have been very much in support of legislation which will provide a tax deduction and an incentive for employee contributions to retirement plans.

Your legislation and Senator Dole's legislation we very much support. We have two recommendations we would like to make, sir.

The first is we feel there should be equality from the standpoint of providing the deduction for people who are both covered and who are not covered, the issue which you were just addressing. One of the big reasons is that people have an opportunity to opt out of a corporate qualified retirement plan; and in order to keep people

from having an incentive to do that, we feel the level should be the same.

I have one other recommendation but my time is up.

Senator CHAFEE. Go ahead. The first point is covered by the bill I have.

Mr. HARRIS. Yes, sir, but not by Senator Dole's bill.

Senator CHAFEE. That is right.

Mr. HARRIS. The other point is that we feel the level of contribution, although it is a wonderful start, is not significant to make any meaningful inroad into the problem that I know that you are trying to resolve. We feel a $5,000 level would be a more meaningful level. It would cover under Senator Dole's approach 15 percent or $5,000, which would allow middle-income people who earn up to $35,000 a year, and that's not too difficult when you have two earners in one family, to be able to make some meaningful retirement contribution.

From the standpoint of the retiree——

Senator CHAFEE. Double earners is a different area. You are getting into a different area when you talk about double earners bringing in a total of $35,000. That would not be covered by either of our bills.

Mr. HARRIS. That is correct, sir.

Senator CHAFEE. Unless you go into this plan proposed earlier, that others be permitted to contribute.

Mr. HARRIS. I think that certainly would be a welcome addition.

From a retirees standpoint, to have the $1,000 limit of Senator Dole's proposal over 20 years of work would net $20,000 plus the earnings, which would not be sufficient, we feel, to encourage people to try to provide for their own retirement security.

Thank you for permitting me to make this statement.

Senator MITCHELL. Mr. Harris, in your statement you indicated that this legislation would tend to mitigate inflation.

To the extent that it reduces revenues and thereby increases the deficit, it will have the opposite effect, will it not?

Mr. HARRIS. That seems to be the raging debate, as to whether that creates or reduces inflation. The point of the matter is that from the standpoint of trying to promote savings rather than consumption it would have the effect of tending to reduce inflation. For that reason, that point was made.

Senator MITCHELL. Do you have any way of estimating the relative force of either of those points?

Mr. HARRIS. No.

Senator MITCHELL. In other words, like a good lawyer, you have taken the argument that favors your position and have left out the argument which goes the opposite way.

Mr. HARRIS. I think to debate the issue of whether reduction of taxes would be inflationary is something that has been raging in Congress and in the country for the past months. I am certainly not qualified to add much to that.

Senator MITCHELL. Do you believe a prime cause of inflation is the Federal budget deficit?

Mr. HARRIS. There is no question that Federal budget deficit creates inflation, but also there is no question that our craze

toward consumption and the lack of incentives to save is an equal force, or certainly a strong force in that direction.

Senator CHAFEE. Thank you very much, Mr. Harris.

The point you make is that if there is going to be a tax cut this legislation removes a certain amount of moneys from the consumption side and puts it into savings, which would be capital investment.

Mr. HARRIS. Yes.

Mr. Grossman is next.

Mr. Mitchell, do you want to introduce Mr. Grossman?

Senator MITCHELL. Mr. Grossman has a fine statement. I will let him introduce himself.

STATEMENT OF NISSIE GROSSMAN, PRESIDENT, NORTHEASTERN RETAIL LUMBERMENS ASSOCIATION

Mr. GROSSMAN. Mr. Chairman and members of the subcommittee, let me first begin by thanking you for the opportunity of appearing before you.

My name is Nissie Grossman. I am president of the Northeastern Retail Lumbermens Association, an organization of more than 1,700 retailers, wholesalers, distributors, and manufacturers of lumber and building materials throughout New York and the New England States.

These hearings came at a most appropriate time for our association because more than 125 of our members from all over the Northeast are here this week attending a Conference on Housing and the Economy. We have come to Washington to discuss with our legislators in the Congress and administration officials the extremely grave situation the housing industry faces in this decade of the eighties.

We sincerely appreciate this opportunity to appear before you and the subcommittee.

Housing, as you know, is a major and critically important segment of the Nation's economy——

Senator CHAFEE. Mr. Grossman, you have an excellent statement here, which of course we will put in the record. However, perhaps if you could summarize it and abbreviate it as much as possible, that would be helpful.

Mr. GROSSMAN. Briefly, let me read one of the paragraphs first and then I will be glad to proceed as you ask.

Economic conditions for the businessmen and their employees who make up the Northeastern Retail Lumbermens Association have been particularly acute. Nationwide the bottom has fallen out of the housing market. In addition, the Northeast's share of housing starts has declined drastically. It represented 20 percent of the national total in 1965, 10 percent in 1980, and it is expected to fall to a mere 8 percent in 1981.

In view of the critical situation in which the housing industry finds itself today, it is our feeling that anything we can do to stabilize the economy, anything that can be done to lower interest rates and control inflation, which are some of the purposes outlined in your bill, will be helpful to the housing industry.

Inasmuch as you have my statement, I have followed your suggestion, Senator, in giving you only a brief comment as to how I feel about it.

I want to thank you and Senator Mitchell for allowing us to appear here today and to submit this written statement to you as well as our saying vocally and verbally what we have had to say. Thank you very much.

Senator CHAFEE. Thank you very much, Mr. Grossman.

It is my impression, in discussions with homebuilders, that even though there is a variety of legislation before Congress to help homebuilders, tax credits for the purchase of new homes, tax credits for some types of homes which have been on the market for *x* number of months, and so forth, that the No. 1 thing that the homebuilders are seeking is to have a reduction in the interest rates. That is the thing that would most help your industry.

Mr. GROSSMAN. There is no question that financing is the big block today. Young newlyweds and other young people are not encouraged to go forward in order to place a mortgage at high rates. As a matter of fact, it is hard to find the money. Even after finding it, the rate is prohibitive, which accounts for the problem we are facing.

Therefore, the reduction of the interest rate is extremely important. If interest rates will come down, people will be encouraged to go forward and make commitments.

Senator MITCHELL. I have no questions.

Senator CHAFEE. Thank you very much, gentlemen. I appreciate your taking the time to be with us.

[The prepared statements of the preceding panel follow:]

NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES
1533 NEW HAMPSHIRE AVE., N.W., WASHINGTON, D.C. 20036 AREA CODE (202) 234-0832

MICHAEL C. NAVE
PRESIDENT

JACK GOLDBERG, VICE PRESIDENT
GEORGE E. AUMAN, DIRECTOR OF FIELD OPERATIONS
L. J. ANDOLSEK, SECRETARY
MONROE W. WILLIAMSON, TREASURER

STATEMENT OF
STEPHEN L. SKARDON, JR.,
LEGISLATIVE REPRESENTATIVE OF THE
NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES
BEFORE THE SENATE COMMITTEE ON FINANCE,
SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY
CONCERNING S.243,
THE SAVINGS AND RETIREMENT INCOME INCENTIVES ACT OF 1981

February 24, 1981

Mr. Chairman, I am Stephen L. Skardon, Jr., Legislative Representative of the National Association of Retired Federal Employees (NARFE). Our Association has a dues-paying membership of 435,000 retired Federal workers, their spouses and survivors. In the past year alone our membership has increased by nearly 60,000--a figure I believe is indicative of the growing concern among the older Americans of the status of retirement income in our country. I am delighted to have the opportunity to appear before your subcommittee to reaffirm the support of our organization for S. 243, known as the Savings and Retirement Income Incentive Act of 1981.

Mr. Chairman, as I am sure you are aware, our Association has long been an advocate of improving the tax status of retirement income, not only to provide a measure of relief to those presently in retirement, but to offer incentives to all Americans to invest in their own retirement during their working years. Our Association supports S. 243, and its companion bill in the House, because its provisions meet these dual goals.

If enacted, this legislation will have a far-reaching impact on the basic structure of retirement income in this country. Presently, the retirement

incomes of most Americans originate from three sources--pensions and annuities, savings and investment, and social security. Because of worsening economic conditions, along with rapidly changing employment demographics, there has been a marked trend among many Americans to rely exclusively on social security as the primary component of their retirement income. We believe this is a dangerous trend in that social security is not designed to function in this manner, nor was it ever intended to fulfill such a need. Your bill, Mr. Chairman, would restore much needed emphasis on pensions and savings as key components of retirement income.

I am sure there will be many witnesses before this panel who will speak to the merits of your proposed expansion of eligibility for Individual Retirement Accounts and incentives for voluntary contributions to retirement programs. I would like to focus the remainder of my comments on that portion of the legislation which provides tax incentives for saving and, in particular, the impact of such incentives on retirees.

According to statistics from IRS, interest income in 1976 represented nearly 25 percent of the income of taxpayers 65 and older, while such income constituted only five percent of the income of taxpayers under 65. Eighty-eight percent of the tax returns filed by elderly persons in 1976 reported interest income, while only 46 percent of the non-elderly reported income from that source. I am also advised that nearly half of all savings in this country are held by persons 55 and older.

However, the most impressive aspect of these statistics is distribution of savings income among various income levels of the elderly. In 1976 IRS reported that 63 percent of elderly taxpayers reporting some income from savings had incomes of less than $10,000 (excluding social security which is tax-free). This figure is most important to our membership in that the average Federal annuity is slightly more than $10,000, while the average Federal survivor

annuity is approximately $4,500.

We welcome the provisions of your bill which would extend favorable tax treatment to interest income from savings accounts. The temporary $200/$400 exclusion for 1981 and 1982, which Congressman Moore so effectively pursued last year is an important step. However, unless that exclusion is made permanent, I seriously doubt that it will have much of a long-term impact in encouraging greater reliance on savings as a component of retirement income.

Mr. Chairman, your legislation would have the effect of saying to all Americans that savings income is an integral part of retirement in this country, and that the Federal government is officially committed to encourage such long-term savings. However, Mr. Chairman, I feel compelled to add one final note of concern.

As I mentioned at the beginning of my remarks, retirement income in this country is based on three components--pensions and annuities, savings and investment, and social security. In the opinion of my Association, it would be most counter-productive for Congress to emphasize the savings and investment component, while at the same time welching on its commitments to the first two components. And yet, there seems to be a substantial contingent in Congress and the Administration intent on doing just that.

I am told that the Budget Committees of Congress are contemplating a plan to rewrite the calculations for determining the monthly Consumer Price Index in order to produce a lower rate of inflation. Such a plan would have a devastating effect on the millions of Americans who depend on the CPI to protect the purchasing power of pensions, annuities, and social security. Since the present CPI is based on the consumption patterns determined largely by non-elderly persons, it already understates the impact of inflation on

older persons. Also, President Reagan has proposed the elimination of certain social security benefits, while reducing the present cost-of-living formula for Federal retirees. Should Congress approve any of these proposals, it would be a clear signal to present and future retirees that they can not depend on the Federal government to live up to commitments it has made to assure them of an adequate retirement. Any benefit elderly persons might receive through passage of S. 243, or similar measures, would be more than wiped out by enactment of any of the kinds of proposals I have just cited.

I also want to use this opportunity to express to Senator Matsunaga the appreciation of our association for his efforts in Congress to insist that all retirement commitments must be maintained. His efforts to update the current Tax Credit for the Elderly and his willingness to speak out on behalf of older persons has been a great source of encouragement for the members of our Association.

Mr. Chairman, I thank you for this opportunity to appear before your Subcommittee.

* * * * *

STATEMENT

of the

NATIONAL RETIRED TEACHERS ASSOCIATION

and the

AMERICAN ASSOCIATION OF RETIRED PERSONS

before the

SUBCOMMITTEE ON SAVINGS, PENSIONS, AND
INVESTMENT POLICY

of the

SENATE COMMITTEE ON FINANCE

on

INCENTIVES FOR SAVINGS

February 24, 1981

Washington, D.C.

SUMMARY

Due to our Associations' recognition that inflation is the greatest problem confronting the elderly today, we strongly urge that the upcoming tax cut be targeted toward saving and productive activity. We are concerned that an alternative tax cut, which would lower tax rates without doing more to reverse the tax code's bias against saving, would accelerate the economy's inflationary pressures. Individual income tax cuts should be modest and geared toward encouraging saving.

With this objective in mind, we believe that tax policy should encourage those who can save to do so and, at the same time, provide tax relief for elderly individuals who can no longer save. S. 243, introduced by Senator Chafee, accomplishes these goals by greatly increasing participation in retirement saving devices (IRA's and qualified pension plans) and also by providing an increased interest and dividend income exclusion for people over age 65.

A. INTRODUCTION

The Need for Savings Incentives

The National Retired Teachers Association and the American Association of Retired Persons, representing 12.5 million people over the age of 55, take a great interest in the upcoming tax cut debate. Because our surveys of our membership and the volunteer leaders of our organizations indicate overwhelmingly that inflation is the most significant problem confronting the elderly today, we must advocate policies, including tax policy, which will bring down our present intolerably high rate of inflation.

Our concerns about inflation and economic growth, in general, cause us to react favorably to the Savings, Pensions and Investment Policy Subcommittee's early consideration of legislation designed to encourage savings. We believe that a moderate tax cut, designed to encourage people to save and engage in productive activity, will provide positive economic effects. In fact, we strongly urge that savings and investment incentives be made the central element of the personal income tax cut package.

If, instead of providing savings incentives, the final tax cut bill only reduces tax rates by ten percent for three successive years, Congress will be risking an increase in inflationary pressures--particularly in the short run. This risk comes from an increase in the federal deficit, as well as from an acceleration of demand caused by the large amounts of revenue returned to individuals. We believe that a preferable approach would be to target a portion of the tax cut to encourage people to engage in the desirable activity of saving and investment.

An additional argument in favor of savings incentives in the tax cut bill involves the present tax code's bias in the direction of consumption. Our tax structure has created a preference for consumption over saving with such provisions as the deductibility of interest expenses and the full taxation of interest income, even if there are no real gains because of inflation. Simply reducing tax rates will not alone remove this bias. Affirmative savings incentives must be placed into the tax code in order to remedy the problem.

B. THE TYPE OF SAVINGS INCENTIVES NEEDED

Our goal for a proper savings incentive device contains two elements: first, we believe that people should be encouraged to save and, second, we feel that those who can save

no longer--the elderly--should be rewarded and, in part, compensated for the impact of inflation on their savings.

1. Encouraging People to Save

This element of the savings incentive device is intertwined with our Associations' retirement income goal. Tax policy should foster the development of "self-help" retirement planning efforts. Because social security alone cannot provide an adequate retirement income, people need to be encouraged to save on their own. However, a number of provisions presently prohibit potential "self-help" measures. Employees who contribute to their qualified pension plan do not presently receive a deduction for those contributions. Additionally, anyone who is a participant in a qualified pension plan is prohibited from utilizing an Individual Retirement Account.

The limitation on tax benefits for retirement saving leads to less capital available for the economy as well as an increased reliance by individuals on government programs for retirement income. Also, in the case of IRA eligibility rules, current tax law creates tremendous inequities. We have received much correspondence from members of our Associations who "participated" in qualified pension plans, yet who never vested. Many seem to have wanted to utilize the IRA if it had been available to them. By ruling them ineligible, the tax code has diminished their retirement planning resources significantly.

To counter these problems, our Associations' recently adopted 1981 Legislative Program calls for the following: "To encourage those who can continue to save, existing savings mechanisms, such as IRA's (and also Keogh plans) and private pension plans, should be strengthened through tax policy. Employees who participate in a public or private pension plan should be given the option to contribute to either the plan or an IRA. A tax deduction should be provided for these contributions and the deductibility limits that were set in 1974 for amounts contributed to IRA's should be raised considerably and then indexed to reflect the effect of inflation.".

We are particularly pleased that the Subcommittee on Savings, Pensions, and Investment Policy is actively considering savings mechanisms which would follow these concepts. The approval of the deductible employee contribution approach will benefit both the nation's economy and the income status of future retirees.

2. Compensating Elderly Savers

Because tax benefits designed to encourage people to save more aid only those who are able to increase their savings, and because the past decade has witnessed a destruction of the value of the elderly's savings, Congress should take separate action to aid those who can save no more--retirees.

As an equity measure and to further encourage others to save for retirement, the Associations support an exemption (beyond that provided in last year's Windfall Profits Tax legislation) of interest and dividend income from taxation for those who are over 65. Our initial recommendation is that the exempt amount for people over 65 be set at $500 ($1,000 for joint returns).

With the dramatic impact that inflation and federal tax policy are having on savers, this modest tax relief measure will be welcomed by many elderly people. Statistics indicate that the elderly are savers. Nearly 95 percent of all people over age 65 with tax liability received interest income, according to the latest available Internal Revenue Service statistics (for tax year 1977). Most of these people, however, have relatively small accounts. A study issued by the President's Commission on Pension Policy indicates that, in 1977, 90 percent of the people age 65 and over who received property income, which includes interest income, received less than $6,000 from this source.

While the amount of interest income received by the elderly is relatively small, it is an important factor in their efforts to make ends meet. We feel that tax policy should also support these efforts.

C. LEGISLATION MEETING THESE GOALS

In reviewing the Subcommittee's choices of possible savings incentive bills, we can observe many positive features. However, we believe that one particular bill, S. 243, introduced by Senator Chafee, actually achieves most of our objectives. S. 243 provides essential saving and retirement planning incentives, and it also compensates the elderly saver. We are pleased to be able to endorse S. 243, and we hope its central elements become a part of the future tax cut package.

STATEMENT OF

C.A. "MACK" MCKINNEY
SR. VICE PRESIDENT for GOVERNMENT AFFAIRS
NATIONAL CAPITAL OFFICE

before the

COMMITTEE on FINANCE
UNITED STATES SENATE
FIRST SESSION, 97TH CONGRESS

FEBRUARY 24, 1981

on

S. 243

"Savings and Retirement Income Incentive Act of 1981"

Mr. Chairman: On behalf of the Non Commissioned Officers Association of the United States of America (NCOA) I welcome the opportunity to appear before this distinguished panel to share the Association's views on the bill, S. 243, sponsored by the Honorable John Chafee, United States Senator.

The bill will authorize regular members of the U.S. armed forces to participate in Individual Retirement Accounts (IRA). NCOA applauds such a proposal and unequivocally recommends its passage at the earliest.

NCOA was the first quasi-military organization to recognize the need of IRA participation for active-duty military personnel. In January 1980 its representatives appeared before the House Committee on Ways and Means urging that panel to adopt such a program. Regretably, the idea was presented before its time. NCOA is particularly pleased that Senator Chafee has seen the need for savings and retirement income incentives and is delighted that he included all military personnel in the bill.

IRAs FOR ALL MILITARY PERSONNEL

The Tax Reform Act of 1976 provided that members of the Reserve Forces of the U.S. Armed Services could establish Individual Retirement Accounts (IRAs). In any year they have 90 or less training days, certain reservists are authorized to deposit moneys in IRAs. The maximum deposit was set at $1,500 each year or 15 percent of income, whichever is the lesser amount. Reservists with unemployed spouses are permitted to deposit annually $1,750 or $875 in two separate accounts.

Prior to 1976, all military personnel, regular and reserve, were barred from participation in IRA. The reason was that they were potential recipients of a retirement annuity "established or maintained" by the U.S. government.

In seeking a reversal to the restriction for reservists, proponents offered three circumstantial points of interest.

1) — "the reserve retirement system offers no vested interest to the participant until he or she has 20 years of service, and will realize no benefits until he or she attains age 60 —

2) — "the amount of retired pay may be very limited and many reservists may not be interested in reserve retirement; many drop out long before completing 20 years of service —

3) — "in the event of a national emergency reservists will constitute the principal and immediate source of trained military manpower; therefore, it is essential that our military reserves attract and retain high quality personnel, and, thus, by ending this form of discrimination Congress will help maintain strong and able reserve forces ready to serve the country in war or in civil disasters."

In comparing reservists with active duty personnel of the armed forces, strikingly similar conditions exist. For example:

1) - the regular retirement system offers no vested interest to the participant until he or she serves a Maximum of 20 years of honorable active duty and, in addition to no vested interest, enlisted personnel — unlike federal employees and many civilian employees — are not entitled to any payment if not permitted to remain in the military services to complete the necessary years to be eligible for retired pay —

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2) - upon reaching the 20th year and becoming entitled to an annuity the majority of military retirees do not receive adequate funds providing for more than the basic needs of a family of two; so many do not stay much longer than an initial tour. (It is estimated that of every 100 persons entering the armed forces only 11 or 12 will remain long enough to become eligible to retire. With current retention rates lower than ever, these numbers might have dropped to 9 or 10.) -

3) - in the event of a war or a confrontation between combatants of the United States and another country, regular military personnel will be the first to lay their lives on the line for their fellow Americans and this great Nation; therefore, it is even more essential that our military attract and retain the highest quality personnel and by ending this form of discrimination Congress will help maintain strong and able regular forces at the ready at all times.

The prinicpal argument against military personnel using IRAs has been the current military retirement system. It is considered a "government plan." The question then will be whether or not the system meets the requirement of being "established or maintained" for all uniformed services personnel.

There is, in a sense, a government plan established for military personnel, but it is not so for regular enlisted men and women whose current enlistment does not include the 20th year of active service. For most, enlistments will be for periods not in excess of six years. At the end of the contractual period each individual is given an honorable discharge and must either leave the services or, if given the authority to do so, reenlist for another term of six years or less. If he or she is denied reenlistment or voluntarily accepts separation, there is no government plan "maintained" that offers individual benefits under the current military retirement system. There are none as long as the individual does not have 20 years of cumulative active service.

Reserve personnel who are currently authorized to participate in IRAs do accrue retirement points for each training period or schools completed. Regular enlisted personnel accrue nothing including years of active service. When and only when they have 20 years of active duty can they seek retired pay which is then computed on the basis of the number of active years served. Unlike certain commissioned officers and reservists, time served in the Reserve and Guard cannot be tabulated.

As for "maintaining" a government plan for military personnel there is no question as to its nonexistence. The Court of Claims has ruled that military personnel have no vested interest or a contractual right to military retired pay.

Further, as noted earlier, there is no current value to which regular enlisted members on active duty can attach to services performed if they have less than 20 years. They may be and often are denied reenlistment up to and including the 19th year of honorable service. If denied, they are not entitled to any severance payment, readjustment payment, or an annuity payment that falls within the purview of an employee pension benefit plan.

The same applies to the enlisted service man or women who decides to leave the armed forces before establishing eligibility for retirement. Only the individual who qualifies for a 30 percent or more physical disability may leave the armed forces with a "pension" prior to completing 20 years of honorable active service.

Congress must consider an early change to the law authorizing IRAs for military personnel of the regular component. The bill, S. 243, sponsored by Senator John Chafee, is the answer. Its adoption will right a law that has been wrong since 1974 — the year IRAs were adopted.

NATIONAL ASSOCIATION FOR UNIFORMED SERVICES
5535 HEMPSTEAD WAY
P. O. BOX 1406
SPRINGFIELD, VIRGINIA 22151
TEL. (703) 750-1342

"The Serviceman's Voice in Government"

"Established 1968"

Statement of

John P. Sheffey
Executive Vice President
National Association for Uniformed Services

Before the
Subcommittee on Savings, Pensions, and Investment Policy
Committee on Finance
United States Senate

On
February 24, 1981

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S.243
Savings and Retirement Income Incentive Act of 1981

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Statement of

John P. Sheffey
Executive Vice President
National Association for Uniformed Services

Before the
Subcommittee on Savings, Pensions, and Investment Policy
Committee on Finance
U. S. Senate
February 24, 1981

on
S.243-Savings and Retirement Income Incentive Act of 1981.

Mr. Chairman and members of this subcommittee, I am John P. Sheffey, Executive Vice President of the National Association for Uniformed Services (NAUS). I welcome the opportunity to present the views of not only NAUS, but I have also been commissioned by the Naval Enlisted Reserve Association and the Disabled Officers Association to inform you of their support of my associations position.

The National Association for Uniformed Services (NAUS) is unique in that our membership represents all ranks of career and non-career service personnel and their wives and widows. Our membership includes active, retired, and reserve personnel of all seven uniformed services: Army, Navy, Air Force, Marines, Coast Guard, Public Health Service, and the National Oceanic and Atmospheric Administration. With such a membership, we are able to draw information from a broad base for our legislative activities.

The basic objective of S.243 is to induce savings by the citizens of this country. The lack of participation in any type of savings program by our citizens, is of great concern to all of us, including President Reagan. It is unnecessary for me to elaborate further on that point.

Of even greater concern to me and my association is the fact that only approximately 11 percent of those entering the uniformed services complete the time in service requirement which makes them eligible for retired pay and benefits. Although technically participating in a retirement plan, the service member acquires no vested retirement rights for the first 19 years of service. Nine out of every ten who enter the services leave after a few years with no transferable retirement equity. Only those of this group who enter the Civil Service or the Reserves ever realize any military retirement benefits. S.243 would help fill this void by encouraging individual savings for retirement.

S.243 also has benefits for the career service member. Uniformed services retired pay, even when augmented by social security, usually is insufficient for retirees and their families to live on. It must be supplemented by either employment or another type of retirement plan. Minimum uniformed services retired pay is 50 percent of active duty base pay. Most career members retire near this level. This in reality is closer to 37 percent of total active duty compensation, which encompasses active duty pay, basic allowance for quarters and subsistence, and specialty or hazardous duty pay.

I recognize that most younger service members will not participate in this program. Those that do, will most likely not be able to participate at the maximum level. However this bill, S.243, does encourage every service member to save. This incentive will increase as the individual progresses in grade and income.

For those active duty uniformed services personnel with working spouses or those in receipt of a specialty reenlistment bonus, S.243 provides a way of reducing tax burdens. Such tax relief is not currently available to them, but it is available to others who are authorized Individual Retirement Accounts (IRA).

In the long term, the U.S. Government will not lose the taxes on IRA savings, but postpone them. Although the taxes paid on withdrawal of IRA funds will be at a lower rate, they will be paid on a greater amount.

Individuals in their late middle age who decide to open an IRA because of a sudden income windfall or for any reason, can do so under the provisions of S.243. The maximum amounts this bill authorizes, deductible as well as non-deductible, allows for large contributions over a relatively short time span. This provision is a definite asset for those who begin to participate after age 50.

For younger participants, S.243 has favorable provisions. These provisions allow the participant to make five withdrawals without penalty. Total amount that can be withdrawn is $10,000 if the money is to be used for first home purchase or for higher education expenses.

The fact that S.243 would also make permanent the increase in the amount of interest and dividend exclusion from federal taxation gives added importance to this legislation. The current $200.00 exclusion on a single tax return, $400.00 on a joint tax return, is due to expire after 1982. For senior citizens, age 65 and over, the amount of

exclusion increases to $500.00 and $1000.00. This exclusion will help those individuals whose income provides for only modest savings or investment as well as those elderly persons with savings or investment. These two groups of savers need such protection if we expect them to continue some form of a savings program.

S. 243 will encourage every worker, young and old, to practice thrift--a practice too long neglected in our society. It will add to self-reliance and, in some measure, reduce the burden of the old and indigent on the government. Most important, it will create capital in the private sector of our economy. I urge this committee to recommend favorable consideration of the bill by the Senate.

I thank you for your speedy scheduling of hearings on this bill. The opportunity to appear here today along with your interest and attention is greatly appreciated. At this time, I am prepared to answer any questions you may have.

THE INSTITUTE OF ELECTRICAL AND ELECTRONICS ENGINEERS, INC.
UNITED STATES ACTIVITIES BOARD

1111 - 19th. Street, NW
Washington, D.C. 20036
(202) 785-0017

Telecopier: (202) 785-0835
USAB Information Line: (202) 785-2180

CONTACT: Tom Suttle
(202) 785-0017

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The following is testimony of the Institute of Electrical and Electronics Engineers, Inc., (IEEE), prepared for submission before the Subcommittee on Savings, Pensions, and Investment Policy; Committee on Finance; United States Senate; on February 24, 1981. This testimony has been endorsed by the American Institute of Aeronautics and Astronautics (AIAA), the American Society of Civil Engineers (ASCE), and the National Society of Professional Engineers (NSPE).
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Mr. Chairman, my name is David Lewis, and I am appearing before you today as the Chairman of the Pension Task Force of the Institute of Electrical and Electronics Engineers, Inc., (IEEE). I am also the IEEE representative to, and Vice-Chairman of, the Engineers and Scientists Joint Committee on Pensions (ESJCP), an organization representing the pension concerns of the half-a-million technical and professional members of 17 scientific and engineering societies. In addition, my testimony has been endorsed by the American Institute of Aeronautics and Astronautics (AIAA), the American Society of Civil Engineers (ASCE), and the National Society of Professional Engineers (NSPE). I appreciate this opportunity to appear before the Subcommittee today.

Founded in 1884, the Institute of Electrical and Electronics Engineers is today the world's largest technical professional society, with more than 160,000 members in this country. Historically, the IEEE has been primarily concerned with the dissemination of technical information and the expansion of the body of knowledge relative to electrical

and electronics engineers. Since 1972, however, through a mandate by the members, the Institute has also concerned itself with the non-technical problems of engineers. In 1972 the number one concern of our members was the inadequacy of available pension programs; and today pensions are still one of their primary non-technical concerns.

I have asked to appear before you today to comment on S. 12 and S. 24, introduced by Senator Dole and others, and S. 243, introduced by Senator Chafee. We are specifically interested in those aspects of each bill which would allow individuals who are contributing to a qualified corporate pension plan to establish their own Individual Retirement Accounts (IRAs).

We are in agreement with the Chairman and other members of the Senate who have spoken out in favor of proposals to stimulate capital formation and to provide incentives for individual savings. The current state of the economy demands mechanisms that would spur our economy through encouragement of individual saving, would increase the incidence of formation of capital, and would encourage industrial innovation. In this context, I would like to call the Subcommittee's attention to the 1979 Annual Report of the Joint Economic Committee of the U. S. Congress. In the Summary Report the Committee states that ". . . a very high rate of capital formation is needed if we are to succeed in revising the disastrous course of productivity growth in the American economy." In addition, in the Minority Supplementary Views of the Summary Report, it was stated that ". . . saving is essential to investment and growth and ought to be encouraged."

When analyzing this deteriorating position of the United States technological base and the drop in productivity growth, it is enlightening to compare the percentages of disposable income that is

saved by our major competitors -- 13 percent in Great Britain; 15 percent in West Germany; 25 percent in Japan; and 4.1 percent in the United States (1978 figures, U. S. Department of Commerce).

In our capacity as the world's largest professional technical association, the IEEE is very concerned about the many inequities replete in pension retirement programs commonly available in the United States today. In particular, we are distressed that individuals who have chosen a highly mobile profession, such as engineering, are penalized by the structure of most pension/retirement programs. The typical IEEE member is an employee of a corporation and is an "active participant" in a qualified pension plan sponsored by that employer. But many of our members, because of the very nature of their work, change employers well before ten years of service; i.e., well before vesting as required by ERISA. Indeed, many of our members change employers again and again, forfeiting pension after pension, and yet never qualify for an IRA because they are always, or almost always, "active participants" in an employer-sponsored plan. Those individuals who do manage to vest in an employer-sponsored plan frequently find themselves with accruals under the employer-sponsored plan of less value than the value they could have had in an IRA had such employees been permitted to "opt out" of the qualified plan and contribute instead to an IRA.

So, there are two significant problems:

First, there is the problem of the mobile employee who changes jobs frequently and, therefore, never vests under a qualified plan and yet never qualifies for an IRA. He/she gets no retirement benefit at all.

Second, there is the individual who manages to vest but vests in a benefit considerably less valuable than the IRA could have been.

Mr. Chairman, I would like to emphasize that these problems are not

unique to engineers and scientists. Department of Labor statistics show that the average time per job for the entire American work force is 4.6 years for men and 2.8 years for women. The pension problems I have described are widespread. Information submitted to the President's Commission on Pension Policy by the Social Security Administration indicates that only 16 percent of retirees who receive retirement benefits through Social Security will also receive benefits from other pension plans.

The aspect of the present pension situation that is particularly galling is that individuals who would like to try to save money for their retirement are systematically discriminated against by the tax code because they are prohibited from establishing an Individual Retirement Account. Mr. Chairman, I submit that individuals who want to save money for their retirement shall be encouraged, not discouraged. Thus, at a minimum, individuals who are "active participants" in pension plans but who are not fully vested and persons who must participate in very poor pension plans should be allowed to establish an Individual Retirement Account.

Several bills have been introduced to this Subcommittee which would encourage individual savings by broadening the eligibility requirements for Individual Retirement Accounts. In general, the Institute of Electrical and Electronics Engineers, Inc., supports the intent of all of the bills. There are two primary features by which we judge a bill: First, we feel strongly that individuals who are not vested in a corporate pension plan or those who are vested but may be vested in a poor plan should be allowed to establish an Individual Retirement Account or something very similar to an IRA. Second, we feel that the amounts which can be set aside should be tied directly to the IRA contribution limits

so that, as IRA limits rise, the limits on all similar types of retirement accounts rise. With this in mind, we are concerned that the limits set forth in S. 12 are $1,000 or 15 percent of gross. We would prefer the limits be $1,500 or 15 percent of gross as currently allowed for IRA contributions.

Lastly, Mr. Chairman, we realize that many pressures surface during the administrative and legislative process associated with the enactment of legislative concepts. We realize that compromise is often effected in order to gain enactment and stave off total defeat of an issue. We realize that the bills being considered are at least as much savings bills as pension bills. However, we feel strongly that individuals should be provided the means to help themselves. In this regard, we wish to encourage the Subcommittee not to compromise on equity to the individual. Should problems arise, we support compromise in implementation methodology which will balance equity with simplicity but appeal to the parties involved to adopt equity as the preferred goal of the legislation.

I appreciate the opportunity to have appeared before you today on behalf of the IEEE, AIAA, ASCE, and NSPE and would be pleased to answer any questions the Subcommittee may have.

SUMMARY OF STATEMENT

SUBMITTED BY

MORTON A. HARRIS, ESQUIRE

ON BEHALF OF THE

SMALL BUSINESS COUNCIL OF AMERICA, INC.

TO THE

SENATE FINANCE COMMITTEE

SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY

FEBRUARY 24, 1981

S.12 AND S.243

This statement is submitted on behalf of the Small Business Council of America, Inc., a nation-wide organization of business and professional men and women whose aim is to monitor and comment on federal tax and employee benefit legislation on behalf of small business corporations.

The Small Business Council of America, only two years old, has a growing membership, presently covering 43 states. The organization has both a legal and a business advisory board which includes leading tax attorneys, accountants, tax and employee benefit consultants and, well-known business owners located throughout the country.

I am President of the Small Business Council of America and am also a practicing attorney in Columbus, Georgia. Many of my law firm's clients are owners and principals of small businesses.

SUMMARY OF STATEMENT

S.12 and S.243

In General

The Small Business Council of America (SBCA) strongly supports and commends Senator Dole and Senator Chafee (and others who may become sponsors of S.12 or S.243) for seeking ways to encourage savings by individual employees for their own retirement and the education of their children.

The SBCA generally supports both S.12 and S.243 which, the SBCA believes, will provide a significant incentive to encourage employees to voluntarily contribute to either a qualified retirement plan, if they are covered and if the plan contains provisions for such contributions, or, in lieu thereof, to an individual retirement account (IRA).

The SBCA strongly supports the traditional concept that there are three fundamental elements of retirement security: (1) Social Security as a base, (2) private employer sponsored retirement plans, and (3) individual savings. Therefore, the SBCA favors and supports economic incentives which encourage the adoption and expansion of privately sponsored retirement plans and _which encourage employees to individually save for their own retirement_.

Although economic incentives of the kind embodied in S.12 and S.243 will not, alone, "cure" inflation and will not totally

protect employees in their retirement, these bills are constructive steps which will tend to mitigate inflation and assist employees in providing for their own retirement.

The SBCA has previously supported similar bills and has submitted a position paper to the President's Commission on Pension Policy on November 29, 1979, dealing with matters of the kind involved in these bills. Since there is not time to restate all of the points which can be made in support of these bills at this hearing, I refer you to our position paper for detailed information and statements of our support for legislation of the kind here under consideration.

Recommendation for Improvement

If the incentives provided in these bills are to give meaningful encouragement to private savings, two changes in the legislation should be considered.

1. Need for Equality Between Qualified Plans and IRA's. There should be no distinction between an employee who is covered under a qualified retirement plan and one who is not insofar as the dollar limit of the voluntary deductible contribution; otherwise, there will remain incentives for employees in certain instances to opt out of the qualified plan.

2. Need for Higher Deductible Contribution. The amount of the deductible contribution should be increased to a higher level, at least $5,000.00 per year, to encourage savings at a

meaningful level for both lower and middle income employees earning less than $35,000.00 per year. The SBCA feels that the amount of the deductible contribution should be: (1) large enough so that the deductible amount will adequately encourage a level of retirement savings which is significant for a majority of America's employees; and (2) large enough so that the administrative costs involved will not be so great in relation to the amount of the deduction that it diminishes the incentive intended by these bills. For example, with a $1,000.00 per year limit, there can be only a maximum of $20,000.00, plus earnings, saved over a period of 20 years. In light of present inflationary conditions and future expectations, this level of savings cannot give many people a feeling that they could adequately save for their own retirement.

Conclusion

To summarize, it is important that there be an equal deductible contribution limit (whether or not covered by a qualified plan) as provided for in S.243 which will remove any incentive for individuals to withdraw from participation in a qualified plan in order to participate only in an IRA and receive a higher deduction. Thus, if $1,000.00 is the limit on deductible contributions as provided for in S.12 while $1,500.00 is the limit on IRA's, then some individuals will still find it to their benefit to drop out of qualified plans in order to establish IRA's.

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Of the two legislative proposals dealing with employee contributions, we urge the format of S.243 with a $5,000.00 deductible limit for the reasons stated above.

Respectfully submitted,

SMALL BUSINESS COUNCIL OF AMERICA, INC.

By ______________________________
Morton A. Harris, President

STATEMENT
OF
NORTHEASTERN RETAIL LUMBERMENS ASSOCIATION

BEFORE THE
SUBCOMMITTEE ON SAVINGS PENSIONS
AND
INVESTMENT POLICY OF THE
COMMITTEE ON FINANCE
UNITED STATES SENATE

Re: S.12, S.24 and S.243

Mr. Chairman and Members of the Subcommittee:

My name is Nissie Grossman. I am President of the Northeastern Retail Lumbermens Association, an organization of more than 1700 retailers, wholesalers, distributors and manufacturers of lumber and building materials throughout New York and the New England States.

These hearings came at a most appropriate time for our Association because more than 125 of our members from all over the Northeast are here this week attending a Conference on Housing and the Economy. We have come to Washington to discuss with our legislators in the Congress and Administration officials the extremely grave situation the housing industry faces in this Decade of the Eighties. We sincerely appreciate this chance to appear before the Subcommittee.

Housing is a major and critically important segment of the nation's economy which spans far beyond those who put together the boards, brick and other materials, to make a structure. It encompasses many millions involved with producing, marketing, transportation, distributing and assembling components and materials and millions more in selling, financing, maintaining and improving homes and apartments of all descriptions.

This many-faceted, giant industry has been one of the earliest victims of the chaotic economic conditions which have marked the Decade of the Eighties. Skyrocketing interest rates have pushed the cost of financing a home beyond the reach of most Americans and the housing market has been rapidly vanishing. This has had a ripple effect throughout the housing industry which has been devastating to all whose livelihoods depend on a stable, healthy home construction industry.

Economic conditions for the businessmen and their employees who make up the Northeastern Retail Lumbermens Association have been particularly acute. Nationwide, the bottom has fallen out of the housing market. Beyond that, the Northeast's share of housing starts has declined drastically. It represented 20% of the national total in 1965, 10% in 1980 and it is expected to fall to a mere 8% in 1981.

One of the problems which has especially beset housing is the national drift away from savings and towards spending. This has been inspired, in part, by high inflation, and by our consumption-directed tax system. Thus, an important step on the road to renewed economic health for our nation and our industry is changes in the tax laws which will encourage savings. In particular, we believe that some of these incentives should be directed towards expanding the supply of money for home financing, as is provided for in the bills before the Subcommittee today.

Individual retirement accounts encourage and enable people to plan for and take care of their own future. Because IRA accounts are generally long-term deposits, they provide lending institutions

with a relatively stable source of funds to make home loans. Encouraging broader use of IRAs, through expansion of eligibility and permitting increased tax-sheltered contributions will thus assist in bringing capital back to investment in home finance and thereby bring interest rates down. Furthermore, the increased use of IRAs will help offset the drain in long-term deposits precipitated by recent expansions in the short-term investment powers of savings and loan institutions, such as NOW Accounts and credit cards.

Both S.12 and S.243 would bring about desirable expansion in IRA eligibility. S.243 goes further, however, by raising IRA contribution levels and by allowing IRA withdrawals for education and housing. As well, it makes permanent the current interest income exemption.

S.243, by allowing IRA withdrawals for housing, and S.24, which provides for the establishment of housing savings accounts, address the problem of the first-time home buyer, who because of rampant inflation, is simply unable to accumulate the money for a downpayment. With record numbers of people expected to enter the home-buying age group in the 80s, not only must we think in terms of a sufficient supply of housing, but we must take steps to insure these new buyers have the financial wherewithal to enter the housing market. We believe that both the IRA housing withdrawal provisions and the housing savings accounts provide a workable method for helping people to help themselves afford a home.

We believe that the concepts embodied in these three bills are a necessary minimum first step in rebuilding the capital

underpinings of the housing industry. We strongly urge that they appear in the first major tax bill out of the 97th Congress, for the crisis in our industry and for those many millions of families seeking the American dream demands immediate action.

Thank you for this opportunity to appear today, and I especially wish to thank Chairman Chafee and Senator Mitchell, whose sensitivities to the unique and critical housing problems of the Northeast made our appearance possible.

Senator CHAFEE. The next panel will consist of the following: Mr. Marvin A. Levins, senior vice president, Group Pension and Reinsurance Operations, Connecticut General Life Insurance Co., on behalf of the American Council of Life Insurance; Jeff R. Hart, executive director, the Association of Private Pension and Welfare Plans, Inc.; Jerry L. Oppenheimer, The ERISA Industry Committee; Gerald Facciani, chairman, Government Affairs Committee, American Society of Pension Actuaries; and Richard B. Taylor, assistant director-compliance, National Automobile Dealers and Associates Retirement Trust.

Again, gentlemen, if you can keep your statements brief, they will be inserted in the record.

We will start with Mr. Levins from the Connecticut General Life Insurance Co.

STATEMENT OF MARVIN A. LEVINS, SENIOR VICE PRESIDENT, GROUP PENSION AND REINSURANCE OPERATIONS, CONNECTICUT GENERAL LIFE INSURANCE CO., ON BEHALF OF THE AMERICAN COUNCIL OF LIFE INSURANCE

Mr. LEVINS. Our panel represents a portion of a broad coalition to support the concept of tax incentives for employee contributions to qualified pension plans.

In the interest of time we have coordinated our testimony to minimize the likelihood of duplication of comments.

I am Marvin A. Levins, senior vice president of the Connecticut General Life Insurance Co., in charge of its group pension operations. I am pleased to be appearing before your subcommittee on behalf of the American Council of Life Insurance. We are pleased that your subcommittee is considering bills on tax incentives for savings. I would like to take this opportunity to provide you with our thoughts on that subject.

The American Council of Life Insurance believes that there is a distinct need to provide incentives which will encourage retirement savings. We believe that S. 12 and S. 243 provide essential provisions to stimulate a successful retirement savings program.

As I am sure you are aware, the savings rate in this country is low compared to other industrialized countries. In the third quarter of 1980 Americans saved only 5.7 percent of disposable income.

This lack of savings is perceived as a major problem by Americans as demonstrated by the recent survey by Roger Seasonwein Associates, a national survey firm which indicated that 72 percent of the work force feels their savings are inadequate to meet their retirement needs.

Furthermore, almost half of the work force surveyed feels they will not be able to afford to retire.

The most commonly asked question today is which tax proposal, whether the 10 percent cut in personal rate over 3 years or the variety of earmarked tax incentives, will induce individuals to save rather than to spend.

It is our strong belief that the increased tax incentives for retirement savings will result in long-term savings and formation of much needed capital and not consumption.

As the Senate Finance Committee recognized last year, increased tax incentives for retirement savings provide immediate and noninflationary tax relief and are, in reality, only a deferral of tax revenue loss.

A further benefit is that as people begin to build up adequate individual retirement income, pressure on the social security system is alleviated. In addition employers will be encouraged to form new pension plans.

There is good evidence that these incentives will work. For example, the Canadian experience with registered retirement savings plans demonstrates that these vehicles are widely utilized and have in fact increased savings. Other evidence comes from Cambridge Reports, Inc., a national survey research firm, which found that:

Fifty-eight percent of American workers currently contributing to a qualified retirement plan would be very or somewhat likely to contribute more money if Congress passed legislation that allowed them a tax deduction for the contribution.

They further found that 47 percent of the above group indicated that the additional money that would be saved because of tax incentives would represent new additional savings. It is significant that these perceptions did not vary widely by income classification. The fact is substantiated by participation rates in our own Connecticut General voluntary investment plan as well as data from our clients' plans, which reinforce the survey findings that employees at all income levels would participate in savings plans through employer-sponsored vehicles.

The availability and ease of access for the employee may explain the high utilization rate expected for employer-sponsored vehicles compared to the results under individual retirement accounts.

To achieve the desired results, we feel that the incentives for retirement savings by qualified plan employees should be available to the largest cross-section of eligible employees and that the deductible limits be equivalent to IRA's to insure understandability and ease of administration.

We further feel that the deduction should be permitted for all employee contributions, whether voluntary or mandatory.

In conclusion, looking at each of the two bills under consideration, we feel that S. 12 meets all but one of the above criteria. We are concerned, however, with disparity between deduction limits for active plan participants and nonplan participants. Different

limits could cause confusion, necessitate more complex regulations, and could in fact provide incentives for employees to opt out of plans.

S. 243 also incorporates much of what we feel should be key provisions of any retirement savings incentive legislation. We are particularly pleased that it includes equal deduction limits for all employees.

We also support your recognition that a larger permissible deductible amount will further strengthen contributions to retirement savings. However, we are concerned that the definition in S. 243 of mandatory contributions will unnecessarily exclude large numbers of employees from tax incentives afforded by the bill. This would produce a significant hardship on those individuals who now participate in plans that essentially have a voluntary contribution feature which would be considered mandatory under your bill.

Second, we are concerned with employing special withdrawal provisions in vehicles designed to encourage retirement savings for nonretirement-related events. Incentives for savings other than retirement we feel should be legislated separately, as recommended in S. 24.

I appreciate the opportunity to appear before you today and would be happy to answer any questions.

Senator CHAFEE. Thank you, Mr. Levins.

STATEMENT OF JEFF R. HART, EXECUTIVE DIRECTOR, THE ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS, INC.

Mr. HART. I am Jeff Hart, executive director of the Association of Private Pension and Welfare Plans.

In beginning, I wish to stress that we endorse the comments just concluded by Mr. Levins, who has provided an overview of this association's concerns with the bills under consideration. Therefore, I would like to focus quickly on the key issue of deductibility for mandatory and voluntary employee contributions.

It is important to note today that the potential for growth in the private retirement system will not be fully realized unless deductions are permitted for both voluntary and mandatory contributions. By mandatory I mean those contributions requiring the employee to participate in a plan or to share in the employer's contribution.

Most plans which require so-called mandatory employee contributions provide for a sliding scale of contributions. For example, a typical thrift-sharing plan will permit contributions anywhere from 1 to 6 percent of an individual's compensation, which in turn will be matched in some corresponding manner by employer contributions.

Those bills before us, which do distinquish between mandatory and voluntary contributions, would deem all contributions matched as mandatory. Under the example plan, then, the entire 6 percent would not be deductible. Therefore, an employee contributing under the 6-percent ceiling, who decides then to increase his savings rate, is faced with an uncomfortable choice. As a first alternative, he must make additional nondeductible contributions up to

the ceiling before then being permitted to make deductible contributions under the plan.

Second, he can make deductible contributions to an IRA, thereby losing the opportunity to participate in his employer's plan and to receive the employer's contribution.

Obviously, this arrangement will be difficult to understand for many, leading to deduction confusion and, more unfortunately, causing some employees to cease making contributions under a plan, thereby forfeiting the value of employer-sponsored benefits.

This inadvertent disfranchisement of many employees should be avoided.

Senator CHAFEE. It was not inadvertent. It was a recognition and a concern we would be giving a tax deduction for literally billions of dollars which are already being saved. The objective of this legislation is to create new savings, incremental savings.

As I mentioned in my opening remarks, there was some concern that last year when we went to the $200/400 interest exemption, interest income and dividend income exemption, we were rewarding people who are already doing what we were encouraging be done.

Under the proposal that you and Mr. Levins are suggesting here, you are sending us into some very, very substantial revenue losses. Maybe the equity is on your side to some degree. However, the costs are mind-boggling.

Senator MITCHELL. I would like to ask both Mr. Hart and Mr. Levins the same question I asked Mr. Harris.

If one believes that inflation is the principal problem we confront in this Nation in our domestic affairs, and if one accepts the argument that Federal budget deficits are a prime cause of inflation, to the extent that these proposals result in significant reductions of revenue to the Government and therefore contribute to the deficit, are these not inflationary proposals?

Mr. LEVINS. Sir, we are looking at these bills in terms of a tax reduction that is being proposed by the administration. We feel that in that context, a more focused approach, with direction toward savings as compared to just a straight tax deduction, would be more beneficial.

It is our feeling that what we are talking about here is not inflationary. It will not be money that will go into consumption but, rather, it will go into savings.

Senator MITCHELL. Are you suggesting this as a substitute for a tax reduction?

Mr. LEVINS. I am suggesting this as part of the proposed tax reduction, that this be an integral part of the current consideration of tax reductions.

Senator MITCHELL. Enacted in lieu of a reduction or in addition to a reduction?

Mr. LEVINS. As part of the proposed reduction; rather than having a simple, unspecified reduction, that part of the reduction be earmarked for savings for retirement programs. It would be part of the basic administration's tax reduction program.

Senator MITCHELL. Anybody who gets a reduction is required to invest it?

Mr. LEVINS. No, sir, but the option would be made available.

Senator MITCHELL. Encouraged.

You are answering my question by saying as part of it, in addition to a tax reduction. You are saying pass the tax cut and then, to encourage people to save the money they receive from the tax cut, pass this program.

Mr. LEVINS. I would express it, sir, on the basis of saying that in terms of making a determination about the total value of a tax reduction package that this be factored in as a portion thereof and be part of that overall tax reduction, that it be an integral part of whatever tax reduction is passed.

Senator CHAFEE. I am prepared to believe that this program, as set forth in our legislation, is essentially noninflationary. It creates capital. It encourages savings. It has a lot of virtues which go along with encouraging savings, as has been pointed out.

However, the point being made here by both you and Mr. Hart gets us into an area which goes way beyond anything certainly I was thinking about.

Mr. HART. I understand the issues in terms of capital formation and further exacerbating inflation. What we are concerned about——

Senator CHAFEE. Before you get into that, do either of you gentleman have a clue as to how much money is already being saved through mandatory pension plans? Just take the Federal Government alone. If both of us are Federal employees, for our pension plan we must save. Under your proposal you give us a deduction for that?

Mr. LEVINS. One proposal would provide if public employees were included that mandatory and voluntary deductions would be included as part of the overall program.

Senator CHAFEE. Have you any idea how much we set aside annually now in mandatory pension contributions?

Mr. LEVINS. No, I do not, sir.

Mr. OPPENHEIMER. Senator, may I contribute a thought to the discussion?

Senator CHAFEE. You certainly may.

Mr. OPPENHEIMER. Under an alternate proposal which I understand may be introduced in the relatively near future, it is suggested—and this is a proposal which my organization would support—that if Government employees are covered by social security they would be treated the same as any private sector employee. However, if they are not covered by social security, they would be allowed a deduction only for contributions in excess of what their social security contribution would be had they been covered by social security.

Of course, if they had any secondary sources of income, for example from moonlighting, that would be treated the same way as private sector employees.

I cannot argue that it contributes a great deal to simplicity but I think it comes closest to treating Government employees in the same way that private sector employees would be treated, and I think it goes a long way toward overcoming your concern.

Senator CHAFEE. You are taking a mammoth hurdle here. You are saying if Government employees are covered by social secu-

rity—and we have enough problems around here immediately, it seems to me, without getting into that one.

You appreciate the sensitivity of putting Government employees into this.

Mr. OPPENHEIMER. Absolutely.

Senator CHAFEE. This is a modest plan. I am not prepared to revolutionize the retirement system of Government employees for the advancement of this plan.

Mr. LEVINS. Maybe I can qualify that. We are not proposing the absolute inclusion of all public employees. We feel that it is a group which needs to be looked at in terms of revenue availability.

We think the problems with public employees are different from those of private employees. They have different types of programs and different types of benefits.

We only are suggesting that if, in fact, it is decided to include public employees, then the considerations as identified by Mr. Oppenheimer be included.

Senator CHAFEE. We don't want to spend too much time on this. Both of you obviously have come up with rather a revolutionary idea, both you and Mr. Hart.

However, that is what you are here for—to give your testimony. We are delighted to hear it.

Mr. HART. Our primary concern is what we think is an overly broad definition of "mandatory." It might be another matter for further consideration if "mandatory" were deemed to be that percentage of contributions required to participate in the plan.

The way it is construed in S. 243, it includes all contributions which are matched, even above that participatory threshold.

The prime concern we have in the private pension area is that denying deductions for a mandatory contribution will discourage new plan formation for employees of small- and medium-sized employers. This is the very segment where increased retirement coverage is most needed today.

We firmly endorse the parity between IRA and qualified plan deduction ceilings featured in S. 243. However, it is our view that distinctions should not be made in private plans between mandatory and voluntary contributions.

If properly constructed, deductions can generate broader pension coverage and enhance capital formation, while reducing pressure on our distressed social security system. We applaud, therefore, all who have introduced bills to encourage retirement savings.

Thank you.

Senator CHAFEE. Thank you.

Mr. Levins, in your statement, as I read your statement, you were resisting the use of IRA for the payment on a first residence or payment on a child's education.

Did you read that?

Mr. LEVINS. We are not resisting it categorically. What we are suggesting is that a bill which talks about tax incentives for retirement programs should be retained just for that purpose. If there is consideration to be given for savings for other purposes, it should be handled in separate legislation.

The nature of the savings for retirement is such that it should not be diluted by other well needed savings programs. They should be handled separately.

Senator MITCHELL. I would like to ask Mr. Levins one question. You made reference to Canada, Mr. Levins, in support of this position.

Mr. LEVINS. Yes.

Senator MITCHELL. It is my understanding that in Canada, for personal income tax purposes interest expenses are not deductible as they are here, and that is one mechanism by which saving is encouraged. It is a disincentive to incurring debt for present consumption.

Do you have any knowledge as to whether or not that might be a principal contributing factor to the rate of savings there as opposed to some other aspect? If so, would you favor that in this country?

Mr. LEVINS. Sir, I do not have knowledge as to what impact that has. I am not prepared to say that would be appropriate for this Nation.

We do know, however, from the surveys that have been conducted and have been identified in the testimony, that there is considerable documentation to support the fact that just the existence of tax exemptions and the probability of that will have a significant impact on individuals making incremental savings.

Both the Cambridge Report surveys and the Roger Seasonwein surveys indicate that there are large segments of the population that would take advantage of this program and make incremental savings to their existing savings programs.

Senator CHAFEE. One of the points in having the college portion in there and the first home is to encourage young people to go into these plans. Your own experience has proven that the IRA's as presently constituted have not been very successful.

Mr. LEVINS. That is right.

Senator CHAFEE. Maybe it is for a variety of reasons. One is that certainly a young person setting aside a modest amount for his old age sees that being so far away and so modest why even bother.

Mr. LEVINS. It is speculation but we feel there is quite a bit of difference between a program which is individually generated, like an IRA, and a program such as we are talking about here, which would be in what we call the group environment, where you have all the synergistic impacts of the group solicitation, payroll deductions, encouragement of participation, ease of administration.

There are a number of plans in place today that our company writes and others write which are totally on a voluntary basis with no tax incentives and they get very, very wide distribution across all income levels and across all age groups.

We believe the reason the IRA situation has not worked well is not because there is something basically unsound with the concept but, I might say, because it just basically has not been marketed properly.

Senator MITCHELL. By you as well as others?

Mr. LEVINS. Insurance companies have not been actively involved in the marketing of IRA's, but I would not think we would do much better had we been in it.

Senator CHAFEE. I worked for a man once where we had some program, and I said, "It is a great idea but it didn't work." He said, "Therefore, it wasn't a great idea."

I am not so sure that does not apply to the present IRA.

Senator MITCHELL. What do you think about that part of S. 243 which includes the special housing and education provision? Do you think that is a good idea?

Senator CHAFEE. Mr. Levins gave his views.

Senator MITCHELL. Is everybody for that? Does anybody think that might not be such a good idea?

I am going to leave and you are going to have to face Senator Chafee for the rest of the day.

Mr. HART. Our association has not made any reference to this issue in its written remarks, nor do we currently have a formal position. However, there is a wide concern among our membership, in the pension plan area, particularly when the pension system is under pressure from several quarters in terms of both coverage and general level of benefits.

We are very concerned, within the context of the retirement vehicle, if we can refer to it as that, about opening it up for other very worthy and laudable social needs that constitute somewhat shorter term savings requirements.

Mr. OPPENHEIMER. Senator Mitchell, I should explain that I am here as counsel to a group of major employers who would encourage all forms of savings but who, I think at this point, believe that if additional incentives are needed for housing and education they could be best provided in separate nonretirement vehicles following the mode, for example, of Senator Dole's bill, which I believe is S. 24.

There is concern that if you allow withdrawals for nonretirement purposes you would reduce the funds available at retirement. There also is concern that you would be shifting from longer to shorter term savings, and there is a concern that you would be introducing added complexity in an area which already is unduly complex.

Mr. TAYLOR. Senator, as a representative of small employers, particularly automobile dealers, we have the same view as large employers with regard to this issue, that is, that this proposal for retirement savings is of primary importance and we need to accumulate greater retirement savings to take some of the pressure off the demands on increased social security benefits to provide more of that three-legged stool we always have had, personal savings, retirement plans and social security.

While this is a good idea, we don't think it ought to be part of this proposal for the reason Mr. Oppenheimer stated—it will reduce retirement savings when the time comes and we will be back in the same boat.

Mr. FACCIANI. We form a united front.

Senator CHAFEE. Not united with the first panel we had, the college presidents.

Are you through, Mr. Hart?

Mr. HART. Yes.

Senator CHAFEE. Gentlemen, we have consumed a lot of time, but I do not want to cut you too short.

Mr. OPPENHEIMER. With your permission, in order to better coordinate and perhaps expedite our testimony, may I go last?

Senator CHAFEE. Yes. Fine.

Mr. Facciani.

STATEMENT OF GERALD FACCIANI, CHAIRMAN, GOVERNMENT AFFAIRS COMMITTEE, AMERICAN SOCIETY OF PENSION ACTUARIES

Mr. FACCIANI. Mr. Chairman, my name is Gerald Facciani. I am chairman of the Government Affairs Committee of the American Society of Pension Actuaries.

ASPA is a national professional society whose 1,800 members provide actuarial, consulting, and administrative services to approximately 25 percent of the qualified retirement plans in the United States. Many of our members provide services primarily to small business organizations. For example, in my particular case I own and operate an actuarial consulting and administration firm which provides a variety of retirement plan services to over 300 retirement plans instituted primarily by small businesses.

ASPA has been and continues to be an active spokesman in support of permitting tax-deductible contributions by employees covered by employer-sponsored qualified plans to such qualified plans or to IRA's.

Senator CHAFEE. You have a long statement. You will not be able to get through it.

Mr. FACCIANI. You are right.

Senator CHAFEE. I know I am right because I propose to control the clock.

Mr. FACCIANI. It has been edited.

Senator CHAFEE. The editing is not in evidence so far. Go ahead.

Mr. FACCIANI. We believe the amount available to be deducted should be the same for qualified plan participants as for those persons contributing to IRA's and any contribution limit be indexed to reflect cost-of-living increases.

We believe allowing such deductible contributions would significantly expand the coverage of the private pension system, particularly in a small employer area, where the most significant problem of noncoverage exists and would stimulate capital formation.

At this point I would like to discuss the reasons why we feel deductible employee contributions would significantly expand coverage under the private retirement plans. My own experience as a consulting actuary indicates that present law has had an adverse effect on employer-sponsored plans by encouraging employees to withdraw from such plans where participation is voluntary to obtain a deduction for an IRA contribution.

This results in noncoverage under the qualified plan for the withdrawing employees and such withdrawals endanger the qualified status of many existing plans.

Second, permitting deductible employee contributions would greatly expand the private system by encouraging small businesses to initiate and improve plans for their employees without incurring heavy cost of providing all benefits.

Employees would be more willing to share this cost burden if contributions were deductible. I can tell you from experience that

employers increase the level of their contributions as time passes, and I would expect the same pattern to prevail if deductible employee contributions were permitted.

You have heard and will continue to hear testimony regarding the problem faced by the United States with regard to inadequate capital formation. I would like to discuss the impact of capital shortage on small business.

The limited financial resources of small business are such that the shortage of available capital is felt most acutely by them. Again my experience indicates that small business organizations have a great need for capital and most difficulty obtaining it when the money supply is tight.

When this fact is considered in light of the contributions of small business to our economy, the present capital shortage problem takes on a significance not readily apparent.

New and existing small companies in recent years have provided 86.7 percent of the Nation's new jobs in the private sector. More than half the major technological advances in this century originated from individual inventors and small companies.

It certainly is true that the shortage of capital affects large as well as small companies.

Senator CHAFEE. Well, Mr. Facciani, I have to blow the whistle on you here. Do you have much more to go?

Mr. FACCIANI. No.

Senator CHAFEE. Thank you.

Mr. Taylor?

STATEMENT OF RICHARD B. TAYLOR, ASSISTANT DIRECTOR-COMPLIANCE, NATIONAL AUTOMOBILE DEALERS & ASSOCIATES RETIREMENT TRUST

Mr. TAYLOR. Mr. Chairman, I will not rehash anything that has been said.

I do want to say, however, the concept of deduction of mandatory contributions is not a new issue. In fact, it is in S. 12. The question of coverage of Government employees is another issue entirely.

I am Richard B. Taylor. I am assistant director of the National Automobile Dealers and Associates Retirement Trust. We are a trust fund of over $400 million in assets, representing over 5,000 small employer plans and about 70,000 individual participants. NADART is part of the National Automobile Dealers Association, which represents 20,000 new car dealers around the country.

As discussed by Mr. Facciani, most small employers need to share the initial burden of establishing a plan. Generally the financial position of our average dealer does not permit him to maintain a plan without seeking to share the cost with his employees. That is demonstrated by the fact that approximately 90 percent of the plans which we administer are contributory, with mandatory contributions.

I believe some of the statistics that participation in our trust demonstrate, show that there is some incentive already existing and that this will be stimulated if a deduction for employee contributions is enacted.

By way of practical experience in this area, I mentioned that 90 percent of our plans are contributory, providing for mandatory

contributions. For that reason we believe people are conditioned right now to make contributions to those plans.

The required amounts are small, usually about 2 percent of pay. Some make larger contributions through voluntary features under the plans, although those amounts still are relatively small.

The average contribution by our small number of participants who are making both mandatory and voluntary contributions is a little less than 4 percent of pay. The voluntary contribution, therefore, turns out to be less than 2 percent of pay on average.

A deduction for contributions will induce participants to increase their voluntary contributions and will also induce approximately 25,000 of the remaining participants who are not making voluntary contributions to begin doing so.

Presently we receive in excess of $72 million a year in contributions from all sources. Deductibility can raise this amount, we think, to about $125 million. That is over a $50 million increase. Adoption of this type of bill will encourage the establishment of new qualified plans.

We ran a computer random sample of our plans recently. I will give you some numbers. There were 51 dealers in that sample. The average size was 15 participants. The average voluntary contribution was 2 percent of pay.

The majority of the employees who are making voluntary contributions make less than $20,000 a year. Employees making voluntary contributions are only 31 percent of all participants. The average employee's wage is only $15,000.

We think from additional contributions plus new participants in the plans who are induced to participate for the first time and new plans formed, that we can increase this contribution level, as I mentioned, by over $50 million.

What we have now——

Senator CHAFEE. The problem here is that you will get a few more people, yes, into the mandatory plans. However, the cost to the Federal Government is astonishing because the people who are already in there are doing it. I am surprised you people do not address that.

Is that of no concern?

Mr. TAYLOR. The amounts of our mandatory contributions are relatively small. We have looked at revenue loss figured in the past——

Senator CHAFEE. But the point is you outline here that they are already in existence. You have *x* thousand participants. "Currently 63,000 of our 70,000 participants are making mandatory contributions."

Therefore, what you are saying is that in order to get more people in, to induce them we will give this deduction to the 63,000. That could be repeated into millions across the country.

Where are you folks on this? Mr. Levins, I look to you as the ringleader on this inasmuch as you spoke first.

Mr. TAYLOR. If I may deal with those statistics from our standpoint, I am doing that strictly from the standpoint of the automobile dealers.

Senator CHAFEE. But it can be repeated all across the country in every industry.

Mr. TAYLOR. I understand, but the amounts in this case are very small. When we are talking about an average wage of $15,000 and 2 percent of pay, it is a $300-a-year contribution. We know from contact with our participants that they will increase their contributions substantially if they are offered this additional incentive.

Mr. LEVINS. May I follow up on that point? I think it is crucial and one of importance to this issue, as well a one that is particularly important to you.

We really believe—and there is documentation which we would be glad to share with the committee that substantiates this fact—that the savings that would be made, the incremental savings due to the change in providing tax incentives for mandatory contributions, those dollars would be additional dollars saved. Fifty-eight percent of the people surveyed in the Cambridge survey indicated that their savings would go into additional contributions.

We really believe that it will not be simply a transfer of funds, and that in fact it substantially will increase the level of savings. That really is a key point, sir. We would like to emphasize that and provide you with the documentation which substantiates that. It is fundamental to our position on this question of mandatory and voluntary contributions.

Senator CHAFEE. All right.

Does that complete your presentation, Mr. Taylor?

Mr. TAYLOR. Yes.

Mr. Oppenheimer wants to give his presentation next.

STATEMENT OF JERRY L. OPPENHEIMER, ON BEHALF OF THE ERISA INDUSTRY COMMITTEE

Mr. OPPENHEIMER. Thank you, Mr. Chairman.

Let me begin by following up on something. I think your principal concern about covering mandatory contributions is giving what might be viewed as a windfall to those Government employees who are covered by mandatory programs.

Senator CHAFEE. That plus the loss in revenue. It is really the loss in revenue.

Mr. OPPENHEIMER. That is not what we had in mind. With your permission, perhaps we could clarify this for the record before it closes.

[Letter to Senator Chafee from Jerry S. Oppenheimer.]

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MAYER, BROWN & PLATT

888 SEVENTEENTH STREET, N.W.
WASHINGTON, D.C. 20006
TELEX 892603 CABLE LEMAYDC
202-785-4443

231 SOUTH LASALLE STREET
CHICAGO, ILLINOIS 60604
312-782-0600

277 PARK AVENUE
NEW YORK, NEW YORK 10017
212-838-7110

122 QUEEN VICTORIA STREET
LONDON EC4V 4BB, ENGLAND
01-248-1465

March 11, 1981

Honorable John H. Chafee
United States Senate
3103 Dirksen Senate Office Bldg.
Washington, D. C. 20510

Dear Senator Chafee:

At your February 24 hearing on savings incentive tax bills I fear that I inadvertently left you confused with respect to my position regarding the proper relationship between allowing deductions for "mandatory" contributions to qualified plans, extending the deduction to government employees, and covering government employees by Social Security.

In an attempt to set matters straight, let me note:

(1) I was <u>not</u> advocating covering government employees by Social Security. Indeed, I did not intend to take any position on that issue.

(2) I <u>was</u> advocating the general position that both "voluntary" and "mandatory" contributions to employer plans should be deductible within the same limits.

(3) And I was also advocating that, if contributions by government employees are to be deductible, a special rule for their contributions to employer (government) plans should be adopted to avoid a "windfall" and to minimize the revenue cost, that is

(a) any contribution by a government employee who is covered by Social Security should be treated the same as any contribution by a private sector employee;

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Senator Chafee
Page Two
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(b) any contribution by a government employee who is not covered by Social Security should be deductible only to the extent that the contribution exceeds the amount of Social Security tax which would have been paid by the employee if he had been subject to Social Security; and

(c) any contribution by a government employee from part-time or other private sector employment to a plan or to an IRA should be treated as any other contribution by a private sector employee.

This approach treats government employees as similarly as possible to private sector employees and, generally, would not give federal (or state) employees, who are not covered by Social Security, deductions for amounts required to be contributed to Federal Civil Service or other government retirement programs.

This is the approach taken by Congressmen Frenzel, Pickle and Rousselot in H.R. 2207 which was introduced on February 26, two days after your hearing, and I understand that it has also been favorably received, although not yet formally introduced, by some of your colleagues on the Finance Committee.

I would welcome the opportunity to offer any further clarification which may be appropriate or to answer any question you or your staff may have.

Sincerely,

Jerry L. Oppenheimer

JLO/sr

Mr. OPPENHEIMER. If I may speak more broadly for a moment, this is the third time in as many years that I have had the opportunity to appear before the full committee or one of its subcommittees, on behalf of a major group of major employers, in strong support of the concept of allowing deductions by those covered by qualified plans, deductions either to qualified plans or IRA's.

In a word, we believe it is an idea whose time has come. We are strongly supportive, notwithstanding some of the disagreements we have had this morning, of the general thrust of what you are trying to do and what Senator Dole and Senator Bentsen are trying to do, and indeed what the Finance Committee was trying to do in its proposals last September.

However, I think it is important to keep whatever system you ultimately agree upon as simple as possible and the administrative burdens at a minimum in order to encourage the maximum public understanding and participation.

If you would allow me to take last September's decision as a model, we strongly endorse its general thrust, but it is an unfortunate example of the complexity that would flow from treating mandatory contributions differently and from treating contributions to IRA's differently than contributions to qualified plans.

At page 7 of my testimony there is an example which might best make this point. I will not take the time to take you through it at the moment, but I do hope at some other time you will have an opportunity to focus on it. It is less than a full page. I think it demonstrates the difficulty the public would have.

I think the point is obvious. I think that you can avoid most, if not all, of that difficulty if you would make deductions to qualified plans and IRA's subject to the same limits, whatever those limits may be, and if you would treat mandatory contributions the same as voluntary contributions.

Thank you, Mr. Chairman.

[The prepared statements of the preceding panel follow:]

SUMMARY OF MARVIN A. LEVINS' TESTIMONY BEFORE SENATE SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY

I am Marvin A. Levins, Senior Vice President of Connecticut General Life Insurance Company, in charge of its group pension operations. I am appearing before your Subcommittee on behalf of the American Council of Life Insurance which believes that there is a distinct need to provide incentives which will encourage retirement savings and that S 12 and S 243 provide the essential provisions to stimulate a successful retirement savings program, commonly referred to as Limited Employee Retirement Accounts (LERA) or Employee Retirement Savings Deductions (ERSD).

Need for Incentives for Savings

The savings rate in this country is low compared with other industrialized countries. As of the third quarter of 1980, Americans saved only 5.7% of disposable income. This lack of savings is perceived as a major problem by Americans as demonstrated by a recent survey by Roger Seasonwein Associates, Inc., a national survey research firm, which indicated that 72% of the work force feel their savings are inadequate and almost half feel they will not be able to afford to retire.

Individual savings for retirement needs to be increased not only to ensure adequate retirement income, but also to:

1. alleviate pressure on the Social Security System for benefits;
2. increase capital formation;
3. encourage formation of new pension plans.

Furthermore, as the Senate Finance Committee recognized last year, increased tax incentives for retirement savings provide immediate and non-inflationary tax relief and are, in reality, only a deferral of tax revenue loss.

An effective way to increase individual savings for retirement across all income levels is through tax incentives. There is good evidence that such incentives will work. For example, the Canadian experience with the Registered Retirement Savings Plans (RRSP) demonstrates that these vehicles are widely utilized and have increased savings. Other evidence comes from Cambridge Reports, Inc., a national survey research firm, which found that:

- 58% of American workers currently contributing to plans would be very or somewhat likely to contribute <u>more</u> money if Congress passed legislation that allowed them deductions;
- 47% indicated that the incremental money would represent new <u>additional</u> savings. It is also significant that these perceptions did not vary widely by income classification.

<u>Recommended Lera Provisions</u>

To achieve the desired results, we feel that incentives for retirement savings by qualified plan employees should be:

- available to the largest cross-section of eligible employees;
- equivalent to the deductible limits for IRA's to

ensure understandability and ease of administration

- permitted for all employee contributions, whether mandatory or voluntary.

S 12 and S 243 Meet Most of These Criteria

S 12 meets all but one of the above criteria because it minimizes the complexity of LERA and maximizes its coverage and flexibility. This is accomplished by:

1. Permitting deductions for all employee contributions;
2. Providing participants the freedom to choose the appropriate investment vehicle for their LERA contributions - the employer's plan or an IRA;
3. Not prescribing burdensome administrative requirements.

We are concerned, however, with the disparity between deduction limits for active plan participants and non-plan participants; different limits will cause confusion, necessitate more complex regulations and could provide incentives for employees to opt out of plans.

S 243 also incorporates much of what we feel should be key provisions of retirement savings incentive legislation. We are particularly pleased that it includes equal deduction limits for all employees. We also support Senator Chafee's recognition that a larger permissible deductible amount will further strengthen contributions to retirement savings. However, we are concerned that the definition in S 243 of "mandatory contributions"

will unnecessarily exclude large numbers of employees from the tax incentives afforded by the bill. Secondly, we are concerned with employing the special withdrawal provisions of vehicles designed to encourage retirement savings for non-retirement related events. Incentives for savings other than retirement should be legislated separately as is done in S 24.

American Council of Life Insurance

1850 K Street, N.W.,
Washington, D.C. 20006
(202) 862-4000

February 24, 1981

STATEMENT BY MARVIN A. LEVINS, SENIOR VICE PRESIDENT, CONNECTICUT GENERAL LIFE INSURANCE COMPANY, ON BEHALF OF THE AMERICAN COUNCIL OF LIFE INSURANCE, BEFORE THE SENATE FINANCE SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY ON THREE SAVINGS INCENTIVE TAX BILLS.

INTRODUCTION

I am Marvin A. Levins, Senior Vice President of Connecticut General Life Insurance Company, in charge of its Group Pension Operations. Today I am appearing before your Subcommittee on behalf of the American Council of Life Insurance. The Council has a membership of 510 life insurance companies which, in the aggregate, have 95 percent of the life insurance in force in the United States and which hold 99 percent of the assets of insured pension plans. We are pleased that your Subcommittee is considering bills on tax incentives for savings and would like to take this opportunity to provide you with our comments on the subject.

BENEFITS OF EMPLOYEE RETIREMENT SAVINGS

We particularly want to address the need to provide incentives which will encourage retirement savings as well as the legislative provisions essential to stimulating a successful retirement savings program. These programs have commonly been referred to as Limited Employee Retirement Accounts (LERA) or Employee Retirement Savings Deductions (ERSD).

During the past several years there has been significant and increasing interest in legislation which would bolster individual retirement savings. This interest has been fueled by the realization that there is a critical need to increase long-term investment capital in the United States and to encourage individuals to save more. Illustrative of this is the fact that as of the third quarter of 1980, Americans saved only 5.7 percent of disposable income, which is significantly below the savings rate of other industrial nations (see Exhibit I).

This lack of savings is perceived as a major problem by a majority of Americans. A recent survey by Roger Seasonwein Associates, Inc. (commissioned by the Council) indicates that while 63% of all Americans feel they are saving too little, an even higher 72% of working Americans feel their savings toward retirement are inadequate. Moreover, almost half the work force feels they will not be able to afford to retire.*/

These concerns are an important reason for the overwhelming public opinion in favor of tax incentives for retirement savings. Indeed, the Roger Seasonwein Associates survey indicates that Americans support this concept by an overwhelming 72% to 15% margin. Also, the President's Commission on Pension Policy, in its final report due out later this week, is expected to conclude that individual savings is a vital resource if an adequate retirement standard of living is to be ensured, and will most likely recommend that favorable tax treatment be extended to employee contributions in all types of pension plans.

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*/ See the attached survey "Americans and Retirement: The Financial Crisis" conducted by Roger Seasonwein Associates.

As has been graphically demonstrated during the last several years, adequate retirement security by Social Security alone is an unaffordable option. In addition to private pension plans, individual savings are necessary to reach the goal of an affordable retirement income system. With the current low rate of individual savings, tax incentives, such as those proposed in the bills being discussed today, are needed to increase individual savings and improve the adequacy of retirement income for a broad cross section of Americans. It is important to note that 89% of the public feels the current level of taxation keeps people from saving more. (See the Roger Seasonwein survey.) Moreover, the Canadian experience with Registered Retirement Savings Plans (RRSP) indicates that tax incentives will be widely used and can yield effective results.

In addition to increasing savings among people participating in pension and profit sharing plans, and thereby improving the adequacy of retirement income, there are several other advantages to an Employee Retirement Savings Deduction. These include reducing the pressures on Social Security, increasing capital formation, providing a non-inflationary tax cut, and encouraging new plan formation.

Let's briefly look at each of these advantages:

(Increased Capital Formation.) Retirement savings are an important source of long-term investment in the capital goods so essential for a growing and dynamic economy. At present, $321 billion in pension investments are helping to create jobs and improve productivity in our nation. ERSDs would significantly

increase the availability of such capital.

(Non-Inflationary.) By encouraging long-term savings and thus contributing to the capital resources of the nation, ERSD is one of the few individual tax cuts that is not inflationary, since money saved through this system will not be used for consumption.

(Encourage New Plan Formation.) By encouraging employee contributions, employers, who could not otherwise afford the cost of a plan, will now find a plan more affordable. This will be particularly true among small and newer employers who find it difficult to form plans because of costs.

(Reduced Pressures on Social Security.) By encouraging individuals to save more for their retirement and employers to establish qualified pension plans, ERSD will alleviate escalating pressures on the Social Security System. The pressures will otherwise become overwhelming during the next several decades, as fewer workers are required to fund benefits for a greater number of recipients.

EXPECTED INCREASED UTILIZATION OF EMPLOYEE RETIREMENT CONTRIBUTIONS IF CONGRESS PASSES SAVINGS INCENTIVE

The following describes expected employee utilization of a retirement savings deduction where the employer does not have a retirement plan or where the employer has a plan as well as a provision for employee contributions. It would be expected that if the employer has no facility for employee contributions, the employee would choose to purchase an IRA.

New Plan Formation

A deduction for employee pension contributions, including

mandatory contributions, would make it feasible for many employers, especially small ones, to establish plans they could not otherwise afford by having their employees share in the costs of their retirement program.

It would also be possible for them to improve benefits in situations where the employers would, themselves, be unable to pay the full cost of the benefit improvement.

Increased Contributions Among Current Contributors

Results from the December 1980 phase of interviews performed by Cambridge Reports, Inc. provide further confirmation of Cambridge survey results from a September 1980 wave of interviews. According to a random sample of current contributors to employer pension, profit-sharing or thrift plans, 58% of Americans, currently contributing on an annual basis, would be expected to contribute more money annually if Congress passed legislation that allowed individuals tax deductions for contributions (see Exhibit II).

It is critical to note that while results on this question correlated with household income, over one-half of the respondents in the $10,000 - $19,999 income category maintained that they would be "very" or "somewhat" likely to contribute more money on an annual basis if legislation were passed (see Exhibit III). This clearly refutes those that suggest such incentives would only be utilized by the wealthy. An informal survey by Connecticut General and other member companies of the Council reinforce the survey findings that employees, at all income levels, would participate in employer-sponsored savings plans.

Another question frequently asked is whether savings incentives of this kind will actually increase total savings or rather simply stimulate "transfers" from one savings vehicle to another. The Cambridge results also shed considerable light on this question (see Exhibit IV). In fact, 47% of the respondents in the Cambrigde survey indicate that the incremental money they expect to contribute would represent "additional savings that would not be saved otherwise." Another 23% maintain that at least some of this money would be "additional savings."

Moreover, over 70% of the respondents consider their contributions to employer pension, profit-sharing and thrift plans as a "long-term savings account for retirement" (see Exhibit V). These expectations of increased savings are supported by current trends in Canada. A recent study performed by Professor Daniel M. Holland of MIT, concludes that contributions to the Canadian Registered Retirement Savings Plan over the last 10 years have, in good part, represented net additions to personal savings.

Summary

According to the Roger Seasonwein survey, 47% of the population of workers currently covered by employer-sponsored retirement plans, said they would start to contribute or increase their contribution if they were already contributing if they received a deduction for their contribution. The average additional contribution would be $617. Based on a private sector work force of approximately 81 million and an estimated incidence of pension coverage of about 48%, one can project that if 47% of covered workers contribute an average $617, the potential for

increased contributions earmarked for retirement is over $11 billion. I must stress that this represents a potential of maximum employee contribution, and not a projection of how much would be set aside if a tax change is adopted. This will, of course, depend on the precise nature of the plan, how it is communicated, the extent of employer cooperation, and other factors.

Increased Savings Among Employees that Do Not Contribute Even Though Employer Plan Has Provision For Contributions

There are those, of course, that have the opportunity to make contributions to pension plans but choose not to. According to the Cambridge surveys, 44% of employees that fit into this category indicate that Congressional legislation for tax deductions would cause them to contribute on an annual basis (see Exhibit VI).

COMPONENTS OF LEGISLATION

The Council believes that an employee retirement savings program should be designed to stimulate high rates of participation and retirement savings. Therefore, legislation must include the following principles:

The Program must be available to a broad cross-section of eligible employees and must be simple to administer.

First, the legislation should be simple for plan participants to understand with its purpose, provisions, and benefits widely known. This will help guard against a repeat of the IRA program's failure to be widely utilized. Second, the legislation should avoid unnecessary administrative requirements. Simplicity in this area will encourage employer sponsorship and, therefore, reach a large number of eligible employees at a wide range of income levels.

The deductible limit for employee contributions should be equal to the IRA limit.

Making limits the same for plan and non-plan participants (currently $1,500 or 15 percent of compensation, if lower) would eliminate any potential confusion on the part of employees as to the maximum amount that may be contributed for retirement savings and would simplify administration for employers and the government.

Employees should be permitted to deduct both mandatory and voluntary contributions.

The allowance of a deduction for mandatory contributions would be a strong incentive for the establishment of new plans or improvements of benefits under existing plans by employers who would otherwise be unable to afford the additional cost. We believe that providing favorable tax treatment for all employee contributions would result in a more equitable treatment of taxpayers. According to the Cambridge Report survey, 50% of the respondents currently participating in mandatory plans would expect to contribute more money if tax deductions were available.

Tax incentives should take the form of a deduction rather than a credit.

A deduction approach would promote simplicity and understandability, and would be consistent with the traditional approach towards tax incentives for retirement programs, such as IRA's or employer contributions to pensions.

DISCUSSION OF S.12 and S.243

Having addressed the broad principles that we believe are essential to the success of employee retirement savings deduction legislation, I would like to make a few specific comments on the

savings incentives offered in the proposals introduced by Senators Dole and Chafee.

Senator Dole's bill (S.12), which provides for limited employee retirement accounts, addresses most of our concerns because it minimizes the complexity of ERSD and maximizes its coverage and flexibility. S.12 accomplishes this by permitting deductions for all employee contributions (voluntary and mandatory), by offering participants a choice between investing their contributions through their employer's plan or an IRA, and by not prescribing burdensome administrative reporting and record-keeping requirements. Our main area of concern with the proposal is that the deduction limit for employees who are actively participating in their employer's pension or profit sharing plan is less than the maximum deduction offered to non-plan participants. This disparity creates two concerns, in addition to the fact that the individual retirement savings would be less:

1. Different limits will necessitate more complex regulations and will offer more potential for employees to make incorrect IRA deposits. For individuals to determine whether or not they are active participants in a qualified plan is difficult, as demonstrated by the current problems with IRA participation rules. This problem has become more significant because of the American work force's increased mobility.
2. Unequal deduction limits for plan and non-plan participants could provide incentives for employees to opt not to participate in their employer's qualified plan. A larger deduction

today as a non-participant may seem more attractive than the furture retirement income offered by the employer's plan. This would negatively impact two important objectives: increasing plan formation and continuation of present plans and providing adequate retirement income.

Senator Chafee's bill, "The Savings and Retirement Income Act of 1981" (S.243), allows equal deduction limits for participants in qualified employer sponsored pension plans, and for non-participants and, therefore, avoids what we feel to be the problems associated with unequal limits. Tax incentives for retirement savings contributions are essential and should be raised to the highest affordable amount. If Congress feels that $2,000 is consistant with the overall economic objectives of bringing inflation under control, we would be supportive.

However, we have two serious concerns with Senator Chafee's proposal:

1. First, mandatory employee contributions are not eligible for favorable tax treatment and, as I have previously stated, this would produce inequitable treatment of taxpayers as well as discourage the establishment of new plans and additional benefit enhancements to existing plans. The purpose of a tax deduction for IRA's and ERSD's is to encourage individuals to set aside savings for future retirement use. Denying the deduction for mandatory contributions will discourage the formation of new plans by small and medium sized employers - the very ones where retirement protection is most needed today. This is so because it would deny a very important

incentive to low and medium income employees who have little or no discretionary income. In addition, it would discourage participation in thrift plans where the employee contribution would be considered a mandatory contribution under Senator Chafee's bill.

2. Second, S.243 proposes to allow penalty free IRA withdrawals for the payment of a child's higher education or the down-payment on a first residence. The Council believes that these special purpose withdrawal provisions should not be incorporated in a retirement savings bill and that individuals should be discouraged from using savings which have been earmarked for retirement for other purposes. As the Cambridge Research, Inc. data has shown, a significant percentage of employees who are currently saving for retirement are doing so exclusively for retirement purposes. ERSD legislation should not create new incentives that might discourage savings for retirement. Our preferred approach to meet additional savings needs would be the approach that Senator Dole takes with his proposed education and housing savings bill (S.24). Although the Council has no formal position on legislation targeted to encourage savings for purposes other than retirement, any such incentives should be separated from ERSD programs.

CONCLUSION

In conclusion, I would reiterate the American Council of Life Insurance's strong conviction that the value of providing incentives

for retirement savings will enhance the adequacy of employees' retirement income, thereby reducing the pressure on Social Security, will increase capital formation, will provide a non-inflationary tax cut, and will stimulate new plan formation.

I have appreciated this opportunity to express the Council's views on this subject and would be happy to respond to any questions the Subcommittee might have, or to furnish any additional information that you desire.

APPENDIX: EXHIBIT 1

RATE OF SAVING AS PERCENTAGE OF
DISPOSABLE PERSONAL INCOME*

COUNTRY	1967	1977
CANADA	7.0%	11.0%
FRANCE	12.0%	13.0%
JAPAN	24.0%	22.5%
WEST GERMANY	13.4%	12.5%

*United Nations Yearbook of National Accounts Based Upon Private Savings as a Percentage of Private Personal Income

APPENDIX: EXHIBIT, II

Q: IF CONGRESS PASSED LEGISLATION THAT ALLOWED YOU TO TAKE A TAX DEDUCTION FOR PENSION PLAN CONTRIBUTIONS, HOW LIKELY WOULD YOU BE TO CONTRIBUTE MORE MONEY ON AN ANNUAL BASIS OR WOULDN'T IT MAKE ANY DIFFERENCE?

VERY LIKELY	SOMEWHAT LIKELY	NOT VERY LIKELY	NOT LIKELY AT ALL	MAKES NO DIFFERENCE	DON'T KNOW
33%	25%	11%	5%	22%	5%

* CAMBRIDGE REPORTS, INC.
ASKED OF ALL THOSE CURRENTLY CONTRIBUTING TO EMPLOYER PENSION PLAN, PROFIT-SHARING PLAN OR THRIFT PLAN.

**AVERAGE CURRENT CONTRIBUTION FOR RESPONDENTS WAS APPROXIMATELY $975; THE AVERAGE EXPECTED INCREMENTAL AMOUNT FOR THOSE RESPONDING "VERY" OR "SOMEWHAT" LIKELY TO CONTRIBUTE MORE WAS APPROXIMATELY $730.

APPENDIX: EXHIBIT III

LEGISLATION QUESTION CROSSTABULATED

BY SELECTED

HOUSEHOLD INCOME CATEGORIES*

	VERY - SOMEWHAT LIKELY	NOT VERY/NOT AT ALL LIKELY	NO DIFFERENCE	DON'T KNOW
$10,000-19,999	51%	16%	25%	8%
$20,000-34,999	63	10	21	6
$35,000 AND OVER	67	22	11	0

* CAMBRIDGE REPORTS, INC.

APPENDIX: EXHIBIT IV

WOULD CONSIDER THE ADDITIONAL CONTRIBUTIONS TO EMPLOYER PENSION FUND AS:*

		RESPONDENTS
1.	MONEY THAT WOULD BE SAVED ANYWAY	16%
2.	ADDITIONAL SAVINGS THAT WOULDN'T BE SAVED OTHERWISE	47%
3.	PARTIALLY MONEY SAVED AND PARTIALLY ADDITIONAL SAVINGS	23%
4.	DON'T KNOW	14%

* CAMBRIDGE REPORTS, INC.

APPENDIX: EXHIBIT V

CURRENT CONTRIBUTIONS TO EMPLOYER
PENSION PLAN CONSIDERED
AS:*

1.	SAVINGS ACCOUNT TO BE USED WHEN NEEDED	14%
2.	LONG-TERM SAVINGS ACCOUNT FOR RETIREMENT	72%
3.	ACCOUNT TO ACCUMULATE FUNDS FOR COLLEGE AND OTHER MAJOR EXPENSES	5%
4.	DON'T KNOW	3%
5.	COMBINATION OF ABOVE	6%

* CAMBRIDGE REPORTS, INC.

APPENDIX: EXHIBIT VI

Q: IF CONGRESS PASSED LEGISLATION THAT ALLOWED YOU TO TAKE A TAX DEDUCTION FOR PENSION PLAN CONTRIBUTIONS, HOW LIKELY WOULD YOU BE TO CONTRIBUTE MONEY ON AN ANNUAL BASIS, OR WOULDN'T IT MAKE ANY DIFFERENCE?

VERY/SOMEWHAT LIKELY	NOT VERY/NOT AT ALL LIKELY	NO DIFFERENCE	DON'T KNOW
44%	23%	37%	5%

*CAMBRIDGE REPORTS, INC.

ASKED OF ALL THOSE NOT CURRENTLY CONTRIBUTING TO EMPLOYEE PENSION PLAN, PROFIT-SHARING PLAN, OR THRIFT PLAN, EVEN THOUGH THE EMPLOYER PLAN HAS PROVISIONS FOR EMPLOYEE CONTRIBUTIONS.

AMERICANS AND RETIREMENT: THE FINANCIAL CRISIS

A Report About A Survey Among
1,000 Americans

Prepared for
The American Council of Life Insurance

February, 1981

roger seasonwein associates, inc.

INTRODUCTION

This report centers on public attitudes about the adequacy of personal financial preparations for retirement.

It was commissioned by the American Council of Life Insurance to provide a framework for evaluating Americans' views about tax deductions for employee contributions to employer-sponsored pension plans or to individual retirement plans as well as to help estimate the impact of such a program---i.e., how many dollars are potentially available for retirement savings if such incentives are enacted.

Data were gathered in a survey that took place from January 20 through February 8. It was conducted by telephone from the Seasonwein headquarters in New Rochelle, New York. A total of 1,000 American adults were interviewed, including 437 working Americans covered by employer-sponsored pension plans. Sampling error, at the 95% confidence level, is 3 percentage points for figures based on total sample; for working Americans covered by employer-sponsored pensions, it is 6 percentage points.

The report begins with the Executive Summary of the findings.

EXECUTIVE SUMMARY

The average working American, increasingly pressed by inflation, and a high tax burden sees his or her family in a financial bind that threatens their ability to retire.

While 63% of all Americans feel they are saving too little, an even higher 72% of working Americans feel their savings for retirement are inadequate. As a result, almost half the work force feel they won't be able to afford to retire.

Consistent with these concerns, the public supports by a 72% to 15% margin allowing a tax deduction for retirement savings by employees covered by pension plans. It is possible that such a deduction may result in contributions earmarked for retirement of as much as $11.3 billion.

FINDINGS

F-1

Consumer Confidence Is Low

Consumer confidence is examined as background to a review of attitudes about the adequacy of financial preparations for retirement.

Attitudes about the current state of the economy remain highly negative, with 60% now saying that the economy is in bad shape.

Negative attitudes about the state of the economy have been rising since the question was first asked in early 1977.

PERCENTAGE WHO FEEL THAT THE STATE
OF THE ECONOMY IS POOR
Percent
70
60
50
40
30
20
10
39
60
77
78
79
80
81

F-3

Inflation Is the Nation's Main Economic Concern

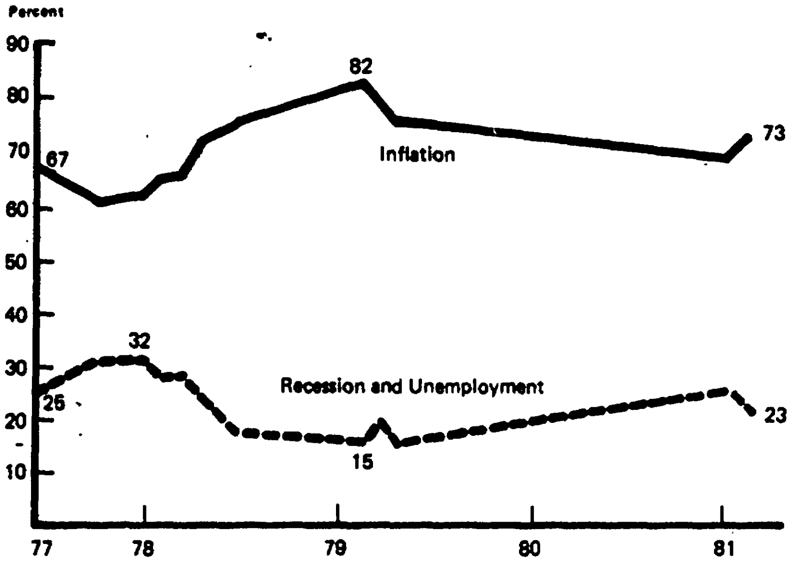
Almost 3 Americans in 4 (73%) see inflation as a more important problem than recession and unemployment.

roger seasonwein associates, inc.

76-188 O—81——17

F4

MOST SERIOUS ECONOMIC PROBLEM



F-5

Americans Feel Their Own Savings Are Inadequate

One of the major impacts of inflation has been on the ability of the average person to save.

Sixty-three percent feel that they themselves and their family are saving less than necessary.

People are even less sanguine about the average American; 84% characterize his or her savings as inadequate.

F-6

ADEQUACY OF SAVING

	Total Public's Views About:	
	Person's Own Family	Average American
Saving as much as necessary	28%	9%
More than necessary	7	3
Less	63	84
Don't know	2	4

F-7

Retirement Savings Inadequate for 7 Americans in 10

Seven working Americans in ten report that their retirement savings are non-existent or inadequate.

Half the nation's working population (51%) says that no money is being put aside for retirement in their household. Another 21% say that less money is being put aside than is necessary.

F-8

WHETHER MONEY IS BEING PUT ASIDE FOR RETIREMENT AND, IF SO, WHETHER THE MONEY IS ADEQUATE

	People Living In Household Where Main Bread-winner Is Working
Putting retirement money aside, and the amount is:	46%
As much as necessary	17
More than necessary	6
Less	21
Don't know	2
Not putting retirement money aside	51
Don't know if putting retirement money aside	3

***

% of public not putting retirement money aside or putting aside less than they think is necessary	72%

NOTE ON BASE: The percentages in this table are based on the 75% of the public who live in a household where the main breadwinner is not retired.

F-9

Inflation Seen As Main Cause of Inadequate Retirement Saving

The inflationary pinch is clearly seen as the number one reason why people are not setting aside adequate retirement funds.

Eighty-three percent feel that the pressure of other expenses is an important reason why they cannot set aside adequate retirement funds. Only 29% accepted the next highest scoring of four reasons---an employer-paid retirement plan. (This was about three and a half times as many as named the Social Security pension as a reason.)

F-10

WHY PEOPLE ARE PUTTING NO MONEY OR NOT ENOUGH MONEY ASIDE FOR RETIREMENT

Given as a reason why savings are not being set aside for retirement or these funds are inadequate	People Whose Savings Toward Retirement Are Inadequate
Other expenses make saving for retirement difficult	83%
An employer pays for a pension or retirement plan that will help pay for retirement	29
Current savings are already adequate to cover or help pay for retirement	10
Social Security will cover all or most retirement needs	8

NOTE ON BASE: The percentages in this table are based on the 51% of working Americans who are not putting money aside for retirement as well as the 21% who are putting less money aside than they feel is necessary.

F-11

More Than 4 In 10 Feel They Will Not Be Able To Afford Retirement

The financial pressures on working Americans lead many of them to question whether the main breadwinner in their household will be able to afford retirement.

While 50% feel that retirement will be possible, a substantial 44% feel it will not be.

P-12

WHETHER THE MAIN BREADWINNER IN A PERSON'S HOUSEHOLD WILL BE ABLE TO AFFORD TO RETIRE AT 65 OR AS SOON AFTER THAT AS DESIRED

	People Living In Household Where Main Bread-winner Is Working
Able to retire	50%
Not possible	44
Don't know	6

NOTE ON BASE: The percentages in this table are based on the 75% of the public who live in a household where the main breadwinner is not retired.

F-13

People See Increased Personal Savings As An Aid To Improving Capital Formation

Another cluster of issues related to attitudes about changing the tax laws that affect retirement savings turn on the relationship of personal savings to capital formation.

The public clearly sees that such a relationship exists, and feels that taxes are hampering savings.

- -89% feel that current tax levels are keeping people from saving more.
- -Two Americans in 3 feel that business faces a shortage of capital.
- -By 53% to 41% Americans agree that savings by individuals are one of the factors that help to create such capital.

F-14

AGREEMENT AND DISAGREEMENT WITH STATEMENTS RELATING TO CAPITAL FORMATION

	Total Public 2/81
Current level of taxation:	
Encourages savings	5%
Keeps people from saving more	89
Don't know	6
Inflation and taxes are greatly reducing saving by individuals	
Agree	86%
Disagree	11
Don't know	3
Right now, business faces a shortage of capital	
Agree	63%
Disagree	25
Don't know	12
Savings by individuals are one of the factors that help to create capital	
Agree	53%
Disagree	41
Don't know	6

F-15

Strong Margin Favors Tax Deduction For Employee Pension Contributions To Employer-Sponsored Plans

People overwhelmingly favor allowing a tax deduction for employee contributions to employer-sponsored pension plans.

The strong 72% to 15% margin for this proposal is consistent with both the public's financial fears relating to retirement, and their feeling that increased savings by individuals will help alleviate the capital shortage they feel the nation faces.

F-16

WHETHER PEOPLE FAVOR OR OPPOSE ALLOWING A TAX DEDUCTION FOR EMPLOYEE CONTRIBUTIONS TO EMPLOYER-SPONSORED PENSION PLANS OR TO INDIVIDUAL RETIREMENT PLANS

	Total Public
Favor	72%
Oppose	15
Don't know	13

F-17

Tax Deductibility Could Direct As Much as $11.3 Billion Of Contributions By Employees Currently Covered By Private Pension Plans.

Retirement savings could increase by as much as $11.3 billion if contributions by employees covered by pension plans to employer-sponsored plans or to individual retirement plans are made tax deductible.

To determine this, people who are now covered by an employer-sponsored plan were given a description of one version of the proposed tax change and asked whether it would lead them to make a contribution or, if already doing so, to increase the contribution. The description was:

> Right now, money that employees contribute to their pension plans do not get a tax deduction. On the other hand, people who are working for employers who do not have pension plans can set up their own pension program and get a tax deduction for the money they put into it each year. Suppose you could get a tax deduction, either for contributing your own money to your employer's pension plan or for setting up your own plan. The maximum contribution for which a person would receive a tax deduction would be $1,500 or 15% of salary, whichever is less. This means that for every dollar you contribute up to $1,500 or 15% of salary you would get a tax deduction. There would be no deduction for amounts above $1,500.

Forty-seven percent of those now covered by an employer-sponsored pension plan said they would make an initial contribution or increase the amount they are now putting aside in it.

When asked for the amount involved, the average person said this would be approximately $617.

The President's Commission on Pension Policy has estimated that just under half of the approximatly 81 million private sector workers are covered by a pension plan. If 47% of these workers contribute an average $617 into a pension plan or their own plan the potential for savings earmarked for retirement is on the order of $11.3 billion. It is to be stressed that this figure represents potential, and is not a projection of how much would be set aside if a tax change is adopted. This will, of course, depend on the precise nature of the plan, how it is communicated, the extent of employer cooperation, etc.

F-18

THE EFFECT OF MAKING EMPLOYEE CONTRIBUTIONS TO PENSION PLANS OR INDIVIDUAL PLANS TAX DEDUCTIBLE

	Persons Covered By Employer-Sponsored Pension Plans
Would contribute for the first time or increase contribution	47%
Would not	53
Average contribution would be	$617

NOTE ON BASE: The percentages in this table are based on the working Americans who reported that they are covered by employer-sponsored pension plans.

F-19

In the survey "Americans and Retirement: The Financial Crisis" conducted by Roger Seasonwein Associates workers covered by pension plans were asked a battery of questions designed to measure how they would respond to a tax deduction of $1500 or 15%, whichever is less, for contributions to employer pension plans or IRAs. Overall, 47% said they would start to contribute or would increase their contributions if they are already contributing.

Among the subset of workers who are currently contributing at least $1500 to their employer's pension plan, 51% say they would contribute at least some of the tax saving.

Of the group that is contributing a sum less than $1500, 51% report they would increase their contribution.

Finally, among covered workers not contributing their own money to the plan 44% say they would begin to contribute.

roger seasonwein associates, inc.

From: American Council of Life Insurance
1850 K Street, N.W.
Washington, D.C. 20006
Contact: Walter Bussewitz
Phone: (202) 862-4064

February 24, 1981

FOR IMMEDIATE RELEASE

EMPLOYEE PENSION CONTRIBUTIONS
SHOULD RECEIVE TAX DEDUCTION,
LIFE INSURANCE SPOKESMAN SAYS

Washington, February 24 -- A spokesman for the nation's life insurance business told a Congressional panel today that Americans should be encouraged to save through enactment of tax incentives for employee contributions to employer-sponsored pension plans.

"The end result would be a reduction of pressure on the already financially strapped Social Security system and an influx of capital into an economy which is striving to expand and increase its productivity," said Marvin A. Levins, senior vice president, Connecticut General Life Insurance Company.

Appearing on behalf of the American Council of Life Insurance (ACLI), Mr. Levins called for passage of legislation that would permit workers covered by employer-sponsored retirement plans to get a tax deduction for contributions they make to their employer's plan or to their own individual retirement plan. These programs have commonly been referred to as Employee Retirement Savings Deductions (ERSD) or Limited Employee Retirement Accounts (LERA).

Mr. Levins told a hearing of the Senate Finance Committee's Subcommitee on Savings, Pensions and Investment Policy, "ERSD is a non-inflationary tax-cut proposal with wide-ranging, positive implications for our economy." The Subcommittee is considering three tax bills designed to provide important new incentives for savings.

Mr. Levins said there were several advantages to an employee savings retirement deduction.

He noted that by providing a tax deduction, employee contributions to their own pension plans will increase and at the same time employers will be encouraged to establish new plans.

- more -

"By encouraging long-term savings and thus contributing to the capital resources of this nation, ERSD will not be inflationary compared with other types of individual tax cuts, since money saved through the system will not be used for consumption," said Mr. Levins.

Mr. Levins pointed to two recent Cambridge Reports Inc. reports and a survey conducted by Roger Seasonwein Associates, Inc. for the ACLI which showed that Americans, given the opportunity, would take advantage of a ERSDoption.

"Indeed, according to a random sample of current contributors to employer pension, profit-sharing or thrift plans, 58 percent of Americans currently contributing on an annual basis, would be 'very likely' or 'somewhat likely' to contribute more money annually if Congress passed legislation that allowed individuals tax deductions for contributions," he said.

The December 1980 Cambridge Reports, Inc. survey also answered questions concerning whether ERSD type incentives will actually increase total savings or just stimulate transfers from one savings vehicle to another. "In fact," Mr. Levins said, "47 percent of the respondents indicated that the incremental money they expect to contribute would represent 'additional savings that would not be saved otherwise.' Another 23 percent maintained that at least some of this money would be 'additional savings.'"

To achieve the desired result, Mr. Levins said, any such legislation should:

- treat employee contributions to qualified pension plans as tax-deferred income up to IRA limits (presently 15 percent of compensation up to a maximum of $1,500);
- be widely available, simple to administer, understandable, and permit employees to deduct both mandatory and voluntary contributuions.

The Council has a membership of 510 life insurance companies which, in the aggregate, have 95 percent of the life insurance in force in the United States and which hold 99 percent of the assets of insured pension plans.

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American Council of Life Insurance

1850 K Street, N.W.,
Washington, D.C. 20006
(202) 862-4000

March 9, 1981

SUPPLEMENTAL STATEMENT TO TESTIMONY BY THE AMERICAN COUNCIL OF LIFE INSURANCE BEFORE THE SENATE FINANCE SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY ON FEBRUARY 24, 1981

INTRODUCTION

At the Subcommittee hearings on S. 12, S. 24 and S. 243 on February 24, 1981, Marvin A. Levins, Senior Vice President of Connecticut General Life Insurance Company, in charge of its Group Pension Operations, presented a statement detailing the position of the American Council of Life Insurance (the "Council") with respect to employee retirement savings deductions.

This supplement to the Council's statement of February 24 expands the discussion at Page 8 urging that both mandatory and voluntary employee contributions be fully eligible for the employee retirement savings deduction.

EMPLOYEES SHOULD BE ABLE TO DEDUCT MANDATORY CONTRIBUTIONS

In General

The Council believes that mandatory contributions to tax-qualified plans should be deductible on the same basis as voluntary contributions. Allowing such a deduction for mandatory contributions would be beneficial for several reasons:

1. It would encourage the establishment of new plans;

2. It would encourage the improvement of benefits under existing plans;
3. It would result in greater vesting under employer-sponsored plans;
4. It would afford greater tax benefits to low-paid employees;
5. It would discourage employees from opting out of pension plans in order to establish IRAs; and
6. It would avoid certain distortions which otherwise would result.

Each of these points is discussed below.

Establishment of New Plans

Establishing new plans is important to the goal of meeting national retirement needs in future years. Employers, particularly small employers, often cannot afford the full cost of a pension plan in the early years of its operation. They are, however, more willing to set up plans where employees are required to contribute a portion of the cost as a condition of participating in the plan. Later, as the plan matures, the employer may pick up more of the cost of the plan. Thus, mandatory contributions are an important means of getting plans started.

This is especially true of small, new and marginally profitable employers, which is precisely the group of employers which do not now have retirement programs. If such employers cannot convince their employees to contribute to the pension plan, the employer will often be unable to establish such a plan. Moreover, if the employees' contributions are not mandatory, it is often difficult

for a small employer to sign up enough employees to qualify his pension plan even if he decides to institute one. Thus, if employers are to be encouraged to establish pension plans and if marginal employees and young employees are to be brought into the private retirement system, a deduction for mandatory employee contributions is important.

Before 1972 this pattern was typical. Employees who consented to contribute to help pay for a plan got the equivalent of tax deductions for their contributions by use of "salary reduction arrangements". When the Internal Revenue Service cast out such arrangements in 1972, the establishment of new plans in this fashion slowed markedly. Allowing a deduction for mandatory contributions would reverse this trend and the law would again encourage setting up new plans through cost-sharing with employees.

Improvement of Existing Plans

Many pension plans established in past years do not have adequate benefit levels. As with setting up new plans, many employers are often unwilling at first to make needed plan improvements unless their employees help to pay for the benefit increases. Then, in later years, the employers tend to pick up more of the cost of the improvements. Many employees need a deduction for their mandatory contributions if they are going to be able to afford to help their employers make these needed plan improvements. According to the Cambridge Report survey, 50% of the respondents currently participating in mandatory plans would expect to contribute more money if tax deductions were available.

There is no reason in basic tax philosophy why employer contributions should be favored over employee contributions. It is an anomolous anachronism that the tax laws have penalized one form of contributions over the other when in reality all of the moneys come from funds either donated by the firm or paid by the employees from salaries received from the firm. Allowing a deduction for mandatory employee contributions is an overdue change toward tax neutrality between the two different sources of retirement funds.

Greater Vesting for Employees

As pointed out, employers are more willing to set up or improve plans where employees contribute a portion of the cost. Employers tend to view employee contributions as not costing them anything when in fact the employers are really paying for both types of contributions. Nonetheless, they get psychological comfort by thinking the employees are helping. There is, however, a great benefit from calling a portion of the contributions "employee contributions". These contributions and earnings thereon are always fully vested. This provides a significant advantage to employees in plans with deferred vesting of employer contributions.

Put another way, there is only one "pool" of money--employer money. When this money goes to employees before it is put in the plan, full vesting is required. Assuming mandatory contributions are used, it is assured that the money will go to the plan as with employer contributions. Thus, vesting is the real difference between employer contributions and mandatory employee contributions.

Tax Benefits for Low-Paid Employees

Some employees cannot afford to make IRA contributions in addition to mandatory plan contributions. Thus, they end up with

no tax deductions for their retirement savings. If they were given deductions for their mandatory contributions, they could then use the tax dollars saved for further retirement savings, if desired. According to the Cambridge Report survey, over one-half of the respondents in the $10,000-$19,999 income category maintained that they would be "very" or "somewhat" likely to contribute more money on an annual basis if legislation allowing a deduction for such contributions were passed.

Discouraging Abandonment of Plans

If a deduction were allowed for IRA contributions but not for mandatory plan contributions, some employees would be tempted to forego the plan contributions in favor of IRA contributions because of the current tax benefit. According to the experience of one major employer with a contributory plan, the number of employees who dropped out of the plan and established an IRA leaped from approximately 1,500 in the 1970-1975 period to approximately 5,000 in 1976 when the tax advantages of the IRA became widely known. By the end of 1979, this number had grown to approximately 6,700 employees.

This erosion of plan participation will limit the growth and stability of plans. Moreover, it will often result in unwise decisions by employees who tend to look to immediate tax benefits and fail to evaluate properly the long-term benefits associated with membership in an employer-sponsored plan. A tax deduction for mandatory contributions would avoid these problems.

Avoiding Distortions

Allowing a deduction for voluntary contributions but not for mandatory contributions may create an incentive for employers to convert their plans, which currently require mandatory contributions, to an arrangement where the employees contribute on a voluntary basis. The amended plan would provide benefits paid entirely by the employer, which would be less than the aggregate benefits provided under the original plan. The employees would then have an option to contribute the present level of contributions on a voluntary, and hence fully deductible, basis in order to have the same benefits as the original plan. This would result in diminished stability for plans and additional paperwork to no useful end. Not only would new savings not result to the extent of the switch to voluntary contributions, but considerable damage would be done to the private pension system. Moreover, we can foresee the possibility of increased plan disqualifications, as younger employees decide not to participate in the plan on a voluntary basis.

Potential Revenue Impact

During the hearing, concern was expressed that if a deduction were allowed for mandatory contributions there would be a substantial revenue loss, particularly if government employees were not excluded. As outlined in our oral testimony, an alternative proposal has been developed which would treat government employees in a manner similar to the treatment of employees in the private sector. This is accomplished by treating qualified plan contributions of government employees not covered by Social Security as a substitute for Social Security contributions. Thus, before getting a deduction for

qualified plan contributions they would have to make nondeductible contributions equivalent to the nondeductible Social Security contributions of private sector employees.

This alternative is specifically part of H.R. 2207, a bill introduced by Congressman Bill Frenzel, J. J. Pickle and John Rousselot, a copy of which is ~~attached to this supplemental statement.~~ in the Committee files. In attempting to assess the revenue impact of this alternative, we have determined that the maximum potential revenue loss for Federal civil servants would be $150 million in 1981. We are developing figures regarding the revenue impact for State and local government employees. The experience with the Federal civil servants, however, suggests that the revenue impact for State and local government employees will not be that significant.

We appreciate the opportunity to submit this supplemental statement for the record. We would be happy to answer any further questions the Subcommittee may have.

STATEMENT

OF THE

ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS

TO THE

SENATE FINANCE SUBCOMMITTEE

ON

SAVINGS, PENSIONS, AND INVESTMENT POLICY

Tuesday, February 24, 1981

Washington, D.C.

STATEMENT OF

THE

ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS, Inc.

SUMMARY

- One of the highest priorities during the forthcoming deliberations over tax legislation shouldbe a deduction for employee retirement savings.

- Such a deduction is consistent with the desires of most employees to save for their retirement security.

- Contributions for retirement savings will provide a net increase in long-term savings, as demonstrated in Canada and by our own experience with Individual Retirement Accounts.

- Savings through the private retirement system is a highly efficient method of investing capital resources.

- The deduction for employee retirement savings will also encourage expansion of the private retirement system but only if mandatory employee contributions are deductible.

- The deduction limit for employee retirement saving must be equal to the limit for IRAs in order to avoid inequity and the difficult administrative problems of different limits.

Mr. Chairman and Members of the Subcommittee:

My name is Jeff Hart. I am the Executive Director of the Association of Private Pension and Welfare Plans (APPWP). The APPWP is a non-profit organization founded in 1967 with the primary goal of protecting and fostering the growth of the private benefits and compensation systems. Our nearly 600 member firms represent the full spectrum of employers, plan sponsors, and professionals involved with the maintenance of every type of private pension and welfare plan being maintained in America today. Our nationwide membership includes employers, actuarial and accounting firms, attorneys, banks, insurance companies, investment firms and counselors, and plan administrators and consultants.

I am pleased to have this opportunity to appear before you today to present APPWP's views on what should be one of the highest priorities for legislation during the forthcoming deliberations over tax legislation -- a deduction for employee retirement savings. Our Association feels strongly that such deductions will generate a substantial net increase in long-term savings, while providing an effective method for expanding the coverage of the private retirement system.

One of the major problems facing our nation today is the comparatively low rate of individual savings. To counteract the Nation's depressed savings rate, this Subcommittee today is considering incentives in three areas where individuals should be motivated to save -- retirement, housing, and education. Our Association believes that the need to stimulate savings for retirement

is critical to providing adequate income replacement for future retirees, particularly in light of our social security system, which is neither designed nor able to provide adequate replacement.

The need to save for retirement is clearly understood by the citizens of this nation. A 1979 study, commissioned by Johnson & Higgins and conducted by Louis Harris and Associates, leaves no doubt as to the retirement concerns of America's workforce. Pension plans are high on their list of priorities. The survey shows that our fellow citizens are concerned about inflation's ravaging impact on their retirement benefits. Significantly, over two-thirds of those interviewed would be willing to contribute to a pension plan if such contributions would increase their benefits. Further, the study clearly demonstrates there are grave doubts held by our fellow citizens that the social security system will provide the benefits currently promised. A vast majority of those interviewed favored a private retirement system outside of Social Security.

The private pension system represents the most efficient possible application of our resources in meeting the need for income replacement in retirement. Furthermore, private retirement plans are a highly efficient method of investing capital resources because they are built on long-term savings. Employers maintaining plans are required by the Employee Retirement Security Act of 1974 ("ERISA") to diversify the plan's investment portfolio in a prudent fashion. Often, due to the substantial accumulation of capital, a plan will engage a professional investment manager to invest the plan's assets

and assure portfolio diversification. Individual savings -- as opposed to the aggregate accumulation of savings of a private retirement plan -- often cannot be invested under the same conditions of efficiency. Beyond the diversification and efficiency inherent in private pension funds, plans tend toward long-term capital investments. Accordingly, capital invested by the private retirement system generally will remain a force in the economy for a longer period of time than capital invested to meet other savings needs.

The potential for enhancing personal savings by permitting tax deductible employee contributions is not a matter of speculation. The Canadian experience under a similar tax deduction clearly demonstrates the dramatic impact of this type of savings incentive. The retirement savings deduction was introduced in Canada in 1970. In the initial year, 2.7 percent of Canadian tax returns included deductions for retirement savings. This figure increased dramatically, and, by 1978, 11 percent of Canadian tax returns included deductions for such contributions. In addition, the average level of contributions rose almost fourfold, from .44 percent of total assessed income in 1970 to 1.7 percent by 1978. The Canadian experience is reinforced by our own recent experience with Individual Retirement Accounts ("IRAs"). Since 1975, several million IRAs have been established. The deduction for IRA contributions in 1978 alone was over three billion dollars.

An equally important goal, in addition to the capital formation potential of deductible employee contributions, is

the potential for expanding the coverage and enhancing the benefits provided by the private retirement system. Such deductions would encourage smaller employers to adopt new plans for their employees. This is because the employer would not have to face alone the heavy initial cost of providing pension benefits to his employees, while trying to keep wages and salaries at competitive levels. Given deductibility, employees could better share in this initial burden by contributing part of the cost of funding their future benefits. The President's Commission on Pension Policy recognized this potential and in its interim report recommended that employee contributions be made tax-deductible.

It is important to note, however, that the potential for growth in the private retirement system will not be fully realized unless deductions are permitted for both voluntary and mandatory employee contributions. By mandatory, I mean those contributions which are required of the employee in order to participate in the plan. To the extent a provision prohibits or severely limits the deduction for mandatory contributions, the potential for new plan formation will be diminished.

Most plans which require so-called mandatory contributions provide for a sliding scale of contributions. For example, a typical thrift sharing plan will permit an employee to contribute anywhere from one to six percent of compensation, which will be matched to some extent by an employer contribution. The term "mandatory contribution", as defined by the bills which distinguish between mandatory and voluntary contributions, includes not only those contributions which are required as a condition

of employment, such as the Federal civil service, but also those contributions voluntarily made by employees in order to receive matching contributions from the employer. Thus, the entire six percent contributed by the employee in the foregoing hypothetical thrift plan would be deemd a "mandatory contribution" under such a definition.

Often employees, even those in the highest income ranges, make contributions below the ceiling on matching contributions under the plan. In the event mandatory contributions are not deductible, employees contributing below the ceiling who decide to increase savings must either: (1) make non-deductible contributions up to the ceiling, before being permitted to make deductible voluntary contributions under the plan; or (2) must make voluntary deductible contributions to an IRA, thereby foregoing the opportunity to participate in the employer's plan and receive the employer's matching contribution. Obviously, this arrangement will be difficult to understand for most employees and could cause some employees to cease making contributions under the employer plan, thereby forfeiting employer-sponsored benefits.

Some contend that granting deductions for mandatory contributions will not enhance capital formation, because the money would still have been saved without the deductions. This argument would have some force were it not for the overly broad definition of mandatory contributions which is found in some of the pending bills. That definition includes amounts voluntarily contributed by the employee, although matched by the employer. Because this savings pattern is totally discretionary with the employee,

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a deduction for such contributions will not only reinforce current savings habits, it will also encourage employees to increase their savings levels. The recent Seasonwein survey, commissioned by the ACLI, clearly demonstrates that individuals, who currently make contributions to a plan, will increase their contributions under the plan if given a tax deduction for all contributions.

In our view, burdensome and complex distinctions should not be made between different types of employee contributions. As a result, we strongly favor Senator Dole's bill -- S. 12 -- because it does not draw a distinction between different types of employee contributions.

Another concern our Association has with some of the pending proposals is the difference in the deduction limits for IRA contributions and those made to a qualified plan. Of course, at the present time, a deduction is available only for contributions to an IRA. This has had adverse affects on pension coverage because individuals who are not covered by employer-sponsored plans are given the opportunity to adopt an IRA, on a pre-tax basis. This had induced many employees to withdraw from employer-sponsored plans in order to obtain IRA benefits. This has jeopardized the "qualified" status of many existing plans, which are required to cover the employer's work force on a "non-discriminatory" basis. Perhaps more unfortunately, it has resulted in undesirable forfeiture by many employees of present or future valuable employer-sponsored benefits.

While a deduction for employee contributions to qualified plans could ease this problem somewhat, we are

concerned that unless the deduction limits for contributions to qualified plans and IRAs are set at equal levels, employees will continue to be induced to establish IRAs. We believe, therefore, that deduction limits for employee contributions to qualified plans and IRAs should be the same. Moreover, if the deduction limits are made unequal, the serious difficulty under existing law of determining whether an individual is an "active participant", and thereby eligible to make a higher deductible IRA contribution, will continue.

Senator Chafee's bill -- S. 243 -- would provide a deduction limit of $2,000 for employee contributions to both the IRA and the qualified plan, whereas Senator Dole's bill -- S. 12 -- will leave a wide gap of $500. We favor, in this regard, the Chafee approach.

The bills being considered by the Subcommittee today include savings incentives for housing and education. We believe that the deduction for retirement savings should be considered separately -- such as Senator Dole's bill does -- rather than in combination with savings incentives for other needs -- the approach taken by Senator Chafee. A primary concern with the proposal for allowing withdrawals from a retirement savings vehicle for the purchase of a home or college education is that it opens the potential for any number of other equally - desirable social purposes which may be added to drain away funds set aside for retirement. We submit that the ability to withdraw amounts, during the employee's working career, for financial needs other than retirement will undermine the goal of providing

retirement security for our citizens.

Members of this Congress are currently confronted with the serious problems facing the Social Security system. By increasing private retirement savings, the deduction for employee contributions to qualified pension plans holds the potential of reducing the need for income replacement after retirement through the Social Security system. We submit that the future pressures facing our Social Security system command a different and higher national priority than are present in housing and tuition considerations.

In summary, we have given you the reasons why our Association believes that one of the highest priorities this year is a deduction for employee retirement savings. Such a deduction will enhance capital formation, stimulate broader pension coverage, and reduce pressure on the already overburdened Social Security system.

We applaude the efforts made by Senators Dole, Chafee, Bentsen a-d Long, all of whom have introduced bills for encouraging retirement savings. While we have pointed out certain items which we believe should be included in the final bill, the ultimate goal of providing for a deduction for employee contributions is common among us. In this regard we are happy to provide whatever assistance your subcommittee believes would be helpful.

Thank you.

February 24, 1981

Statement of
JERRY L. OPPENHEIMER
On behalf of
THE ERISA INDUSTRY COMMITTEE (ERIC)
Before
THE SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY
Of the
SENATE COMMITTEE ON FINANCE
Regarding
SAVINGS INCENTIVE TAX BILLS

Summary

Deductible contributions for retirement savings should be allowed both to Individual Retirement Accounts (IRAs) and to qualified retirement plans which accept deductible contributions.

By deferring tax, deductible retirement savings contributions would foster capital formation, enhance retirement security, encourage self-reliance through long-term personal savings, and relieve pressures on Social Security.

By providing current tax relief for savings, the net amount available for current consumption would be reduced with a consequent easing of inflationary pressures.

By deferring tax rather than forgiving tax on contributions, and by ultimately taxing all earnings on contributions, the principal effect would be less tax now and more tax later, with little long-term revenue effect, without regard to the stimulative effect on the economy.

Mr. Chairman, I am Jerry L. Oppenheimer, a member of the law firm of Mayer, Brown & Platt, here in Washington. I appear today on behalf of The ERISA Industry Committee (ERIC). ERIC's some 100 members include half of the nation's fifty largest industrial companies and represent a broad cross-section of the nation's largest retailers, utilities, banks and insurers. Participants in pension plans sponsored by ERIC members represent about 20% of all participants in private pension plans.

As you well know, Mr. Chairman, under existing law, an employee covered by a qualified pension plan cannot contribute to an IRA, and no employee contribution to a qualified plan is deductible. <u>ERIC strongly urges that employees covered by qualified plans be allowed to deduct retirement savings contributions to qualified plans or to IRAs</u>.

Deductible retirement savings contributions would enhance capital formation, increase employees' retirement security, foster the growth and improvement of private plans, encourage self-reliance through private savings, and relieve pressure on Social Security.

We believe that, by encouraging longer term individual savings, this proposal would reduce amounts available for current consumption which would be less inflationary than other proposed forms of individual tax reduction. In addition, unlike

other proposals to encourage capital formation, the amounts deducted, and all earnings on them, would be taxed when distributed. Hence, the Treasury would be compensated for the present drop in tax receipts by appropriately larger collections in later years, even without considering the favorable economic effects that would be promoted by adding to the country's capital base. In the long run, therefore, this proposal would essentially change the time of tax collection, with little long-term revenue effect.

Mr. Chairman, as you well know, personal savings are disturbingly low, whether judged by historical American levels or by current levels in other industrialized countries. This is particularly so among middle income Americans who are hard pressed by high inflation, higher Social Security taxes, and still higher income taxes due to "bracket-creep". By deferring taxes, this proposal would encourage employees to save for longer periods and to help themselves provide for a more secure retirement.

As is evident from the testimony today, employees and employers -- large and small -- support the concept of deductible retirement savings contributions. According to the recent findings of Roger Seasonwein Associates, 72% of Americans favor a tax deduction for retirement savings by employees covered by qualified plans, and it could result in additional savings in excess of $11 billion per year. The proposal is supported by a broad group which includes small businesses, large employers,

banks, retired persons, thrift institutions, insurance companies, automobile dealers, retailers, manufacturers, and pension consultants, administrators and actuaries.

Mr. Chairman, we strongly support the general thrust of your bill (S. 243), Senator Dole's bill (S. 12), and Senator Bentsen's bill (S. 486). We strongly supported the Finance Committee's decision last September to include a retirement savings provision in its tax reduction bill, and we were happy to note its reintroduction by Senator Long as a part of S. 394. We would like to see the best of these proposals combined and would be pleased to have the opportunity to assist in this regard.

In our view, the ideal bill would be simple enough to be promptly enacted, would encourage the broadest possible participation by employees and employers, would be simple to administer, and would avoid all unnecessary, costly, and counterproductive complexity.

More specifically, the deduction should apply to contributions to both IRAs and qualified plans. For example, some employees might prefer the independence associated with individual investment through an IRA; others might prefer the more sophisticated investments and lower administrative costs that might result from having employers handle contributions on a collective basis through a qualified plan. All bills pending before the Subcommittee satisfy this criterion.

In addition, <u>an employee covered by a qualified plan should be allowed to deduct the same amount that could be contributed to an IRA by an individual not covered by a qualified plan</u>. Uniform limits would promote neutrality between IRAs and qualified plans and would be simplest for the public to comprehend and easiest for the Internal Revenue Service to administer. For example, the Service would not have to question whether persons who claimed a deduction participated in qualified plans or only in IRAs to which different limits might apply.

Uniform limits would also avoid problems for persons who are covered under a qualified plan for only part of a year. If different limits were adopted, refunds and adjustments of previous contributions might have to be made. Perhaps more importantly, uniform limits would promote ready public comprehension, which is, of course, a very important aspect of any voluntary contributory program.

Happily, the Chafee and Bentsen bills would provide uniform limits, but, unfortunately, the Dole and Long bills would subject deductions to qualified plans to a lower ceiling than that applicable to IRAs; thus, they would fail to provide the very desirable simplicity which would flow from uniform limitations.

<u>Deductible retirement savings contributions should be available to</u> all workers, including <u>the self-employed</u>. A major criticism of the current tax treatment of private plans is the different treatment of the self-employed. Covering the broadest possible range of individuals avoids any increased

disparity and should result in greater capital formation and savings. Accordingly, we prefer those features of the Chafee and Bentsen bills which would include self-employed individuals.

Deductions should also be allowed for employee contributions that are mandatory under a qualified plan. On this point we strongly prefer the approach of Senators Dole and Bentsen. Including mandatory contributions would avoid unnecessary complexity and would assist in both the creation of new plans and the improvement of inadequate benefits provided by existing plans.

Many rank and file workers now covered by "matching" plans contribute less than the maximum mandatory (employer "matched") contribution (usually 5% to 6% of compensation) and make no voluntary contributions. They would get little or no advantage from the Chafee or Long bills. Allowing a deduction for mandatory contributions would encourage these participants to contribute more to qualified plans, and the resulting increase in "matching" employer contributions would further enhance capital formation and savings.

In addition, a lower limit for mandatory contributions would create an incentive to revise present contributory plans to provide appropriately lower benefits paid wholly by the employer, with an option for employees to make the present level of contributions on a voluntary, and hence fully deductible, basis in order to have the same benefits in total. Such revisions would be good tax planning, but poor plan design, and

the tax law should neither encourage bad plan design nor establish complex, technical distinctions that can be circumvented.

Let me also suggest that qualified plans should not be required to accept employee contributions. Although we expect that many employers would readily decide to accommodate deductible employee contributions in their plans, other employers may not want to assume the responsibility of administering or investing employee contributions. Furthermore, employers maintaining more than one plan may find it administratively convenient to handle all deductible contributions in a particular plan. Because the employee would always have the option to contribute to his own IRA, it is not necessary to require all employer plans to accept employee contributions. We believe this flexibility is important and appropriate, and all of the pending bills satisfy this criterion.

We believe that all savings, including savings for educational expenses and housing, should be encouraged, but it is difficult to single out some purposes to the exclusion of others. Accordingly, we believe that retirement savings should be held separate from savings for other purposes, regardless of how laudable those other purposes may be. If IRAs could be used for purposes other than retirement security, there could be intense pressure to enlarge the list of permitted uses, eroding the basic goal of retirement income security.

If savings for other laudable purposes need tax incentives, we feel they would be better provided independently of retire-

ment savings vehicles. Accordingly, Mr. Chairman, we would favor Senator Dole's approach (embodied in S. 24) to establish separate savings accounts to encourage savings for housing and education.

Finally, in order to achieve maximum voluntary participation, it is important to keep the system as simple as possible and administrative burdens at a minimum. The retirement savings contribution proposal which was included in last September's Finance Committee tax reduction proposal is an important endorsement of the general concept which we strongly favor, but it is also an unfortunate example of the complexity which we hope you will take particular care to avoid. The complexity would flow principally from last year's decisions (1) to treat mandatory contributions to qualified plans differently from voluntary contributions to plans or to IRAs and (2) to establish different limits for contributions to plans and to IRAs.

The point may be best understood by envisioning a typical newspaper advertisement (if last year's rules had been adopted) of a bank, thrift institution, or insurance company and the difficulty of its personnel trying to explain the rules to a potential saver. One could readily imagine an advertisement encouraging the public to contribute $1,750 (the limit is now $1,500) or 15% of compensation whichever is less; unless the potential saver had a non-working spouse at the end of the year who was not covered by a qualified plan at any time during the year, in which case the $1,750 or 15% limit would be $2,000 or

15%; and unless the potential saver was on any day during the year (regardless of whether any vested benefit accrued) a participant in a qualified plan, in which case the maximum contribution would be $1,000 or 15% of compensation (regardless of whether the potential saver had a non-working spouse at the end of the year); however, if the potential saver was covered by a qualified plan and had a working spouse, the spouse could qualify for a deduction of $1,750 or $1,000 or 15% of compensation in the spouse's own right, depending on whether the spouse was covered by a qualified plan.

And consider the reaction when, for example, our hypothetical saver decided it would be simpler (and, perhaps, better) to deduct $1,000 contributed to his employer's plan rather than contribute the same amount to an IRA, only to discover that mandatory contributions would be limited to $100 and would include, for example, a "voluntary" contribution to his employer's plan which is matched by his employer.

Consider also an employee who earns $20,000 and has previously contributed $500 a year "voluntarily" to his employer's plan because he gets a "matching" employer contribution. Under last year's decisions, he could deduct up to $1,000 of voluntary contributions to an IRA or to his employer's plan. Assume that he wanted to increase his plan contribution and use his tax savings as part of that increase. However, because his entire plan contribution is matched up to 6% of his compensation ($1,200), he could deduct only $100 of a $1,000 contribution to

the plan. To get the maximum deduction, he would have to contribute either $2,100 to the plan (which he probably could not afford) or $1,000 to an IRA, which would mean foregoing any employer contribution (which could be more advantageous than the tax deduction, depending upon the vesting schedule). By contributing to an IRA, he would also forego the convenience of automatic savings through payroll deductions, which enabled him to save systematically. Even if he fully comprehended his choices, which is very doubtful, the decision would be difficult, and the law should not force him to decide. It should be neutral. In addition, if enough of his fellow employees decided to withdraw from the employer's plan to contribute to their own IRAs, the plan could be disqualified for failure to meet the Code's coverage and discrimination tests.

Other examples could be given, but the point is obvious. This complexity is, at best, a disservice to the public. It is counterproductive. It cannot be understood by and can only discourage those who should be encouraged to make retirement savings contributions. Fortunately, this complexity is unnecessary and, by adopting the same limits for contributions to IRAs and to qualified plans and by making no distinction between voluntary and mandatory contributions, you can avoid it.

I will be happy to try to answer any questions you may have.

Statement of
GERALD D. FACCIANI
On behalf of the
AMERICAN SOCIETY OF PENSION ACTUARIES
Before
THE SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY
Of the
SENATE COMMITTEE ON FINANCE
Regarding
SAVINGS INCENTIVE TAX BILLS

February 24, 1981

My name is Gerald Facciani, and I am Chairman of the Government Affairs Committee of the American Society of Pension Actuaries. The American Society of Pension Actuaries is a national professional society whose 1800 members provide actuarial, consulting and administrative services to approximately 25 percent of the qualified retirement plans in the United States. A good proportion of the members of our Society provide services primarily to small business organizations. We have been and continue to be a leading spokesman in support of permitting tax deductible contributions by employees covered by employer sponsored qualified retirement plans to such qualified plans, or to IRAs. Furthermore, we believe the amount available to be deducted should be the same for qualified plan participants as for those persons contributing to IRAs. We believe allowing such tax deductible contributions would significantly expand the coverage of the private pension system particularly in the small employer area, where the most significant problem of non-coverage exists, and would stimulate capital formation.

I do not believe it is necessary to detail for this Subcommittee the problem faced by the United States with respect to inadequate capital formation. At present the investments backing up private retirement plans exceed $300 billion. Permitting tax deductible contributions to qualified plans or IRAs for those now covered by qualified plans would significantly expand the total assets of such plans or IRA accounts, and thus help ease the capital shortage problem. Such tax deductible contributions would result in a net increase in savings in the United States, thus aiding greatly in the capital formation process. (See Norman Ture, The Future of Private Pensions, American Enterprise Institute, Studies in Social Security and Retirement Policy, Washington, D.C., 1976.) A report recently prepared by Roger Seasonwein Associates, Inc. for the American Council of Life Insurance indicates that 89% of the individuals surveyed feel current tax levels are keeping people from saving more, and that 47% of those now

covered by an employer-sponsored pension plan said they would make an initial contribution or increase the amount they are now contributing if deductible employee contributions were allowed.

At this time I would like to discuss the impact of capital shortage on small business. The limited financial resources of small business are such that the shortage of available capital is felt most acutely by small business. Typically, the small business organization has the greatest need for capital and the most difficulty in obtaining it when the money supply is tight. When these facts are considered in light of the contributions of small business to our economy, the present capital shortage problem takes on a significance that might not be readily apparent. As noted in the April 1980 report to the President of the White House Commission on Small Business, new and existing small companies in recent years have provided 86.7% of the nation's new jobs in the private sector. Furthermore, a study by the Office of Management and Budget shows that more than half the major technological advances in this century originated from individual inventors and small companies. It is certainly true that the shortage of capital affects large as well as small business. The point we would like to emphasize is that capital shortage impacts most severely on small business, and small business plays a vital role in technological innovation and new job creation.

I would like at this point to discuss the reasons why we feel deductible employee contributions would significantly expand coverage under private retirement plans. First, present law has had an adverse effect on employer-sponsored qualified plans by encouraging employees to withdraw from such plans where participation is voluntary, to obtain a deduction for an IRA contribution. Not only does this result in non-coverage under the qualified plan for the withdrawing employees, but such withdrawals also may

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endanger the qualified status of many existing plans which must cover a broad range of employees to maintain their qualified status.

Second, permitting deductible employee contributions would greatly expand the private retirement system by encouraging small businesses to initiate and improve plans for their employees without necessarily incurring the heavy cost of providing all retirement benefits, in addition to the salaries being paid. Employees would be more willing to share this cost burden if contributions were deductible. Historically, the traditional pattern has been that the employer increases the level of employer contributions as time passes, and we would expect this same pattern to prevail if deductible employee contributions were permitted.

Statistics compiled by the Pension Benefit Guaranty Corporation (PBGC) indicate that approximately 25,000 defined benefit plans have terminated from the time of ERISA's passage through September, 1979. The rate of termination has been particularly heavy among small plans. The major reason for the number of terminations and the reluctance of employers to initiate new plans is cost. Not only do the vesting, funding and other substantive provisions of ERISA increase costs, but the ERISA reporting and disclosure requirements, particularly as they have been interpreted by the administering agencies, have resulted in significant increases in administrative costs.

Finally, any broad-based expansion of the private retirement system should, concomitantly, help relieve pressures on the social security system.

With regard to the specifics of legislation permitting deductible employee contributions, we believe an employee covered by a qualified plan should be allowed to deduct the

SUMMARY

1) Enacting legislation permitting deductible employee contributions for individuals covered by qualified plans will stimulate capital formation.

2) Enacting legislation permitting deductible employee contributions for individuals covered by qualified plans will encourage the creation of new plans and the improvement of benefits under existing plans, particularly in the small business area.

3) Legislation permitting deductible employee contributions should provide a deduction limit identical to the IRA limit and should not differentiate between the treatment of voluntary and mandatory contributions. Additionally, any dollar limit should be indexed to take cognizance of cost of living increases.

National Automobile Dealers
& Associates
Retirement Trust

Your key to retirement planning

Richard B. Taylor
Assistant Director-Compliance

8400 Westpark Drive,
McLean, Virginia 22102
(703) 821-7053

February 27, 1981

Honorable John H. Chafee
United States Senate
3103 Dirksen Senate Office Building
Washington, D. C. 20510

Dear Senator Chafee:

I am writing to follow-up testimony that I presented before your Sub-Committee on Savings, Pensions, and Investment Policy, Tuesday, February 24, 1981. I appreciate the opportunity that you afforded our organization to present our views on the issue of deductibility of employee contributions to qualified plans.

As a result of questions, both you and Senator Mitchell raised at the hearings, I want to clarify our position with regard to the deductibility of mandatory contributions under qualified plans. Senator Dole's bill, S.12, includes deductibility for mandatory contributions under such plans but does not include government employees, therefore, the potentially large revenue loss that would be associated with deductibility of contributions by government workers would not occur. Your bill, on the other hand, includes government employees but does not permit deductibility of mandatory contributions.

It is important to clarify what we mean by "mandatory" contributions. We do not define mandatory contributions as those made by employees who must contribute to a plan as a condition of employment, but rather as those contributions which an employee who voluntarily elects to participate in a plan must make in order to share in employer contributions. Federal employees, as a condition of employment, must make contributions. While these contributions would also be considered mandatory under our definition, it also covers all of those cases where employees may elect to participate or not. In those cases where they do they must make contributions in order to be a participant or to receive matching contributions from an employer.

Our goal is to include mandatory contributions as we define them. If government employees are to be included there is a solution to the windfall problem. For those not covered by the Social Security System their mandatory contributions, to the extent that they do not exceed Social Security

Honorable John H. Chafee
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contributions they would normally be required to make if they were covered by Social Security, would be excluded from deductibility.

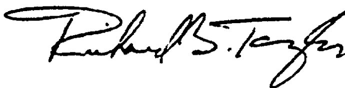
We don't believe that deduction of mandatory contributions provides a windfall to employees and that not allowing such a deduction eliminates such a windfall. This is evidenced by the fact that employees under our programs, and many similar to them, can simply elect not to participate in the employer's plan, or if they are already participating, they may elect to withdraw and contribute their mandatory contributions to an IRA and thereby avail themselves of such a tax deduction. Therefore, in these cases, not giving them the deduction for mandatory contributions does not eliminate the revenue loss associated with deduction of mandatory contributions. Withdrawal leads to an additional problem and that is the one that we have experienced in our plans - employees elect to withdraw in order to establish IRAs. This situation presents continuing qualification problems for the plans, as we have pointed out in our written testimony. The employer finds it difficult to continue to maintain the qualified status of his plan within the coverage requirements of the Internal Revenue Code.

We believe the mandatory contribution deductibility feature will eliminate this problem, as well as encourage those who are not in plans now to begin making contributions for the first time, and that those who are in the plans will be encouraged to increase their contributions through voluntary features. Therefore, the issue goes considerably beyond the question of the deductibility of mandatory contributions, to the heart of such things as capital formation and reduced pressure on Social Security through increased personal savings generated under the company sponsored retirement plan.

During the hearings, Senator Mitchell expressed concern about the inflationary aspect of such deductibility and what part it should play in any tax reduction proposal. Our view is that it would be part of any tax cut. This would be accomplished by first determining the revenue loss of a deductibility feature. If revenue loss was determined to be $2 billion and the administration tax reduction was to be $20 billion, then personal tax cuts would only amount to $18 billion which, when added to the non-inflationary, non-consumption oriented tax cut that this represents, would total the $20 billion in cuts.

I would be happy to provide you with further statistical information if it will be helpful.

Sincerely,



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CC: Senator Mitchell
Senator Dole

STATEMENT

OF THE

NATIONAL AUTOMOBILE DEALERS AND ASSOCIATES RETIREMENT TRUST

TO THE

SENATE FINANCE SUBCOMMITTEE

ON

SAVINGS, PENSIONS, AND INVESTMENT POLICY

Tuesday, February 24, 1981

Washington, D. C.

SUMMARY OF THE

STATEMENT OF THE

NATIONAL AUTOMOBILE DEALERS AND ASSOCIATES RETIREMENT TRUST

Deductible employee contributions by participants in company sponsored plans should be allowed to either those plans or IRA's.

Such deductible contributions will increase personal savings thus creating growth of investment capital, will relieve pressure on the Social Security system and will encourage the establishment of new plans by small employers.

This provision will also remove the incentive employees now have to withdraw from participation in company sponsored plans in order to establish IRA's and will thus relieve the qualification problems created by such withdrawals.

In addition, employees presently participating in company sponsored plans will be induced to either begin making contributions or increase the amounts now being contributed, substantially increasing their future retirement benefits.

My name is Richard B. Taylor. I represent the National Automobile Dealers and Associates Retirement Trust (NADART). NADART is a part of the National Automobile Dealers Association, a trade association representing 20,000 retail automobile dealers throughout the United States. I appreciate this opportunity to present to the Committee our view that Congress should adopt a LERA provision permitting a deduction for employee contributions to qualified retirement plans or IRAs.

NADART is the sponsor/plan administrator of four Master Plans approved by the Internal Revenue Service. Members of the National Automobile Dealers Association may adopt one or more of the Master Plans sponsored by NADART. Currently, NADART administers over 5,000 small employer retirement plans, covering in excess of 70,000 employee participants.

We believe the enactment of a provision allowing employees who participate in company sponsored plans to contribute either to such plans or to an IRA is extremely important for the following reasons:

1.) We believe that people will save if they can achieve a goal. The savings goal, which is clearly understood by the people of this country, is the need to save for their retirement security.
2.) With these attitudes and the record of the private pension sector we believe that the creation of capital will occur more rapidly, be retained for a longer period of time, encompass more economic segments of our population, accomplish more societal goals and produce an ever-expanding capital source.

3.) As personal savings increase, providing an even larger share of the retirement needs, less pressure is exerted upon the already overburden-ed Social Security System to provide ever escalat-ing benefits.

4.) We believe that not only will deductibility of employees' contributions have a salutary effect on the qualification of plans, it will also produce greater participation in existing plans.

5.) In addition, such a deduction, perhaps most im-portantly, will encourage the establishment of new employer sponsored plans, thus providing coverage for a larger percentage of the work-ing population, many of whom are not presently covered. This will occur because employees will be more willing to share the cost of es-tablishing a new plan.

The private retirement system covers over one-half of the Nation's work force. Each year contributions to the system have exceeded disbursements. This creates an ever expanding pool of capital. According to a 1977 reprot of the Securities and Exchange Commission total private pension assets (both insured and non-insured) have grown dramatically.

$320 billion in assets were held by pension plans of private employers at the end of 1978, and this constitutes the nation's largest institutional pool of long-term capital.

The private pension system provides the single most important and reliabile mechanism for the growth of savings available for long-term investment because of the long-term nature of pension plans. We need to expand this essential capital pool by covering employees currently participating in the private retirement system and encourage the improvement of their coverage. This can be accomplished by permitting active participants in qualified retirement plans to make tax deductible contributions to employer sponsored plans or IRAs. In the last few years this concept has become acceptable to Congress.. The House of Representatives passed a provision which permitted deductible contributions in the Tax Reform Act of 1976. The Senate also voted to adopt the concept in the Revenue Act of 1978. It has been endorsed by numerous organizations, including the U.S. Chamber of Commerce, ERISA Industry Committee (ERIC), American Council of Life Insurance, American Society of Pension Actuaries, American Association of Life Underwriters, American Association of Retired Persons, the Investment Company Institute, and many other companies and organizations.

Generally, the financial position of an average dealer does not permit him to maintain a plan without seeking to share the cost with his employees by requiring them to contribute to the plan. This is clearly demonstrated by the fact that approximately 90% of the 5,000 plans we maintain are contributory.

The Employee Retirement Income Security Act of 1974 (ERISA) permits certain employees to use pre-tax dollars to fund a retirement benefit by deducting contributions to an Individual Retirement Account (IRA). Employees who are covered under a tax-qualified plan are not, however, allowed to

participate in an IRA. Because of this limitation a number of the participants in our contributory plans have elected to withdraw in order to participate in an IRA. This clearly indicates that employees will attempt to save if given sufficient incentive to do so.

In addition, the individuals who are presently induced to drop out of such plans create qualification problems for the company sponsored plan because the employer then finds it difficult to maintain the required coverage percentage to meet Internal Revenue Code requirements. Present proposals will eliminate this counter incentive by permitting employees belonging to qualified plans to deduct their contributions to these plans.

Although, in most situations, the participant would have been better off in the dealer's plan, the deductibility of contributions to an IRA appears to attract the individual away from the plan. In virtually every case the participant's net savings from the IRA deduction is less than the amount he has given up in dealer contributions. Many of our plans also have a significant death benefit for active participants, which, depending upon the age and compensation of a rank and file employee, can be as high as $75,000. When an employee is induced toleave the dealer's plan his family loses this valuable benefit. In addition, a participant who withdraws no longer continues to accrue vesting in dealer contributions during his period of inactive status. Our experience indicates that a participant often fails to recognize the substantial benefits which he will lose when electing out of a delaer's plan.

The ramifications of the trend to elect-out of the contributory plan are very serious for NADART and its Master Plans. As previously stated, a dealer must be able to demonstrate that a fair cross-section of his employees participate in the plan at all times in order to retain the tax-qualified

status of the plan. Many of the participants who elect-out of the Master Plans are lower paid rank and file employees. As these employees withdraw from the plan the dealer's ability to demonstrate that a fair cross-section of employees participate diminishes. When the dealer is unable to demonstrate that a fair cross-section of his employees participate in the plan the tax qualified status of the plan is lost.

Because many of the dealers in NADART's Master Plans have fewer than twenty employees, withdrawal of even one employee can have a significant impact on the dealer's ability to maintain tax-qualified status for his plan, particularly for the dealer who must adopt a contributory plan. Failure to enroll several employees will severely restrict his ability to demonstrate that a fair cross-section of employees will participate.

Traditionally, retirement needs have been provided through the three-legged stool with the legs being personal savings, social security and employer sponsored pension plans. However, as the personal savings rate has dropped drastically this leg has been virtually sawed off and the result has been to compensate with ever increasing social security benefits, bringing the system precariously near bankruptcy. The deduction for employee contributions will go a long way toward reversing this trend and thus relieve pressure now being continually exerted on social security.

As stated earlier, approximately 90% of the plans we administer are contributory. Most of our plans provide for mandatory contributions by participants. Because of this we find that people are conditioned to, and are in the habit of, making contributions to company sponsored plans.

However, the required amounts are often very small, for example, 2% of an employee's compensation. Some employees, of course, make larger contributions through the mechanism of

voluntary contributions, however, the percentage of such participants making contributions is relatively small (approximately 1/3 of our 70,000 participants, or 26,000).

Currently approximately 63,000 of our 70,000 participants are making mandatory contributions to our Master Plans. However, only about 70% of all eligible employees of dealerships participate in a plan. Therefore, we estimate that there are another 25,000 to 30,000 potential plan participants who are not participating in the Master Plans who may be induced to participate by a tax deduction. We recognize that some of these employees participate in IRA's but if we assume that just half of this additional uncovered group enroll, about 13,000 to 15,000 more employees will begin for the first time to accumulate funds for their future retirement. This is a reasonable assumption because of the attraction of a tax deduction and the availability of participating through payroll deductions with the employer which will most likely induce these uncovered employees to participate. In addition, many of the 63,000 existing participants who are only making the minimum mandatory contributions will be induced to make voluntary contributions, thereby increasing their potential retirement benefits dramatically. As previously stated, a typical NADART plan provides for a 2% employee mandatory contribution. Thus, an employee earning $10,000 makes a contribution of only $200. Assuming such employee is age 35 and is induced to increase his contributions to $400 per year, as a result of the deductibility of his contributions his account balance could be expected to accumulate an additional amount of approximately $40,000 by age 65, which would increase his retirement benefits about $400 per month.

The average contribution by the small number of our participants who are making both mandatory and voluntary contributions amounts to slightly less than 4% of pay, meaning that the voluntary contribution by such participants is less than 2% of pay. A deduction for employee contributions will induce participants to increase their voluntary contributions and could also induce approximately 25,000 of the remaining participants who are not making voluntary contributions to begin doing so.

Presently, we receive in excess of $ 72 million in annual contributions from employers and employees. We expect that deductibility of employee contributions could, based on the occurence of some of the potential changes alluded to, raise this amount to almost $125 million, an increase of over $ 50 million per year. The primary reason would be the additional incentive available through tax deductibility of contributions that would then exist.

Adoption of such a bill by the Committee will, among these other things, encourage the establishment of new qualified plans by small employers who will be able to share the cost of providing meaningful retirement benefits with their employees. This development will be crucial to the health of the private pension system in the future.

An interesting and important feature of the employee purchased portion of a pension plan is that under ERISA rules these benefits are fully and immediately vested in the employee If the employee accounts were made totally tax deductible, these accounts could be rolled over into an IRA or a successor employer's plan upon an employee's termination, thus providing a totally portable pension.

In summary, we have pointed out a number of reasons why we support legislation to end tax discrimination against employee contributions to pension plans. We believe of the

present bills pending before the Senate that S.12, introduced by Senator Dole, incorporates the proper policy to achieve our goals. However, in our support of S.12, we are concerned that the amount of deductibility contained in the bill is limited to $1000. We strongly believe that it is necessary for equity and simplicity that the amounts for IRAs and employee deductibility under qualified plans be the same. Therefore, we urge the Committee to raise the amount to be equal to the amount which may be contributed and deducted under an IRA. We enthusiastically endorse the Dole provisions that provide for mandatory employee contributions under qualified plans to be treated exactly the same as voluntary. This is a must as an integral part of any such legislation.

We agree with the two bill approach as sponsored by Senator Dole through S.12 and S.24. We support the concept of providing for increased retirement benefits that S.12 accomplishes by encouraging individual retirement savings and encouraging those funds to remain in the retirement plan for as long as possible to provide for retirement needs.

Though S.243 is a commendable approach to the needs of young families for homes and education we do not believe that certain of its provisions should be included in a package designed to meet retirement income needs. Our concern would be that withdrawals would be encouraged by such provisions and that retirement savings are for the purpose of accumulating retirement benefits. In addition, we believe that eventaully more good purposes will arise and we can see a growing expansion of reasons for allowing withdrawals in the future, thus defeating the retirement accumulation concept.

We appreciate the opportunity to appear before the Committee and will be happy to answer any questions the Committee may have.

Senator CHAFEE. I will read that over. Thank you very much, gentlemen. You have stirred things up.

Now let's take the next panel. We have to move right along. We have Mr. Silver, Mr. Hutchinson, Mr. Cugini, and Mr. Tucker.

I want to pay tribute to Mr. Silver and Mr. Cugini for the help they have given us in representing the financial institutions in trying to arrive at this bill. We are very grateful to you for that as well as for the help you are giving us with respect to the study by Professor Boskin of Stanford.

Mr. Silver, why don't you proceed?

STATEMENT OF DAVID SILVER, PRESIDENT, THE INVESTMENT CO. INSTITUTE, ACCOMPANIED BY EDWIN S. COHEN, COUNSEL

Mr. SILVER. Thank you for your generous words, Mr. Chairman.

My name is David Silver. I am president of the Investment Company Institute.

I have a longer statement which I will leave to be submitted for the record, Mr. Chairman.

Senator CHAFEE. All right. That will be included following your oral presentation.

Mr. SILVER. I am accompanied this morning by Edwin Cohen, who has been tax counsel to the institute probably longer than I have been a lawyer, which is indeed a long time.

We appreciate the opportunity to appear here this morning. The ICI is the national association of the mutual fund industry. Our 545-member mutual funds have assets of some $125 billion and approximately 8.5 million shareholders.

We strongly support S. 243 and its companion bill in the House, H.R. 1250, which would modify the Federal income tax laws to promote capital formation through increase in savings and investment.

Personal savings by U.S. citizens as a percentage of disposable income fell during the years 1977 to 1980 to the lowest level in almost 20 years. Our savings rate is lower than in other major countries, including Canada, West Germany, France, and Japan. Moreover, from 1970 through 1978 our productivity growth was less than any of our seven major trading partners except Great Britain.

We have studied carefully the tax-related savings plans in these countries, and we feel we can benefit from their experience. However, the primary purpose and the primary support we have for S. 243 is based on our domestic needs. We have long believed that the Federal tax laws should provide further encouragement for individual savings in a manner that would serve socially desirable and anti-inflationary purposes, such as providing for retirement, housing, and education. S. 243 accomplishes these objectives readily and simply by building on existing programs rather than creating new tax structures.

The provisions contained in S. 243 would permit IRA's to play a major and efficient role in capital formation by stimulating individual savings and investment.

I will mention only a few of the reasons: The bill would utilize the existing IRA structure without requiring a new type of account with new rules and regulations. In fact, the bill would simplify

existing IRA provisions which have caused administrative complexities and which have also significantly reduced the number of eligible users. These limitations have also discouraged savings and investment institutions from promoting IRA's because promotional expenses have been too high in relation to the permitted size of these plans.

S. 243 also has the virtue of neutrality in at least two respects:

First, as to the allocation of IRA contributions by taxpayers, all savings investment media can be utilized. Thus, stocks, bonds, Government obligations, bank deposits, and insured annuities will be eligible.

Second, the bill is neutral in that the taxpayer can take advantage of its benefits by either choosing to make additional contributions to an existing employer plan, if such plan permits, or to his own IRA.

More importantly, the expanded IRA will permit some withdrawals without tax penalty to meet the basic family needs of purchasing a home or for education.

In summary, Mr. Chairman, we believe that S. 243 combines in a single package the benefit of many proposals that have been advanced and which have achieved broad support. We think it would be a major contribution to the economy of the Nation. It would not be inflationary because the funds in the IRA's would be saved and invested to help fill the Nation's need for capital formation and improved productivity.

I would be happy to answer any questions. We would appreciate the opportunity to submit further information for the record.

[The following material was subsequently submitted for the record:]

76-138 O—81——21

Analysis of the Savings and Retirement Income Incentives Act of 1981 by Michael J. Boskin, Professor of Economics, Stanford University

The United States has the lowest private saving rate of any advanced economy; in recent years, the personal saving rate has fallen still further; both to provide a source of income in later years (especially retirement) and to help finance badly needed capital formation, it is widely recognized that an increase in our saving rate is an extremely high priority. The Savings and Retirement Income Incentive Act of 1981 contains a variety of features designed to encourage saving. The extent to which it does so depends upon the extent to which each of its provisions reaches a substantial fraction of the population; the nature of the changes in the incentives these people face; and their response to these changed incentives. The major provisions of the Bill are as follows:

A. Liberalization of Individual Retirement Accounts.

1. Allows all employees to start an IRA;
2. Increases deductible limit to $2,000;
3. Eliminates 15% ceiling;
4. Allows supplemental non-deductible annual contributions up to $2,000; and $8,000 lifetime additional;
5. Allows withdrawals prior to age 59 1/2 of up to $10,000 under certain conditions.

B. Makes the $200 interest/dividend exclusion permanent and increases it to $500 for taxpayers over age 65 (double these for joint returns).

For each of these aspects of the Bill, it is necessary to determine the taxpayers who will be affected; how they will be affected; and their response to these changed incentives. Using a variety of data sources, usually from the year 1976 (then updated to the present) such as the

Statistics of Income, special supplemental reports on Individual Retirement Accounts, etc., I determine for each of these provisions the number of individuals likely to be affected; the likely change in the incentives they face - both in terms of their after-tax income and the effective after-tax after-inflation rate of return on their saving opportunities; and, their likely response to such changes. It is important to note that at each stage of this process, a variety of assumptions must be made. For example, once we determine how many newly eligible for expanded IRA coverage returns there will be, we still have to assume an interest elasticity of private saving, an effective tax rate, a distribution of current savings in the population newly affected, etc., in order to derive the change in aggregate saving the provision will induce. These assumptions are discussed below.

The effect on saving from expanding coverage would create approximately 33 million newly eligible returns. I estimate under what I consider to be the most reasonable set of assumptions an aggregate annual increase in saving of approximately 10.3 billion dollars. This number is derived by taking the distribution of saving for newly and previously eligible returns to be the same; and assumes that approximately one-half of those households currently saving zero will have some response to the availability of an IRA. We have also assumed a modest interest elasticity of saving of 0.4. [1]

[1] To test the sensitivity of our results to variations in the assumptions, we note that assuming a larger interest elasticity of saving, such as 1.0, would increase the aggregate saving response by approximately 60%; assuming that all of those who are currently saving zero respond would increase the response by about 50%; assuming that none do would reduce it by approximately 50%. Assuming that participation rates under the newly available IRA's would remain at the participation rates of 1976 for those then eligible for IRA's would reduce our figures to about one-quarter of the total presented above. However, IRA participation has apparently expanded greatly since 1976; the likely development of increased IRA participation by spouses; the preferable liquidity features under the proposed law, etc., all suggest that participation rates are likely to be larger than they were in 1976 under the existing law.

Approximately 45% of those who are already eligible for IRA participation contribute the maximum. By taking the distribution of those already saving $2,000, or greater than 15% of AGI, we can estimate those who may be "constrained" by the limit. This leads to an estimated saving increase of 0.4 billion dollars.

The non-deductible contribution is also likely to encourage saving substantially. This occurs because the interest on the non-deductible part of contribution is not taxed on accrual, and hence the effective after-tax, after-inflation rate of return on such contributions is greater than that on ordinary saving taxed on accrual under current law. Once again, the size of the estimated response depends upon assumptions about how those currently saving zero will respond, the assumed interest elasticity, etc. My best estimate is that this provision of the Act will encourage approximately 7 billion dollars of saving annually.

The effect of the special exclusion for those over age 65 is unlikely to be large because the overwhelming bulk of taxpayers over age 65 receive interest and dividends beyond the exclusion; hence, there would be no rate of return effect for them. Further, the elderly have higher propensities to consume than the average. The total increase in saving would certainly be less than one billion dollars.

The effect of making the interest/dividend exclusion permanent relative to having it expire as under current law, is difficult to estimate because data for the very recent past on the distribution of interest and dividend receipts is difficult to come by. Using data from even a few years ago, given the substantial increase in interest rates and nominal asset values in last several years, could make the estimate quite misleading. It is

important to note that a substantial fraction of the low and moderate income population receives less than the $200/$400 limit, because their saving both annually and in the aggregate is quite modest. For this group, a price effect would be created and we would expect some increase in their saving. My own best guess is that perhaps another billion dollars or so would be generated under such a scenario.

Thus, a best guess aggregate effect would be as follows:

Saving gain from:

Expanded coverage	10.3 billion
Increased limit for those currently eligible	0.4 billion
Non-deductible option	7.0 billion
Dividend/Interest exclusion (of which maximum of $1 billion due to extra exclusion of elderly)	2.0 billion
TOTAL (in 1976 dollars)	19.7 billion per year*

The estimated annual increase amounts to approximately 28% of personal saving based on 1976 saving levels; and perhaps slightly more based on the current lower personal saving rate. Therefore, it appears that the impetus for saving will be substantial and very cost-effective from the expansion of IRA coverage and the inclusion of the non-deductibility option. The key is to broaden participation in such programs.

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* Changing this total to 1981 dollars, using the GNP deflator would result in an increase of approximately 40% between 1976 and early 1981.

These estimates refer to the eventual, or steady-state response, to the incentives in this Act. I would expect it to take several years before the full impact was reached; it is not possible to estimate precisely the time pattern of movement to these levels. Hence, for example, they should not be construed as fully applicable to the next year or two.

Any tax legislation such as the one currently being analyzed, which shifts the disposition of income away from spending toward saving, will lessen the potential inflationary impact of a tax reduction. While the additional saving, and decreased consumption, are of modest magnitude, and should not be thought of as the major vehicle for fighting inflation (that job falls primarily on the FED's monetary policy), our current and prospective inflation situation is bad enough to warrant additional consideration for saving incentives to assist other anti-inflationary policies.

Further, the newly generated saving, especially as it cumulates over several years will provide an urgently needed increase in the flow of funds available for private capital formation in the U.S. This in turn will stimulate productivity, increase future GNP (and, ultimately provide tax revenue reflows) and lead to more remunerative employment for American workers.

Technical Appendix

As mentioned above the impact of each of the features of the Savings and Retirement Income Incentive Act of 1981 depends upon three factors:

1. The extent to which each feature affects various groups in the population;

2. The nature and extent of these effects, e.g., changes in after-tax rates of return;

3. The response of the affected groups to these changes in incentives.

For each of the features we have attempted to gather the most salient information from which to estimate the likely effects on aggregate private saving and on saving by adjusted gross income class. We start by noting some basic facts about current eligibility and use of Individual Retirement Accounts. These data are summarized in Table 1. The most important point to note that while a substantial fraction of the population are eligible for IRA usage, this fraction is greatest in the lower and middle income classes, which groups thus far have very low participation rates in Individual Retirement Accounts compared to upper income groups, (see Table 1).

Next we must decompose the incentive effects of the individual provisions into their effects on their after-tax expected rate of return and on after-tax income. Eligibility for Individual Retirement Accounts, for those not currently eligible, implies that at the margin the individual or family may save at the before, rather than at the after, tax rate of return. Such long-term saving as embodied in IRA accounts means that the tax-induced differential in rates of return, compounded over the normal length of time between saving and dissaving[1] leads to enormous differences in the cost to

[1] It is assumed to be 20 years for the purpose of this calculation.

Table 1.

Data on Current IRA Eligibility and Use

A. Who is eligible under current law?

[Sources: President Commission on Pension Policy and 1976 Statistics of Income]

Adjusted Gross Income Class ($000)	0-5	5-10	10-15	15-20	20-50	50+
# of Tax Returns in AGI Class (000's)	23935	19893	14552	11197	13918	1175
% eligible for IRA's	85.0	70.0	60.0	45.4	24.9	28.6
#of returns with eligible individuals (000's)	20345	13925	8731	5083	3466	336

Total # (in 000's) of returns with eligible individuals: 51,886; % eligible: 61:3

B. Who had set up IRA's by 1976?

[Source: 1976 Statistics of Income Supplement: Individual Retirement Arrangements and President's Commission on Pension Policy]

AGI Class:	0-5	5-10	10-15	15-20	20-50	50+
% eligible who have IRA :	0.2	1.3	3.3	5.5	21.7	52.4
% returns who have IRA:	0.17	0.9	2.0	2.5	5.4	15.0
# Returns with IRA (000's):	42	180	284	299	767	147

Total # of returns (000's) with IRA: 1724; % of eligible=3.3; % total returns=2.0

C. How much was contributed in 1976?

[Source: 1976 Statistics of Income Supplement: Individual Retirement Arrangements]

Amount Contributed ($000's) :	26872	141040	259469	321323	997217	223298
Average dollar contribution per return:	640	784	907	1075	1300	1519

Total Contribution in 1976: $1.970 billion. Average Contribution per return: $1143. Average Contribution per IRA: $1052.

a family of purchasing future consumption by setting aside funds today in an IRA account as opposed to a fully taxable account. It is important, however, to note that for those groups currently dissaving or saving substantially more than the limit to the IRA account, this after-tax rate of return effect will not exist. Further, for those currently saving, net of borrowing, zero, the response to an increase in the potential after-tax rate of return to saving may not be identical to that of those already saving positive amounts. Therefore, we will present some sensitivity analyses to this effect below.

The impact of raising the limit to $2,000 and eliminating the 15% of AGI limit on those currently eligible for IRA participation are rather straightforward. For those who have not set up an Individual Retirement Account, there should be no impact unless there are large fixed costs for setting up an IRA. We would expect, as discussed below, some of the features of the Act to encourage participation for those who have not already set up an IRA.

For those who have an IRA, who plan to contribute less than the current limit, expansion of the limit should not induce any additional saving. For those who are at the limit, a very large fraction, approximately 45% of the total, we would expect the effects to be the familiar after-tax rate of return and income effects discussed above.

As noted above, some of the features of the Act are likely to encourage participation and contribution. Perhaps one of the most important is that of allowing early withdrawal without penalty under certain circumstances. The lack of this option under current IRA regulations certainly discourages IRA participation among lower and middle income groups in the population, who are not willing to sacrifice liquidity in order to achieve the higher after-tax return.

It is important to note also that the allowances for non-deductible contributions also have a rate of return effect. While the non-deductible contribution will not raise the after-tax rate of return on such saving by nearly as much as the deductible contribution, the fact that the non-deductible contributions will earn interest which will not be taxed on accrual implies that their after-tax rate of return will also be higher than that on normal saving vehicles. It is also important to note that the analysis discussed above is applicable, albeit with a lower net of tax increase in the rate of return, and is only applicable to those who would contribute the maximum deductible amount to the Individual Retirement Account.

In moving from current IRA eligibility and use to analyze the impact of the new incentives on saving, we need to work through data on saving rates, marginal tax rates, etc. The personal saving rate has fallen to a post-War low in the last few quarters. We use our estimate of net financial investment to disposable income of 6% in most of our calculations, which is slightly higher than the current saving rate, equal to that derived from the Federal Reserve Flow of Funds for 1978 and somewhat lower than the saving rates of the early and mid-1970's. We believe this to be a reasonable rough estimate averaged over the next few years of the average personal saving rate.

In order to know the extent to which the after-tax rate of return has been increased by the availability or extension of coverage for the non-deductible option in the IRA, we need to know the average marginal tax rate in each AGI class. From the 1976 Statistics of Income, we note in Table 2 the weighted average marginal tax rate by AGI class. These tax rates have probably risen slightly since then, and obviously are undergoing scrutiny at the moment. The increases since 1976 will not have a

large impact on the calculations below, but it should be noted that any bias in our estimated saving response will be on the low side since the tax disadvantage of ordinary types of saving vehicles with higher tax rates will be still greater relative to an IRA.

Table 2.

Weighted Average Marginal Tax Rates

[Source: 1976 Statistics of Income]

AGI Class	0-5	5-10	10-15	15-20	20-50	50+
Average Marginal Tax Rate	5.54	18.03	21.41	23.69	30.18	51.28

We must next analyze saving in the different AGI classes in order to estimate the potential impact of these features of the IRA expansion by AGI class. Table 3 presents a rough estimate of the distribution of savers among those who are dissaving, saving zero, and saving various positive fractions of their AGI. As can be noted from Table 3, a substantial percentage of returns, especially at the lower income class levels are not saving positive amounts. Therefore, we must make some assumptions about how those saving zero will respond relative to those currently saving positive amounts. We present three such estimates below.

Using the information above, we can calculate the change in the effective after-tax real rate of return to saving and real net income from the expansion of IRA coverage, the availability of the non-deductible provision, etc. by AGI class. This will tell us what the net change in the incentives faced by the typical individual in each AGI class would be. Using the distribution of saving, as discussed above, and different assumptions about the rate of return elasticity of private saving, we can calculate the change in saving induced in each AGI class and the aggregate change in saving for expanding coverage. (See Table 4.)

Table 3.

Distribution of Savers. (Source: Feldstein + Feenberg + assumptions)*

Ratio of Change in Financial Assets	AGI Class 0-5	5-10	10-15	15-20	20-50	50+
	Percent of returns					
<0	23	23	24	26	24	20
0	46	46	40	31	25	21
0-.04	11	11	16	20	19	22
.04-.10	6	6	8	10	11	9
.10-.18	4	4	4	4	9	6
.18-.36	4	4	4	5	7	10
>.36	6	6	4	4	6	12

* Martin Feldstein and Daniel Feenberg "Alternative Tax Rules and Personal Savings Incentives: Microeconomic Data and Behavioral Simulations", unpublished NBER paper, January, 1981.

Table 4.

Change In Saving for Expanding Coverage

Assumptions: All newly eligible with positive post-IRA desired saving participate.

		Total (in billions)
Interest elasticity: 0.4		
Those saving zero: respond	(1)	$15.3
: 1/2 respond	(2)	10.3
: don't respond	(3)	5.3
Interest elasticity: 1.0; zeros respond	(4)	23.9
Participation rates among newly eligible same as current, by AGI class: interest elasticity = 0.4; zeros respond	(5)	2.9

By AGI Class, as examples (Cases (1) and (3) above):

AGI Class	0-5	5-10	10-15	15-20	20-50	50+
(in $million)						
Case (1)	32	895	2305	3595	8006	400
Case (3)	0	36	728	1504	2989	48

It is clear that the size of the response, as estimated with a moderate interest elasticity of 0.4, will be quite substantial to the expansion of coverage even if those saving zero currently do not respond and participation rates are no larger than those estimated in 1976 for current eligibles. There is substantial reason to believe that at least some fraction of those saving zero will respond, and that the participation rates are likely to be higher; we have noted a liquidity effect above; it is also the case that a spouse will now be able to set up an IRA account rather than just enable a current participant to slightly extend their contribution. Therefore, I would expect participation rates to be much higher eventually under the proposed legislation than under the current situation. It is also clear that a still larger interest elasticity, for example, the 1.0 presented would cause a substantially larger increase. My own best estimate from these considerations would correspond to the moderate interest elasticity, and assuming approximately one-half of those currently saving zero eventually respond to the IRA coverage by setting one up for moderate amounts. This leads to an implied increase in saving from the expansion of coverage to those not currently eligible of $10.3 billion.

Raising the limit for those already eligible will have only a negligible impact. 45% of those who already have IRAs contribute the maximum, and a substantial fraction of these are already saving at least $2,000. Some of these may be saving the additional funds in taxable forms and hence, may have a slight reduction in their rate. Our estimate, working through these calculations by AGI class, concludes that the increase in saving from an increase of the limit to $2,000 for those already eligible will amount to only 0.3 billion dollars.

The $2,000 annual non-deductible contribution (and correspondingly, the one-time lifetime additional $8,000 contribution) may increase utilization if fixed costs are large and will have the modest after-tax rate of return effect discussed above, smaller than that for the deductible contribution, but since the interest is not taxed on accrual, higher after-tax rate of return than many other saving vehicles. Once again we work through the analysis by calculating the change in the after-tax return for taxpayers in each AGI class, given their marginal tax rates calculated above, and present estimates of the total increase in saving due to the $2,000 non-deductible contribution. This amount would be buttressed somewhat by the $8,000 lifetime contribution addition,but we made no separate calculation of this effect. Table 5 presents these estimates by AGI class under the assumptions that all currently eligible who are at the limit will move to the new limit, that the $2,000 non-deductible contribution is marginal, and that all positive savers who are newly eligible will participate. As noted above, lower participation rates would decrease these percentages accordingly. We present for sensitivity analysis purposes our estimates based on our preferred set of estimates of 0.4 elasticity of saving and also for the somewhat larger 1.0 elasticity and various scenarios with respect to the responses to those currently saving zero.

Table 5.

Change In Saving From $2,000 Non-deductible

Interest Elasticity	Case	AGI Class (in $million) 0-5	5-10	10-15	15-20	20-50	50+	Total (billions
0.4	zeros respond *	0	78	188	578	6399		8.7
	zeros do not respond	0	78	188	578	4382		6.3
1.0	zeros respond	0	195	1293	4366	15983	1474	23.3

* Intermediate cases were estimated by estimating the proportion of respondents who would move to the deductible limit and hence would be eligible for the new non-deductible contribution. Our best estimate of the most likely total response was $7.0 billion.

The effect on saving of the $500.00 interest and dividend exclusion for taxpayers over 65 (double this for joint returns) is likely to have a very small impact on aggregate saving for two reasons:

1. It is infra-marginal for a large fraction, and thus without any rate of return effect, and those whose rates of return are changed are unlikely to increase saving, at least if they are already retired.

2. The income effect on saving will also be small since the elderly would be expected to have high marginal propensities to consume. As an example, from the 1976 Statistics of Income derived from a year when interest rates were much lower than at present, we note that the average dividend and interest received even in the AGI class, 0 to $5,000, for persons with a household head of an age over 65, was $1,158; further, 80% of such returns had positive interest payments. The average interest and dividend increased substantially even among low and middle income elderly households so that the aggregate amount of the exclusion, while providing some minor tax relief for the elderly, will not change the after-tax rate of return on additional saving for many of them.

Making the $200 interest and dividend exclusion permanent (double these for joint returns) will affect the savings of those receiving very low interest and dividend payments through rate of return effects and also will have a small impact on aggregate saving through the tax reduction embodied in the exclusion of the interest and dividend from tax payments. It is extremely difficult to estimate this impact in the current economic scenario. This is because interest rates and nominal asset values have gone up so much, that the sources of information available on interest received and the average dollar amount of interest combined with information on saving behavior comes from the mid-1970's when interest rates were much lower. It is clear that a non-trivial part of the population has very small saving and also small interest and

dividend returns and that these people will have an extra incentive to save. Even estimating the percentage of interest accruing to such individuals in 1980 by adjusting 1976 Statistics of Income data would be hazardous at best. Suffice it to say that our analysis makes several assumptions which deliberately err on the conservative side in doing so and still come up with a very modest impact of the interest and dividend exclusion. Indeed, it would be necessary to have a much larger interest and dividend exclusion in order to begin to cover a large fraction of taxpayers receiving positive interest payments and still larger an exclusion to cover the majority of interest and dividends received.

Finally, we might note that several assumptions have been used in these archetypal calculations and note how variations in these assumptions might effect the estimates presented above. First, we assume that the tax rate at retirement is approximately half the individual's current rate of tax. This seems to be standard in much actuarial calculation concerning pension funds, etc. We assume a nominal interest rate of 10%, clearly below current market rates but similar to a reasonable average for the last few years, and a long-run inflation rate of 7%. We assume that the average number of years to dissolve the plan is 20. If it is the case that the after-tax, after-inflation rate of return on ordinary saving plans is still lower and the removal of the double taxation of saving via expansion of the IRA to newly eligible individuals will cause a still greater increase in the real after-tax rate of return, and hence a larger increase in saving than the numbers presented. I believe these estimates to be conservative for these reasons. If however, we believe that nominal interest rates and inflation rates will be much lower than 10 and 7 percent respectively in the near future, these estimates slightly overstate the effect on saving.

Senator CHAFEE. All right. Fine. Thank you, Mr. Silver.

When we are through with this panel I will ask you about the problems raised in the prior panel about not permitting deduction in the mandatory retirement plans.

Mr. Hutchinson?

STATEMENT OF JOHN J. HUTCHINSON, PRESIDENT, NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS, ACCOMPANIED BY DICK McCONNELL, EXECUTIVE VICE PRESIDENT

Mr. HUTCHINSON. Mr. Chairman and members of the subcommittee, I am John J. Hutchinson, president of the National Association of Federal Credit Unions and manager of the Hamilton Standard Federal Credit Union in Windsor Locks, Conn. That credit union serves the employees and their family members of that division of United Technologies Corp.

The National Association of Federal Credit Unions is the only national trade association exclusively representing the interests of our Nation's federally chartered credit unions. There are 12,716 Federal credit unions throughout the country whose 25.9 million members hold more than $36.5 billion in savings.

I appreciate the opportunity to appear before you today. With me is Dick McConnell, the executive vice president of our association.

In determining the form and composition of a viable tax cut plan, I would urge this subcommittee to expand and make permanent the $200/$400 exclusion for interest and/or dividends contained in section 204 of Public Law 96-223, relax the eligibility requirements and contribution limits for individual retirement accounts, and allow penalty-free withdrawals from these accounts for housing and higher educational purposes. It is the position of the National Association of Federal Credit Unions, as well as my own personal conviction, that such actions by Congress would be noninflationary, encourage savings, and assist in capital formation.

Each of the bills before this subcommittee today attempts to provide some of the needed savings incentives. The Savings and Retirement Income Incentive Act of 1981, however, appears to combine the positive aspects of S. 12 and S. 24 with its own provisions to form a comprehensive package of tax incentives.

The individual retirement account program established by the Employee Retirement Income Security Act of 1974 encourages eligible individuals to create their own retirement plans through a constructive system of tax incentives. Contributions to such plans are excludable, within limits, for Federal income tax purposes, and no Federal tax is paid on those funds or their earnings until they are withdrawn, normally after age 59½. IRA accounts are attractive to credit unions and other financial institutions since they provide the institution with a highly stable pool of long-term funds which may then be extended to borrowers in the form of consumer or mortgage loans.

Recent figures indicate that while over 55 million Americans are eligible to open an individual retirement account, less than 6 percent of those eligible had established such accounts. Available data indicates that only about 2 percent of all Federal credit unions currently offer these accounts. While the Congress and the regulatory agencies have done much to facilitate the establishment of

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IRA accounts since their inception in 1974, further refinements in the statutes and regulations impacting on these accounts are in order.

Specifically, S. 243 proposes several changes in the IRA structure that would make these accounts much more attractive to both the consumer and the financial institution. Although they have not been sufficiently utilized, IRA's are existing accounts whose mechanics are familiar to most financial institutions. Altering some of the characteristics of this existing account to permit penalty-free withdrawals for a home purchase or educational expenses would be much simpler than instituting two new accounts.

In summary, Mr. Chairman and members of the committee, the National Association of Federal Credit Unions urges you to incorporate into your recommendations provisions which will: expand and make permanent the tax incentive for savers, relax the eligibility requirements and contribution limits for IRA accounts, and permit withdrawals from individual retirement accounts without penalties for the purchase of a first home or for higher education of the account-holders' children.

Senator CHAFEE. Thank you very much, Mr. Hutchinson. We appreciate that as well as all the help you have given us as we have gone along with this legislation.

Mr. Cugini?

STATEMENT OF JOSEPH N. CUGINI, CHAIRMAN-ELECT, CREDIT UNION NATIONAL ASSOCIATION, INC.

Mr. CUGINI. Good afternoon, Mr. Chairman.

I am Joseph N. Cugini, chairman-elect of the Credit Union National Association, Inc., and president and general manager of the Westerly Community Credit Union in Westerly, R.I.

I would like to say that I am especially delighted that Rhode Island's Senator Chafee will lead the way in the U.S. Senate on policies such as this. Senator, we are delighted and proud.

Senator CHAFEE. Thank you very much, Mr. Cugini.

Mr. CUGINI. I would like to highlight my comments and also try to prove that Rhode Islanders are fast talkers, but only in such a way that is not derogatory.

CUNA supports the $200/$400 permanent exemption. We also support the $500/$1,000 figure proposed in S. 243.

CUNA strongly recommends that Congress increase the current $1,500 maximum that can be contributed to an IRA account. S. 243 proposes an increase in the limit to $2,000.

S. 24 suggests that the maximum deductible allowed for the special education and housing savings accounts be indexed. CUNA thinks this indexing should be given serious study by Congress for all IRA's as well as for other special accounts.

While S. 12 proposes to allow "active participants" of most pension plans to participate in the IRA program, it specifically singles out Government employees for exclusion. We do not think such an exclusion is justifiable and we hope that the final IRA bill will not discriminate against types of employers.

CUNA supports efforts to encourage further additions to IRA accounts above the amount allowed as a tax deduction. S. 243 proposes that an additional $2,000 nondeductible amount could be

contributed each year, plus an additional $8,000 over the employee's lifetime in order to help financial institutions absorb the expenses.

CUNA supports efforts to improve the coverage of spousal IRA accounts.

In our view the bills being considered today fail to establish a parity between employer pension plans and IRA's with regard to the early withdrawal penalty. It is our opinion that, if employer pension plans are permitted to accept voluntary deductible contributions from employees for retirement purposes, the same 10-percent tax penalty should apply to those deductible contributions withdrawn prior to age 59½ and not rolled over into an IRA account, as apply to IRA's directly.

CUNA wants to encourage its members to plan for their children's education and to help younger members be able to buy their first homes. We do question why housing savings accounts as outlined in S. 24 should be subject to the $1,500 contribution cap if there is to be a $15,000 overall limit. This would limit the advantages sought by the bill.

CUNA is always concerned about changes in the law that would increase the recordkeeping burdens on financial institutions.

Thank you, Mr. Chairman, for the opportunity to make these brief comments. Our complete prepared statement will be available for the record.

Senator CHAFEE. Thank you, Mr. Cugini. Those are valuable thoughts that you have made here, particularly coming from your experience as an individual and as chairman-elect of CUNA.

I notice in the prior testimony of Mr. Hutchinson that he stated that only 2 percent, I think he said, of the Federal credit unions had been using the IRA's. What is your experience?

Mr. HUTCHINSON. In our particular union——

Senator CHAFEE. I referred to Mr. Cugini.

I believe you said 2 percent, didn't you, Mr. Hutchinson?

Mr. HUTCHINSON. Two percent of the Federal, yes.

Mr. CUGINI. We have 400 credit unions nationwide, both Federal and State. I think, Mr. Chairman, they probably represent about $15 million at this particular point in time. We feel as though S. 243, if passed, will certainly encourage more credit union members to participate in this type of account.

Senator CHAFEE. Did you say most of your credit unions are offering some type of IRA now? I missed that.

Mr. CUGINI. Only about four to five hundred of them, not very many, Senator.

Senator CHAFEE. Thank you for coming here today, Joe.

Mr. Tucker?

STATEMENT OF RICHARD C. TUCKER, PRESIDENT, TRI-STATE INDUSTRIAL BANK, DENVER, COLO., ON BEHALF OF THE NATIONAL CONSUMER FINANCE ASSOCIATION

Mr. TUCKER. Thank you, Chairman Chafee.

I am Dick Tucker. I am president of Tri-State Industrial Bank in Denver, Colo., and chairman of the advisory group to the thrift section of the National Consumer Finance Association. I am also

president of the Industrial Bank Savings Guarantee Corp., of Colorado.

I appreciate very much the opportunity to appear before this subcommittee to offer the views of NCFA on S. 12, S. 24, and S. 243, each of which addresses a vital issue of providing incentives for savings and capital formation.

The CFA represents consumer installment lenders, including those unique depository institutions which are not commercial or mutual savings banks, savings and loan associations, or credit unions. NCFA member depository institutions are industrial banks and thrift and loan companies. These State-chartered and regulated organizations have the dual purpose of providing consumer credit and accepting savings deposits from customers.

Industrial banking companies currently operate approximately 1,600 offices in the most recent figure we have, which I think is 1979. We are in 11 States and have $2.3 billion in savings.

I believe that the topic of tax incentives for savers is of particular significance to the industrial banking community. First, a majority of the depositors in industrial banking institutions are 50 years of age or older. In eight States these depositors enjoy the benefits of a tax exclusion of IRA's, coupled with a superior rate of return afforded through industrial banks. In my own company this week's certificate rate was 15.51 percent, with a resulting yield over a 12-month period of 16.343 percent.

Second, the State usury restrictions under which industrial banking institutions labor restrict profit significantly. The high yield we are proud to offer depositors is balanced by State statutes mandating 18 percent loans. Until significant rate relief for industrial lenders comes from Federal preemption of archaic State usury restrictions, the profit margin available to the Nation's industrial bankers will be thin and, in a highly inflationary economy, nonexistent.

Even the superior yields industrial banks offer to consumers do little to encourage savings in today's economy. For the past 2 years the growth in industrial banking companies has merely equaled the accrued interest from existing deposits.

For these reasons, NCFA supports S. 12 and S. 24, introduced by Finance Chairman Dole, and S. 243, introduced by you, Chairman Chafee, as very effective measures to stimulate capital formation and assist in curtailing inflation and improve our national productivity.

We have to rebuild this economy, and we think that your bill addresses this situation. We think it addresses it very candidly.

The decline of the Nation's personal savings rate during the 1970's may well be termed one of the tragedies of the decade. This decline has resulted in a reduced rate of the requisite capital formation to rebuild the Nation's aging industrial infrastructure and a reduced stable supply of funds for mortgage lending.

NCFA supports your bill, S. 243, which expands the coverage and concepts of IRA's. The fact of the matter is we endorse it wholeheartedly.

In conclusion, NCFA urges the rapid passage of these bills to provide the necessary catalyst to stimulate capital formation. We

wish to commend you, Mr. Chairman, and the full committee Chairman Dole for efforts in this area.

I thank you for this opportunity to present our views on this very vital issue.

There is one final thing I would like to comment on, if I may, sir, from the last panel. That is the fact that we do feel that it is appropropriate and proper for home purchases and for education to be taken from IRA's. How else are we to stimulate this growth for the younger people and show them example if not by this?

Thank you very much, Chairman Chafee.

Senator CHAFEE. Thank you very much.

Could you gentlemen comment briefly on the points that were raised by the last panel, specifically with regard to the nondeductibility for the mandatory pension contributions?

Mr. SILVER. I think it would be foolish for the apprentice to speak in the presence of the master.

Senator CHAFEE. Let's have the master speak.

Mr. SILVER. May Mr. Cohen speak to that?

Mr. COHEN. Mr. Chairman, I cannot live up to that billing, but I will try to be brief.

I think you have yourself pointed out the reasons for the provisions in S. 243. I worked on the preparation of some of the features of that bill.

I think our primary concern was that if one permitted mandatory contributions to be included and permitted Government employees to enjoy the same benefits as non-Government employees the revenue costs would become astronomical. For that reason, S. 12, while permitting deduction for mandatory contributions to establish pension plans, excludes all employees of the Federal Government and also excludes employees of State and local governments and political subdivisions such as authorities which may run transportation and electrical operations, et cetera.

It seemed unfair not to permit any of those persons to have participation in a retirement savings program such as the IRA's. Hence, the provision that is in S. 243 does not exclude those employees but instead excludes the mandatory contributions.

I think in the bill passed in the Senate Finance Committee reported last September mandatory contributions were permitted but only to the amount of $100. I would think that is too small an answer to the problem and undoubtedly leads to complications.

Beyond that, aside from the technical issues, the question Senator Mitchell asked was as to whether the loss of revenue would contribute to inflation.

To the extent that S. 243 or these other bills permit and encourage additional contributions, those amounts are placed in savings—stocks and bonds and other savings accounts, et cetera—and serve to help finance the Federal funding of its budget. However, if you extend the benefits of these bills to existing mandatory contributions, you do not have that type of additional savings but you have, in addition to the existing deficit, an additional need for Federal financing.

We felt that from the standpoint of capital formation and noninflationary effects it was better not to extend the bill to the mandatory contributions.

There might be some room for consideration of modifications of the definition of mandatory versus voluntary contributions, as Mr. Oppenheimer suggested in the earlier panel.

Senator CHAFEE. Thank you, Mr. Cohen.

Mr. Cugini, you mentioned you thought it was wrong not to have a penalty for the early withdrawal of deductible contributions to the private pension plans. Why did you think it was important to have that penalty there?

Mr. CUGINI. Mr. Chairman, we feel very strongly about that, so much so that last night I wrote this down so I could get it into the record.

We feel as though the early withdrawal penalty should apply to voluntary deductible contributions to pension plans in the same fashion it applies to the IRA accounts because without it you don't have a tax-deferred retirement account. You just have a tax-deferred savings account within a pension plan.

This is because there is no mechanism to urge that the funds be there for retirement since most plans provide that an individual can receive those contributions in cash when changing jobs, or annually as in the case of some profit-sharing plans. We feel that would definitely put us at a disadvantage. If I had the option of making contributions to my own private pension plan which was over and above regular contributions, on a voluntary basis, and I knew I wasn't going to suffer a 10-percent penalty, I certainly would go that way as opposed to putting it into an IRA account in my financial institution.

[The prepared statements of the preceding panel follow:]

SUMMARY OF PRINCIPAL POINTS IN
STATEMENT OF DAVID SILVER
ON BEHALF OF THE
INVESTMENT COMPANY INSTITUTE
BEFORE THE SUBCOMMITTEE ON SAVINGS, PENSIONS
AND INVESTMENT POLICY OF THE
COMMITTEE ON FINANCE

February 24, 1981

To increase savings and investment, aid capital formation, provide retirement income and meet family needs for housing and education, the Congress should enact S. 243. The bill would make permanent the $200/$400 dividend and interest exclusion, increase it to $500/$1,000 for taxpayers age 65 or over and expand the existing Individual Retirement Account (IRA) system by -

- <u>Removing the present prohibition against use of IRAs by persons who are "active participants" in a qualified employer plan.</u> This would greatly increase the availability of IRAs and remove the present discrimination against those who participate in employer plans but have small benefits, or who are not vested and will lose benefits if they switch jobs. Active participants could make contributions to their employer plans in lieu of contributions to IRAS, if they should choose to do so.

- <u>Increasing the deductible contributions to IRAs (now 15% of earned income with a maximum of $1,500) to the total amount of earned income with maximum of $2,000; and allow nondeductible contributions up to $2,000 a year plus an additional lifetime amount of $8,000.</u> Increasing the maximum size of IRAs will reduce the expense ratio in the maintenance of the accounts and encourage their promotion and use. Nondeductible contributions are permitted in employer plans and Keogh plans and should also be permitted in IRAs.

- <u>Permitting limited withdrawals from IRAs without the present 10% penalty tax (a) to purchase a first home or (b) to pay for higher education or vocational training of children.</u> This would encourage use of IRAs, particularly by persons with moderate incomes in their early working years, because it would prevent a complete lock-in of the funds to age 59-1/2 if they become necessary for these two prime family needs.

These changes, readily accomplished within the existing IRA structure, would greatly increase the use of IRAs. They would be neutral as between various forms of investment, would increase savings for retirement, housing and education and would significantly aid in capital formation. Thus, S. 243 will provide the type of economic stimulus that the nation so urgently needs.

STATEMENT OF DAVID SILVER
ON BEHALF OF THE
INVESTMENT COMPANY INSTITUTE
BEFORE THE SUBCOMMITTEE ON SAVINGS, PENSIONS
AND INVESTMENT POLICY OF THE
COMMITTEE ON FINANCE

February 24, 1981

My name is David Silver. I am President of the Investment Company Institute. I am accompanied by Edwin S. Cohen, of the law firm of Covington & Burling. Mr. Cohen has been outside tax counsel to the Institute for many years.

The Institute is the national association of the mutual fund industry. Its membership includes 545 open-end investment companies ("mutual funds"), their investment advisers and principal underwriters. The Institute's mutual fund members have assets of about $125 billion and have approximately 8.5 million shareholders. Thus, the average mutual fund shareholder account size is about $14,117.

Mutual funds provide an economical way by which an investor of modest means can obtain the same professional advice and diversification of investments as a wealthy individual or institution. A wealthy person can retain an investment adviser to select and manage his or her investments, and by investing in a number of different securities can achieve diversification of risk. Mutual funds are designed to permit thousands of investors to pool their resources as shareholders in a fund which in turn invests in a large number of stocks or debt instruments under the supervision of a professional

investment adviser. The shareholders of the fund are the owners and are entitled to all of the fund's net income, which consists of the gross income generated by the fund's investments, less the fund's operating expenses such as investment advisory, custodial and accounting fees.

There are mutual funds designed for many different investment objectives: some funds invest in common stocks; some invest in bonds issued by corporations or the federal government; some invest in obligations of state and local governments; and some, known as money market funds, invest in short-term money market instruments such as certificates of deposit issued by banking institutions, commercial paper and United States Government obligations. All of the funds are regulated by the Securities and Exchange Commission under the Investment Company Act of 1940.

Mutual funds distribute their income, including capital gains as well as ordinary income, currently to their shareholders. In order to avoid placing a federal income tax burden on persons investing through mutual funds that would be heavier than the tax burden on persons who could afford to invest directly, the Internal Revenue Code for some forty years has treated mutual funds essentially as conduits. Known in the Code as "regulated investment companies," mutual funds are relieved of federal income tax at the company level if they meet various specified requirements, including prescribed

diversification of their investments, provided they currently distribute all their income to their shareholders. Each mutual fund shareholder then reflects in his or her own return the income he or she receives from the fund. The government thus obtains essentially the same revenue as if the person invested directly in a pro rata portion of the mutual fund's investment portfolio.

The Institute strongly supports S. 243, introduced by Senator Chafee, and an identical bill, H.R. 1250, introduced by Congressman W. Henson Moore. These bills would modify the federal income tax laws to promote capital formation through increases in savings and investment. Personal savings by United States citizens as a percentage of disposable income fell during the years 1977-1980 to the lowest level since 1963. Our savings rate is lower than that in other major countries, including Canada, West Germany, France and Japan. Moreover, from 1970 through 1978 our productivity growth was less than that of any of our seven major trading partners except for Great Britain. The decline in productivity is a major national problem.

To overcome the problems stemming from reduced productivity and savings, and to promote capital formation, expand job opportunities, and improve our ability to compete with other countries, we believe the federal tax law should be modified

to provide further encouragement for individual savings in a manner that would serve socially desirable and anti-inflationary purposes such as providing for retirement, housing and education. S. 243 accomplishes these objectives readily and simply by building on existing programs without creating new tax structures.

First of all, the bill makes permanent the exclusion from tax of the first $200 ($400 on a joint return) of dividend and interest income and increases that amount to $500 ($1,000 on a joint return) when an individual or spouse attains the age of 65. The $200/$400 exclusion was enacted as part of the Windfall Profit Tax Act of 1980 for taxable years beginning after December 31, 1980 and before January 1, 1983 and must be made permanent to assure taxpayers that current levels of savings and investments will continue to be encouraged. Expansion of the exclusion for those over 65 will further stimulate private savings for retirement.

Additionally, the bill expands the use of the existing Individual Retirement Account (IRA) system by eliminating the provision that prohibits its use by anyone who is an "active participant" in a qualified employer plan. IRAs were introduced in ERISA in 1974 as a result of a Treasury proposal in 1971 to permit retirement savings by persons who either were not covered by employer-sponsored qualified plans or for whom the employer contributions were less than $1500. However, the difficulty of

measuring the employer contribution by an employee in many plans led the Congress to make ineligible for IRAs all employees who are "active participants" in employer plans. This provision has created serious administrative complexities and has operated unfairly in many instances.

To promote savings and investment, aid capital formation and help to meet such family needs as housing, education and retirement, the bill makes all persons with earned income eligible for IRAs even though they may be covered by qualified plans.*/ This would greatly expand eligibility and would be especially fair to lower and middle income groups. Often these groups are participants in plans which build on social security, with the result that the plans provide only modest amounts of retirement income. The proposal would also eliminate the present unfairness to workers whose pension rights are not fully "vested," and who may lose retirement benefits if they change jobs, yet are now ineligible for IRAs.

Currently deductible contributions to IRAs are limited to the lesser of $1500 or 15 percent of earned income. One of the major drawbacks to existing IRAs is that the $1500 ceiling

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*/ If the employee prefers, and if the employer's plan allows, the bill permits the employee to place his deductible contribution in his employer's plan rather than his own IRA. To be deductible, this contribution must be in excess of any contributions which are required as a condition of employment, as a condition of participation in the plan or as a condition of obtaining benefits under the plan attributable to employer contributions.

on annual contributions is too low. This low ceiling means that the necessary expenses of maintaining IRA accounts in a bank, insurance company or mutual fund is high in relation to the income on the $1500 investment. Further, the small size of the account does not provide adequate incentive to those who would incur the expense of advertising the availability of the accounts and promoting their use. Finally, the tax advantages to the owner of such a small account are too limited to be a meaningful encouragement, particularly in light of the inflation that has occurred since 1974. Dollar limits for contributions and benefits under corporate plans are indexed under present law, but those for self-employed plans and IRAs have been confined to their 1974 levels, although inflation has eaten into their value by some 40 percent. S. 243 raises the ceiling on deductible contributions to an IRA to the lesser of $2,000 or the amount of compensation earned by the taxpayer during the taxable year. Permitting the taxpayer to enlarge the size of the account by depositing larger deductible contributions materially lowers the expense ratio in the account and induces sponsors of the account to promote their use.

In addition to the increased deductible contribution, S. 243 permits nondeductible contributions to an IRA of $2,000 per year, plus an additional $8,000 over the taxpayer's lifetime. Under existing law, nondeductible contributions are permitted to be made by employees to qualified pension and profit sharing

plans and to plans for the self-employed. They should be permitted similarly for IRAs as a means of encouraging additional retirement savings and investment, and increasing the size of the IRA to further absorb the costs of maintaining the accounts and encouraging their use. A nondeductible contribution costs no revenue when it is made, although the tax in future years on interest, dividends and capital gains received on the investment of that contribution will be deferred until retirement years.

S. 243 permits withdrawal, up to a lifetime maximum of $10,000, from an IRA without penalty if the withdrawn amount is used either (a) to purchase a first home or (b) to pay for the post-high school education or vocational training of a child of the taxpayer. Withdrawals must be made in increments of at least $2,000 and the value of the account must be at least $2,000 immediately after the withdrawal. The IRA rules now prohibit withdrawal of any amounts by the taxpayer prior to his attaining age 59-1/2, except in the case of death or disability. Amounts withdrawn for other reasons are subject to a 10% withdrawal penalty tax. This is a severe penalty -- superimposed on the regular income tax that must be paid on the withdrawn amounts -- and undoubtedly has a discouraging effect upon the savings of persons of moderate incomes, especially in their early working years, who are concerned about locking up funds until age 59-1/2. Two principal concerns of

those groups are the need for a down payment to purchase a first home and the financing of higher education for their children. Permitting limited withdrawals up to an aggregate of $10,000 without a penalty tax should alleviate their concerns about the lock-in to age 59-1/2.

Little or no revenue is obtained from the existing penalty, and its removal in these two cases should greatly stimulate the use of IRAs without seriously affecting long-term retirement plans. Amounts withdrawn, to the extent that they exceed the taxpayer's total nondeductible contributions to the account, would be includible in income, though without penalty tax -- a factor which encourages retention of funds in the final account until retirement age without making withdrawal for purchase of a home or higher education prohibitively expensive.

The tax cut fashioned by S. 243 would not be inflationary. By stimulating the use of IRAs, taxpayers would be encouraged to save; once in an IRA, funds would be invested rather than spent. Thus, there would be more money saved for capital formation, housing, education and retirement and less spent for consumption. We strongly urge that our nation's tax structure begin to encourage saving and investing over immediate consumption through the enactment of S. 243.

In sum, we believe S. 243 has major advantages in the cause of capital formation and the promotion of savings and investment because -

- It utilizes the existing IRA structure without requiring a new type of account with new rules and regulations to be promulgated.

- It eliminates or modifies existing IRA provisions that have caused administrative complexities, that have significantly reduced the number of eligible users and that have caused the necessary expense of promoting and maintaining the accounts to be high in relation to their permitted size.

- It is neutral as between various applications of IRA funds -- common stocks, preferred stocks, various types of debt instruments, government obligations, bank deposits, insured annuities, etc.

- It permits an employee who is an active participant in an employer plan to choose to make his contribution to the employer's plan or to his own IRA, and thus is neutral as between the use of a separate account or the employer plan.

- It permits some withdrawal, without tax penalty in excess of the usual income tax, of funds for prime family needs of purchasing a first home or higher education or vocational training of children.

- It permits accumulation of investment income, including roll-over of capital gains, on funds in the account with reasonable ceilings placed on the amounts of deductible and nondeductible contributions.

We believe that this program combines in a single package the benefits of many separate proposals that have been pending in numerous bills, and that it would be of major advantage to the economy of the nation.

We would be happy to answer any questions or submit any further details the Committee may deem appropriate.

76-138 O—81——23

National Association of
Federal Credit Unions

1111 N. 19th Street
Arlington, Virginia 22209

703/522-4770

Statement of John J. Hutchinson

President of

The National Association of Federal Credit Unions

Before the Subcommittee on Savings, Pensions,

and Investment Policy of the

Committee on Finance

United States Senate

Regarding

Savings Incentive Proposals
(S. 12, S. 24 and S. 243)

February 24, 1981

Mr. Chairman and members of the subcommittee, I am John J. Hutchinson, president of the National Association of Federal Credit Unions and manager of Hamilton Standard Federal Credit Union in Windsor Locks, Connecticut. The National Association of Federal Credit Unions (NAFCU) is the only national trade association exclusively representing the interests of our nation's federally chartered credit unions. There are 12,716 Federal credit unions throughout the country whose 25.9 million members hold more than 36.5 billion dollars in savings.

I appreciate the opportunity to appear before you today as you consider new proposals contained in S. 12, introduced by Senator Dole and Senator Cochran; S. 24, introduced by Senator Dole, Senator Chafee, Senator Danforth, Senator Garn, Senator Hatfield and Senator Wallop; and S. 243, introduced by Senator Chafee to encourage savings. The tax policy decisions made by this subcommittee will have a substantial impact not only on our nation's credit unions, but upon every American consumer. With me today is Dick McConnell, the executive vice president of our association.

INTRODUCTION

Mr. Chairman and members of the subcommittee, the spectrum of issues before you today reflects concerns very much present in the minds of all Americans, particularly those of us who are responsible for the management and direction of our nation's consumer-owned financial institutions. We have a fiduciary responsibility to our member owners which we cannot take lightly. The Federal Credit Union Act states clearly that a Federal credit union is "a cooperative association organized ... for the purpose

of promoting thrift among its members and creating a source of credit for provident or productive purposes ...". (12 U.S.C. 1752 (1)). Unfortunately, due to economic conditions, Federal credit unions are finding it more and more difficult to fulfill these statutory obligations. My recommendations to the subcommittee, if acted upon favorably, would greatly assist member-owned credit unions in meeting these obligations and in realizing the goals envisioned by the Congress when it passed the Federal Credit Union Act nearly one-half century ago.

In determining the form and composition of a viable tax cut plan, I would urge this subcommittee to: expand and make permanent the $200/$400 exclusion for interest and/or dividends contained in Section 404 of Public Law 96-223; relax the eligibility requirements and contribution limits for Individual Retirement Accounts; and allow penalty-free withdrawals from these accounts for housing and higher educational purposes. It is the position of the National Association of Federal Credit Unions, as well as my own personal conviction, that such actions by the Congress would be non-inflationary, encourage savings, and assist in capital formation.

TAX INCENTIVES FOR SAVERS

Over the past number of years the National Association of Federal Credit Unions, with the welcome support of many members of Congress and of this subcommittee, has recommended that the Internal Revenue Code be amended in order to reward rather than penalize consumer savings. The tax incentive provision contained in Section 404 of the "Crude Oil Windfall Profit Tax Act of 1980" -- which permits the exclusion from taxable income of the first

$200 ($400 in the case of a joint return) of interest or dividends earned on savings or investments in domestic corporations during calendar years 1981 and 1982 -- is an encouraging first step. Nevertheless, it is obvious to the more than 7,500,000 individual credit union members represented by NAFCU that the Congress must go much further in providing truly meaningful savings incentives.

Each of the bills before this subcommittee today attempts to provide some of these needed incentives. Senators Dole and Chafee, as well as the co-sponsors of S. 12, S. 24 and S. 243, should be commended for assuming leadership roles in this area. The National Association of Federal Credit Unions supports the principles underlying all three of these bills. The demand for this kind of relief is imperative.

As you know, the majority of American people, as well as your colleagues in Congress, recognize the severity of the problem created by the deterioration in the net value of savings held by consumers -- for the most part, small savers -- in accounts at our nation's depository institutions. I therefore urge this subcommittee to include in any tax cut legislation provisions which would expand the partial tax incentive for savers already provided by Public Law 96-223, and to make that measure permanent.

S. 12

In recognizing the need for more attractive savings incentives, Senator Dole introduced S. 12, which would allow a retirement savings deduction for persons covered by certain pension plans. There are many positive aspects to this legislation. Inflation has taken its toll on the elderly, while pressures on the Social Security system and private retirement plans point to the need for additional sources of retirement funding.

S. 24

S. 24 calls for the establishment of two new kinds of accounts similar to the Individual Retirement Account. Each of these accounts would be for a single purpose: either housing or higher education. These are both valid interests of the consumer and there is no doubt that the need for this kind of saving exists. However, these accounts would be single-purpose and thus, short-lived accounts. This may not be the most efficient way to accomplish these ends.

The tax on these savings would be deferred, as in Individual Retirement Accounts, except that the child would be required to pay the deferred taxes in the case of the education account. The bill calls for attributing the deferred amounts to the child's income over a ten-year period beginning in the year the child attains age 25. I question whether we should place this burden on the individual between ages 25 and 35. This would be the time when that individual would be trying to purchase a home and this additional burden seems to be inappropriately placed.

S. 243

The "Savings and Retirement Income Incentive Act of 1981" appears to combine the positive aspects of S. 12 and S. 24 with its own provisions to form a comprehensive package of tax incentives.

The Individual Retirement Account (IRA) program, established by the Employee Retirement Income Security Act of 1974 (ERISA), encourages eligible individuals to create their own retirement plans through a constructive system of tax incentives. Contributions to such plans are excludable, within limits, for federal income tax purposes, and no federal tax is paid on those funds or their

earnings until they are withdrawn (normally after age 59 1/2). Benefits previously available only to individuals covered by an employer's pension plan or the self-employed were made available through the introduction of IRA accounts to many working Americans. IRA accounts are attractive to credit unions and other financial institutions, since they provide the institution with a highly stable pool of long-term funds which may then be extended to borrowers in the form of consumer or mortgage loans.

Recent figures indicate that while over 55 million Americans are eligible to open an Individual Retirement Account (IRA), less than 6% of those eligible had established such accounts. Available data indicates that only about 2% of all Federal credit unions currently offer these accounts. While the Congress and the regulatory agencies have done much to facilitate the establishment of IRA accounts since their inception in 1974, further refinements of the statutes and regulations impacting on these accounts are in order.

Specifically, S. 243 proposes several changes in the IRA structure that would make these accounts much more attractive to both the consumer and the financial institution. Although they have not been sufficiently utilized, IRAs are existing accounts with mechanics familiar to most financial institutions. Altering some of the characteristics of this existing account to permit penalty-free withdrawals for a home purchase or educational expenses would be much simpler than instituting two new accounts. IRAs could be used to accommodate housing and educational purposes and still fulfill retirement needs.

Financial institutions would find this package more attractive, as it would be easier and more economical to manage and market. In one compact piece of legislation, the interest/dividend exclusion would be made permanent, and even expanded for senior citizens; at the same time, IRAs would be made both available and accessible to all wage earners.

The National Association of Federal Credit Unions endorses prompt action by the Congress to expand and make permanent the tax exclusion for interest and/or dividends; to implement changes in IRA eligibility so that any wage earner may establish an IRA or contribute a tax-deductible amount to a pension plan; to expand the maximum tax deductible limit from $1,500 to $2,000 per year while allowing non-deductible contributions of $2,000 per year plus $8,000 over a lifetime; and to permit withdrawals from these IRAs for the purposes of housing or higher education.

If these proposals are positively acted upon by this subcommittee and passed into law, a much greater number of citizens would become eligible to establish Individual Retirement Accounts. Obviously, this would benefit the individual credit union member, and also promote a fundamental public policy of providing added retirement security for our older citizens.

Additionally, greater participation in IRA programs would translate into an increased individual savings rate for each credit union member, and a corresponding increase in total shares. These funds could then be extended by the credit union to other members in the form of loans, helping the credit union to fulfill its statutory mandate to serve as "a cooperative association

organized ....for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes ...". (12 U.S.C. 1752(1)). Such an expansion of savings would contribute substantially to the capital formation needs of our nation.

CONCLUSION

In summary, Mr. Chairman and members of the subcommittee, the National Association of Federal Credit Unions urges you to incorporate into your recommendations provisions which will:

- Expand and make permanent the tax incentive for savers authorized by Public Law 96-223;
- Relax the eligibility requirements and contribution limits for Individual Retirement Accounts; and,
- Permit withdrawals from Individual Retirement Accounts without penalties for the purchase of a first home or for the higher education of the account-holder's children.

I thank the subcommittee for the opportunity to appear, and will be pleased to respond to any questions you might have at this time.

TESTIMONY OF

JOSEPH N. CUGINI, CHAIRMAN-ELECT

CREDIT UNION NATIONAL ASSOCIATION, INC. (CUNA)

BEFORE THE

SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY

ON

TAX INCENTIVES FOR SAVERS

FEBRUARY 24, 1981

The Credit Union National Association, Inc. (CUNA) is an association of credit union leagues, representing each state and the District of Columbia. Through the leagues, CUNA represents approximately 20,000 federally and state chartered credit unions which serve more than 40 million members. Credit unions are cooperative, non-profit associations that offer various financial services to their members.

Good Morning, Senator Chafee, and other members of the Subcommittee, I am Joseph N. Cugini, Chairman-Elect of the Credit Union National Association, Inc. (CUNA) and Chairman of CUNA's Governmental Affairs Committee. I am also President and General Manager of the Westerly Community Credit Union, a state-chartered credit union in Westerly, Rhode Island. I welcome this opportunity to appear before you today.

I would like to offer CUNA's support for the encouragement that S. 12, S. 24, and S. 243 offer individuals to save for their own future as well as their nation's future. The actions taken by the 96th Congress to treat some portion of interest and dividend income differently than ordinary income was an important first step in curbing a national mania of "buy now, pay later," a philosophy we all know not only fuels the fires of inflation, but also robs the nation and its people of the funds they need to finance their future. Therefore, CUNA supports the efforts of this Subcommittee and others of the 97th Congress to carry this important work forward with legislative proposals that provide not only incentives for savings, but for other important goals-such as education, housing and retirement.

It is our belief that the job of encouraging individuals and families to save is too important to delay. This task cannot be put off until work on the Administration's Kemp-Roth proposals are completed but must be dealt with now. It is our belief that any delay in implementing savings incentive proposals such as these before the Subcommittee would not only damage attempts to encourage capital formation but would also undermine the important psychological perception the American people now have that the new leadership will quickly and dynamically tackle the economic problems confronting the nation. Therefore CUNA urges that Congress act to insure the concepts embodied in the bills before us today are made an integral part of the first tax legislation this Congress enacts.

$200/$400 INTEREST TAX DEDUCTION

As a minumum, CUNA urges Congress make the $200 ($400 for joint returns) deduction for interest earnings permanent, as provided for in S. 243. We support special consideration for the nation's elderly by allowing them a higher deduction such as the $500/$1000 figure proposed in S. 243. We hope that Congress will further examine the benefits of increasing the tax exclusion for all savers to a much higher figure, such as $2,000.

INCREASE IN THE DOLLAR LIMIT OF IRA'S

CUNA strongly recommends that Congress increase the current $1,500 maximum that can be contributed to an IRA account. It should be recalled that the $1,500 figure was first proposed about a decade ago. With the inflationary pressures experienced in the 1970's and the expectation of continuing inflation, an increase is necessary to make the IRA accounts capable of building enough retirement savings to help sustain our elderly during their retirement years. S. 243 proposes an increase in the limit of $2,000. CUNA hopes that Congress will consider an even greater increase to better reflect current economic conditions.

INDEXING THE DOLLAR MAXIMUM

S. 24 suggests that the maximum deduction allowed for the special education and housing savings accounts be indexed. Indexing would result in the maximum deductions being increased periodically in step with inflationary pressures. CUNA thinks that indexing should be given serious study by Congress for all IRA's, as well as for other special accounts, in order to avoid the current problem of Congress periodically being asked to address the need for adjusting a cap which is diminishing in terms of real dollars.

Obviously, curbing inflation is a preferable solution to acknowledging that inflation is likely to always be with us through indexing. However, until we can bring inflation under control the indexing solution offered by S. 24 will help solve the current problem created by putting a cap on deductions.

ELIMINATION OF THE "ACTIVE PARTICIPANT" REQUIREMENT

CUNA strongly supports broadening the eligibility of those allowed to establish IRA accounts. Currently, there are many Americans who shift jobs frequently, and who because they are "active participants" in qualified retirement plans are therefore, ineligible to establish IRA accounts. Many of these job-mobile people are not vested and will never vest in an employer's pension plan. The "limited employee retirement account" (LERA) concept will allow an employee covered by a plan to make a tax deductible contribution to his or her employer's retirement plan or to an individual retirement account. There have been a number of methods proposed to extend IRA eligibility and we only urge that any method chosen be kept as simple as possible. We prefer the approach in S. 243 which would merely eliminate the "active participant" restriction and all workers could establish the IRA under the same terms. S. 12 would subject active participants to a lower dollar contribution than those not covered by pension plans. Our particular concern with this approach is that the financial institution offering an IRA plan might have to verify that the person opening the account is an "active participant" and to monitor a lower dollar limit on these accounts. Such requirements would only serve to discourage financial institutions from actively marketing these programs.

While S. 12 proposes to allow "active participants" of most pension plans to participate in the IRA program, it specifically singles out government employees for exclusion. We do not think such an exclusion is justified and we hope that any final IRA bill will not discriminate among types of employers.

ADDITIONAL NON-DEDUCTIBLE CONTRIBUTIONS TO IRA'S

CUNA supports efforts to encourage further additions to IRA accounts above the amount allowed as a tax deduction. This will help our members plan for their retirement years and will help make more credit unions able to offer IRA services. The relatively small amount that currently can be contributed a year lessens the attractiveness of offering IRA accounts because of the time involved for personnel to become knowledgeable about complex IRA provisions, and the administrative burdens of maintaining these accounts. S. 243 proposes that an additional $2,000 non-deductible amount could be contributed each year plus an additional $8,000 over the employee's lifetime in order to help financial institutions absorb the expense of promoting and managing these savings plans. We hope this idea is incorporated in any final bill improving the current IRA law.

SPOUSAL IRA'S

CUNA supports efforts to improve the coverage of spousal IRA's. Married couples who diligently seek to provide for themselves in later years through individual retirement accounts will fail to adequately do so because of defects in IRA qualifications and contribution limitations. I am speaking specifically about non-employed spouses and those spouses who are employed part-time and

are, therefore, excluded from making meaningful contributions to IRA accounts. If a spouse is not employed, an IRA contribution is in effect limited to $250 over and above the $1,500 contribution limit provided the employed spouse. When it comes time to withdraw those funds, the couple will surely find the amount inadequate retirement income for two, or that the IRA account is prematurely depleted.

These accounts are important to help homemakers prepare for their retirement years. CUNA does not understand why S. 243 proposes to eliminate spousal IRA's completely and we feel this move is clearly in the wrong direction. We hope this Subcommittee will seriously study proposals to allow non-working spouses or those employed on a part-time basis to establish a regular IRA based upon the working spouse's income.

15% OF INCOME LIMITATION

CUNA supports the elimination of the 15% of income limitation in S. 243. Presuming that IRAs will still be limited to wage earners, CUNA recommends eliminating the 15% restriction which currently creates unnecessary confusion. This will simplify the contribution limits under the law and will leave only an annual contribution limit of $1,500 for each individual ($1,750 joint) or such higher ceilings established by Congress. Also eliminating the 15% restriction will perhaps allow moderate income wage earners to make better use of the account.

Although, it will not be particularly significant to many potential IRA contributors, a person with income of less than $10,000 should be able to contribute the dollar maximum up to his earned income if he so chooses. This may be attractive, for instance, to a older, married woman who is working part-time and who would prefer to defer part of her earned income to plan for her retirement years.

DIFFERENT TREATMENT OF WITHDRAWALS FROM AN IRA OR A PENSION PLAN

In our view the bills being considered today fail to establish a parity between employer pension plans and IRAs with regard to the early withdrawal penalty. It is our opinion that, if employer pension plans are permitted to accept voluntary deductible contributions from employees for retirement purposes, the same 10% tax penalty should apply to those deductible contributions withdrawn prior to age 59 1/2 and not rolled over into an IRA account, as apply to IRAs directly. Currently, non-deductible employee contributions to a pension, profit-sharing or thrift plan may be withdrawn at severance (or annually under some plans). If this same provision were to apply to deductible employee contributions, we feel there would be a competitive disadvantage to financial institutions offering IRAs. We feel that this disparity should be addressed in any final bill, so that funds intended for retirement will be used for that purpose.

SPECIAL EDUCATIONAL AND HOUSING ACCOUNTS

Credit unions want to encourage their members to plan for their children's education and to help younger members be able to buy that first house. Both S. 243 and S. 24 contain provisions to help in these areas of major family expenditures. S. 243 proposes to allow an individual to withdraw from an IRA account (or IRA accounts) up to $10,000 without tax penalty, either to purchase a first home or to pay for children's higher education (but an IRA account could not end up less than $2,000). This bill does not appear to change the provision that the withdrawal be taken into gross income and taxed as ordinary income by the individual who sets up the IRA account. S. 24 takes a different approach. A new "education savings

accounts" and a new "housing savings account" could be established for these two purposes completely separate from the IRA program. The educational account would allow taxpayers to set up different accounts for each of their children (and the child could be the beneficiary of only one account). The taxpayer could take a maximum deduction per account each year of $1,000. The money could later be used to pay the expenses of the child for college or a vocational school, and the taxpayer/parent would not be taxed on the funds used. However, the child would pay ordinary income taxes on the funds starting at age 25 over a ten year period.

The housing savings account would allow an individual to establish a special account for the purpose of saving the down payment for the first house and take a tax deduction of $1,500 a year ($3,000 for joint filings) up to a maximum of $15,000/$30,000. When the funds are withdrawn from the account, a taxpayer would not take the amount withdrawn into gross income, but instead would reduce his or her basis in the house purchase by the amount of the withdrawal (which will increase the capital gains tax eventually paid on the sale of residential property).

We question why housing savings accounts should be subject to a $1,500 contribution cap a year if there is a $15,000 overall limit. This would limit the advantages sought by the bill. Many young couples might want to sacrifice for 3, 4 or 5 years to save as much as they can in order to buy a house. If they can save $4,000 in one year, we question why they should not be able to shelter the entire amount, since the funds will be used to buy that house.

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If Congress decides it is desirable to establish specialized accounts for socially desirable purposes such as education and home ownership, it does seem important to examine if requiring the funds be immediately taken into gross income undercuts the value of the new accounts. CUNA believes the taxation approach taken in S. 24, which will tax the beneficiary on the use of the educational funds and shift the tax consequences to the basis in the house, will probably help to carry out Congressional intent in establishing such special accounts.

RECORDKEEPING

CUNA is always concerned about changes in the law that will increase the recordkeeping burdens on financial institutions. In designing these changes we hope that Congress will recognize that financial institutions should not be forced to certify that funds are being deposited by those eligible to do so such as determining that a person is an "active participant" (in S. 12 subject to certain lower limits) or that a withdrawal is being used for a proper purpose (such as for education or a first house). The burden of proof in such instances should rest with the individual.

The IRA law is suppose to be a relatively simple pension law. Although, compared to many other pension trusts, an IRA is simple, it is not a simple law for financial institution personnel to become knowledgeable about or for individuals to comprehend. We hope that the burdens of administering this law can be minimized to the greatest extent possible and that the law can be written in the most comprehensive language possible. To do otherwise would only serve to thwart the intent of Congress.

CONCLUSION

An opportunity exists for this Congress to meet and merge the immediate and long-term needs of many segments of our nation by providing as a part of a tax cut package, tax cuts for people through tax-incentives for savings, investment, education, housing and retirement.

Through this method, Congress could go great lengths toward correcting the inequities and inadequacies surrounding the use of private retirement plans. Public policy could be altered this year to further encourage individual savings and investment, by developing a broader tax policy that recognizes the benefits of treating interest and dividend income separately from other types of income. This will enhance the future financial security of our citizens, lessen dependence on Social Security, and provide financial institutions and other intermediaries with a source of stable funds for lending and investment, thus reducing pressure on interest rates and encouraging capital formation.

Thank you for the opportunity to testify before this Subcommittee. I will be happy to answer any questions you may have.

NATIONAL CONSUMER FINANCE ASSOCIATION
1000 SIXTEENTH STREET, N.W., WASHINGTON, D.C. 20036 (202) 638-1340

SUMMARY OF STATEMENT ON S.12, S.24 and S.243

Appearing on behalf of the National Consumer Finance Association (NCFA), Mr. Richard C. Tucker, President of Tri-State Industrial Bank, Denver, Colorado, expressed support for S.12, S.24, and S.243. NCFA represents those unique depository institutions termed "industrial banks" or "thrift and loans" which operate in 1600 offices in eleven states with annual deposits exceeding $2.3 billion.

Tax incentives to encourage capital formation through thrift are of particular importance to industrial banks, the majority of whose depositors are fifty years of age or older.

Today's industrial banker is caught in the vise of disincentives to save, and limited return on lending brought upon by archaic state usury limits.

NCFA supports S.12, S.24 and S.243 as necessary legislation to encourage capital formation through thrift and to address the national tax system's bias against savings.

NCFA commends Subcommittee Chairman Chafee and full committee Chairman Dole for their efforts in addressing this vital issue.

NATIONAL CONSUMER FINANCE ASSOCIATION
1000 SIXTEENTH STREET, N.W., WASHINGTON, D.C. 20036 (202) 638-1340

STATEMENT OF

RICHARD C. TUCKER

ON BEHALF OF THE

NATIONAL CONSUMER FINANCE ASSOCIATION

BEFORE THE

SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

ON

TAX INCENTIVES FOR SAVINGS

(S.12, S.24 and S.243)

FEBRUARY 24, 1981

Mr. Chairman,

My name is Richard C. Tucker. I am President of Tri-State Industrial Bank, Denver, Colorado and Chairman of the Advisory Group to the Thrift Section of the National Consumer Finance Association. I am also serving in my third year as President of the Industrial Bank Savings Guarantee of Colorado. I appreciate the opportunity to appear before this Subcommittee to offer the views of NCFA on S.12, S.24, and S.243, each of which addresses the vital issue of providing incentives for savings and capital formation.

The NCFA represents consumer installment lenders including those unique depository institutions which are not commercial or mutual savings banks, savings and loan associations or credit unions. NCFA member depository institutions are industrial banks, industrial loan companies, and thrift and loan companies. These state chartered and regulated organizations have the dual purpose of providing consumer credit and accepting savings deposits from customers.

Institutions which have the dual purpose of making short intermediate-term credit available to consumers and of accepting some form of savings deposit from individuals have been in existence since 1910, when the Fidelity Savings and Trust Company of Norfolk, Virginia, was established by Arthur J. Morris. This was the beginning of Morris Plan companies by which name some are still known, though more frequently institutions of this type are popularly called "industrials" or "thrift and loans" - T & L's for short. The term "industrials" is used in

the sense that the savers and the borrowers from these institutions were originally industrial workers - it is not used in the sense that these institutions make industrial loans. Thrift and loans, on the other hand, should not be confused with savings and loans which have the savings deposit feature, but whose main lending activities are confined to mortgages.

"Thrift and loans" and "Industrials" are variously known as industrial loan companies, industrial banks, industrial savings banks, industrial loan and thrift companies, loan and investment companies, and Morris Plan companies. As a depository institution, industrial banking companies in at least eight states are currently participating in the U.S. Treasury's program for the direct deposit of recurring payments. Industrial banks, like other state-chartered banking organizations, are eligible for membership in the Federal Deposit Insurance Corporation and in the Federal Reserve System. In addition, several states insure consumer deposits through state-chartered guarantee corporations, such as Colorado's, of which I am President. Other NCFA member organizations offer consumer credit and also issue interest bearing obligations under state securities laws.

Industrial banking companies currently operate approximately 1600 offices in eleven states (California, Colorado, Hawaii, Indiana, Iowa, Kentucky, Minnesota, Nebraska, Rhode Island, Utah, and West Virginia). In the most recent year for which complete figures and available (1979) the amount of deposits held by industrial banking companies in these states exceed to $2.3 billion.

I believe that the topic of tax incentives for savers

is of particular significance to the industrial banking community. First, a majority of the depositors in industrial banking institutions are fifty years of age or older. In eight states these depositors enjoy the benefits of the tax exclusion of Individual Retirement Accounts (IRA), coupled with the superior rate of return afforded through industrial banks. In my own company this week's certificate rate was 15.51% with a resulting yield of 16.343%.

Second, the state usury restrictions under which industrial banking institutions labor restrict profit significantly. The high yield, I am proud to offer my depositors, is balanced by state statutes mandating 18% loans. Until significant rate relief for industrial lenders comes from federal preemption of archaic state usury restrictions, the profit margin available to the nation's industrial bankers will be thin, and in a highly inflationary economy - nonexistent.

Finally, even the superior yields industrial bankers offer consumers do little to encourage savings in today's economy. For the last two years, the growth in the industrial banking industry has merely equaled accrued interest from existing deposits.

For these reasons, NCFA supports S.12 and S.24, introduced by Finance Committee Chairman Dole, and S.243, introduced by Chairman Chafee, as effective measures to stimulate capital formation, assist in curtailing inflatiion, and improve our national productivity. Today, as the job of rebuilding America's economy begins, it is imperative that tax policy be changed to provide incentives for the consumer to save.

The decline of the nation's personal savings rate during the nineteen seventies may well be termed one of the tragedies of the decade. This decline has resulted in a reduced rate of the requisite capital formation to rebuild the nation's aging industrial infrastructure and in a reduced stable supply of funds for mortgage lending.

The disintermediation of funds from the nation's depository institutions, limited by administered rates, to money market funds which often invest in high-yield federal government guaranteed securities, led to industry and housing competing with the federal government for needed capital. Few of these funds allow the truely small savers to participate; as the required initial investments are high and ready access to funds for the marginal saver is inadequate.

Ironically, the national tax system further discourages capital formation through thrift. As taxpayers find themselves paying higher income taxes as inflation fueled "bracket creep" propels them into higher tax rates, the tax system provides a further disincentive by taxing interest and dividends. It is understandable why a small investor, upon seeing his yield reduced substantially below the inflation rate, converts his available funds from thrift to consumption, thereby further fueling the inflation rate.

In the United States, until 1932, the federal tax law provided for a tax exclusion of the first $300 interest earned in "building and loan associations" accounts. IRAs, many of which I am proud to say are held in industrial banking organizations, and the current temporary $200-400 exclusion for interest and

dividends have been important first steps in correcting the nation's overwhelming imbalance against savings.

NCFA supports S.12, which would allow employees who participate in tax-qualified retirement plans to receive a tax deduction for contributions to an employer sponsored plan or to establish an IRA subject to a $1,000 ceiling on annual deductible contributions. Under the present law, an employee is entitled to deduct the amount contributed to an IRA up to the lesser of 15% of compensation for the year or $1,500. The current law precludes an employee who is an active participant in an employer qualified pension plan from contributing to an IRA even if the pension plan provides less generous benefits, even if the employee has not been vested in the pension plan and is unlikely ever to be vested in the plan. In today's highly mobile society, an employee may change jobs too frequently to ever vest in any single employer's retirement plan, leaving only social security benefits as retirement earnings.

NCFA supports S.24, which expands the tax deferred savings account concept to saving for the first time home buyer and higher education. This bill addresses the needs of the young family seeking to obtain a stake in society, yet lacking the appreciation from equity the owner of an existing home enjoys when purchasing another house.

Additionally, the higher education benefit aids families in dealing with the dramatic increases in the cost of higher education. Encouraging savings for higher education lessens the need for future loans and grants as students reach college age.

NCFA also supports S.243, which expands the coverage and concept of IRAs and further encourages individual savings by making permanent the $200-400 interest and dividend exclusion and expanding that exclusion to $500-1,000 for individuals 65 years of age and over. The enactment of this legislation, particularly the increase to $2,000 of the maximum tax deductible IRA contribution, will not only stimulate capital formation but act to relieve the growing pressures on the Social Security System. Currently wages subject to FICA are scheduled to increase incrementally to $42,000 and the social security tax rate will increase to 7.15% by 1986. Today nearly three-fifths of the nation's senior citizens derive the majority of their income from social security. As the post-World War II "baby boom" generation ages, the percentage of the total population eligible for social security will increase dramatically. Passage of this legislation will encourage individual savings for retirement and make self reliance possible.

In conclusion, NCFA urges the rapid passage of S.12, S.24, and S.243 to provide the necessary catalyst to stimulate capital formation. NCFA wishes to commend you, Mr. Chairman, and full committee Chairman Dole, for your efforts in this area.

I thank you for this opportunity to present the views of NCFA on this vital issue.

Senator CHAFEE. Thank you very much, gentlemen. I appreciate your coming down.

The next and final panel includes Mr. Lee Gunderson, Mr. Albert Hooks, Mr. Edwin Brooks, and Mr. Robert O'Brien.

Mr. Gunderson, please start off. The time limit is 3 minutes each. Please proceed, Mr. Gunderson.

First, I want to thank you for coming.

STATEMENT OF LEE E. GUNDERSON, PRESIDENT, BANK OF OSCEOLA, OSCEOLA, WIS., AND PRESIDENT, AMERICAN BANKERS ASSOCIATION

Mr. GUNDERSON. Thank you, Mr. Chairman. I am pleased to be here.

My name is Lee Gunderson. I am president of the Bank of Osceola, Osceola, Wis., and also president of the American Bankers Association.

Our association certainly wants to commend you and the other members of the committee for the intent of these efforts to provide incentives to save. Our association supported the $200/$400 exemption. We believe it should be permanent.

It is inappropriate for us to attempt to determine what the magic number should be on any increased incentives because we feel certainly your Committee on Finance will have to recognize and evaluate this in the context of the overall budget decisions.

I would like to share with you a little bit how some of these things impact on my own community and my own bank because I know that best.

We are a community bank, as are 12,000 others within our association. Our major challenge is attracting and retaining funds to serve the economic needs of our community.

Our ability to do this has been inhibited by a number of factors—Regulation Q, for one, which places what we feel are unrealistic ceilings on savings; inflation; and tax provisions that penalize savings. We have some concerns about the targeting of savings incentives for specific objectives—housing and education—although we feel these are certainly commendable goals and are high priorities for all of us in banking.

My own bank has 45 percent of its loan portfolio in long-term real estate mortgages. Yet, at the same time the responsibility of my bank and other banks like it throughout the country is to serve the overall broad economic needs of our communities—small business, agriculture, consumers. We have a number of people in housing that are customers of our banks and I empathize with the problems that they are having right now. However, I also have some automobile dealers who are not doing too well, either. They need funding. It is very important for them.

Our feeling is that in many cases the marketplace really is the best determining factor for the allocation of credit.

We support expansion of IRA plans. We feel these are very important. I have seen the impact of inflation on the retired and the elderly and the problems that people have in accumulating funds toward retirement.

These would also provide longer term funds that are more stable so that all financial institutions are in a better position to loan these out.

We are committed, as we have been, to the phaseout of the artificial ceiling of regulation Q. We feel this is a major deterrent to savings.

We think the tax bias that attracts people away from savings needs to be addressed. Certainly the underlying and the major problem for all of us in attempting to meet these challenges is getting inflation under control.

Thank you very much, Mr. Chairman.

We have submitted our statement. I would be very pleased to respond to any questions you might have.

Senator CHAFEE. Mr. Gunderson, I have just one quick question.

Do you find burdensome the legislation which provides for permitting a five-times withdrawal for a total of $10,000?

Mr. GUNDERSON. As allocated toward housing and other areas?

Senator CHAFEE. Yes, in other words, preretirement.

Mr. GUNDERSON. As I mentioned, our preference would be to see it not restricted to certain areas.

Senator CHAFEE. I am not sure what you mean by that.

Mr. GUNDERSON. Even though we believe housing has some real problems, we have some concerns about allocating savings and retirement programs toward housing.

Senator CHAFEE. What would you do? Would you give broader latitude?

Mr. GUNDERSON. We would set up savings and retirement programs to meet that need. Then let the market allocate the funds through the market forces rather than just saying they must go into housing to qualify for benefits.

Senator CHAFEE. I am not sure I understand.

Mr. GUNDERSON. You are talking about taking money out.

Senator CHAFEE. I am talking about the withdrawal feature, yes. What I am saying is this: As you know, there has been some testimony here this morning objecting to permitting withdrawal for the first payment on a home or for the education of children, for college education.

My bill provides that there can be a total of five withdrawals up to a total amount of $10,000.

Do you find as a banker with savings accounts in your bank that the $10,000 withdrawal is onerous on your making long-term investments?

Mr. GUNDERSON. It could have some potential problems, Mr. Chairman.

Senator CHAFEE. Are they more than offset by what you believe will be the added attraction of the IRA's due to the fact people can withdraw their money?

Mr. GUNDERSON. At this point in time I am not sure I can comment on that. We will have to wait and see what the attraction would be and how they would come in.

Senator CHAFEE. Obviously it was our belief that by putting in the college and the home that it provided an attraction, particularly for the young people to go into an IRA.

Mr. GUNDERSON. Yes.

Senator CHAFEE. You cannot venture a guess on that?
Mr. GUNDERSON. No, I would not at this time.
Senator CHAFEE. Thank you, Mr. Gunderson.
Mr. Hooke?

STATEMENT OF ALBERT B. HOOKE, CHAIRMAN, THE NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS, AND PRESIDENT, THE COMMUNITY SAVINGS BANK, ROCHESTER, N.Y.

Mr. HOOKE. My name is Albert B. Hooke. I am president of the Community Savings Bank of Rochester and chairman of the National Association of Mutual Savings Banks.

The National Association of Mutual Savings Banks was one of the early supporters of S. 243 because this legislation extends IRA accounts into a broad-based tax-deferral provision which would encourage individuals to undertake long-term savings for retirement and other major purposes. The tax-deferral approach in our judgment is the most effective way of providing expanded tax savings incentives for savings.

We also endorse the provisions of S. 243 which would make permanent the present $200/$400 exclusion for interest and dividends and increase the exclusion for taxpayers 65 years and older. Furthermore, we support the general thrust of S. 12 which would extend the IRA program in certain respects and S. 24 which would provide for the establishment of housing-educational savings accounts along the line of IRA's. All of these proposed changes would reward and stimulate private saving.

We heard Representative Moore speak earlier this morning about the fact that this legislation provides tax incentives for savings which are vitally needed in many areas. Such action would correct the antisaver bias persisting in our tax laws. It would stimulate our Nation's perilously low personal savings rate and strengthen periodically battered long-term capital markets.

The tax reduction package to be considered in Congress should include provisions aimed specifically at stimulating saving, capital formation, and real economic growth.

This can best be achieved, we believe, by a widely available tax deferral provision patterned after the IRA program, as provided in S. 243. Thus, we have long supported an increase in deductible contributions, an expansion of coverage to taxpayers not now eligible for IRA's and permitting additional nondeductible contributions to IRA's. The resulting broad-based tax deferral provision would have certain major advantages:

It would reward and encourage new incremental saving, rather than past accumulations of savings.

It would stimulate longer term saving and more stable savings flows to financial institutions which are ideally suited to home mortgage lending. We heard Mr. McCarthy testify earlier today about the advantages of encouraging longer term saving. We certainly agree with his concern.

It would help individuals prepare for their own retirement needs, at a time when the social security system is under increasing pressure.

It would build on the precedent of existing programs which are widely understood.

It would promote equity for those taxpayers who do not have an opportunity to undertake long-term saving on a tax-deferred basis through employer-sponsored programs.

It would permit the Treasury to recover part of the initial loss, even aside from the increased tax revenues resulting from more rapid economic growth.

Mr. Chairman, what desperately is needed, and needed now, is a tax policy which provides a direct incentive to save. I hope these comments will be helpful.

Senator CHAFEE. Thank you, very much.

How do you feel about the $10,000? Does that represent a problem? I refer to withdrawal prior to retirement.

Mr. HOOKE. We have some problems with it, but we would like to say let's try the five withdrawals and see how they go.

We agree with your comments of earlier today that some young couple who has to look at age 59 before they can get any of the funds out without a penalty might be discouraged from utilizing this program, and this might be of assistance in that area.

Senator CHAFEE. Thank you, very much.

Mr. Brooks?

STATEMENT OF EDWIN BROOKS, JR., PRESIDENT OF SECURITY FEDERAL, RICHMOND, VA., ON BEHALF OF THE U.S. LEAGUE OF SAVINGS ASSOCIATIONS

Mr. BROOKS. Thank you, Mr. Chairman.

I have filed with you a written statement. I have a short oral comment I would like to make.

My name is Edwin B. Brooks, Jr. I represent here today the United States League of Savings Associations. We thank you for this opportunity to present our views on S. 12, S. 24, and S. 243.

I will say at the outset that we endorse the thrust of these three measures. Each contains features which will go far toward encouraging thrift among Americans as well as toward rebuilding the Nation's badly depleted capital pool, a benefit urgently needed if the United States is to realize the twin goals of reindustrialization and an adequate supply of affordable housing.

Integrating the special purpose education and housing accounts into the familiar and popular individual retirement account as would be done to S. 243 is a particularly innovative approach. This permits the familiar basic private retirement savings instrument to become a multipurpose savings instrument.

Important in all three bills is a recognition of the need to broaden the eligibility for IRA participation by including current members of the qualified plans and allowing tax deductible contributions to be made to the employer plans or a separate IRA. We would suggest that the current, annual contribution limit of $1,500, which was set nearly 7 years ago, should be increased in order to keep pace with inflation. It should be at least $2,000 a year.

In my written testimony I outlined in some detail our views of these bills as well as the suggested new account designed to create additional capital for housing.

Homes for many families are more than mere shelter. They are the principal investment of that family. Eventually most individuals are faced with disposing of their home in order to move to

quarters more fitting to a changing lifestyle and family circumstances, but because of the structure of our capital gains taxes these family options are limited.

Unless the individual is age 55 or older and eligible for a one-time $100,000 capital gains exclusion, he or she must pay heavy capital gain taxes on the proceeds of a home sale or reinvest those proceeds within 18 months in a residence of equal or higher cost. Some families after their children are reared, for example, buy more house than they need or desire because of these tax consequences.

This account, which we call the "home equity preservation account," would earmark all deposits for housing finance. Interest would be tax free and its term would be for a fixed period. Upon maturity, the account holder would have the option of renewing it or withdrawing his money and at the same time paying the capital gains tax, if indeed capital gains exposure would apply.

It benefits the homeowner for he or she would not be forced by the tax laws to buy expensive real estate for which he or she may have no need. By "parking" the capital gains the home seller could increase his or her retirement income.

The Treasury would lose little, if anything, by way of tax-free interest earned since the funds invested in these accounts would otherwise have been plowed into more expensive homes. The home-buying public would benefit because depository institutions would be required to make these funds available for housing finance.

If our Nation is to realize faster productivity growth, if we are to conquer inflation and high interest rates, if we are to meet the capital needs of the 1980's in housing, industrial and commercial modernization and expansion as well as in energy * * * if we are to do these things * * * then we must dramatically improve our thrift habits, and we must do it immediately with meaningful incentives which can be enacted into law early this year.

Thank you, Mr. Chairman. I look forward to your questions.

Senator CHAFEE. Thank you, Mr. Brooks, for that interesting proposal you have. I certainly will want to look that over. We appreciate your bringing it to our attention.

Mr. BROOKS. Thank you, sir.

Mr. O'Brien?

STATEMENT OF ROBERT B. O'BRIEN, JR., VICE PRESIDENT, THE NATIONAL SAVINGS & LOAN LEAGUE, AND PRESIDENT, CARTERET SAVINGS & LOAN ASSOCIATION

Mr. O'BRIEN. I am Robert O'Brien, president of Carteret Savings & Loan Association in New Jersey.

By the way, Mr. Chairman, I bring you greetings from our Governor, Brendon Byrnes, your classmate.

Senator CHAFEE. Classmate at Harvard Law School. That is correct.

Mr. O'BRIEN. As you know, the Governors are in town at the Hyatt Regency. He asked me last night to be remembered to you.

Senator CHAFEE. Thank you. If you see him, convey my regards. I read in the paper that he said he came down here to Washington and he has gotten excellent satisfaction. He came to seek relief

from the drought and it has rained ever since he got here. [Laughter.]

Mr. O'BRIEN. Of course, we need this rain desperately up in New Jersey. It has been raining up there as well, so he did not really improve his situation too much.

I appear today before you as vice president of the National Savings & Loan League. In the interest of time I will summarize my oral summary.

We at the National League do support the President's program.

I want to call your attention to some data that was referred to earlier by Congressman Moore, and that is a study done by the Urban Institute under contract with the Federal Home Loan Bank Board. It refers to what you heard about earlier, the Canadian experience.

The highlight is that based on their analysis, if we were to have a similar IRA provision here with the $3,000 limit modeled on their plan, it would have resulted in $10 to $21 billion in additional savings in 1978, which was the year they used in this study.

Therefore, the available evidence that we have and which has been developed at the Bank Board and with the Urban Institute is a body of proof that increased IRA eligibility limits and the universality of same would at least raise the savings by approximately 10 percent and maybe more.

As you know right now, only about 1.5 percent of total S. & L. deposits represent IRA funds. We would favor seeing that go up to 10 percent, which these proposals would do based on the Canadian experience.

Under the three bills which have been discussed today we think that S. 12, introduced by Senator Dole, is a good bill. However, it does not address the problem of the erosion of the value of the current $1,500 deductible contribution by inflation.

S. 24, also introduced by Senator Dole, is a bill which we can and do support.

S. 243, introduced by you, is in our judgment the most comprehensive bill of all three and would probably do the most to increase savings. It addresses the universal IRA, expands the contribution levels, and combines allowable withdrawals for housing and educational purposes.

We do not have any problem, by the way, with the $10,000 withdrawal figure that you have been questioning us about. In fact, we think it is a pretty good marketing tool. We think one of the reasons the IRA has not gone over too well is because people know they cannot get access to their money. Therefore, we think this can be turned into an advantage. We support that.

Senator CHAFEE. What about Keogh? Have you had much success with Keoghs?

Mr. O'BRIEN. Not too much. It is a very limited market with Keoghs. There are a certain number of people who qualify for Keogh. They are serving a pretty useful purpose, particularly in the New York metropolitan market. However, it has not been a big success nationally.

The only thing I might add in closing is to urge you to consider increasing the savings exemption amounts to $1,000-$2,000 for all taxpayers.

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Finally, I would just like to say that we in the thrift business in New Jersey have adopted the flag of the Rhode Island regiment as our banner. As you know, it has the word "hope" on it.

Thank you, Mr. Chairman.

Senator CHAFEE. That is not only the Rhode Island regiment, but our State seal has the word "hope."

[The prepared statements of the preceding panel follow:]

SUMMARY OF TESTIMONY OF LEE E. GUNDERSON ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION ON THREE SAVINGS INCENTIVE TAX BILLS BEFORE THE SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY OF THE SENATE FINANCE COMMITTEE

FEBRUARY 24, 1981

Each of the three bills is designed to provide tax incentives for savings. Personal savings are an important source of the capital needed for productive investment in business and industry, but they are also very important as a source of economic security to individual savers.

A tax code biased against savings and investment and in favor of consumption has, given double-digit inflation, made speculation and consumption more attractive to individuals than savings. This creates personal financial hardship and undermines the capital base necessary for American industry to modernize and improve productivity.

The ABA supports a permanent partial exemption for interest income, but feels that any decision on increasing the amount of the present exemption should be made in the context of the overall tax reduction on which the Congress will act this year.

The ABA supports an expansion of eligibility for individual retirement accounts and an increase in the tax-deductible contribution limits under IRAs and Keogh plans.

The ABA believes that narrowly targeted tax incentives for first home purchases and for vocational and higher education costs may discriminate against other equally important and legitimate investments, and that enactment of such incentives may not be appropriate for a limited tax reduction program.

The ABA believes that each of these proposals should be evaluated for its contribution to, and appropriateness under, the tax reduction measure proposed by the President, and that any tax reduction should be keyed to a program of corresponding reductions in Federal expenditures. What America needs is a coordinated program of monetary and fiscal policies designed to combat inflation, reduce government spending, and encourage savings and productive investment.

Testimony of

Lee E. Gunderson

on behalf of

the American Bankers Association

on

Three Savings Incentive Tax Bills

before the

Subcommittee on Savings, Pensions, and Investment Policy

of the Committee on Finance

United States Senate

February 24, 1981

Mr. Chairman and members of the Committee, I am Lee E. Gunderson. I am president of the Bank of Osceola, located in Osceola, Wisconsin, and I am president of the American Bankers Association. The ABA is the nation's largest trade association for the banking industry. Over 90 percent of the nation's almost 15,000 full-service banks are members of the ABA, including over 12,000 community banks with deposits of $100 million or less. Over 4,000 of our member banks exercise trust services.

Each of the bills before you is designed to provide tax incentives for savings. They address a common problem: How can the government encourage individuals to save money when inflation taxes away 12 percent or more of what is saved and when the tax law tends to reward consumption and penalize savings?

The problems which have created the need for such incentives are well known. Our tax system has an inherent bias against saving and in favor of consumption. The harmful effects of this bias are aggravated by the severe inflationary conditions that have plagued our economy. Savers of more modest means suffer from governmentally imposed, discriminatory deposit interest rate ceilings which significantly reduce their incentive to save.

The major cause, but certainly not the only one, has been inflation. Inflation has produced excessively high interest rates, because lenders sought to obtain inflation premiums in their debt contracts merely to offset the decline in the purchasing power of the dollar. Yet the interest return embodied in these premiums is taxed in the same way as income which increases one's command over real sources. Inflation is public enemy number one to all savers, and it must be reduced as an essential step in encouraging the public to save more.

Perhaps most important of all is the uncertainty and instability created by the inflation rate and what it has done to the investment climate. For the most part, investors are no longer concerned about which companies are well managed and most productive. Their main concern is how to hedge against inflation. For very good reasons, the investment media they are attracted to have changed dramatically in recent years. Table 1 at the end of our testimony shows the compound annual appreciation in selected investable assets. Investment in the three assets with the highest rate of appreciation, gold, stamps, and diamonds, represents no jobs or production for the American economy. Farmland and single family houses did relatively well. Despite the drastic decline in the value of the dollar, four of the strongest foreign currencies managed to stay only three tenths of one percent ahead of the average rate of inflation, which was 7.5 percent. High grade corporate bonds, bank savings deposits,

and common stocks, major sources of funds for investment in the factories and businesses that create jobs and goods which enhanced our standard of living, are all at the bottom of the list. None of them has kept up with inflation.

Last, but not least, is the structure of the income tax system itself. The system was designed to be progressive on the theory that those who reap the greatest rewards from our highly productive economic system should bear a greater proportionate share of the tax burdens. We have no quarrel with this rationale and would certainly not suggest doing away with the progressive tax structure. But we must call attention to the pernicious ways in which this tax structure is interacting with the inflationary conditions of today's economy. Under non-inflationary conditions the incentive to work and save is not significantly harmed by a moderately progressive tax structure. One can still be assured that a significant proportion of the increased rewards of extra work will accrue to those who put forth the extra effort. But when people are pushed into higher tax brackets merely because they try to assure that their wages keep up with inflation, the incentive to work even harder and produce more goods and services disappears.

My main reason for discussing these broader aspects of the tax structure and the general problem of inflation is that we hope the Committee will consider the bills before it within the context of the broad and fundamental economic problems facing our nation and its policymakers. These bills are constructive and we support them. But we hope the Committee will not consider any of them to be the fundamental answer to our problems. This they are not. What is needed most urgently is strong Congressional support

for the monetary and fiscal policies needed to control inflation, and a more broad and fundamental examination of our tax structure and the way in which it deters savings and productive investment. Now let me turn to the bills before your subcommittee today.

The ABA was a principal supporter of the exemption for up to $200 per year in interest on savings which just took effect in January. The small saver, particularly, deserves a better break. This exemption is clearly a step in the right direction. Any change in the tax law which encourages and rewards saving and investment rather than consumption is an important weapon in the fight against inflation, thus, we think the exemption should be made permanent. Any increase in the amount of the exemption should be evaluated in the context of the broader tax reduction proposals which your committee will be examining this year. The ABA believes that the overall tax reduction package, including any increase in the exemption for interest, should be contingent upon the extent to which corresponding reductions in Federal expenditures can be made.

Banks have also been leading supporters of individual retirement accounts and the Keogh plan, which encourage savings for retirement. We believe that savings for this goal should be encouraged, and that eligibility for these plans should be broadened to include more people who are concerned about their future.

As you noted in your report last year which accompanied H.R. 5829, an individual covered by an employer-sponsored plan may never derive substantial benefits from that plan for a number of reasons. Permitting a

broader class of taxpayers to save for retirement on a tax-favored basis will redress this inequity. An increase in the tax deductible amounts which may be contributed under the IRA and Keogh accounts will provide an incentive for greater long-term savings and bring those amounts more in line with their original economic value. In addition, it should be noted that, unlike the interest exemption, the IRA and Keogh accounts require additional saving each year in order for the taxpayer to receive the tax benefit of the deduction. The long-term nature of the savings placed in IRA and Keogh accounts are particularly important to the economy as a source of capital for long-term investment in the new plants and equipment that are going to be critical to improving our competitive position in world markets and in home mortgages.

The purchase of a first home, and the payment of the costs of vocational or higher education for one's children, are important, worthwhile investments. To single out these two narrow areas for tax favorable treatment, however, may discriminate against or discourage investment in other legitimate and important areas. We urge you to evaluate these proposals in the context of the overall tax reduction package. The amount of the expenditure reductions places, we believe, a limit on the amount of the tax reduction the nation can afford. If we can afford only a limited tax cut, it may be better to concentrate that cut in the areas of a general tax reduction for individuals and capital formation for business and industry.

In conclusion, Mr. Chairman, each of the three bills before the subcommittee today represents an attempt to deal constructively with a difficult and fundamental problem facing the United States. We support fully the effort to expand the availability of individual retirement accounts and to increase the amount of the tax-deductible contributions which might be made to such accounts or under Keogh plans. We support fully the effort to make the present interest exclusion permanent. We would like to urge you most strongly to consider these proposals and others carefully within the context of a program of monetary and fiscal policies needed to combat inflation and a more general restructuring of the tax system that would, on balance, encourage savings and productive investment.

TABLE I

Average Annual Appreciation in Selected Investments

1970 - 1980[1]

		Percent
1.	Gold	31.6
2.	Stamps	21.8
3.	Diamonds	15.1
4.	Farmland	12.6
5.	Single Family Houses	10.2
6.	Foreign Currencies[2]	7.5
7.	High Grade Corporate Bonds	6.4
8.	Bank Savings Deposits[3]	5.0
9.	Common Stocks	6.8

(1) Figures are as of June 30, 1979

(2) W. German Mark, Japanese Yen, Swiss Franc, and Dutch Guilder

(3) Figures are of year end 1979

Base Year 1968=100

Source: Salomon Brothers and the American Bankers Association

Statement
of the
National Association of Mutual Savings Banks
on
Tax Incentives for Saving
Before the
Subcommittee on Savings, Pensions, and Investment Policy
Committee on Finance
United States Senate
February 24, 1981

Summary of Principal Points

1. Legislation to provide tax incentives for individual saving is vitally needed to stimulate our nation's perilously low personal saving rate. Such legislation would encourage increased investment and productivity growth in the economy, and thereby make a major contribution to combating inflation and reviving long-term economic growth.

2. This can best be achieved by extending the Individual Retirement Account program into a broadly-based tax deferral provision available generally to all taxpayers and for a broadened range of long-term saving purposes. NAMSB has consistently supported increasing deductible contributions to IRAs, expanding coverage to all taxpayers and permitting additional nondeductible contributions to IRAs. Accordingly, we strongly support S. 243, as well as the general thrust of S. 12 and S. 24. We also urge that the present $200-$400 interest-dividend exclusion be made permanent.

3. An IRA-type tax deferral program would encourage new, incremental saving, rather than rewarding past saving. It would be ideally suited to the objective of increased long-run noninflationary economic growth. The tax deferral feature would permit the Treasury to recover part of its initial revenue loss, even aside from the increased tax revenues resulting from more rapid real economic growth.

4. The general tax reduction package which the Congress will be considering should include provisions aimed specifically at stimulating saving. This is essential to encouraging capital formation and real economic growth.

Statement
of the
National Association of Mutual Savings Banks
on
Tax Incentives for Saving
Before the
Subcommittee on Savings, Pensions, and Investment Policy
Committee on Finance
United States Senate
February 24, 1981

Mr. Chairman and members of the Subcommittee, my name is Albert B. Hooke. I am President of The Community Savings Bank, Rochester, New York and Chairman of the National Association of Mutual Savings Banks.

The National Association represents the nation's 462 mutual savings banks. Located in 17 states, savings banks are community-oriented mutual institutions without stockholders. In the areas where they are most heavily concentrated, savings banks are the dominant mortgage lenders, as well as the largest holders of consumer savings among the various types of depository institutions. Total assets of mutual savings banks exceed $170 billion, two-thirds of which is represented by mortgage investments.

I appreciate the opportunity to present the views of the mutual savings bank industry on S. 243 introduced by Chairman Chafee and on S. 12 and S. 24 introduced by Finance Committee Chairman Dole.

Summary of Savings Bank Industry Position

The National Association of Mutual Savings Banks was among the earliest supporters of S. 243. This legislation would extend the existing Individual Retirement Account program into a broadly-based tax deferral provision which would encourage individuals to undertake additional long-term saving for retirement and other major purposes. The tax deferral approach, in our judgment, is the most effective means of providing expanded tax incentives for saving.

We also endorse the provision of S. 243 which would make permanent the present temporary $200-$400 exclusion for interest and dividends and increase the exclusion for taxpayers 65 years of age or older. Furthermore, we support the general thrust of S. 12, which would extend the IRA program in certain respects, and S. 24, which would provide for the establishment of Housing and Educational Savings Accounts along the lines of Individual Retirement Accounts. All of these proposed changes would reward and stimulate private saving.

Legislation to provide tax incentives for saving is vitally needed on many grounds. Such action would help correct the anti-saver bias persisting in our tax laws. It would stimulate our nation's perilously low personal saving rate and strengthen periodically battered long-term capital markets. As a result, it would encourage increased investment and productivity growth in the economy, and thereby contribute importantly to the battle against inflation and to increased long-run economic growth. The tax reduction package which the Congress will consider should, therefore, include provisions aimed specifically at stimulating saving, capital formation and real economic growth.

This can best be achieved, we believe, by a widely available tax deferral provision patterned after the Individual Retirement Account program, as provided in S. 243. Thus, we have long supported an increase in deductible contributions, an expansion of coverage to taxpayers not now eligible for IRAs and provision for additional nondeductible contributions to IRAs. The resulting broadly-based tax deferral provision would have certain major advantages:

-- It would reward and encourage new, incremental saving, rather than past accumulations of savings;

-- It would stimulate longer-term saving and more stable savings flows to financial institutions which are ideally suited to home mortgage lending;

-- It would help individuals prepare for their own retirement needs, at a time when the Social Security System is under increasing pressure, as well as for other major long-term savings purposes;

-- It would build on the precedent of existing programs which are widely understood and have a proven track record;

-- It would promote equity for those taxpayers who currently do not have the opportunity to undertake long-term saving on a tax-deferred basis through employer-sponsored thrift programs; and

-- It would permit the Treasury to recover part of the initial revenue loss, even aside from the increased tax revenues resulting from more rapid real economic growth.

Need for Tax Incentives for Saving

In his address to the nation on February 5, 1981, President Reagan discussed the virulent inflation of recent years and asked: "What initiative is there to save?" He then observed that:

> "And if we don't save, we're short of the investment capital needed for business and industry expansion. Workers in Japan and West Germany save several times the percentage of their income that Americans do."

Inflation is indeed a severe deterrent to saving. Many nations, however, have succeeded in maintaining high saving rates despite inflation. They have adopted tax incentives which help offset the depressing effect of inflation on individuals' willingness to save, while also helping to correct the underlying inflation problem.

While a reduced rate of inflation will tend to stimulate saving in America, we cannot afford to wait. It is widely agreed that even if the

Administration's anti-inflation program is successful, results will be painfully slow in coming. The economic disease that took years to incubate, cannot be cured overnight. What is desperately needed -- and needed now -- is a direct incentive to save through tax policy. And a higher rate of saving will in itself contribute importantly to our anti-inflation efforts.

The need for tax incentives for saving is becoming increasingly recognized. It has been underscored in recent years by our nation's low personal saving rate, declining productivity growth and explosive inflation rate. It has been reflected in the depressed state of capital markets, resulting from the unwillingness of many investors to supply long-term funds. It has been underlined also by the "revolt of the small saver," beleaguered by inflation and by a tax system that discourages saving while favoring spending and borrowing. It has been dramatized further by the recent experience of our nation's thrift institutions, which have suffered record disintermediation and unprecedented earnings pressures, resulting from inflation-induced increases in open-market interest rates.

With respect to the personal saving rate, the basic facts are well known. After averaging nearly 7 per cent of disposable income during most of the post-World War II period, personal saving has declined below that level during the past 4 years. In 1980, the saving rate was 5.6 per cent for the year as a whole.

This record contrasts sharply with that of other industrialized nations, many of which have provided tax incentives for saving. According to the latest available United Nations data, the saving rate in 1978 was 20 per cent in Japan, 14 per cent in France, 14 per cent in West Germany, and 13 per cent in Belgium.

With respect to productivity, our nation's record is equally dismal. From 1947 to 1970, productivity in the private business sector

increased at an average annual rate of about 3 per cent. During the past decade, however, productivity grew less than half as fast -- at a rate of 1.4 per cent a year. In the last three years, moreover, productivity actually declined.

The unfavorable trends in the personal saving rate and in productivity gains have obviously contributed to the problem of "stagflation" -- rapid inflation combined with sub-par growth -- which plagues our nation. These trends will not easily be reversed without tax incentives for increased saving and capital formation. Since the household sector in recent years has accounted for 60 to 80 per cent of total gross saving in the nation, specific incentives for personal saving are essential to an effective anti-inflation effort and to promote strong long-term economic growth.

In this regard, individual savers are caught in a vicious circle of rapid inflation that erodes the real value of their savings while pushing their incomes into higher tax brackets. And after siphoning off part of their incomes at steeply rising marginal rates, the tax system reduces further the return on funds that taxpayers manage to set aside in savings.

A tax incentive would be the most direct and practical means of improving real after-tax returns to savers and stimulating increased saving. Thrift institutions, it should be noted, suffered large-scale disintermediation in 1980. This brought mortgage lending to a virtual standstill in many areas and contributed greatly to the recession in housing. A tax incentive would be the best means of assuring an adequate supply of funds for housing in future high interest rate periods. It would increase savings flows while contributing to lower mortgage interest rates by relieving deposit cost pressures at financial institutions.

This would be particularly true if the incentive were designed to encourage long-term saving, in a manner similar to the IRA/Keogh programs. These retirement savings have been one of the few stable elements in the savings bank deposit structure. In 1980, for example, IRA/Keogh balances at savings banks increased by an estimated $500 million, excluding interest, contrasting with a net loss of $5.3 billion in other savings and time deposits in the same period. Retirement and other long-term savings are particularly appropriate for mortgage lending and would help to redress the borrow-short, lend-long imbalance in the thrift institution structure.

The Budgetary Impact of a Savings Tax Incentive

A major concern regarding tax incentives for saving, of course, is the impact on federal tax revenues. This is an important point at a time when greater federal budgetary restraint is critically needed. Over the longer-run, however, an increased level of private saving and capital formation would provide more than offsetting economic benefits to the nation, particularly in reducing inflationary pressures. Increased private saving, for example, would help reduce the inflationary potential of cutting overall tax rates on consumers. To the extent that more savings are channeled to the depressed housing sector, furthermore, the need for costly federal subsidy programs would be further reduced.

Increased real economic growth, moreover, would generate increased tax revenues and thus help offset any initial revenue loss. And, of course, the tax deferral route would ultimately permit the U. S. Treasury to regain much of its initial revenue losses.

In any event, major tax reduction legislation is obviously in prospect. This situation provides a golden opportunity to tailor tax relief specifically to the critical longer-run need to promote noninflationary economic growth through increased private saving and capital formation.

Details of Specific Tax Incentive Proposals

The three tax incentive proposals which are the subject of these hearings represent extensions of the basic IRA concept to a larger number of taxpayers, or to a broader variety of savings purposes in addition to retirement. This is precisely the thrust of NAMSB tax incentive proposals, as presented to the Committee on Finance at hearings held in July 1980. Thus, NAMSB has strongly supported the expansion of the IRA program in the following ways:

1. Increase the maximum deductible contribution;

2. Permit taxpayers already covered by qualified retirement plans to establish IRAs; and

3. Permit individuals to make additional nondeductible contributions to IRAs.

We have also suggested that consideration be given to adapting the IRA concept to certain major nonretirement saving purposes, such as down-payments on first-time home purchases and education expenditures. Education expenses are among the most important financial demands on many families, while home ownership is beyond the resources of many individuals who have not had the opportunity to accumulate equity in an existing home. A tax incentive geared to these purposes would encourage younger families to undertake long-term saving plans.

S. 243 addresses each of the specific proposals advanced by NAMSB. This legislation would increase the ceiling on deductible contributions from the lesser of $1,500 or 15 per cent of annual compensation to $2,000 or total earned income, whichever is less. Furthermore, it would permit the establishment of IRAs by employees who are covered by employer-sponsored

retirement plans, subject to the same limits. Alternatively, employees would be permitted to make voluntary contributions to their employer-sponsored pension funds.

It would also permit additional nondeductible contributions of $2,000 annually plus an additional $8,000 over the employee's lifetime. Finally, S. 243 permits an employee to withdraw without penalty up to $10,000 in order to purchase a first home or to pay for children's higher education.

We enthusiastically support the IRA-extension provisions of S. 243 because they would create the broad-based tax deferral provision which we believe is particularly suited to stimulating new, long-term saving and capital formation in our nation. We also believe that the present $200-$400 exclusion for interest and dividends should be made permanent, as provided by S. 243. To permit this provision to expire after 1982 would turn the clock back on tax incentives for saving and would therefore be highly unfortunate. Raising the exclusion to $500-$1,000 for taxpayers aged 65 or more, as further provided by S. 243, would also be a useful step and would be particularly helpful to those who are dependent on investment earnings to meet living expenses.

S. 12 would take an important step toward the widely available tax deferral provision which we believe is essential. Under this bill, employees currently covered by employer-sponsored pension plans would be permitted to establish an IRA, or contribute to employer-sponsored plans, subject to a $1,000 ceiling on annual deductible contributions. Current limits for existing IRAs would be unchanged, however, and no provision is made for additional nondeductible contributions. We respectfully urge that consideration be given to incorporating an increase in the contribution

ceiling for all IRAs and that additional nondeductible contributions be permitted. Both of these provisions are vitally important as incentives for saving.

S. 24 would provide for establishment of Educational Savings Accounts and Housing Savings Accounts along the lines of the IRA program. Deductible contributions would be subject to a $1,000 ceiling in the case of the education account and to $1,500 annually and to a $15,000 maximum lifetime deduction ($3,000 and $30,000 for joint accounts) in the case of the housing account. In order to receive tax benefits, the amounts accumulated in these accounts must be used for education expenditures or for the purchase of a first-time principal residence. As indicated earlier, NAMSB supports the thrust of both S. 12 and S. 24.

Advantages of the Tax Deferral Approach

All of these proposals point in one direction -- toward an expanded and more widely applicable tax deferral provision to permit and encourage individuals to undertake long-term savings for retirement and other purposes. The tax deferral approach has certain major advantages in providing incentives for saving.

Perhaps most importantly, the IRA-type approach encourages and rewards regular, incremental saving, rather than past accumulations of saving. Each year, the amount eligible for investment is tax deductible while earnings are tax-deferred. Furthermore, withdrawals are discouraged except under specified circumstances. As a result, this approach tends to stimulate new saving that would not be otherwise undertaken. And it is new saving, year in and year out, which is so desperately needed in our country today.

Such a tax deferral incentive would have a continuing economic impact. Therefore, it would be ideally suited to the objective of increased long-run noninflationary economic growth, as well as an ideal vehicle for mortgage lending.

In addition to IRA-Keogh plans, there are precedents for tax-deferred saving in private IRS-approved saving plans, annuities and U. S. savings bonds. The tax-deferred saving approach, therefore, is well understood. It is only equitable, furthermore, to make tax-deferred saving available to all taxpayers, and through a wide range of savings instruments, rather than on a narrow basis as permitted under present law.

Finally, revenues will be recovered by the Treasury because funds accumulated in IRA-type accounts are tax-deferred. This will offset part of the initial revenue loss, even aside from the increase in revenue generated by more rapid real economic growth resulting from greater saving and capital formation.

Concluding Comment

In conclusion, the savings bank industry strongly supports enactment of a long-term tax deferral provision to promote increased personal saving. Such an incentive is urgently needed in the long-run battle against inflation. It is needed to provide increased rewards to all savers. We hope that our comments will be useful to the Members of the Committee as you consider this critical issue.

news release

IN NEW YORK:
Richard E. [illegible], *Director of Information* .... (212) 973-3325
Arthur M. [illegible], *Assistant Director/Public Relations* ..... (212) 973-4706
IN WASHINGTON, D.C.:
Phyllis S. Miller, *Assistant Director/Public Affairs* .... (202) 783-8144

RELEASE DATE: IMMEDIATE

NAMSB NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS

Savings Bank Industry Backs Legislation to

Open Up IRA Program to All Taxpayers

WASHINGTON, D.C., Feb. 24 — The top spokesman for the $172 billion savings bank industry today expressed strong support for legislation which would provide a tax incentive for long-term saving by opening up the highly successful Individual Retirement Account program to all taxpayers.

"The tax reduction package which the Congress will consider should include provisions aimed specifically at stimulating saving, capital formation and real economic growth," said Albert B. Hooke, chairman of the National Association of Mutual Savings Banks, during testimony before the Senate Subcommittee on Savings, Pensions, and Investment Policy.

"This can best be achieved, we believe, by a widely available tax deferral provision patterned after the Individual Retirement Account program, as provided in S. 243," said Hooke, referring to legislation introduced by Subcommittee Chairman John H. Chafee (R-R.I.). The NAMSB chairman also expressed support for the general thrust of two other bills before the subcommittee, S. 12 and S. 24, both of which would expand the IRA program in certain respects.

The savings bank industry was among the earliest supporters of S. 243, noted Hooke, who is also president of The Community Savings Bank, Rochester, N.Y. He emphasized that the industry has long supported an increase in deductible contributions to IRAs, expansion of the program to cover taxpayers not now eligible and provision for additional nondeductible contributions to IRAs.

- more -

The NAMSB chairman pointed out that expansion of the IRA program would have a number of major advantages.

"It would reward and encourage new, incremental saving, rather than past accumulations of savings;

"It would stimulate longer-term saving and more stable savings flows to financial institutions, which are ideally suited to home mortgage lending;

"It would help individuals prepare for their own retirement needs, at a time when tne Social Security System is under increasing pressure, as well as for other major long-term savings purposes;

"It would build on the precedent of existing programs which are widely understood and have a proven track record;

"It would promote equity for those taxpayers who currently do not have the opportunity to undertake long-term saving on a tax-deferred basis through employer-sponsored thrift programs; and

"It would permit the Treasury to recover part of the initial revenue loss, even aside from the increased tax revenues resulting from more rapid real economic growth."

Hooke noted that virulent inflation is a severe deterrent to saving, but that many nations have succeeded in maintaining high saving rates despite inflation. They have accomplished this, he continued, by adopting tax incentives which help to offset the depressing effect of inflation on individuals' willingness to save, an action which has the additional benefit of helping to correct the underlying inflation problem.

"While a reduced rate of inflation will tend to stimulate saving in America, we cannot afford to wait," the NAMSB chairman stated. It is widely agreed that the Administration's anti-inflation program will be "painfully slow" in achieving results, he pointed out.

"The economic disease that took years to incubate cannot be cured overnight," Hooke emphasized.

"What is desperately needed -- and needed now -- is a direct incentive to save through tax policy," he concluded.

STATEMENT OF EDWIN B. BROOKS, JR.

ON BEHALF OF THE U.S. LEAGUE OF SAVINGS ASSOCIATIONS

BEFORE

THE SENATE SAVINGS, PENSIONS & INVESTMENT POLICY SUBCOMMITTEE

February 24, 1981

Thank you Mr. Chairman and members of this Subcommittee. My name is Edwin B. Brooks, Jr., and I am President of Security Federal Savings and Loan Association of Richmond, Virginia. Also, I am the immediate Past President of the U.S. League of Savings Associations*, and presently serve that organization as Vice Chairman of its Legislative Committee.

We thank you for this opportunity to present our views on S. 243, introduced by Chairman Chafee, as well as S. 12 and S. 24 as introduced by Chairman Dole. Each of these bills contains features which will go far toward encouraging thrift among Americans as well as toward rebuilding the nation's badly depleted capital pool, a benefit urgently needed if the United States is to realize the twin goals

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*The U.S. League of Savings Associations has a membership of 4,400 savings and loan associations representing over 99% of the assets of the $625 billion savings and loan business. League membership includes all types of associations -- Federal and state-chartered, stock and mutual. The principal officers are: Rollin Barnard, President, Denver, Colo.; Roy Green, Vice President, Jacksonville, Fla.; Stuart Davis, Legislative Chairman, Beverly Hills, Cal.; William O'Connell, Executive Vice President, Chicago, Ill.; Arthur Edgeworth, Director-Washington Operations; Glen Troop, Legislative Director, Washington; and Phil Gasteyer, Assoc. Director-Washington Operations. League headquarters are at 111 E. Wacker Dr., Chicago, Ill. 60601. The Washington Office is located at 1709 New York Ave., N.W., Washington, D.C. 20006, Telephone: (202) 637-8900.

of reindustrialization and an adequate supply of affordable housing. Even farther reaching are the benefits which this proposed legislation would provide in educating this nation's youth, as well as preserving dignity and freedom from financial hardship for our nation's elderly in their retirement years.

At the outset, however, I must express my concern and the concern of many others over last Wednesday's unveiling by President Reagan of his program for Federal tax and budget reductions. My concern is whether President Reagan's proposals will indeed correct the imbalance between savings and consumption in our economy. As recognized by the three bills on today's agenda, the need for incentives to save is urgent. It is now...today.

As a nation we have too long delayed this most necessary measure for encouraging thrift. As you well know, America ranks last among its industrial trading partners in percent of disposable personal income saved. Last year in the United States the rate was 5.7 percent. Most recent available comparisons show that Canada in 1979 had a personal savings rate of 13.9 percent of disposable income. In the United Kingdom, the rate was 13.8 percent. It was 15.9 percent in West Germany, and in Japan the rate was a staggering 26 percent.

Clearly, there are forces at work in these other nations that result in these higher savings rates. In a word, those forces are incentives, and they come in the form of favorable tax treatment for those who conserve rather than consume.

If our nation is to realize faster productivity growth... if we are to conquer inflation and high interest rates...if we are to meet the capital needs of the 1980s in housing, industrial and commercial modernization and expansion...and in energy...we must dramatically improve our thrift habits. And we must do it immediately, with meaningful incentives which can be enacted into law early this year. The nation has waited too long already, and the resultant stultifying effects on our economy are all too apparent. I would urge this Subcommittee and this Congress to move with all deliberate speed to rapid enactment of a tax reduction package which includes incentives to encourage personal thrift.

With that said, I would now like to move on to a general discussion of tax incentives for saving and then offer our views on the three bills under consideration, along with a fourth concept designed to provide capital for housing finance.

As mentioned earlier, we have a major savings problem in the United States, and there are two reasons for this: inflation and taxation.

Our tax system presently is strongly biased against saving. Indeed, it is oriented more toward consumption. Savings interest is fully taxable at the highest marginal tax rate, with the Federal government taking away anywhere from 20 to 70 percent of thrift's reward. This is not the case in Canada, Germany and Japan, for instance. In those nations, savings interest is generously excluded from taxable income. With such tax incentives for saving, it is quite clear why these nations enjoy such high rates of saving, productivity and employment.

Inflation also discourages saving in a manner similar to the tax bias against saving. An individual who saves $1000 this year has a right to expect that those savings will have the same purchasing power next year. We know well that double digit inflation makes this impossible. In actual fact, the person who saves $1000 this year will have lost money in 12 months, and it is the widespread understanding of this which contributes so tremendously to the consumption psychology which is prevalent today.

Let us take an example. Assume that in January of 1980 you placed $10,000 in savings in a six-month Money Market Certificate, today's most popular savings plan, at the then-prevailing rate, 11.86 percent; assume further that you left the funds on deposit for another six months in July, when the rate was 8.59 percent. By January of this year you would have earned interest of $1,022.50, bringing your account total to $11,022.50

Now, recall that the calendar year 1980 inflation rate was 12.4 percent. Your $11,022.50 savings account is worth only that much less the rate of inflation, or only $9655.71 in real purchasing power.

Let us next assume that the saver were in the 25 percent tax bracket. This means the Federal government would take away 25 percent of the $1,022.50 interest income or $255.63, leaving the saver with an account worth only $9,400.08.

In actual fact, after taxation and inflation work their ways, your savings account is worth only 94 percent of what it was in January of last year. Even if the interest rate paid on this account were equal to the inflation rate -- which at 10.23 percent it nearly was -- the saver would nevertheless still realize a negative return on the account.

We should not wonder that personal savings rates in this country lag the rest of the industrial world by such embarassing margins.

It goes without saying that ours is a serious problem which can only worsen without a Congressional commitment to reverse the trend. Public tax policy must move away from encouraging consumption, and thereby inflation, to encouraging thrift and its attendant impacts of reduced inflation, increased productivity, reduced interest rates, and adequate capital to meet the investment needs of this decade.

We long have felt that, from a national policy viewpoint, a series of questions should be applied to any proposals for tax relief on savings interest. It should be asked; for example:

1. -- Would the plan provide a substantial incentive to save additional dollars as opposed to spending on consumption?
2. -- How many taxpayers would be affected by the incentives?
3. -- Would the plan provide an incentive to save across various income brackets?
4. -- Would the plan encourage systematic savings?
5. -- Is there an incentive for increasing savings from year to year?
6. -- Is it easily understandable and easy to implement through the tax code?
7. -- Will the plan encourage long-term savings?

8. -- Does the plan encourage shifting of savings from one form to another without providing net new savings?

Application of these criteria to any examination of S. 12, S. 24 and S. 243 produces generally positive responses. These three bills each provide for long-term, systematic savings and encourage annual savings increases. They provide incentive to save at all income levels. (See Addendum A).

At the outset, they might result in some shifting from the more traditional means of accumulating savings, but such shifts would be accomplished quickly and without disruptive impact. As to the public's ability to quickly grasp the mechanics of such new accounts, I'm quite certain that there will be intensive public education programs as depositories compete for these funds.

Chairman Dole's bill, S. 24, establishes separate, tax-favored accounts for accumulating savings for use in the purchase of a first home and for higher education beyond the secondary school level. Aside from the redirection of tax policy, this bill promotes important social objectives which are being threatened by inflation.

Consider what inflation has done to the prospective homebuyer. Biennially the U.S. League of Savings Associations conducts a nationwide survey of homebuying habits. The most recent -- based on 1979 data and published June 4, 1980 -- shows the following:

-- Median home prices increased 14.8 percent a year in 1978 and 1979, rising from $44,000 in 1977 to $58,000 in 1979.

-- Median monthly housing costs, including the mortgage payment, taxes, utilities and hazard insurance, increased from $400 to $550, an annual rate of 17.3 percent.

-- From 1977 to 1979, the percentage of first-time home buyers fell from 36 to 18 percent of all buyers.

-- In large cities, the percentage of first-time buyers fell from 39.1 percent in 1977 to 18.5 percent in 1979.

-- Nearly 46 percent of all home buyers spent more than one-quarter of their income on housing expenses in 1979, compared to 38 percent in 1977.

-- 43 percent of all home buyers made downpayments of less than 20 percent in 1979, in contrast to 32 percent in 1977.

-- 62 percent of all first-time home buyers made downpayments of less than 20 percent in 1979, up significantly from 47 percent in 1977.

While these statistics are by now more than a year old, inflation has not abated and as anyone who has been in the housing market in recent months can attest, the price of housing has at least kept pace with it. What these findings demonstrate so clearly is that, while all prospective home purchasers are feeling the pinch, it is the first-time home buyer who is hardest hit. Indeed, tens of thousands of young American families are being forced out of the housing market, having to settle for rental quarters instead of being able to realize the American dream of home ownership.

More people than ever before are entering the prime home buying years. This age group -- from 25 to 44 years -- accounts for nearly 70 percent of all home buyers, and will account for 32 percent of the total population by 1990. A record 42 million people will reach the age of 30 during this decade -- 10 million more than in the 1970s. Their proportion of the total population through the 1980s will be similar to that of the same age group in the period 1946-50, which was the

thick of the post-World War II housing boom. Their absolute number, however, will be about 25 million higher.

Numerous studies have attempted to forecast housing demand into the 1980s. A study produced for the National Association of Home Builders (Demand and Production in the Housing Industry 1979-1988) using the Jaffee-Rosen econometric model forecasts that the total demand for housing over this decade will be 20.8 million to 23.2 million units.

Another projection, done by Thomas Marcin of the U.S. Department of Agriculture, yields a range of total housing demand for the 1980s of 23.2 million units on the low end to 25.2 million units as a maximum.

These projections make two points:

First, that we are about to witness an explosion in need for new housing units and we must immediately get down to the business of developing the housing capital pool necessary to meet that need.

Second, with inflation having done the damage it already has done in terms of skyrocketing housing prices, we must simultaneously find some means of helping first-time home buyers qualify financially to enter the housing market.

Chairman Dole's bill, S. 24, as well as Chairman Chafee's bill, S. 243, both address this problem by making it possible for first-time home buyers to accumulate the funds necessary for downpayments without having to be concerned that Federal taxation will crack their nest egg. Further, the tax-sheltered housing account would slow our rate of consumption and provide long-term capital which could be invested in a manner which would contribute to increased national productivity. The housing construction sector, of course, would receive a portion of such invested funds, and this would not come one moment too soon.

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As the managing officer of a depository institution whose principal concern is housing finance, my expertise lies in that area. However, as one who is also a father, the education savings account incentive of S. 24 will provide additional support for higher education -- an essential ingredient for American progress. With S. 24, the dreams of higher education and homeownership will be available to more of our citizens.

While we generally support the thrust of all three bills before this subcommittee today, we feel that the establishment of these special purpose savings accounts might be facilitated by integrating them with the familiar and successful Individual Retirement Account. This approach, being advocated by Chairman Chafee in S. 243, expands the retirement purpose of the traditional Individual Retirement Account to include homeownership and education. In other words, the basic private retirement savings instrument, the IRA, would now become a multi-purpose savings vehicle encouraging individuals to save for education and housing in addition to retirement.

In hopes of improving the Individual Retirement Account (IRA), both Chairman Chafee (S. 243) and Chairman Dole (S. 12) propose to broaden eligibility for IRA participation by including current members of qualified plans and by allowing tax deductible contributions to the employer plans or a separate IRA. We strongly support these changes and hope, in addition, that contribution levels enacted back in 1974 will be increased (at the minimum) to $2000 to keep pace with the escalating cost of retirement. Addendum A provides a Treasury Department estimate of the potential increase in IRA accounts which might result from extending IRAs to the 44.4 million taxpayers who are qualified plan participants and thus currently ineligible for this benefit. It is estimated that $7.2 billion in additional IRA savings will be generated by this change.

This substantial increase in net new savings would be long-term and available for retirement, education, and homeownership. It would also help relieve the mounting pressure on the Social Security System.

I would also like to comment on some rather innovative ideas contained in Chairman Chafee's bill (S. 243), entitled "Savings and Retirement Income Incentive Act of 1981". The savings and loan business strongly endorses efforts to increase existing interest exclusion amounts and make them permanent. Therefore, we endorse the provision in S. 243 to increase exclusion amounts to $500/$1000 for persons 65 years of age or older, and making the current exclusion permanent. We also support the authorization of a $2000 voluntary contribution, which would allow deferral of earnings but no deduction of contributions. This voluntary contribution authority is similar to that already authorized under the Keogh plan for self-employed persons.

We would like to make an additional suggestion for the Chafee bill, S. 243: Incorporate the "spousal" concept which is already part of the Individual Retirement Account pattern. At a time when we are trying to expand the benefits and incentives of private retirement programs to include non-income earning spouses, we should not ignore the progress already made in this area. Therefore, we would suggest that the spousal IRA be retained with the same increased contribution maximums as those proposed for individuals ($2,000), with the wage earner permitted to establish the subaccounts under that maximum (as in current law).

Finally, on the question of withdrawals, it is important to carefully balance the need for accessibility to IRA for educational and homeownership savings, with the need to encourage longer-term systematic savings. Too many allowable withdrawals for education and housing could destroy the primary purpose of this account, i.e. -- long-term systematic savings for retirement. If the number of allowable withdrawals is held to a minimum, the integration of savings purposes will make the IRA account the principal savings tool of the American family. Therefore, because of the potential for greater utilization, the U.S. League endorses allowing limited IRA withdrawals for education or homeownership.

At this time I would like to advance for your consideration a modest proposal for a new savings account which we believe will provide new and stable funds for home finance without Treasury impact and, at the same time, solve a situation of economic waste. Homes for many families are more than mere shelter; they are the principal investment of that family. Eventually, most individuals are faced with disposing of their home in order to move to quarters more fitting to a changed life style and family circumstances. Because of the structure of our capital gains tax, these family options are limited.

Unless the individual is age 55 or older and eligible for the one-time $100,000 capital gains exclusion, he or she must pay hefty capital gains taxes on the proceeds of a home sale, or reinvest those proceeds within 18 months in a residence of equal or higher cost. Some families -- after the children are raised, for example -- buy "more house" than they need or desire to avoid tax consequences. Had they been able to save all or a portion of that gain, it could have been turned to more productive use.

We, therefore, are suggesting for these home sellers the establishment of a special Home Seller Capital Gains Account, all deposits in which would be earmarked for housing finance. Interest earned on these accounts would be tax free, and its term would be for a fixed period. Upon maturity, the account holder would have the option of renewing it or withdrawing his money and at that time paying the capital gains tax on it if capital gains exposure would apply.

The benefits of such an account are numerous:

1. -- The home seller is not forced by the tax laws to buy expensive real estate for which he or she may have no need.
2. -- The home seller would be permitted to "park" his or her capital gain until qualified to take advantage of the one-time $100,000 exclusion at age 55, and thereby increase retirement income.
3. -- The U.S. Treasury would lose little if anything by way of tax-free interest earned, since the funds invested in these accounts would otherwise have been plowed back into more expensive homes (often with larger mortgage and property tax deductions).
4. -- The homebuying public would benefit because depository institutions which established Home Seller Capital Gains Accounts would be required to make those funds available for housing finance.

As this Subcommittee and the Congress pursue means of improving the thrift habits of the American public, we believe such an instrument as the Home Seller Capital Gains Account should be given serious consideration.

Before concluding, I would like to offer one final note on the need for expanding the eligibility for Individual Retirement Account participation, and for increasing the deductible limits. Just last week, the American Council of Life Insurance announced the results of a nationwide survey which shows that one in four -- that is one in four -- of U.S. workers believes his current retirement savings are not adequate. Nearly half believe they will not be able to afford retirement when the time comes. Further, those surveyed said their retirement savings are inadequate or nonexistent, and they support permitting a tax deduction for employee contributions to employer-sponsored pension plans or their own Individual Retirement Accounts.

In summary, I must say that we of the U.S. League of Savings Associations applaud the efforts of this Congress and this Administration to reestablish thrift as a virtue in this nation. With legislative proposals such as those before this Subcommittee today, however, we feel confident that the future of American families -- families seeking homes, education for their children and secure retirement -- will be considerably brighter. Thank you.

* * *

ADDENDUM A

POTENTIAL IRA ACCOUNTS BY ADJUSTED GROSS INCOME CLASS

Income class	(1) Estimated number of taxpayers with salaries & wages (millions)	(2) Estimated number of taxpayers eligible to use IRAs (millions)	(3) Estimated number of IRAs (millions)	(4) Utilization rate (percent)	(5) Ineligible taxpayers (millions) (1)-(2)	(6) Number of potential IRAs (millions)	(7) Annual average addition to IRA balance	(8) Potential IRA savings (millions)
$0-$4,999	20.7	17.6	.04	.2%	3.1	.0060	$ 780	$ 4.68
$5,000-$9,999	19.0	13.3	.18	1.4	5.7	.0798	803	64.08
$10,000-$14,999	17.5	10.5	.35	3.3	7.0	.2310	1,029	237.70
$15,000-$19,999	16.3	7.4	.40	5.4	8.9	.4806	1,097	527.22
$20,000-$49,999	24.9	6.2	1.35	21.8	18.7	4.0766	1,348	5,495.26
$50,000 & over	1.4	.4	.21	52.5	1.0	.5250	1,614	847.35
TOTAL	99.8	55.4	2.53	4.6%	44.4	5.3990	---	$7,176.29

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, March 27, 1979.

USL WASHINGTON OFFICE
UNITED STATES LEAGUE of SAVINGS ASSOCIATIONS
1709 NEW YORK AVENUE, N.W. / WASHINGTON, D.C. 20006

NEWS

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CONTACT: Alan Wade or Kathy Ulman
(202) 637-8930
Jim Kendall or Allan Friedman
(3120 644-3100

WASHINGTON, D.C. -- Tax incentives to encourage personal savings must be enacted early this year if the nation is to develop the capital necessary to finance an economic revival, a savings and loan association executive told a Senate Finance subcommittee today.

Edwin B. Brooks, Jr., in testimony before the Senate Savings, Pensions and Investment Policy Subcommittee, said he was concerned "whether President Reagan's proposals will indeed correct the imbalance between savings and consumption in our economy."

President Reagan's tax proposals, unveiled February 18 before a joint session of Congress, contained no specific proposals for encoutaging personal savings.

"If our nation is to realize faster productivity growth ... if we are to conquer inflation and high interest rates ... if we are to meet the capital needs of the 1980s in housing, industrial and commercial modernization and expansion... and energy ... we must dramatically improve our thrift habits," Brooks told the Subcommittee.

Brooks, president of Security Federal Savings and Loan Association of Richmond, Va., addressed the Senate panel on behalf of the U.S. League of Savings Associations, of which he is immediate past president. The League's 4,400 members provide the bulk of home mortgages in the U.S.

-more-

The Subcommittee is considering legislation (S. 12 and S. 24) introduced by Chairman Robert Dole (R-KS) and S. 243 introduced by Chairman John Chafee (R-RI) which would allow for tax-free interest on special purpose accounts established to finance higher education, a first-home purchase and retirement.

Brooks endorsed all three bills, and recommended that their housing and higher education aspects be integrated into the existing Individual Retirement Account structure. Brooks also recommended that the current tax-excluded $1,500 annual contribution limit on IRA accounts be increased to $2,000 "to keep pace with the escalating cost of retirement."

A new concept in savings accounts -- termed the Home Seller's Capital Gains Account -- was introduced by Brooks during the hearing. Deposits in such accounts would be earmarked for housing finance, Brooks said.

"Now, unless the individual is 55 or older and eligible for the one-time $100,000 capital gains exclusion, he or she must pay hefty capital gains taxes on the proceeds of a home sale, or reinvest those proceeds within 18 months in a residence of equal or higher cost," Brooks pointed out.

"Some families -- after the children are reared, for example -- buy 'more house' than they need or desire in order to avoid tax consequences. Had they been able to save all or a portion of that gain, it could have turned to more productive use," he observed.

-more-

Under Brooks' proposal, interest earned on a Home Seller's Capital Gains Account would be tax free. The term of such an account would be for a fixed time period. Upon maturity, the account holder would have the option of renewing it or withdrawing the funds. At that time, capital gains tax would be paid if capital gains exposure applied.

# # # #

Testimony of
Robert B. O'Brien, Jr.
on behalf of the
National Savings and Loan League
on Savings Incentive Tax Bills
S 12, S 24 and S 243
before the
Subcommittee on Savings, Pensions and
Investment Policy
Committee on Finance
United States Senate
February 24, 1981

Mr. Chairman, members of the subcommittee, I am Robert B. O'Brien, President of Carteret Savings and Loan Association, Newark, New Jersey. I am appearing before you today as Vice President of the National Savings and Loan League, whose views I represent.

The National League is pleased to have the opportunity to participate in these hearings on savings incentive legislation. We in the savings and loan business are acutely aware of the immensity of the task before this subcommittee in constructing a tax package that will meet the needs of the current recessionary economic environment and provide long-range benefits while at the same time reducing inflationary pressures.

The ultimate goal before you is to take steps that will lead to economic vitality and real economic growth while reducing inflation, which are the objectives of the Reagan

Administration. These steps include a reduction in the growth of federal spending, a reduction in the onerous tax burden facing both individuals and business, and creation of incentives for savings and investment necessary to allow for increased production. We agree with President Reagan that a comprehensive plan blending tax cuts and spending cuts is necessary if we as a nation are to regain our place as a strong productive competitor in the world market and if we are to provide an adequate and growing standard of living for our people at home.

I am pleased that Senator Chafee and the members of this subcommittee have chosen to focus on the need to increase incentives for saving and investments. That such incentives are needed can hardly be in doubt.

During the fourth quarter of 1979, the rate of personal savings in the United States fell to a low of approximately 4.7%, the lowest percentage in thirty years. While it increased somewhat in the first half of 1980, it has begun to decline again and is far below the 8.5% level experienced in 1973-1975. In fact, the Commerce Department recently announced that the savings rate had declined to 4.6% in January of this year, which was equal to the very low figure in December 1979. Earlier in 1980, the savings rate had been above 6%.

Such a savings rate is certainly not adequate to provide capital for investment to provide for the increased productivity that is needed if we are to improve our economic picture in the future. You will recall that productivity factors were negative in 1980. There are several factors that account for the low rate of savings, the most important of which has been inflation. At current rising rates of inflation, people are encouraged to spend and consume, rather than to save. It is perceived as better to buy today because tomorrow the cost of the item will be much higher, i.e., inflationary psychology.

Further, inflation has pushed people into higher income tax brackets, leaving them with less disposable income in real terms and, therefore, less available funds for savings. Commerce Department figures show that while per capita income in current dollars increased 9.5% from the third quarter of 1979 to the third quarter of 1980, real per capita income actually declined by 1%. This indicates the effect of high inflation rates on savings. This problem was exacerbated when the new payroll taxes took effect in January 1981. The projected rise in federal revenues for 1981 is $86 billion, of which it has been estimated that $50 to $60 billion represents new taxes. This increase will even more adversely affect the ability of the taxpayer to save and invest. President Reagan has recognized this and

his recommendations include reducing revenues in FY82 by $60 billion over what President Carter recommended, most of it in the form ̣̃ personal and business tax cuts.

Individual Retirement Accounts

Before specifically addressing the three bills before this subcommittee, I would like to suggest that priority consideration be given to expansion of the IRA. This saving incentive can be built on an already existing structure that is in place and that has worked successfully. The IRA contribution amount should be increased, eligibility should be extended to all wage earners regardless of participation in a qualified pension plan, and the spousal account should be modified accordingly.

Expansion of IRAs would serve two pressing social and economic needs. First, this action would be a useful weapon in countering inflation by encouraging additional savings instead of consumption. Secondly, the universal IRA account would widen the options of the consumer in saving for retirement and provide a positive incentive for people to plan ahead during their income-producing years to assure security in retirement.

The Urban Institute, under contract to the Federal Home Loan Bank Board, has been doing some very interesting work in projecting the impact of expanding the IRA program on

savings flows. While their work is still in the preliminary stage, we believe you would be interested in what they have found so far. The Institute used 1978 as the base year because data were readily available, but the projections can be applied to other years.

Assuming that there is some positive interest sensitivity of savings, i.e., as real interest rates increase, households will increase their amount of savings, expanding the IRA program will result in increased savings flows. Depending on different assumptions concerning the level of that interest sensitivity, the Institute estimates that with universal IRAs and an annual contribution limit of $3,000, savings flows would have increased by $28 billion to $55 billion over what they would have been in 1978. Since the actual amount of funds saved was $140 billion, this represents an increase of between 20% and 39%. While the 39% estimate may seem high, the Institute notes that this assumes all families eligible use the fully allowed amount of $3,000.

In order to verify these estimates, the researchers at the Institute analyzed the experience of retirement savings plans (RSPs) in Canada, which have been authorized since 1957. Under the RSP, any household, whether it belongs to a pension plan or not, can contribute to a tax-exempt retirement account. The Canadian experience offers some

useful insights. Based on their analysis of the Canadian experience, the Institute researchers predict that a universal IRA with a $3,000 limit would have resulted in between $10 billion and $21 billion in additional savings in 1978. While this is lower than the other estimates, they are relatively similar. These dollar figures represent an increase of between 7% and 14% in 1978 savings levels.

Thus, the available evidence and research indicates that expansion of IRA eligibility limits and universality would at least raise savings by approximately 10 percent and perhaps more. Since a significant portion of this increase would go to thrift institutions, mortgage lending would also increase substantially, which is sorely needed. According to the Bank Board, S&Ls now hold $7.5 billion in IRAs, or approximately 1.5% of total S&L deposits. Increasing IRA deposits would be especially suitable for mortgage lending because generally they are long-term deposits.

It is particularly imperative that the laws in this area be revised because of the effects of inflation on current individual retirement plans as well as private pension plans. While we have moved a great deal closer to the goal of universal coverage for retirement security, inflation has caused decreases in the adequacy of that coverage. Rises in the cost of living have exceeded increases in benefits for many retirees who have private

pension plans. The rising cost of living has also decreased the value of the $1,500 tax-deductible amount allowed under the provisions of the Internal Revenue Code governing the IRAs. We need to take steps now to provide people with the necessary tools to assure an adequate standard of living in retirement.

The unprecedented number of people who are now entering their thirties will, in thirty more years, put a severe strain on social security and other government programs to aid older citizens. Enactment of changes in laws on individual retirement accounts would help to shift the economic burden of security in retirement from the government to the private sector and to the individual. In addition, IRAs bring the assurance of immediate vesting, portability, and personal management of funds for retirement to the individual, which is extremely important in our increasingly mobile society.

Expanded individual retirement accounts offer several positive features. The retirement savings in IRAs would provide increased capital and increased savings with relatively little revenue loss. The funds in an IRA represent longer-term funds that can be used effectively to invest in housing, plant, and equipment to build our productive capacity. Since taxation of such funds is

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deferred, rather than exempted, the ultimate revenue loss to the Treasury is lessened.

In addition, by the encouragement of savings and investment, the modified IRA represents an efficient tax deferral that can be combined with President Reagan's individual tax cuts to provide benefits to the consumer while achieving national goals of increased savings and investment.

The three bills under consideration in these hearings, S 12, S 24 and S 243. are consistent with the goals I have just outlined.

S 12, introduced by Senator Dole, addresses the universal IRA issue which the National League considers to be of primary importance. While it might be preferable to have a higher allowable deduction, this bill offers a needed expansion of the IRA concept essential to increasing use of these accounts. S 12 does not address the problem of the erosion of the value of the current $1,500 deductible contribution by inflation. The subcommittee might want to consider amending the legislation to take care of this problem.

S 24, also introduced by Senator Dole, expands the IRA concept to include housing and education accounts as well as individual retirement accounts. These are certainly

worthwhile needs, and the National League would support the creation of such accounts.

S 243, introduced by Senator Chafee, is the most comprehensive bill of the three. It addresses the universal IRA, expands the contribution levels and combines allowable withdrawals for housing and educational purposes. In addition, it makes permanent the current $200/$400 exemption on interest and increases the exempt amounts for persons 65 or older. The National League certainly supports the concepts embodied in this legislation and the companion bill introduced in the House by Congressman Henson Moore, HR 1250. We urge you, however, to consider increasing the amounts to $1000/$2000 for all taxpayers.

The National League will be happy to work with this subcommittee to develop a practical, viable IRA. Any approach adopted should at least:

> Raise ceilings on the tax-deductible amount that can be contributed to at least $2,000, or $2,500 for a joint account.

> Eliminate current eligibility requirements which exclude those persons participating in a qualified retirement plan by creation of a "universal" IRA account with a deductible contribution limit of at least $1,000, or $1,500 for a joint account.

These are the minimum changes that need to be made in the existing laws on IRAs. There are many other changes that could be adopted to make these accounts more effective. For example, an additional nondeductible contribution to an IRA could be authorized such as is contained in S 243. Such a provision would encourage people to save even more while keeping the cost to the Treasury lower since only the tax on the interest earned by the additional contribution would be deferred.

These are but a few of the large number of options available to this subcommittee in expanding IRAs. The important point is that changes need to be made. Current rules restrict participation to a limited number of people. In addition, they are confusing. The consumer does not really know the options open to him or her. It is difficult to market IRAs today and make consumers aware of the accounts because so many of those interested are prohibited from participation.

It is imperative that we take this opportunity to widen the options to the consumer and to effectively use these accounts as a means of providing increased savings and investments.

Summary

The National Savings and Loan League strongly supports the Reagan Administration's economic program to reduce

federal government spending and to cut taxes for individuals and business in order to improve the stability of our economy. As a representative of an industry that has suffered enormously from the high and volatile rate of inflation and the resulting swings in interest rates, I can assure you that I consider these actions to be imperative if I am to continue my business of financing home mortgages.

As I have outlined in my testimony, I believe that the expansion and modification of the Individual Retirement Account and the principles embodied in S 12, S 24 and S 243 are consistent with the goals outlined by President Reagan. The IRA is a long-term savings instrument that, with modifications, can provide the vehicle for increased savings and investment so sorely needed if we are to revitalize our housing and capital intensive industries while giving the individual relief from the onerous tax burden of today.

I appreciate the opportunity to present the views of the National Savings and Loan League on this important topic. As I stated earlier, we will be pleased to work with this subcommittee in any way we can to assure that the needed changes in the tax and spending programs are realized. Also, I would be pleased to answer any questions the members of the subcommittee might have.

News
National Savings and Loan League

1101 Fifteenth Street NW
Washington, DC 20005
202 331-0270 Cable: NATLISA

#81-106

FOR IMMEDIATE RELEASE
Attn: Financial Editors

Contact:
Jim Eberle

NATIONAL LEAGUE ENDORSES

EXPANDED I-R-A PROGRAM

WASHINGTON, D.C., February 24, 1981--The National Savings and Loan League today urged Senate lawmakers to give priority consideration to expanding the Individual Retirement Account program.

Testifying before the Senate Finance Subcommittee on Savings, Pensions and Investment Policy, National League Vice President Robert B. O'Brien, Jr. said: "The IRA contribution amount should be increased, eligibility should be extended to all wage earners regardless of participation in a qualified pension plan and the spousal account should be modified accordingly."

O'Brien said the National League's recommendations were consistent with three bills the subcommittee is considering to improve the IRA program, provide additional tax incentives to encourage saving, and expand the IRA concept to include housing and education accounts.

The National League's specific recommendations on IRA improvements include raising the tax-deductible limit to $2,000 for an individual account and $2,500 for a joint account and creating a universal IRA account with a tax-deductible limit of at least $1,000 and $1,500 for a joint account.

(more)

In addition to these minimum changes in the IRA program, the National League recommended that Congress consider authorizing an additional non-deductible contribution.

O'Brien cited preliminary results of a study by the Urban Institute, under contract to the Federal Home Loan Bank Board, showing that universal IRAs with an annual contribution limit of $3,000 would increase savings flows by $10-$21 billion over 1978 savings, an increase of 7-14 percent.

Savings and loan associations now hold $7.5 billion in IRA deposits, which are particularly suitable for mortgage lending because they generally are long-term deposits, O'Brien said.

O'Brien also urged the lawmakers to make the existing tax exemption for interest earned from savings a permanent part of the tax code and increase the current temporary $200/$400 exemption to $1,000/$2,000.

"As a representative of an industry that has suffered enormously from the high and volatile rate of inflation and the resulting swings in interest rates, I can assure you that I consider these actions to be imperative if I am to continue my business of financing home mortgages," said O'Brien, who is also president of Carteret Savings and Loan Association, Newark, N.J.

"The IRA is a long-term savings instrument that, with modifications, can provide the vehicle for increased savings and investment so sorely needed if we are to revitalize our housing and capital intensive industries while giving the individual relief from the onerous tax burden of today," O'Brien added.

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Senator CHAFEE. Thank you very much, gentlemen. You are all very distinguished and busy and we appreciate your taking the time to be here.

That completes the hearing.

[Whereupon, at 12:50 p.m., the subcommittee recessed, to reconvene at the call of the Chair.]

[By direction of the chairman the following communications were made a part of the hearing record:]

ARNOLD & PORTER
1200 NEW HAMPSHIRE AVENUE, N. W.
WASHINGTON, D. C. 20036
(202) 872-6700

CABLE: "ARFOPO"
TELECOPIER: (202) 872-6720
TELEX: 89-2733

1660 LINCOLN STREET
DENVER, COLORADO 80264
(303) 832-2900

February 23, 1981

Honorable John H. Chafee
Chairman, Subcommittee on Savings,
Pensions and Investment Policy
Senate Finance Committee
2227 Dirksen Senate Office Building
Washington, D.C. 20510

Re: Statement of Inter-Local Pension Fund of the Graphic Arts International Union

Dear Senator Chafee and Members of the Subcommittee:

The following statement is submitted on behalf of the Inter-Local Pension Fund of the Graphic Arts International Union with respect to proposed legislation (S. 12 and S. 243) under consideration by the Subcommittee on Savings, Pensions, and Investment Policy.

The purpose of this statement is to request that the Subcommittee extend the provisions of S. 12 and S. 243, which would permit the deduction (subject to specified limitations) of employee contributions to plans and trusts described in Internal Revenue Code

sections 401(a) and 501(a),[1/] to plans and trusts which are exempt under sections 501(c)(18) and 501(a).

Summary of Principal Points

1. The purpose of the pending bills (S. 12 and S. 243) clearly seems to be to encourage individuals to provide for their own financial security upon retirement through their own contributions to qualified pension plans and trusts which meet the standards for exemption established under the Internal Revenue Code.

2. Internal Revenue Code section 501(c)(18) was enacted as part of the Tax Reform Act of 1969 to provide, under certain specified requirements and conditions, tax exempt status for pension plans and trusts funded by contributions of employees. This exemption was necessary because section 401(a) was and is limited to trusts forming part of a pension plan of an employer. Section 501(c)(18) plans and trusts are plans and trusts of the employees only, not supported by contributions of employers.

3. Employee contributions to section 501(c)(18) plans and trusts should receive the same treatment as

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1/ All references hereafter to sections are to sections of the Internal Revenue Code of 1954, as amended.

is proposed to be provided for employee contributions to section 401(a) plans. Section 501(c)(18) plans are designed so that individual employees may provide for their retirement security by their own contributions.

4. By virtue of the limitation in section 501(c)(18) to plans and trusts established before June 25, 1959, only a handful of plans and trusts qualify under this section, and the revenue impact of extending limited deductibility, as contemplated by S. 12 and S. 243, would be minimal.

5. Accordingly, the Subcommittee is urged to extend the deduction provisions of S. 12 and S. 243 to employee contributions to plans and trusts qualifying for tax exemption under section 501(c)(18).

Amplified Statement

S. 12 provides for the deduction, up to 15 percent of compensation or $1,000, whichever is less, of employee contributions to plans established under sections 401(a), 403(a), and 405(a), to IRAs under section 408(a) or (b) or section 409, and to retirement trusts maintained by unions under section 501(c)(5).

S. 243 provides, among other things, for the deduction of employee contributions, up to the amount of compensation income or $2,000, whichever is less, to plans and trusts described in sections 401, 403(a), 405(a), and 805(d)(3) (for employees of a life insurance company).

Both Bills seek to encourage contributions by an individual for his own future financial security by providing for limited income tax deductions for contributions to pension plans and trusts. The deductions are provided for contributions to pension plans and trusts which meet the standards for tax exempt status under the Internal Revenue Code, *i.e.*, plans established for the exclusive benefit of employee-participants and which provide benefits in a nondiscriminatory fashion to the participants, whether they be high-paid supervisory persons or rank and file wage earners.

The plans to which contributions may be made under the Bills are employer-established plans, but it seems clear that the purpose of the proposed legislation is to encourage individual *employees* to contribute and set aside funds for their own future security. The Bills do not affect employer contributions or employer deductions for such contributions.

Section 501(c)(18) plans and trusts consist of pension plans and trusts established by employees. The trusts are funded solely by employee contributions; employers make no contributions thereto. Section 501(c)(18) plans and trusts are exempt equally with section 401 plans and trusts because they must meet the same basic standards, i.e., be created for the exclusive benefit of employee-participants, and provide nondiscriminatory treatment of employee-participants.

The nature of a section 501(c)(18) plan and trust may be illustrated by the Inter-Local Pension Fund of the Graphic Arts International Union. This Fund was established originally in 1950 by the then Lithographers International Union. Each local of the union which elects to participate in the Fund becomes a "participating local" for the purposes of the Fund. Members of a participating local become participants in the Fund by making contributions thereto. The Fund is managed by trustees designated by the participating locals and their members. The Fund provides defined benefits in the sense of section 414. It is fully funded at this time.

Originally the Fund was ruled to be tax exempt by the Internal Revenue Service under Code section 501(c)(9). In later years the Fund ceased to be exempt under that section because section 501(c)(9) limited the amount of investment income which an exempt trust could receive and because the Internal Revenue Service changed its view, holding pension benefits to be outside the scope of section 501(c)(9). In 1959, under the provisions of section 801(b)(2)(B) of the Code, the Fund was viewed and taxed as a life insurance company and, in practical effect, was not subject to Federal income taxes. When amendments were proposed to the life insurance company provisions in 1969 which would have terminated the status of the Fund as a life insurance company, Congress enacted Code section 501(c)(18) as part of the Tax Reform Act of 1969, thereby establishing clearly the tax exempt status of the Fund. Pursuant thereto, the Treasury Department promulgated regulations in 1972.

Even before the regulations were promulgated, the Inter-Local Pension Fund of the Graphic Arts International Union received a ruling of tax exemption on June 10, 1971 from the Internal Revenue Service.

This ruling has been confirmed by IRS ruling letters of June 26, 1973 and December 5, 1975.

The Fund is, of course, subject to the provisions of ERISA, and files regular reports with both the Department of Labor and the Internal Revenue Service.

For other purposes of the Internal Revenue Code, the Fund is treated in the same manner as a qualified plan and trust under Code section 401(a). For example, a trust meeting the requirements of section 501(c)(18) is, equally with trusts, established under section 401(a), barred from engaging in prohibited transactions by section 503.

There is every reason, therefore, to provide as favorable treatment for employee contributions to a trust exempt under section 501(c)(18) as for employee contributions to a trust established under section 401(a). We request that the Subcommittee give favorable consideration to extending the provisions of S. 12 and S. 243 to employee contributions to section 501(c)(18) pension trusts.

We appreciate the opportunity afforded us to file this statement with the Subcommittee, and to testify

before the Subcommittee and respond to any questions or inquiries which the Subcommittee may have.

Respectfully submitted,

Walter J. Rockler

March 6, 1981

Mr. Kent Jay Levine
Deleware Legal Center
1150 Deleware Street
Denver, Colorado 80204

Dear Mr Levine:

Thank you for your letter of February 20th.

The insight you provided on the home office deduction issue is excellent and will help push enactment of the legislation I have introduced to repeal the IRS policy disallowing deductions for most home offices. I've inserted the material you provided into the hearing record and will send you a copy once published.

Thanks again.

Best regards.

Sincerely,

William L. Armstrong

WLA:bwc

LEVINE AND PITLER, P. C.
ATTORNEYS AND COUNSELORS AT LAW

MARK LEE LEVINE
ROBERT L. PITLER
KENT JAY LEVINE
MARK JAY RUBIN
GARY H. LEVINE

DELAWARE LEGAL CENTER
1150 DELAWARE STREET
DENVER, COLORADO 80204
(303) 892-5891

February 20, 1981

HAND DELIVERED

The Honorable William Armstrong
1045 Lincoln Street
Denver, CO 80204

ATTENTION: Brian Waidmann

RE: Home Office Deduction -

Dear Senator Armstrong:

I regret being unable to attend the Hearing scheduled for Monday, February 23, 1981, however, I would respectfully request this letter be read into and made part of the record.

A brief background statement appears to be in order. In addition to my practice of law, I am an instructor at the Community College of Denver, Red Rocks Campus. I have primary responsibility for teaching for the real estate program and business law. Additionally, I have an office for each respective profession. Further, aside from my practice and teaching, I also publish extensively and lecture for a variety of audiences locally as well as nationally. My endeavors in publishing and lecturing necessitate a suitable office to prepare and carry on this activity. This enterprise is not associated with my law practice nor with my teaching responsibilities at the college. Rather, it is entirely separate and stands on its own.

I have maintained an office in my home for quite a number of years now to fulfill my authoring and lecturing enterprises. My office in my home is utilized exclusively for the preparation of manuscripts for my publishing as well as preparation of material for the lectures I conduct.

Recently, on January 6, 1981 my income tax return for the tax year 1979 was audited. The examination resulted in a denial of a $445

home office deduction. The basis for this denial was explained to me by the auditor that the Internal Revenue Service takes the position that an individual can have only one primary place of business. Because my law practice or teaching would necessarily be deemed the primary business, with my lecturing and writing secondary, it follows that I could not have the home office deduction insomuch as my authoring and lecturing was not my primary business and thus the office in the home would not be deemed to be my primary place of business.

At this juncture, my case has not been closed. I explained to the examiner that my "business" consist of three businesses. As mentioned above, it consist of my law practice, teaching, as well as authoring and lecturing. I expressed the fact for my publishing and lecturing, my primary place of business was at my home and accordingly I felt the deductions should have been sustained. I explained to the examiner that I do not hold myself out to be sophisticated in the tax law area and accordingly would be consulting with others in attempting to do some preliminary research to determine if my position was sound or if the Internal Revenue Service's position is the correct conclusion. Upon returning to my office and having some brief consultation, and preliminary research, I discovered the case of Edwin R. Curphey vs. Commissioner decided February 4, 1980 by the tax court that permitted Dr. Curphey to deduct his home office expense even though he was engaged in another "primary" occupation that of a dermatologist.

Accordingly, it appears that the Internal Revenue Service is taking the position that they are not bound by the Court's determinations. Therefore, I earnestly feel it is extremely imperative that clarification be made in this area. I should also like to pass on the fact that almost one week out of my life was taken in preparation for the examination. That is, to put in proper order and make copies of all the documentation necessary to try to sustain my employee business expenses. From a philosophical point of view, it appears inconsistent and without a justifiable basis to permit one to deduct expenses when one engages an office setting outside of one's home, but not to permit a deduction when the same office is maintained, although at a different location, i.e. in the home. Further, one of the factors relied upon when purchasing our home was the fact that I was able to have my office be situated in my home, and properly furnished to permit a conducive atmosphere for productive work. As mentioned, I utilize my office exclusively for that purpose. In reacting perhaps somewhat negatively, I must pounder what is the sociological impact of the service's position. I have concluded that it is to force, at lease income tax wise, one to have only one single business. That is, with the service maintaining the position that one can only have one primary business it would appear therefore defintionally impossible to have more than one primary business. Although,

as mentioned previously I view my "business" to consist of three subparts, each of which is primary important and necessary for me to support my family, the service has rejected this position.

In conclusion, I am hopeful that Congress will rectify this wrong, and encourage rather than discourage productivity consistent with our enconomic philosophies and capitalistic society through appropriate clarification of our tax laws.

I do thank you for permitting these facts and my concerns to be properly aired and brought to your attention.

Respectfully submitted

LEVINE AND PITLER, P.C.

By Kent Jay Levine
van
Kent Jay Levine

KJL:van

March 6,1981

Mr. Richard Stef
3434 South Laredo Court
Aurora, Colorado 80013

Dear Mr. Stef:

Thank you for your letter of February 15th.

The insight you provided on the family rental issue is excellent and will help push enactment of the legislation I have introduced to repeal the IRS policy disallowing deductions for rental to family members. I've inserted the material you provided into the hearing record and will send you a copy once published.

Thanks again.

Best regards.

Sincerely,

William L. Armstrong

WLA:bwc

February 15, 1981

Mr. Bryan Waidmann
140 Russell
Washington, D. C. 20510

Dear Sir:

Per our telephone conversation, enclosed please find the summation that you requested on February 12, 1981

On October 9, 1980, I was requested by the IRS to bring in my 1978 Tax Return for "Medical and Rental Income and Expenses" audit. The medical was resolved without any problem and closed. The rental portion was not resolved.

The auditor assumed that I did not charge a fair rental value amount because I had rented the house to my son and that I would have to prove otherwise. I did so by collecting a number of affidavits from "Renters" in the neighborhood which proved to be less than the $330 a month charged to my son.

This was done at the first re-hearing on October 23, 1980. The review person admitted that I had done a good job, however, the charge was wrong, that it should have been "renting to a relative" and not "less than fair rental value charge," and that she was going to change it, and did so.

The IRS had stated, "If I rented to a stranger or friend, this problem would not have occurred. It would be perfectly legal to declare a net loss on the rental unit in this situation, is this not "discrimination" against me and my son, who is totally emancipated from us? The results of this hearing was also negative to me.

From there I was instructed that I would have to go before the appeals board if I wish to contest their decision. On February 4, 1981, I was heard by the appeals board, to no avail. Joyce Larson was the person in charge of this hearing. She followed the letter of the law as it was stated, and said my next move would be to go before the Tax Court or I could choose District Court.

I have until February 17, 1981 to make my decision as to whether to pay $550 plus penalties, or go to tax court. I have decided to go through tax court and will await their notice of deficit and date of hearing. (Approx. one year hence.)

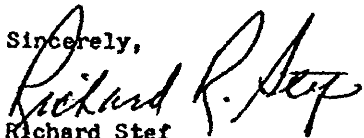
Hopefully by then, Congress will have ruled on this law and revised same in our behalf. The house I purchased in November 1977 was for the purpose of supplementing my retirement income of which I will have very little, as things are now. I am presently 54 years old and with my present employer for one year, three months. There is not going to be a great amount of retirement income with approximately 11 years service. I have no other form of income pending and this purchase looked like a good chance to gain additional income in my later retirement years.

Please keep me posted on the progress of Senator Armstrong's bill to correct this deficit in the law. I thank you and the Senator for your time and anything you are able to do.

Mr. Bryan Waidmann -2- February 15, 1931

I shall await your reply.

Sincerely,



Richard Stef
3434 South Laredo Ct.
Aurora, Colorado 80013

Phone: Home - 303-690-0580
Business: 303-740-1960

STATEMENT TO THE SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY OF THE SENATE FINANCE COMMITTEE BY ROBERT A. BECK, CHAIRMAN, BUSINESS ROUNDTABLE SOCIAL SECURITY AND PENSION TASK FORCE

The Business Roundtable recommends that legislation be enacted to permit tax-deferred employee contributions to either an Individual Retirement Account (IRA) or to a qualified pension plan that agrees to accept deductible contributions. The tax-deferred contribution limits should be the same for persons covered by qualified pension plans as the limits for those who are not covered. In addition, those limits should be expanded to recognize inflation since IRA legislation was first enacted in 1974.

Advantages

There is substantial need to encourage additional sources of capital formation in the United States. Additional sources of capital formation are essential to help create jobs and to improve the productivity of the economy. The additional individual savings resulting from the recommended incentives would provide an important source of capital formation.

Individual savings can provide a significant source of capital formation, and they have typically furnished approximately one-third of the total capital investment in the U.S. However, they are an even more significant source of capital formation in other industrialized countries. For example, the rates of individual savings in other industrialized countries are typically twice as high as those that have prevailed in the U.S. and the Japanese rate is approximately three times as high. Further since other countries have provided incentives to encourage individuals to save, the rates of saving in other countries have been increasing while the U.S. rates have been decreasing.

The following table illustrates these trends:

Rate of Saving as Percentage of DPI

Country	1967	1977
United States	7.7%	5.1%
Canada	6.2%	9.8%
France	15.9%	16.1%
Japan	18.5%	21.5%
West Germany	11.3%	14.0%

Tax deferred employee contributions for retirement saving represent a form of individual tax reduction that would help control inflation. In the short term, the amounts saved would result in less immediate consumer demand. In the long term, the capital formation thus created would improve economic productivity thereby reducing inflation.

In addition to enhancing productivity and controlling inflation, the individual savings generated by the proposed incentives would provide a valuable source of retirement income. This would help alleviate pressures on the over-burdened Social Security program. Demographics and concerns about intergenerational equity will pose tremendous problems for that program in the future, and it is critical that individual savings for retirement be encouraged.

The experience of other major industrialized countries indicates that persons at virtually all income levels are capable of accumulating significant savings given the proper incentives. This experience is confirmed by the experience of thrift plans in the U.S. even though the incentives to maintain the savings are modest. The information provided in the Appendices furnish evidence of this experience and indicate the potential that individual savings offer.

It is important to note that the proposed incentives would merely defer rather than forgive taxes. The contributions plus investment appreciation would be taxed as ordinary income when the benefits are received. This fact, together with increased tax revenues resulting from the improved economic productivity, would more than compensate the Treasury for short-term revenue losses.

Recommendations

Simplicity of the program would be enhanced by permitting the same contribution limits for all workers, whether or not covered by a qualified pension plan. Public understanding and acceptance of the program would be facilitated by such uniform limits. Since there are many advantages that would result from the additional savings, the program should be as simple as possible to encourage broad participation.

In addition, simplicity would be enhanced by permitting tax deferrals for employee contributions that are mandated by a qualified pension plan, if the worker so elects. This would encourage employers to establish new plans or to liberalize existing plans. This would also serve as an incentive for the employee to maintain savings for lengthy periods of time.

The contribution limits should be increased to recognize inflation since IRA legislation was first enacted. Increased limits would stimulate additional savings. The previously mentioned advantages would be enhanced by such additional savings. Experience indicates that persons at virtually all levels of income have the capability to set aside significant savings and the limits should be sufficient to encourage such savings.

Conclusion

The Business Roundtable supports legislation that would permit tax-deferred employee contributions to either an IRA or a qualified pension plan. Such legislation would encourage additional sources of capital formation thereby improving economic productivity. Individual saving for retirement would be stimulated and if the legislation incorporates the recommendations included in this statement, it would also encourage the development of new pension plans and expansion of existing plans thereby alleviating pressures on the over-burdened Social Security program. The legislation would merely defer taxes and offers the added advantage of being a noninflationary tax cut. Finally, the experience from other countries indicates that persons at virtually all levels of income would benefit from the legislation.

Senators Dole and Chaffee are commended for introducing legislation to stimulate retirement savings. Such legislation has broad support from many constituencies. It is hoped that this statement will encourage adoption of amendments that will result in final legislation that will enable the public to realize the full potential of the advantages.

APPENDIX

Incentives to Encourage Saving - Canadian Experience

Description

Canada has two major programs to encourage individuals to set aside savings for retirement. First, employee contributions to employer-sponsored pension plans in Canada are tax deferred in amounts up to $3,500 per year. Second, taxes are deferred on contributions made to "Registered Retirement Savings Plans." These "RRSPs" are comparable to U.S. IRAs, but they are available to everyone and they allow higher contribution limits. For example, if a person is not covered by an employer-sponsored pension plan, the limits are the lesser of $5,500 or 20% of earnings. If they are covered, the limit becomes the lesser of $3,500 or 20% of earnings reduced by the amount the employee contributed to an employer-sponsored pension plan.

Results

- In 1977, almost three-quarters of those participating in "Registered Retirement Savings Plans" had incomes of $25,000 or less.
- The number of "RRSPs" almost doubled between 1973 and 1977.
- The average amount saved by those participating in "RRSPs" in 1977 was $1,662.
- Employee contributions were required for 72% of all those covered by employer-sponsored private pension plans.
- The average amount saved by those contributing to an employer-sponsored pension plan in 1977 was $701.
- During the period between 1967 and 1977, individual saving in Canada grew from 6.2% to 9.8% of disposable income while individual saving in the U.S. declined from 7.5% to 5.1%. This period corresponds with the period of substantial growth in savings in "RRSPs."

Implications for the United States

- "RRSP" experience indicates that persons at all income levels can be encouraged to set aside savings for retirement.
- If employee contributions were tax deferred in the U.S. they would:
  - Encourage employers to establish new pension plans, and
  - Encourage employers to liberalize existing plans, such as improving benefits to compensate for inflation.
- Pressure to further expand Social Security benefits and costs would be alleviated and over-all retirement security would be improved.
- Capital formation would be fostered as retirement savings represent long term, additional savings.
- Inflationary pressures would be lessened by reducing current consumption and by providing a source of capital essential to improve the productivity of the economy.

Incentives to Encourage Saving - French Experience

Description

Since 1978, French citizens have been able to deduct up to 5000 francs (approximately $1,200) per year from their taxable income if the amounts deducted are used to purchase stocks of French companies. Additional income tax deductions may be taken for investments made on behalf of dependent children.

The investor must leave the money invested for at least three years to qualify for the deduction. However, the money may be reinvested in different securities during the minimum period.

Results

- Middle income wage earners, who had not previously considered owning shares of French industry, have been encouraged to make such investments as a result of the law.
- More than one million French taxpayers have claimed the exemption during the brief period of time the law has been in effect.
- Within nine months of enactment, the average price of stock on the Paris exchange increased by 44% and by March of 1980 had increased by 66%.
- It is estimated that the law resulted in the injection of approximately $1.8 billion into the French stock market.
- French industrial firms, encouraged by the government's concern about the market and industry in general, have employed the additional $1.8 billion for new capital investment.
- The individual saving rate in France increased to 17% by 1979 while the rate of saving in the U.S. was rapidly falling.

Implications for the United States

- Incentives of this nature would help broaden the base of industrial ownership in the U.S. as middle-income wage earners would be encouraged to purchase stock of U.S. companies. During the past 10 years, the number of individual shareholders in the U.S. has actually decreased from 31 million to 25 million.
- Industry would receive an additional source of funds essential for major, new capital investment.
- The new capital investment would improve productivity, create new job opportunities and reduce inflation.
- Individual, long term saving would be stimulated among a wide range of wage earners.

Incentives to Encourage Saving - Japanese Experience

Description

There are three major types of incentives to encourage savings as follows:

(1) Interest earnings on the first $23,000 of principal are tax exempt.

(2) A one-time federal bonus is paid based upon savings set aside for housing. The bonus varies from 6% to 10% of the principal amount saved and the maximum bonus varies from $135 to $225 per year.

(3) An employer can establish a special savings account for an employee. The first $2200 of annual employer contribution and interest earnings is not treated as taxable income. Only one-half of the additional contributions and interest earnings are treated as taxable income.

Results

- Individual saving in Japan is very high (21.5% of disposable income in 1977) for a variety of reasons. Incentives have contributed to the high savings rates but there are other factors that have contributed such as:
  - Their Social Security program provides a more modest level of benefits than that provided in other industrialized nations.
  - A substantial portion of the Japanese salary, approximately 25%, is paid in the form of bonuses which tend to be saved.
- Lower income Japanese wage earners are able to set aside significant savings. For example, the rate of individual saving for the lowest 20% of the wage earners for the period from 1963 through 1978 was approximately 16% of earnings.

Implications for the United States

- The Japanese economy provides an excellent example of the advantages of capital formation arising from their high rates of saving.
- The Japanese place more emphasis on individual initiative and thrift than other industrialized countries as indicated by their more modest level of Social Security benefits.
- Lower income wage earners are able to set aside significant levels of saving.

Incentives to Encourage Saving - West German Experience

Description

West Germany encourages long term saving by providing a federal bonus to eligible persons who set aside savings. These savings have to be held for periods of from five to seven years. Eligibility for the bonuses is based upon income. For example, married couples would be eligible if their incomes were less than approximately $25,000. The bonuses are one-time bonuses added directly to the amounts saved.

A one time bonus, 30% for single workers and 50-63% for married couples, is provided on the first $325 of annual amounts saved through payroll deductions. An additional, one-time bonus of 14%, plus 2% for each dependent child, is provided on other savings up to a limit of $435 of annual saving.

Results

- The bonus program is considered a success and higher limits are anticipated.
- Among eligible workers, 75% use these long-term accounts.
- Among blue-collar workers, 94% of those workers have established a savings account.
- Approximately 60% of the amounts saved in the special long term accounts are maintained after the mandatory holding period of five to seven years. This holds true for all socio-economic levels.
- The rate of individual saving in West Germany is more than twice as high as that generally prevailing in the U.S.
- The rate of inflation in West Germany is significantly lower than the rate of inflation in the U.S. It is likely that the capital formation arising from their high savings rates has contributed to the control of inflation and vice-versa.

Implications for the United States

- Given proper incentives, lower and moderate income earners are able to set aside savings.
- Similar long term savings in the U.S. would help meet the country's capital formation needs.
- Additional sources of retirement income would be created even though the savings accounts are not specifically restricted for such purpose.
- A similar program in the U.S. would help to reduce inflation.
- The disparity in the amounts saved in the U.S. by income category would be lessened.

Incentives to Encourage Saving - Prudential Thrift Plan Experience

Description

Prudential offers employees who have been employed for more than one year the opportunity to participate in a thrift plan through means of pay-roll deductions. There are two primary incentives that encourage participation. First, the Prudential will match the first 3% of salary saved by the employee. The employee contributes after-tax dollars, the company's matching contribution is treated as tax deferred compensation for the employee. Second, investment earnings need not be declared as earnings until they are withdrawn from the plan.

Most employees are eligible to save up to an additional 10% of salary. The company does not match these additional savings, but the investment earnings on these savings are tax deferred.

Results

- Approximately 90% of the eligible employees participate in the plan. The participation rates are very high among all levels of wage earners as can be determined by reviewing the attached Table I.
- One-third of the participants save 3% of their salary. Two-thirds of the participants save more than 3% with approximately one-third of all participants saving the maximum of 13% of salary.
- Among those who participate, the total savings rate, including the employer contribution, is 10.5% of earnings. The savings rate is high among all levels of wage earners as indicated in attached Table II.
- The total amount accumulated on behalf of the participants had grown to $378.3 million by the end of 1979. The total amount has been growing at a rate of approximately 20% per year.
- The average amount accumulated per participant was approximately $8,000 even though the program was slightly less than 10 years old.

Implications for the United States

- Individual saving of this type is a valuable source of capital formation.
- The amounts saved have helped to combat inflation as current demand for consumption is reduced and the capital improves productivity.
- These savings can be used as a significant source of retirement income.
- Individuals at all levels of earnings have the capacity to save significant portions of their salary.
- Additional incentives, such as allowing employees to tax defer some portion of their contributions, would encourage additional saving among Prudential employees, and encourage more employers to establish similar plans.

PRUDENTIAL THRIFT PLAN EXPERIENCE

TABLE I

Participation Rates by Income Level, 12/31/79

Income Level	Years of service			Total
	Less than 2 years	2 year to 5 years	More than 5 years	
Less than $10,000	56.5%	79.9%	89.5%	73.1%
$10,000 to $14,999	81.6%	87.5%	94.8%	92.5%
$15,000 to $19,999	87.2%	92.1%	97.5%	96.2%
$20,000 to $29,999	67.0%	94.9%	98.1%	97.7%
$30,000 to $49,999	100.0%	92.8%	99.1%	98.7%
$50,000 and over	100.0%	100.0%	99.7%	99.7%

TABLE II

Income Level	Employee Savings Rate					Average Total Savings Rate*
	3%	4-6%	7-9%	10-12%	13%	
Less than $10,000	44%	17%	7%	7%	25%	9.7%
$10,000 to $14 999	35%	17%	7%	8%	33%	10.6%
$15,000 to $19,999	35%	17%	9%	8%	31%	10.5%
$20,000 to $29,999	30%	16%	11%	9%	34%	10.9%
$30,000 to $49,999	23%	13%	11%	9%	44%	11.9%
$50,000 and over	19%	8%	8%	9%	56%	12.9%

* Includes employer contribution rate of 3%.

76-128 O—81——30

STATEMENT OF STANLEY TAUBE, PRESIDENT OF THE NATIONAL APARTMENT ASSOCIATION* BEFORE THE SENATE SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY OF THE SENATE COMMITTEE ON FINANCE.

Mr. Chairman and Members of the Subcommittee:

My name is Stanley Taube, and I am an apartment owner and developer from Minneapolis, Minnesota. I am President of the National Apartment Association, a trade association of approximately 105 local and state affiliates whose combined membership includes about 45,000 owners, managers, and developers of multifamily housing.

The three bills which are the subject of this hearing all have one major goal--providing savings incentives. The NAA supports this goal. Without increased savings, the rental housing industry will not have sufficient capital to build enough rental housing to satisfy the growing demands of this decade. There will be a demand for approximately 615,000 additional multifamily rental units per year in the 1980's compared to present production levels of less than approximately 300,000 multifamily rental units per year. Already the nation's vacancy rate of 5% is at a 24 year low. In view of the critical shortage of rental housing facing this nation in the 1980's, the NAA feels that increased savings should be a national priority.

However, in addition to encouraging increased savings, Congress should provide legislation to insure that a fair share of increased savings will be made available to provide financing for rental housing construction in order to avert the rental housing shortage.

*The National Apartment Association is an association of over 105 local and state apartment associations whose combined membership includes over 45,000 developers, owners, and managers of rental housing. Its headquarters is located at 1825 K Street, NW, Washington, D.C. 20006 and its national officers are: President Stanley M. Taube of, Minneapolis, Minnesota; President-Elect Robert E. Esrey of Kansas City, Missouri; Vice President James L. Reeder, Jr. of Fremont, California; Treasurer S. Cody Engle of Chicago, Illinois; Secretary Roland Freeman of Dallas, Texas; and National Apartment Council Chairman Marvin Isgur of Houston, Texas.

We urge passage of legislation that will increase the contribution limits to individual retirement accounts, and broaden eligibility for IRA's to include taxpayers presently covered by an employer sponsored retirement plan. We also support legislation to make permanent the interest and dividend exclusion and raise the exclusion limits. However, we do oppose proposed legislation to amend the tax code to permit contributions to IRA's to be used to purchase a home as proposed in S. 243. Such a change in the tax code only increases the bias of the tax code in favor of homeownership to the detriment of renters. For the same reason we oppose S. 24 which would provide for individual housing accounts.

In fiscal year 1982, the tax code will provide homeowners with a tax subsidy of over $35 billion through the deduction for mortgage interest and property taxes.[1]

A recent report of the Congressional Budget Office stated, "Recent economic studies, however, suggest that the deduction (mortgage interest) may have important adverse consequences both for housing markets and for the economy as a whole. Besides creating substantial losses of federal revenues, it appears to have contributed both to a serious decline in the construction of rental housing and to the conversion of rental housing into condominiums and cooperatives."[2]

The NAA is not against homeownership; however, we feel the choice whether to rent or own should be a life style decision, not a tax decision. Amending the tax code to permit tax deductible IRA contributions[3] *to be used to purchase a home would only increase the already overwhelming tax bias in favor of homeownership and all but destroy the rental housing industry.*

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[1] *In addition, the deferral of capital gains on home sales will provide a $1.125 billion tax benefit in fiscal year 1982.*

[2] *Reducing the Federal Budget: Strategies and Examples; Fiscal Year 1982-1986, Congressional Budget Office, February, 1981, at page 784.*

[3] *Even if the contributions to an IRA used to purchase a home were not tax deductible, the tax exempt status of an IRA still provides a significant tax benefit.*

Because of the existing tax benefits for homeownership, middle income families refuse to pay rents that would provide sufficient income to adequately maintain existing buildings or justify new rental housing construction. Instead they choose homeownership. Thus, many people willingly pay $300-$400 more in mortgage payments then rent for the same dwelling. Consequently, rent increases lag behind increases in operating costs (see table A). Rental housing becomes a less desirable investment, resulting in less new rental construction and greater dependence on government subsidies (see table B).

We recognize that because many homeowners have purchased their homes in reliance on the mortgage interest and property tax deduction; these tax benefits could not be eliminated from the tax code. However, in view of the critical rental housing shortage, the Congress should seek to provide tenants of this country with tax equality with homeowners through a deduction for the portion of their rent attributable to property taxes and mortgage interest.

I realize that the issue of a tenants' tax deduction is not within the jurisdiction of this Subcommittee. However, for your information I will submit a memorandum entitled Tenants' Tax Equality and Tax Relief which explains the need for a tenants' tax deduction.

Conclusion

The need for tax incentives to encourage savings is well documented. But in an effort to provide a savings incentive Congress should not provide an additional subsidy for homeownership.

The NAA supports:

1) An expansion of eligibility for tax deductible IRA contributions to include individuals covered by employer sponsored retirement plans,

2) An increase in the IRA contribution limits,

3) An expansion of the interest and dividend exclusion, and

4) *A requirement that a fair share of the increased savings be made available to provide financing of rental housing construction.*

The NAA opposes:

1) *Allowing IRA funds to be used for a home purchase, and*

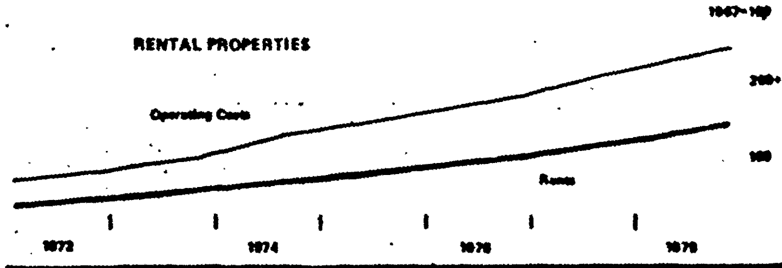
2) *Individual housing accounts.*

A tax incentive for savings will increase availability of capital thereby benefiting all industries including the multifamily rental housing industry and the single family industry. There is no need for an additional special tax benefit to help the single family industry.

This concludes my statement. Thank you for the opportunity to express the views of the National Apartment Association.

TABLE A

Increase in Rents and Operating Cost



SOURCE: Federal Reserve Bulletin
Rental Housing: A National Problem That Needs Immediate Attention, GAO, CED 80-11, November 8, 1979.

TABLE B - Starts

	Multifamily Starts (2 units or more per building)	Rental Starts (2 units or more per building)	Percentage of Rental/MF Starts	Percentage of Government Subsidy (5 units or more)
1972	1,047,500	NA	NA	22%
1973	913,300	NA	NA	24%
1974	449,700	319,000	(71%)	28%
1975	268,300	223,000	(83%)	30%
1976	375,100	312,000	(83%)	33%
1977	536,000	445,000	(83%)	36%
1978	587,000	455,000	(78%)	44%
1979	551,000	378,000	(69%)	50-60%
1980(est.)*	441,000	260-270,000	(62%)	50-60%
1981(proj.)*	460-500,000	280-300,000	(60%)	

* National Apartment Association estimate as of January 1, 1981.

Source: U.S. Department of Commerce

General Accounting Office Report, Rental Housing: A National Problem That Needs Immediate Attention, November 8, 1979.

TENANTS' TAX EQUALITY AND TAX RELIEF

We urge that the tax code be amended to provide tenants with a tax credit or deduction for the portion of their rent payment attributable to mortgage interest and property taxes. Presently, under the Internal Revenue Code, homeowners receive a tax deduction for property taxes paid on the dwelling and the portion of the mortgage payment attributable to interest. However, the tenants' rent payment which is used to pay part of the mortgage interest and the property taxes is not deductible. As the result of this bias in the tax system towards homeownership, many individuals choose to own rather than rent due to tax consequences and not as a result of the choice of living style.

Over 50 million Americans live in rental housing. To many of these tenants, rental housing provides many advantages over owner-occupied housing, such as better and less expensive recreational facilities, a convenient location, lower living costs, and little or no maintenance responsibilities. In addition, in a highly mobile society, a tenant encounters less relocation problems than an owner.

The National Apartment Association feels that the choice of living style should be a personal choice and not a tax decision. In order to provide tenants' tax equality with homeowners, the tax code should be amended to provide tenants with a tax credit or deduction for the portion of their rent payment attributable to mortgage interest and property taxes.

In addition to providing tenants' tax equality, a tenants deduction or credit will provide tenants with much needed tax relief.

According to the Special Analyses Budget of the United States Government for Fiscal Year 1982, the loss in tax revenue in fiscal year 1982 due to the homeowner's property tax deduction and the mortgage interest deduction will be $35.465 billion. In essence the government is providing a tax subsidy for the living expenses

of homeowners, while tenants, who have suffered greater hardship due to inflation, receive no tax benefits. According to the General Accounting Office, from 1973 through 1977, the median income of tenants rose 5.6% per year while the median income of homeowners rose 9.8% per year.[1]

Over the last decade tenants have begun to spend a greater percent of their income on rent. The number of tenants paying 25% of their income as rent increased from 41% in 1973 to 49% in 1977.[2] However, this is not due to unfair rent increases. Rent increases have been 3-4% less than the overall increase in the consumer price index and have been less than the increases in operating costs. (Table A)

As Table B indicates, tenants are in a significantly lower income bracket and less able to withstand inflationary pressures than homeowners. In 1977, over 56% of tenants had annual incomes of less than $10,000 compared to only 30% of homeowners. Tenants should be provided with some tax relief.

Summary

A tenants' tax deduction or credit for the portion of rent attributable to the mortgage interest and property tax would provide tenants with tax equality with homeowners and much needed tax relief.

We recognize that the revenue impact of a deduction or credit for tenants for the portion of rent allocable to both property taxes and mortgage interest would result in a significant revenue loss. Therefore, as a first step for tenant tax equality and tax relief, the tax code should be amended to provide for a tenant's deduction or credit for the portion of rent attributable to property taxes.

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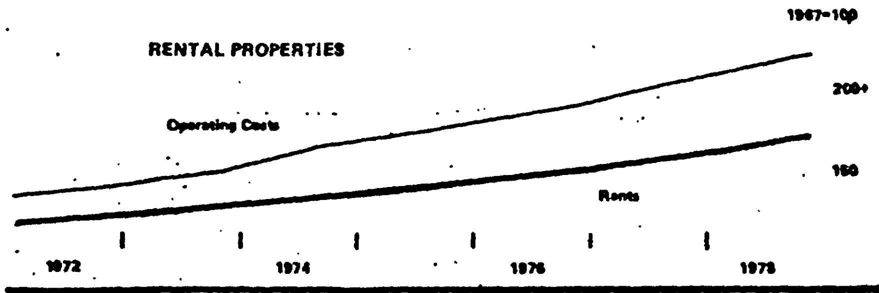
[1] Rental Housing: A National Problem That Needs Immediate Attention, GAO, CED-80-11, November 8, 1979.

[2] Annual Housing Survey - 1977

TABLE A

Increase in Rents and Operating Cost



SOURCE: Federal Reserve Bulletin
Rental Housing: A National Problem That Needs Immediate Attention, GAO, CED 80-11, November 8, 1979.

TABLE B

Owner and Tenant Incomes

Occupant Annual income	Owner-Occupied Units	Percent	Renter-Occupied Units	Percent
	(000 omitted)		(000 omitted)	
Less than $7,000	9,469	19.4	10,723	40.4
$7,000 to $9,999	4,797	9.8	4,232	16.0
$10,000 to $14,999	8,571	17.6	5,328	20.1
$15,000 or more	25,929	53.2	6,232	23.5
Total	48,766	100.0	26,515	100.0

SOURCE: Rental Housing: A National Problem That Needs Immediate Attention, GAO, CED 80-11, November 8, 1979

STATEMENT OF ARNOLD CANTOR, ASSISTANT DIRECTOR, DEPARTMENT OF ECONOMIC RESEARCH, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS BEFORE THE COMMITTEE ON FINANCE, SENATE SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY ON S. 12, S. 24 AND S. 243

March 10, 1981

The AFL-CIO wishes to go on record in opposition to S. 12, S. 24 and S. 243 -- measures to provide added tax deductions for Individual Retirement Accounts (IRA) certain savings accounts and income from interest and dividends.

Each of these bills has been advocated as a means to increase savings and provide "incentives" to individuals to save for retirement and/or education and the purchase of a home.

We are convinced that none of these goals will be served. The revenue losses involved in each of these bills and the impact on federal deficits, increased government borrowing and interest rates will more than offset any possible additions to private savings. Each of these measures involves a deduction from taxable income and therefore the tax benefits are concentrated on those in the higher income brackets. Each of these measures completely excludes those who are unable to save and each will provide windfall tax benefits to those who can and do save.

S. 12 would expand IRA definitions to permit tax deductions for individuals covered by "qualified" exployer pension plans. Employees would be allowed to deduct contributions to such plans or set up their own IRA's. The deduction would be limited to 15% of income with a maximum annual deduction of $1,000. The rationale for the present IRA law was to encourage individuals who were not covered by private pension plans to establish their own plans. The measure was also justified as a device to provide tax benefits to certain employees similar to the benefits available to the self-employed under the H.R. 10 or Keogh type plans which allow as much as $7,500 per year to be excluded from income.

Extending IRA tax benefits to employees covered by qualified plans merely ratchets up the revenue loss of IRA's. Pension protection

would not increase -- some of the costs would merely be shifted from employers to employees and taxpayers. The revenue loss has been estimated at $2 billion in the first full year rising to $2.7 billion in 1985.

S. 24 expands the IRA retirement tax exclusion concept to "education savings accounts" and "housing savings accounts." Under the former a taxpayer would be allowed to exclude $1,000 per year per beneficiary for amounts transferred to an education savings account. In addition, the $1,000 per year per beneficiary would be "indexed" to the Consumer Price Index. The beneficiary, after age 25, would begin to pay taxes on the formerly excluded amounts over a 10 year period.

The effect would be to allow parents who can afford to set aside $1,000 per year per child to defer taxes and shift the liability to the presumably lower tax bracket of the beneficiary. It adds up to a zero interest student loan and subsidy program targeted to the wealthy.

The housing savings account in S. 24 would allow a deduction up to $3,000 (joint return) and $1,500 (single) for amounts contributed to such an account. These deductions similarly would be indexed for inflation but subject to a maximum lifetime deduction of $30,000 (joint) and $15,000 for single taxpayers. Distributions out of the savings account would not be taxable as long as the account was used in connection with the purchase of a first principal dwelling.

Again, we see this provision as a costly device which rewards the well-to-do for what they do anyway and excludes those who cannot afford such set asides. Moreover, the revenue loss -- $5.7 billion in F.Y. 1982 -- would add to government borrowing needs, increase the competition for available funds and contribute to upward pressures on interest rates specifically, and inflation generally.

S. 243 contains elements of the aforementioned bills and a provision to make permanent the current $200 - ($400 on a joint return) exclusion of interest and dividend income.

Specifically S. 243 makes <u>everyone</u> eligible to establish an IRA -- however employees would not be allowed to include as an IRA contribution mandatory contributions to a qualified employee plan. The bill also:

- increases the IRA maximum to $2,000
- allows additional contributions of up to $2,000. The added contribution would not be tax deductible, but the income from that contribution would not be taxed.
- allows individuals to withdraw up to $10,000 if the funds are used to purchase a first home or for higher education.

This measure has little bearing on retirement security, education financing, or housing. It merely widens the definition of tax privileged savings to make room for more participants and adds a $2.8 billion loophole to the tax structure.

We are convinced these measures are counter productive as well as unfair. Such tax incentives would aggravate the problem of high interest rates by increasing government borrowing needs and the effective returns on certain savings accounts; heightening competition for available funds and putting further upward pressure on the cost of credit.

The impact of this process will prove particularly inequitable to low and moderate-low income families who would receive little or no benefits from these tax subsidies.

The attached tables illustrate the likely impact of these savings "incentives." Table I based on University of Michigan Survey Research Center data shows, for example, that in 1977 23% of the nation's families had no savings accounts and over 1/2 had savings accounts of less than $2,000. Among low and moderate income groups most families had savings of less than $500. Table II, based on Joint Commitee on Taxation estimates of the current ~~low~~ law interest and dividend exclusion shows that approximately three-fifths of the taxpayers receive no benefit and those that do benefit are primarily in the upper income brackets.

We therefore urge rejection of S. 12, 24 and 243.

Table I

Value of Savings Accounts by Income

	Value of Savings Accounts						
	None*	Amount not Ascertained	$1 -499	$500 -1,999	$2,000 -9,999	$10,000 or more	Total
All Families	23%	15%	17%	13%	19%	13%	100%
Total Family Income							
Less than $5,000	51	7	17	9	10	6	100
$5,000 to $9,999	33	8	24	13	15	7	100
$10,000 to $14,999	19	11	25	17	17	13	100
$15,000 to $19,999	11	9	24	20	24	12	100
$20,000 to $24,999	9	8	14	22	36	11	100
$25,000 and over	5	12	6	11	28	38	100

*Includes 'not ascertained' whether family had savings.

Source: Survey Research Center, Economic Behavior Program, 1977 Survey of Consumer Finances

Table II

Distribution of Benefits of Interest and Dividend Exclusion

By Income Class[1]

Income Class	% of Tax Returns	% Benefiting From Proposal	% Receiving No Benefit	Revenue Loss (Millions $'s)	% of Revenue Loss
0-$5,000	26%	4%	96%	$ 22	1.1%
5-10,000	22	37	63	198	9.5
10-10,000	29	52	48	573	27.4
20-30,000	15	72	28	571	27.3
30-50,000	7	85	15	485	23.1
50,000 and over	2	85	15	243	11.7
Totals	100%	42%	58%	$2.1 bil.	100%

[1] Refers to $400 (201 single returns) interest & dividend exclusion proposal.

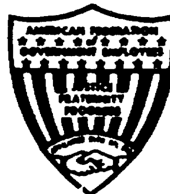
SOURCE: AFL-CIO Research Department calculations based on Joint Committee on Taxation Staff estimates.

AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES

AFFILIATED WITH THE AFL-CIO

KENNETH T. BLAYLOCK, NATIONAL PRESIDENT — JOSEPH D. GLEASON, EXECUTIVE VICE PRESIDENT — NICHOLAS J. NOLAN, NATIONAL SEC.-TREAS.

1325 MASSACHUSETTS AVE., N.W. WASHINGTON, D.C. 20005
Telephone (202) 737-8700



IN REPLY PLEASE REFER TO
6s/Legis.

March 13, 1981

Senator John H. Chafee, Chairman
Subcommittee on Savings, Pensions and
Investment Policy
Room 3103, Dirksen Senate Office Building
Washington, DC 20510

Dear Senator Chafee:

The American Federation of Government Employees, which represents over 700,000 federal workers, is pleased to offer its support to Senate Bill 243, the "Savings and Retirement Income Incentives Act of 1981." The legislation, if enacted, would provide new tax incentives to encourage savings, which are essential to the growth and stability of our economy.

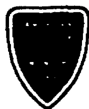
We are especially pleased that S. 243 contains provisions which would enable federal, military and civilian personnel to establish an Individual Retirement Account (IRA). Such provisions provide major incentives for voluntary contributions to retirement programs which supplement income from the Civil Service Retirement and Social Security systems.

Unfortunately, the benefits of participation in IRA's have, in the past, been confined to only a relatively small proportion of the labor force. In 1977, for example, only 1.1% of those wage earners making less than $10,000 per year were covered by Individual Retirement Accounts according to the President's Commission on Pension Policy. Your legislation -- which clearly establishes that savings income is an essential component of retirement in this country -- would extend eligibility to previously excluded groups of wage earners, and would provide new tax incentives for participation in such voluntary programs. At a time when the retirement benefits of the career civil service are under attack, AFGE believes that federal employees should be given every opportunity to provide for their future financial security.

Sincerely,

Kenneth T. Blaylock
National President

TO DO FOR ALL THAT WHICH NONE CAN DO FOR ONESELF



AMERICAN SOCIETY OF CIVIL ENGINEERS

345 EAST 47th STREET • NEW YORK, N Y 10017 • (212) 644-7496

From the Past President • WALTER E. BLESSEY
Tulane University
Civil Engineering Department
New Orleans LA 70118
(504) 861-1551

January 28, 1981.

The Honorable John H. Chafee
United States Senate
3103 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Chafee:

The American Society of Civil Engineers notes with great pleasure your recent introduction of S. 243, and we wish by this letter to be the first Society of engineering professionals to endorse the proposal.

For some time, our Society has been concerned with the relatively narrow application of individual retirement accounts, so as to cover persons who are not participants in pension programs only. We believe that by the provisions of S.243 many more Americans will be encouraged to participate in IRA's, providing simultaneously the opportunity for persons to feel secure in their retirement yeats and infusions of much-needed investment capital to assist in the economy as a whole.

We look forward to working with you and Congressman Moore in seeing that such a proposal is enacted, so that civil engineers in our organization (some 80,000 strong) can participate in the growth of our economy while assisting in building their own financial security.

Please do not hesitate to contact our Society if we can be of assistance, and we would most definitely offer our testimony, as appropriate, as the legislative process works its will.

Sincerely,

Walter E. Blessey

Walter E. Blessey

WEB/chl

CIVIL ENGINEERING: *A PEOPLE-SERVING PROFESSION*

TENNESSEE VALLEY AUTHORITY
RETIREMENT SYSTEM

410 MILLERS BUILDING
KNOXVILLE, TENNESSEE 37902
TELEPHONE 615-632-2904

MAR 9 1981

The Honorable John H. Chafee, Chairman
Subcommittee on Savings, Pensions,
and Investment Policy
Committee on Finance
The United States Senate
Washington, DC 20510

Dear Mr. Chairman:

I want to express the interest of the 29,000 members of the Tennessee Valley Authority Retirement System in S. 12 and S. 243, two bills pending before your Subcommittee that would allow Federal income tax deductions for certain contributions an individual employee makes to a pension plan. We understand a hearing was held last week on these bills and would appreciate the Subcommittee's consideration of these views and its making this letter a part of the hearing record.

The contrast between S. 12 and S. 243 clearly points out the issue that most concerns TVA Retirement System members. S. 12 would cover various kinds of tax-qualified pension plans, but then expressly excludes plans established by a Federal, State, or local government instrumentality. In contrast, S. 243, the bill you introduced, does not expressly exclude plans established by government instrumentalities so long as they are otherwise tax-qualified plans. The members of the TVA Retirement System, a tax-qualified plan, believe the outright exclusion of government plans is patently unfair and urge your Subcommittee to eliminate this provision from any legislation before it is reported.

TVA employs more than 51,000 employees who work on TVA projects and in offices located principally in the seven Tennessee Valley States. Most of these employees are represented by either the Tennessee Valley Trades and Labor Council (consisting of 15 national and international unions) or the Salary Policy Employee Panel (consisting of 5 labor organizations). TVA employees paid on an annual basis are members of the TVA Retirement System. The TVA Retirment System is not a "government" pension plan. In operation since 1939, it is a qualified employee pension plan under section 401(a) of the Internal Revenue Code. The general administration of the Retirement System is provided by its own Board of Directors composed of seven members. Three are elected from the membership of the System; three are appointed by TVA; and these six select the seventh member. We are gratified that in contrast to the vast unfunded liabilities of many government plans, which must look to future taxpayers to meet their obligations, the TVA System is fully funded and able to meet its members' entire vested benefits at any time.

The nature of TVA employment and the source of funds for the System are different from most, if not all, pension plans established by government instrumentalities. First, TVA employees and TVA itself are subject to

-2-

MAR 9 1981

The Honorable John H. Chafee

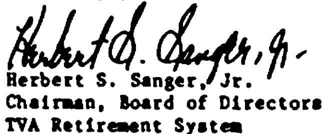
the same social security taxes that are applicable to private sector employment. Second, no tax funds are mixed with employee contributions to the System. The contributions of a TVA employee are used exclusively to fund an annuity at retirement. TVA's contributions are used to fund pensions for employees, a separate part of the total retirement package. Only about 6 percent of TVA's contribution consists of funds appropriated by Congress; the remainder is derived from the revenues of TVA's self-financing electric power system.

More than 22,000 TVA employees are hourly wage employees who are not members of the TVA Retirement System. As a result of a collective bargaining agreement negotiated with the Tennessee Valley Trades and Labor Council, TVA, like a private employer, contributes to 13 international associations' and unions' pension funds on behalf of these employees. Although these employees do not presently contribute to their pension funds through wage deductions, the benefits of the tax deduction would not extend to them under S. 12 if they began pension contributions by payroll deduction in the future. Although I cannot speak for these employees, I am bringing this matter to the attention of the Council.

The TVA Retirement System is not taking any position on the enactment of a tax deduction for pension plan contributions. We recognize that the Committee on Finance must take into account many factors before it adopts such legislation. We ask only for equal treatment if such legislation is adopted. The TVA Retirement System is just like a private, tax-qualified pension plan. Consequently, an express exclusion of government employees, such as provided for in S. 12, serves only to separate private plan members into the haves and the have-nots based on the status of their employer. The pension plan contribution deduction provision adopted last year by the Committee in H.R. 5829 expressly included all TVA employees. We urge the Committee to take similar action this year.

We appreciate the Subcommittee's consideration of our views. These views are being submitted solely on behalf of the TVA Retirement System and its members. They do not necessarily represent the views of TVA.

Sincerely yours,



Herbert S. Sanger, Jr.
Chairman, Board of Directors
TVA Retirement System

March 03, 1981

Mr. Robert E. Lighthizer
Chief Counsel
Committee on Finance
Room 2227
Dirksen Senate Office Building
Washington, D. C. 20510

Dear Mr. Lighthizer:

Concerning hearings on S. 12, S. 24, and S. 243, three bills concerning savings incentive tax relief measures, I am in favor of the three bills, but note the following comments:

- As concerns S. 12, it may be wise to tie the individual allowance into the annual present contributions made by an employer to the taxpayer's employer-sponsored retirement plan, in this way, granting the tax benefit primarily to those individuals whose employer's plans are minor or moderate in amount.
- As concerns S. 24, I feel this bill is a duplication (and complication) of S. 243 and its concepts of tax relief for initial home ownership and higher education.
- As concerns S. 243, I support the increased contribution to $2,000. As well, I greatly support the concept of withdrawals for home purchase and higher education. Such a plan would free considerable assets already in existing IRA's into the housing industry, allowing people a practical savings method for a home. Additionally, while the withdrawal "mortgages" one's future to some extent, it does not really do so, as the home is usually 100% owned at the time of retirement. The concept of these two withdrawals for home and education makes good sense combined into the IRA concept, as opposed to additional special interest accounts, such as proposed by S. 24.
- As concerns the making permanent the interest and dividend exclusion, I am opposed, because I feel you are not providing the maximum available incentive for the amount of tax dollars the plan will cost the Treasury.

- continued, to page 2 -

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To continue my thought, it occurs to me that almost all individuals (or a large percentage) in our society have some level of savings. The Treasury is negating the tax benefit/society benefit by merely increasing the exclusion. Rather they should exclude/skip/exclude to bring more money into capital investment in this country.

To explain, assume that the exclusion were written as follows:

- $100 ($200 on a joint return) for the first $100 (or $200 on a joint return of interest/dividends earned.
- no exclusion for the next $400 ($800 on a joint return) of interest/dividends earned.
- $500 ($1,000 on a joint return) for the next $500 ($1,000 on a joint return) of interest/dividends earned.

While the numbers themselves can be changed, or percentage brackets or amounts added, the concept is the important thing here. It is the concept of not just returning a tax benefit for something society already has, i.e., a level of savings on an average that brings about $200 per individual. Instead the concept is to tie the tax benefit into a system that brings society what it most needs, i.e., savings and investment encouraged by tax reform that exceeds the current average levels of savings and investment.

I will be happy to comment further. If you have any questions or comments, please feel free to call upon me personally at my office. In Washington, you may reach me at (202) 842-2346.

Thank you.

Very truly yours,

William A. Hohns
Treasurer

WAH/bh
cc: Senator John Heinz
Representative Jack Kemp

TESTIMONY OF DONALD H. SEIFMAN
BEFORE THE SENATE FINANCE, SAVINGS, PENSIONS,
AND INVESTMENT POLICY SUBCOMMITTEE

Members of the Subcommittee, my name is Donald H. Seifman and I represent the National Association of Police Organizations, better known as NAPO. NAPO was incorporated on June 15, 1979 to unite all law enforcement organizations within the United States to effect legislative change for the benefit of its members. When NAPO began in 1979, it met in Washington, D.C. with 38 individuals representing 22 police associations from six states. In May of 1979 the Steering Committee of NAPO held a three-day meeting in Kansas City, Missouri that attracted 27 police associations representing more than 100,000 officers.

One of the major goals of NAPO is to provide adequate retirement benefits for its members. Accordingly, I have come before you today to testify in favor of S. 12 and S. 243 and to suggest several amendments to enable police officers across this nation to adequately provide for their retirement.

Currently, police officers are generally covered by government pension plans which make them ineligible to contribute to an Individual Retirement Account (hereinafter referred to as an IRA). In addition, upon retirement police officers usually receive a lump sum retirement benefit including but not limited to the following:

(1) terminated leave payments;

(2) accumulated sick leave payments;

(3) payments in respect of unused vacation days;

(4) deferred salary payments; and

(5) accumulated compensation days (unused days off).

In the year of retirement, the police officers must then pay income taxes on the lump sum distribution. Often, the cumulation of these amounts in a single payment produces an undesired "notching" effect, forcing retirees into progressively higher tax brackets in their retirement year.

I submit to you that the police officers of this country should not be discriminated against and should be allowed to participate in IRA's, and in addition, be allowed to roll over their lump sum payments that they receive upon retirement into IRA's, so that they need not recognize the income in the year of retirement and be forced to pay taxes on that "retirement benefit."

Police officers, like other United States citizens, save considerably less than citizens in other Western industrialized nations. It is currently believed that this lack of saving has led to a productivity problem and to inflation in the United States today. Accordingly, it is my belief that police officers of this nation should be allowed to participate in IRA's and to roll over the entire lump sum benefit, including retirement benefits, to IRA's to increase savings in an attempt to decrease inflation and increase productivity.

Since 1973, the United States saving rate has been in a state of decline and has dropped substantially to a 4.5 percent rate in 1979. This included a 3.5 percent rate in the fourth quarter of the year, the lowest recorded quarterly level ever. (These figures were quoted by Senator Durenberger in speaking of S. 330, the "Investment Income Incentive Act of 1981").

As previously stated, annual savings rate during the past decade ranks lowest among the Western industrialized nations. During the 1970's the United States managed a 6.6 percent annual savings rate as compared with:

(1) 19.6% in Japan;

(2) 15.4% in West Germany;

(3) 12.4% in the United Kingdom; and

(4) 9.2% in Canada.

This drop in the United States savings rate was reflected in a significant drop in our productivity growth rate, which tapered to a near standstill in the late 1970's.

LABOR PRODUCTIVITY GROWTH RATES IN THE UNITED STATES, BY SECTOR, SELECTED PERIODS, 1947-1979 (Percent changes at annual rates)

Periods	Total Private Business	Farm	Total Nonfarm Business	Manufacturing	Nonfarm Nonmanufacturing
1947-1955	3.5	6.4	2.7	3.6	2.2
1955-1965	3.0	5.1	2.6	2.8	2.4
1965-1973	2.2	5.2	1.9	2.4	1.7
1973-1978	1.0	2.8	0.9	1.5	0.6
1978-1979	-0.8	4.7	-1.0	0.8	-2.0

SOURCE: U.S. Department of labor, Bureau of Labor Statistics.

This slowdown has retarded improvement in living standards, increased costs of production, and diminished the long-term prospects of the United States economy.

In addition, the reduced productivity growth has also played a major role in driving up inflation. It is no coincidence that productivity growth has declined along with the savings and investment rate while inflation has risen inversely.

In a report published by the Congressional Budget Office this past January, the question was raised as to what government policies might induce households to increase their share of savings.

One suggestion made by the Congressional Budget Office was a savings exclusion. This approach would permit additions to savings held in financial assets to be excluded from taxable income until retirement, at which time the taxpayer could be expected to be in a much lower tax bracket. One method of implementing such a plan would be to give every taxpayer the right to establish an IRA whether or not he is an active participant in a qualified or government retirement plan. Currently, IRA's are available to persons not otherwise participating in a pension plan. Under current law, non-working spouses have no opportunity for IRA participation unless the working spouse is eligible. Those authorized to establish an IRA can exclude the maximum of $1,500 per year per working person, or $1,750 per year in the case of a joint return and a joint IRA if only one spouse is employed.

The likely effects of tax incentives that succeed in increasing savings or in changing its composition may be summarized as follows: 1/

(1) Measures raising the overall saving rate would not have a large effect on the capital stock or on productivity for a number of years;

(2) Measures changing the composition of savings would have a quicker effect on capital and productivity, although the early-year effects would still be quite modest; and

(3) Over ten years or more, however, tax policies raising the saving rate and/or directing a larger portion of investment in the productive capital stock would have a substantial effect on productivity and real per capita income.

These conclusions can be established considering the arithmetic of saving, investment, and capital accumulation.

Even if it were assumed that very large tax incentives would be provided for saving and the responsiveness of saving to changes in real after-tax rates of return would be relatively high, induced annual increases in saving would be small relative to the existing stock. It is believed, under assumptions favorable to the discovery of a big impact on capital, the first year induced increase in capital stock would be less than 1.5%.

While it is important not to overestimate the short-run effects of increased saving on productivity, it is essential to recognize that the longer-term effects of a small increase in the saving rate could be quite large. If, for example, the rate of business fixed

1/ The type of tax incentives that are discussed in the January 1981 report of the Congressional Budget Office are the following:

(1) reducing the marginal tax rate on interest over dividend income;

(2) excluding net additions to savings held in financial assets from taxable income until the saver retires; and

(3) limiting the deductibility of interest payments by consumers and borrowers.

capital formation were to increase by one percentage point, say from 2.5% per year (the average for the 1970's) to 3.5%, the capital stock would be $700,000,000,000 larger by the year 2000 than with the slower growth path reflected in the 1970's. This amounts to approximately 1/3 of the current United States capital stock. That alone might be sufficient to increase labor productivity by five to ten percent in the year 2000.

Accordingly, in an attempt to increase saving and productivity in the United States, to decrease inflation and to allow the police officers of this nation to do their share without being unduly discriminated against, I support S. 12 and S. 243 in principle with the following suggested amendments:

1. Any bill that is passed by Congress should allow an active participant in either a private qualified plan or a government plan to establish an IRA without any distinction between the two; and

2. That a specific provision be included that would allow policemen, upon their retirement, to "roll over" their lump sum retirement payments into an IRA. These benefits eligible for roll over should include:

(1) terminated leave payments;

(2) accumulated sick pay payments;

(3) payments in respect of unused vacation days;

(4) deferred salary payments; and

(5) accumulated compensation days (unused days off).

14450 Jefferson Ave.
Orland Park, Ill. 60462

February 26, 1981.

Mr. Robert E. Lighthizer
Chief Counsel
Committee On Finance
Room 2227, Dirksen Senate Office Building
Washington D.C. 20510

Dear Mr. Lighthizer,

I am very much in support of the bill, "S.24", which would permit individuals to establish tax deductable savings account, for the purchase of a new home (up to $1,500)

Being married for only a few years, we are at the age of actively pursuing the purchase of a home. This bill, would definitely make the difference of being able to purchase a home within a two year period, or fight a losing battle of trying to save money without help, versus the "spiraling" costs of a home.

I feel this bill is very important to the future home buyers and the housing industry in general.

The passage of this bill, could make the difference of thousands, or even hundreds of thousands of homes being sold. If not passed, continue stagnation and possibly erosion of the housing industry. We, potential home buyers" are out here. All we are asking is for some assistance and you will see results.

I have shown this bill to many people in my area, which is a growth oriented suburb, south of Chicago, filled with young couples who feel the impact of interest rates and housing prices. And everyone is excited, with the potential of the

bill. Please hear us; it is often said that people are "apathetic" or a "silent majority", etc. Well I am not!

The rest is up to the committee. The passage of this bill could be great relief to the potential homebuyers. The failure of this bill, could mean the end of some very promising politic$al careers. Because I assure you, the people will be watching the results of this propesal very carefully.

I shall continue my campaign for the continue support of passage of this bill.

Sincerely,

James Sherriffs

THE NATIONAL ASSOCIATION OF PENSION CONSULTANTS AND ADMINISTRATORS, INC.

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February 25, 1981

Staff Director
Committee on Finance
United States Senate
Dirksen Senate Office Building
Washington, D.C. 20510

Re: February 24, 1981 Hearings on S.12 and S.243.

Dear Sir:

The purpose of this letter is simply to register the very strong support of the National Association of Pension Consultants and Administrators, Inc. (NAPCA) for the concept expressed in the two captioned bills.

NAPCA is an organization of consultants and administrators of employee benefit plans of all types. The clients of NAPCA's members are primarily small businesses which maintain small employee retirement and welfare benefit plans. The thrust of NAPCA's efforts, since its founding in 1974, has been to identify problems in the small employer plan area and to seek solutions either through the regulatory agencies or the Congress. To this end, NAPCA has devoted substantial effort towards the elimination of unnecessary paperwork and administrative burdens, and in support of tax incentives for the establishment, maintenance and improvement of plans. Representatives of NAPCA have testified before Senate Finance Subcommittees in the past in support of expanded individual retirement savings deductions, and that support is restated here in the strongest terms.

Our economy's existing bias against savings, and in favor of current consumption, must be corrected. Initiatives such as S.12 and S.243 will tend to correct the bias in a graduated and constructive fashion, and would be desirable if they accomplished nothing more. However, they would do far

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more. Specifically, they would encourage the private sector to provide for adequate retirement and would strengthen the partnership between employers and employees in accomplishing that objective.

Over the long term, NAPCA views initiatives such as S.12 and S.243 as essential to maintaining a strong and viable private pension system in the United States.

We would very much appreciate your incorporating this letter in the official record of the February 24 proceedings.

Thank you.

Very truly yours,

By:
Harry V. Lamon, Jr.
General Counsel

By:
Stanley H. Hackett
Associate General Counsel

1125 Fifteenth Street, N.W.
Washington, D.C. 20005

Mortgage Bankers Association of America

Thomas T. Sheehy
President
Mortgage Bankers
Association of America
202-861-6501

March 10, 1981

Honorable John H. Chafee
Chairman
Subcommittee on Savings, Pension
and Investment Policy
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

On behalf of the Mortgage Bankers Association of America (MBA), I should like to offer these comments for the hearing record on S 12, S 24, and S 243, legislation dealing with tax incentives for savings. MBA, the trade association of this Nation's mortgage lending industry, supports the concept of tax incentives for savings as a means of increasing the current unacceptably low saving rate in the United States, in order to provide affordable funds for mortgage finance to meet this country's housing needs in this decade.

The housing need during the 1980's is projected to be the greatest in U.S. history. Nearly 41 million persons will reach the prime home-buying age of 30 during the 1980's, 10 million more than reached that age during the 1970's. Many housing analysts feel that housing starts of 2 million annually may be needed to satisfy this demand. A shortage of affordable funds for mortgages kept starts at less than 1.3 million in 1980. Housing starts will probably be no higher than 1.5 million this year.

The key factor in meeting the projected housing need will be an adequate supply of affordable funds for home mortgages. In the past, the housing and mortgage finance industries have depended upon the personal savings of millions of Americans to supply the necessary funds for home mortgages. However, personal savings can no longer be counted upon as a dependable, stable source of funds for mortgage lending in part because the rate of personal savings is so low. For 1980 the rate was just above 5.5 percent, well below the 8.5 percent average experienced in the first half of the 1970's. Unless there is an increase in the rate of personal savings it will be extremely difficult to secure affordable mortgage financing to meet America's housing needs.

We believe that tax incentives for savings will not only cause a substantial increase in the personal saving rate, but are necessary for such an increase to occur. The structure of the current tax system discourages savings. Interest income from savings is added to a taxpayer's wage or salary income and is consequently taxed at the taxpayer's highest marginal tax rate. By imposing such a high, effective tax rate on income from savings, any natural propensity to save is discouraged. President Reagan's program for cutting

Honorable John H. Chafee
March 10, 1981
Page Two

personal income taxes, which MBA supports provided appropriate reductions are made in government spending, will not change this tax treatment of interest income. Marginal rates will be reduced but interest income from savings will still be added to a taxpayer's wage or salary income and taxed at the taxpayer's highest marginal tax rate.

In order to reverse this disincentive and increase personal savings to create an affordable source of funds for home mortgages, MBA supports:

- establishment of tax deductions for contributions made to Individual Retirement Accounts (IRAs) by participants in qualified pension plans in order to stimulate new and additional long-term savings that will be well suited for mortgage lending;
- an increase in the maximum tax deductible contribution to an IRA made by an employee who is not a participant in a qualified pension plan from $1,500/$1,750 to $2,000/$2,250; and
- an increase in the current $200/$400 interest dividend income exclusion to $1,000/$2,000, in order to stimulate additional savings by middle and upper middle income taxpayers who now have little incentive to save because interest income from savings is taxed at a taxpayer's highest marginal rate.

These concepts, or variations of them, are contained in S 12, S 24 and S 243. We strongly urge the Subcommittee to draft a single bill that encompasses all of them. Such a comprehensive bill could be a primary means of reversing the trend of a steadily declining saving rate by American families.

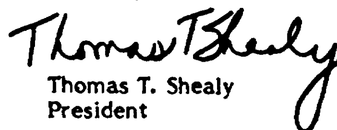
Specifically, MBA supports enactment of tax deductions for contributions to an IRA by persons already enrolled in a qualified pension plan, as provided for in S 12. MBA also supports the concept of Housing Savings and Education Savings Accounts contained in S 24. However, we urge that provisions in S 24 to create tax deductions for contributions to such accounts be enacted in addition to provisions in S 12 that would broaden the eligibility for IRAs and increase the available tax deduction for contributions to IRAs. MBA particularly endorses the concept of yearly indexing of the maximum deduction for contributions to housing and education accounts. We urge the Subcommittee to consider providing similar indexing for the maximum tax-deductible contributions to IRAs.

Additionally, MBA supports the provisions in S 243 that would make permanent the existing $200/$400 exclusion for interest income and would increase the maximum tax-deductible IRA contribution to $2,000 and eliminate the 15 percent of gross income limit. We strongly urge the Subcommittee to consider increasing the maximum exclusion to $1,000/$2,000. We endorse the provision to allow additional, non-deductible contributions to IRAs of $2,000 annually, together with a maximum life-time contribution of up to $8,000 over and above the $2,000 annual limit. The deferral of taxation on the income earned from these additional contributions represents a limited expansion of the $200/$400 exclusion and as such we support it. Finally, MBA could support the provisions in S243 to permit qualified withdrawals from IRAs for home purchases and education in lieu of permitting tax deductions for contributions to separate accounts set up for these purposes.

Honorable John H. Chafee
March 10, 1981
Page Three

Thank you very much for the opportunity to present our views on this subject.

Sincerely,



Thomas T. Shealy
President

TTS/pmb

TAXATION WITH REPRESENTATION FUND

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TESTIMONY OF THOMAS F. FIELD, EXECUTIVE DIRECTOR
TAXATION WITH REPRESENTATION FUND

regarding

THREE SAVINGS INCENTIVE TAX BILLS

(S. 12, S. 24, and S. 243)

Mr. Chairman and Members of the Subcommittee on Savings, Pensions, and Investment Policy:

Political Attractiveness versus Effective Policy

The political attractiveness of the proposals before you is clear. I am confident that the members of this Subcommittee frequently receive letters from their constituents that urge new tax incentives to spur savings. Similarly, I am confident that many members of my own organization find attractive the idea of providing a tax deduction for money set aside to provide retirement benefits, a college education, or a home.

Nevertheless, the proposals before you do not represent sound tax policy or sound budget policy, and they are not likely to be effective in achieving their goals. For that reason, just as I have an obligation to seek to point out these realities to my membership, so too this Subcommittee has an obligation to ponder whether the goals you seek are not better achieved by some other means.

Solving the Wrong Problems

The three bills before you exhibit an almost uncanny tendency to provide the wrong solutions to the serious problems relating to capital formation and retirement savings that currently face us as a nation.

Capital Formation. Contrary to what some would have us believe, Americans continue to be a frugal people, and our national savings rate compares favorably with most other industrialized countries, with the possible exception of Germany and Japan. In January 1981, for example, the Congressional Budget Office issued an excellent report entitled The Productivity Problem: Alternatives for Action. It states (p. 11) that "Americans save much more than is indicated" by the National Income Account measure of personal savings, while noting that savings rates "are still higher in some other industrialized countries, notably in Germany and Japan."

But this is not to say that we are not faced with serious problems connected with capital formation. As the Congressional Budget Office report goes on to indicate (id.):

> A more important question is how savings are used. Although Americans have exhibited a marked propensity to defer consumption, only a small share of this saving gets transformed into additional private, nonresidential investment in plant and equipment. * * * In fact, during the 1970's when individuals were increasing the proportion of saving devoted to housing and other durable goods, they reduced, in nominal dollar terms, their direct holdings of corporate equity shares.

Thus, overinvestment in housing and real estate is one of the principal causes of the "capital shortage" about which we hear so much. And, the tax system, in turn, is one of the principal means that we have used to divert capital from productive investment to housing. See, for example, "Capital Perversity," by Robert J. Samuelson, National Journal, October 25, 1980, p. 1805.

> Upper-middle-class taxpayers (the main beneficiaries of the deductions) simply buy larger homes. Meanwhile, they aren't investing in business, which helps explain why American industry has so much trouble raising funds.

If those who need help in buying homes were benefitting from homeowner tax deductions, the damage that those deductions do to American industry might possibly be excused. But, as a forthcoming Tax Notes article by Joan Williams makes clear:

> Whereas in the period from roughly World War II until 1965, homeowners' deductions offered a relatively shallow subsidy for a large proportion of the middle class, in the last decade they have come to offer a relatively deep subsidy for a comparatively small number of the well-to-do.

Against this background, proposals such as those contained in S. 24 and S. 243 to provide new tax subsidies for the purchase of a home seem perverse. We need to reduce rather than increase the tax incentives that we now provide for housing, so as to increase the relative attractiveness of investments in financial assets, such as stocks and bonds.

Retirement Savings. The central problem that we face as a nation in connection with retirement savings is the need to provide pension coverage for the poor and middle class. As the second interim report of the President's Commission on Pension Policy makes clear (pp. 16-20) less than half of all employees are covered by a private pension plan. Furthermore, of those who are covered by a pension plan, only 25 percent have vested rights to a pension. (See Report, p. 21.)

If increased tax incentives for contributions to individual retirement accounts (IRA's) were the answer to these problems, everyone would cheer. But in the whole list of tax incentives set forth in the Internal Revenue Code, there are few that are so clearly focused on the well-to-do as are individual retirement accounts.

For example, of the 20.7 million wage earners who took home less than $5,000 in 1977, less than two-tenths of one percent had established an IRA. Another 15 percent were covered by a public or private retirement plan. But almost 85 percent had no pension coverage at all. In contrast, of the 1.4 million wage earners earning over $50,000 in 1977, 15 percent had established IRAs, while another 71 percent were covered by public or private pension plans. Only 13.6 percent had no pension coverage. For further information on IRA coverage, see the Treasury's November 29, 1979 statistics appended to this testimony.

Clearly, therefore, the individual retirement account device is a means of ameliorating the least serious of the pension coverage problems that we face as a nation. If further government action in this area is warranted, as it may be, it should probably take the form of mandatory private pension coverage, so that the most disadvantaged workers can be assured of some modicum of

pension coverage. See, for example, "The Case for Mandatory Private Pension Coverage," by Gabriel Rudney, Tax Notes, June 9, 1980, pp. 843-849.

The plain fact of the matter is that the tax system is a highly ineffective way of promoting broader pension coverage. Those who most need coverage are least likely to be affected by a tax incentive, while those who are already best able to provide for retirement through personal savings get the biggest tax breaks.

Student Aid. Another facet of the bills before this Subcommittee is the provision of student aid in the form of a tax deduction for money set aside for higher education. Perhaps the best current commentary on this proposal is provided by President Reagan's February 18, 1981 "Program for Economic Recovery," which states (p. 2-3) that there is a need "to restore the focus" of the federal government's higher education programs "on the truly needy and to emphasize the traditional role of the family and the student in contributing to meeting the costs of higher education." Accordingly, the Reagan Administration proposes to cut direct spending for federal student loans and grants by $9.2 billion over the period 1981-1986. "Without these major reforms," the President warns, "the Guaranteed Student Loan program, in particular, could be recklessly expanded over the next few years."

In light of this move to cut direct spending on educational assistance, it is ironic that S. 24 and S. 243 should both seek to provide expanded tax aid for savings set aside for higher education. Due to the progressive nature of our tax system, the primary benefits of this aid will go overwhelmingly to the upper-middle and upper class -- the very groups whose student aid President Reagan seeks to curtail. And the cost of these enlarged tax subsidies for the parents of students could easily exceed the $9.2 billion that President Reagan seeks to save in the years 1981-1986 by curtailing direct student aid expenditures.

If it is right to curb direct federal expenditures for student aid, so as to focus these programs on the needy, then it is wrong to establish a program of backdoor spending through the tax system to benefit the same groups whose direct assistance is being curtailed. Direct aid is at least monitored by the Bureau of the Budget and the Congress to prevent reckless expansion, but tax subsidies are not.

What Should Be Done?

What, then, should be done about the question of capital formation, the decline in American productivity, and related issues? To the extent that inadequate savings contribute to these problems, there is one direct, sure road to an increase in the U.S. savings rate: run a government surplus, or at least reduce the size of the deficit. If the government returns funds to the market as it pays off debt (or at least reduces its borrowing demands) added funds will become available for private investment.

Note, however, that the proposed bills run directly contrary to this goal. Tax expenditures, such as those proposed by the bills before you, increase the budget deficit in precisely the same way as direct expenditures. Because enactment of these bills means bigger deficits, this legislation exacerbates the very problems it seeks to cure.

Another route to increased savings is a reduction in the corporate tax rate. While this is certainly not a politically popular proposal, it will be effective in providing funds for investment in plant, equipment, and other productive assets. It is certainly superior to the indirect, roundabout, savings incentives provided in the bills before this Subcommittee.

But when all is said and done, there is not much that can be done through use of tax incentives to increase the rate of savings. See, for example, the enclosed review by Michael J. McIntyre of Professor Richard M. Bird's Tax Incentives for Investment: The State of the Art. This review will appear in the March 9, 1981 edition of Tax Notes. As it makes clear, Bird has exhaustively reviewed the literature relating to tax incentives for investment; his overall conclusion is that tax incentives have not been successful in increasing investment levels.

The lesson of all this is that savings and investment are matters best left to the working of the market economy. If it is necessary for government to get involved, direct expenditures should be the preferred means of intervention, since they can be scrutinized and controlled - and curtailed when they have served their purpose.

Who Saves and Who Has?

One final observation is important: When considering the question of tax incentives for savings, it is very important to remember that saving is a luxury enjoyed principally by the rich. 1/ This fact makes it very difficult to provide

---

1/ The best available figures on this subject are set forth in Department of Labor Report 455-3, which is part of that Department's Consumer Expenditure Survey Series. See "Average Annual Expenditures for Commodity and Service Groups Classified by Nine Family Characteristics, 1972 and 1973."

tax incentives for savings without having the incentive turn into a program whose benefits go almost exclusively to the well-to-do. This is precisely what has been allowed to happen in the case of the individual retirement account plan. Trying to put caps on the tax benefits that can be claimed under various savings plans is one possible way to cope with these problems, but to the extent the cap is effective the savings incentive offered by the plan is less.

Another approach to this problem is to forget about the tendency of savings incentives to benefit the rich and to rely instead on the estate and gift tax as a means of backstopping the income tax and preventing the accumulation of wealth that tax incentives make possible. Unfortunately, our existing estate and gift taxes are not very revenue-productive, and the Chairman of the Senate Finance Subcommittee on Estate and Gift Taxation, Sen. Steven D. Symms, R-Idaho, has recently proposed outright repeal of estate and gift taxes. Accordingly, it seems unwise to rely on the estate and gift tax to prevent further growth in the already formidable concentration of wealth that characterizes our nation. 2/

At a time when direct expenditures -- which mainly benefit the poor -- are being cut in the name of fiscal austerity, it therefore seems that this committee should approach with great caution the development of new tax incentives that will confer most of their benefits on the well-to-do.

2/ The most recent available figures on wealth concentration appeared in Tax Notes magazine for April 26, 1976, at p. 20. Those figures, compiled by Professor James D. Smith, now of the University of Michigan, indicate that the richest one-half of one percent of the U.S. population owns 49.3 percent of the corporate stock, 52.2 percent of the bonds, and 80 percent of the trust assets in the U.S. Overall, that same one-half of one percent had a net worth amounting to 20 percent of the total for the entire United States.

TABLE VI

DISTRIBUTION OF PARTICIPANTS AND NON-PARTICIPANTS IN PUBLIC AND PRIVATE RETIREMENT SYSTEMS BY LEVEL OF INCOME 1977 (EXCLUDING SOCIAL SECURITY)

FAMILY ADJUSTED GROSS INCOME (IN DOLLARS)	NUMBER OF WAGE EARNERS (MILLIONS)	PERCENTAGE OF DISTRIBUTION OF WAGE EARNERS BY INCOME CLASS		
		COVERED BY PUBLIC OR PRIVATE PLAN	IRA	NON-PARTICIPANTS
0 - 5,000	20.7	15.0	.2	84.8
5,000 - 10,000	19.0	30.0	.9	69.1
10,000 - 15,000	17.5	40.0	2.0	58.0
15,000 - 20,000	16.3	54.6	2.5	42.9
20,000 - 50,000	24.9	75.1	5.4	19.5
OVER 50,000	1.4	71.4	15.0	13.6

Source: U.S. Department of Treasury, November 29, 1979.

PRESIDENT'S COMMISSION ON PENSION POLICY

76-188 O—81——82

TAX INCENTIVES FOR INVESTMENT: A REVIEW OF A STUDY OF THE STUDIES

by Michael J. McIntyre

Michael J. McIntyre is a professor of law at Wayne State University in Detroit, Michigan. He is the author of numerous articles on federal tax issues.

In this article, McIntyre reviews a recently published book by a noted development economist, Richard M. Bird, who is director of the Institute for Policy Analysis at the University of Toronto. Bird's book examines several dozen studies of tax incentives, which have been written in Canada, the United States, and elsewhere. As McIntyre outlines, Bird concludes that little is known about the actual effects of tax incentives, that available research techniques are not able to improve this situation very much, and that what evidence there is casts considerable doubt on the effectiveness of most tax incentives.

Listen with care
to this, now, and a god will arm your mind.
Square in your ship's path are Seirenes, crying
"Tax Incentives" to bewitch men coasting by;
woe to the innocent who hears that sound!
He will not see his lady nor his children
in joy, crowding about him, home from sea;
The Seirenes will sing his mind away
on their sweet meadow lolling. There are bones
of dead men rotting in a pile beside them
and flayed skins shrivel around the spot.
Steer wide;
Keep well to seaward; plug your oarsmen's ears
with beeswax kneaded soft; none of the rest
should hear that song.

Adapted from Kirke's warning to Odysseus in The Odyssey, translated by Robert Fitzgerald (or some other writer of the same name).

The siren song of tax incentives has bewitched the minds of politicians for decades. That song has particular allure for the new administration, which has come to power on a pledge both to revitalize the U.S. economy and to get the government off the back of the American business community. Policy makers in the new administration are inclined to believe that the federal government can effectively regulate the economy through the judicious use of bigger and better tax incentives. Before acting on that inclination, they should read a new book by Richard M. Bird entitled *Tax Incentives for Investment: The State of the Art.*[1] Unless they have already stopped their ears with wax, they will hear proof that tax incentives are an unreliable, perhaps ineffective mechanism for guiding private economic choices.

Mr. Bird undertakes in his book to examine critically the several dozen studies of tax incentives carried out in Canada, in the United States, and elsewhere. Though Bird's focus is on Canada, his "three rather disconcerting conclusions" are equally applicable to the United States. First, Bird reports that economists and other researchers know amazingly little about the efficiency and effectiveness of the investment incentives used so profligately by many national governments. Second, he reluctantly concludes that "the available research techniques are incapable of improving this sad state of affairs very much." Third, Bird finds that the available evidence suggests that tax incentives "are neither efficient nor effective in achieving most of the objectives for which they were supposedly introduced." (p. 2.)

Why We Know So Little

Our general ignorance of the overall impact of tax incentives is due to the complexity of the measurement problem, not to a lack of research. Indeed, Bird thinks that "further research along traditional lines seems unlikely to prove profitable." (p. ix.) Measurement is difficult for at least three reasons. First, economists have not developed a "generally accepted or acceptable theory of investment behavior." (p. 56.) Economists feel forced to pretend that business executives make investment decisions according to the so-called neoclassical model—which assumes a fully competitive market, a profit-maximizing motive, and full knowledge of the likely yields from alternative investment strategies. In fact, of course, market forces do not

[1] Published by Canadian Tax Foundation, Toronto, Canada. 68 pp., $4.50. Professor Bird is Director of the Institute for Policy Analysis at the University of Toronto and has written extensively in the field of public finance.

Our general ignorance of the overall impact of tax incentives is due to the complexity of the measurement problem, not to a lack of research.

operate freely in parts of the economy, and some evidence suggests that investors make their decisions more as a reaction to the expected level of future sales than to carefully calculated expected profit from those sales. (p. 36.) Small businesses, moreover, generally "do not really do the explicit investment profitability calculations needed to make full use of the incentives." (p. 52.)

A second measurement problem arises because of the possible effects of an incentive on reducing investment in the disfavored portions of the economy. Bird notes that several studies show that investment incentives "affect not the level but the composition of investment." (p. 47.) This impact might be desirable under certain circumstances, but in other situations the change in composition of investment may reduce overall productivity or defeat whatever other goal the incentive may be pursuing. Studies based on interviews with business executives can tell nothing about the secondary impact of incentives; an executive in the favored manufacturing sector, for example, will have no reliable information about the possible negative impact of a manufacturing tax subsidy on the real estate sector. Econometric studies are better suited to taking those secondary effects into account, but Bird nevertheless concludes that the present state of the econometric art is not up to that task. (p. 48.)

Several studies show that investment incentives affect not the level but the composition of investment.

Finally, the impact of an investment incentive depends upon the economic environment in which it is offered. All tax incentives reduce government revenues otherwise available. That revenue loss can be financed through higher taxes, through deficit spending, or through spending cuts. All of these alternatives have difficult to determine but potentially dramatic effects on investment behavior. Yet studies of tax incentives have great difficulty taking these environmental factors into account.

Incentives Are Probably Ineffective

Because of the formidable measurement problems, Bird is agnostic about the effectiveness of tax incentives. He allows that some may be useful and some may produce unmitigated disasters though the "whens" and the "whys" are unclear. He does stress that there is absolutely no empirical or theoretical evidence to support the grand claims for tax incentives often made by their political advocates. On the contrary, almost all of the econometric studies he reviews conclude that tax incentives have not been successful in increasing investment levels—the claim most often made for them in the United States. Indeed some studies indicate that the typical investment incentive either destroys jobs or, at best, creates a few jobs at enormous cost, though job creation is another of the commonly stated objectives of investment incentives.

Even survey studies based on interviews with business executives often report a disappointing impact of incentives on the investment decision—generally showing a minor change in the timing of investment but none in the overall level of investment. One Canadian survey study showed a dramatic impact of incentives on the level of investment, but Bird seriously undermines the credibility of that study. For the reasons discussed above, the studies are not conclusive of the impact of incentives, but they certainly raise some strong negative presumptions.

What Use Are Studies?

Despite the inadequacies of the incentive studies reported by Bird, most of the studies are not a waste of time or money. Though they are tricky to interpret and do not give refined answers to important questions about the overall impact of tax incentives on the national economy, many at least reduce the area of uncertainty.

There is absolutely no empirical or theoretical evidence to support the grand claims for tax incentives often made by their political advocates.

For example, studies can measure, albeit crudely, the relative effectiveness of different types of incentives in achieving specified goals. Similarly, they sometimes can determine an upper bound on the possible impact of incentives and can specify the conditions required for tax incentives to have any reasonable chance of achieving their objectives. Thus the studies provide some constraint on the idle boasts of those who seek to feed at the public trough.

Conclusion

Bird concludes that tax incentives may be good in some ways, or for some people, and bad in other ways or for other people. More importantly, he demonstrates that the theoretical and empirical foundation for tax incentive policies is extremely weak. This state of affairs is all too common in other areas of public policy—no one seriously believed, for example, that the Tellico Dam project could be justified on cost/benefit grounds. But Congress and the interested public at least are aware of the rules of the game when wasteful direct expenditures are enacted.

Tax incentives, in contrast, get support not only from the special interests and the back scratchers of Congress but from genuine, though misinformed patriots of all political stripes. Bird is resigned to the fact that "yet another report concluding that most investment incentives have been tried and found wanting" will have little success in "dampening the enthusiasm of the advocates of such devices." (p. 2.) He has nevertheless made accessible to policy makers an analytical summary of the scholarly literature on tax incentives. The book is remarkably free of ideological bias and economic jargon. It deserves to be read by anyone who is tempted to ignore Kirke's timeless warning to Odysseus.

Almost all of the econometric studies . . . conclude that tax incentives have not been successful in increasing investment levels—the claim most often made for them in the United States.

Testimony of Thomas McDermott and James Bugden, Co-Chairmen of the Government Affairs Committee, in support of tax incentive legislation for savings and construction. Prepared for the Senate Finance Committee, February 24, 1981.

Mr. Chairman. The American Supply Association is pleased to have the opportunity to testify on S. 24 and S. 243.

Our Association has appeared before this Committee before and is, as you know, the single national organization of plumbing-heating-cooling-piping wholesalers. We are basically small businesses whose primary function is wholesale distribution, but whose fate is closely tied to the construction industry in this country.

We are presently engaged in the introduction of our own bill in the House of Representatives; however, it is very similar to the bills now before this committee. Like you, we are particularly concerned about the availability and cost of money. Like you, we feel compelled to call for immediate action at the heels of the second worst year for housing construction since World War II. And, like you, we clearly see the relationship between these two concerns. The Congress must enact -- as a part of its first order of business -- significant incentives for savings and construction. ASA believes that such a measure cannot wait for a second round of tax legislation. The construction industry cannot wait, nor can the 1200 ASA wholesale firms. Measures such as ours and yours must proceed immediately.

The American Supply Association supports the following concepts:

1) An increase in the incentives to individual taxpayers through passage of a permanent tax credit for savings;

2) An expansion of IRA's to permit greater tax deductible contributions;

3) Utilization of up to $10,000 in an IRA account for the purchase of a new principle residence, with the tax consequence deferred until the taxpayer's principle residence is sold and not rolled over.

We urge you consideration of these policy positions as the Committee modifies S. 243 and S. 24. ASA believes that incentives to savings must be substantial -- that is why we propose a tax credit, amounting to a greater savings than under the existing plan. ASA is also convinced that assistance and incentives to first-home purchases is important -- but that it does not go far enough. An incentive to purchase a new principle residence operates as an immediate stimulus to the housing industry and to savings: present IRA participants may use existing funds for purchase of a residence, such as retirement housing, while others will be encouraged to begin IRA's for more reasons than simply as a retirement nestegg. As its appeal is broadened, it will thereby also broaden the age and income characteristics of present IRA participants.

ASA looks forward to working with the Committee as it proceeds with this tax legislation. We are grateful for this opportunity to be heard.

ROBERT F. GRAY

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March 2, 1981

Mr. Robert E. Lighthizer
Chief Counsel
Committee on Finance
Room 2227
Dirksen Senate Office Building
Washington, D. C. 20510

Re: Savings Incentive Legislation

Dear Mr. Lighthizer:

I believe tax saving incentives such as IRA should be extended on an equal basis to all citizens regardless of whether they are participants in a qualified pension plan or not.

My reasons for this opinion are outlined below:

1. Company pensions are elusive targets.

   55% of the people 40 years or older in this division are not vested in our plan or any other plan. These people have worked for twenty or more years and still do not have any pension protection. They may in the future but do not have pension protection at this time.

2. All pension plans are not created equal.

   The vesting periods vary and the benefit levels vary. The ability of companies to provide pension benefits vary greatly from company to company and industry to industry. Pensions are funded from profits and profitability cannot be legislated.

3. The present IRA law is discriminatory.

   The tax deferred savings of an IRA participant can greatly exceed the benefits of a pension program plus taxed savings.

   For example. An IRA participant making $24,600 to $29,900 does not pay the 32% tax on his $1500 savings per year. At the end of 35 years, his savings, compounded at 10%, would amount to $406,537. A participant in a qualified pension plan who dedicated the same $1500 of pretax income would be saving only $1020 per year ($1500 less taxes) and his money would compound at 6.8% per year instead of 10% because of taxes. At the end of 35 years, he would have savings of $134,998, a difference of $271,539. (This calculation ignores the tax creep caused by the interest income.)

Mr. Robert E. Lighthizer

Page 2 March 2, 1981

Nor does the inequity stop at retirement. The IRA participant still pays no taxes on his interest income and the pension plan participant still pays taxes on his interest income. The $406,537 as a 20-year annuity earning 10% would yield $47,752 per year. The $134,978 as a 20-year annuity earning 7.6% (10% less 24% tax) would yield only $13,343 per year. No pension plan for a man making $24,600 to $29,900 per year would ever give that person a $34,409 pension (the difference between the two) regardless of how long he worked. If the pensioner had worked for two or more companies during his working career, his problem would be even greater.

4. Savings incentives stimulate capital formation and dampen inflation.

   The United States desperately needs to generate capital for investment in new plants and equipment. A straight tax cut would not necessarily stimulate capital formation; the dollars could very well go to current consumption instead of savings. Savings incentives, on the other hand, will generate the needed capital.

5. Savings incentives return the control of wealth to the individual – middle-class as well as the rich.

   This is a very worthwhile national goal. The combined investment decisions of millions of individuals will certainly be better than the decisions made by an entrenched bureaucracy. These types of decisions built this country and, given the opportunity, they can rebuild it.

I hope that you will take these thoughts into consideration as you prepare your recommendations for saving incentive legislation.

Thank you.

Sincerely,

Robert F. Gray

RFG:st

PROFIT Sharing Council Of America
SUITE 722 20 NORTH WACKER DRIVE
CHICAGO, ILLINOIS 60606 (312) 372-3411

March 2, 1981

The Honorable John H. Chafee
Chairman, Subcommittee on Savings,
Pensions & Investment Policy
Committee on Finance
United States Senate
2227 Dirksen Senate Office Bldg.
Washington DC 20510

Dear Senator Chafee:

Re: Subcommittee Hearings on S.12, S.24 and S.243
February 24, 1981

The Profit Sharing Council of America, a non-profit association of approximately 1400 employers who have profit sharing plans covering about 1,750,000 employees located throughout the United States and engaged in practically all areas of economic activity, wishes to offer the following statement for inclusion in the printed record on the above hearings.

The Profit Sharing Council urges the Subcommittee to approve legislation which will allow employee participants in tax qualified profit sharing plans a Federal income tax deduction for their contributions to such plans. The tax deduction should be allowed for both mandatory and voluntary contributions.

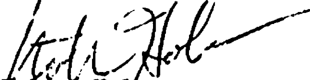
Enactment of legislation allowing tax deductions for employee contributions will encourage more employees to participate in profit sharing plans and to make additional contributions to such plans. These contributions will provide increased capital formation which is so desperately needed in our economy. Further, encouragement of this type of employee savings is anti-inflationary in that it pulls monies out of the spending stream and thereby reduces pressures on consumer prices.

Qualified profit sharing plans make a substantial contribution to meeting the retirement needs of the approximately 14 million participants in approximately 250,000 tax-qualified profit sharing plans. Accumulated employee savings in profit sharing plans will also act to ease the demands for increased benefits from Social Security when the employee retires.

The Honorable John H. Chafee
March 2, 1981
page two

The Council wishes to offer the Subcommittee any assistance it can with regard to this important provision and will offer any additional information the Subcommittee should request.

Respectfully submitted,



Walter Holan
President

mc/

Unionmutual

Portland, Maine 04122
(207) 780-2211

March 4, 1981

Robert E. Lighthizer, Chief Counsel
Committee on Finance
Room 227, Dirksen Senate Office Building
Washington, D. C. 20510

Dear Mr. Lighthizer:

I am writing to you in behalf of Union Mutual Life Insurance Company, Unionmutual Pension and Insurance Corporation, and Unionmutual Stock Life Insurance Company of America (collectively "Unionmutual.") Unionmutual is the tenth largest writer of insured pensions in the United States. We strongly support S.12, a bill to create Limited Employee Retirement Accounts, and urge the Committee's favorable action on this bill.

Enactment of a bill of this type will encourage employees to set aside their own monies for retirement. It has been clearly demonstrated that adequate retirement income depends on properly funded Social Security, employer-sponsored pension plans, and private savings. It is to the last of these that this bill is directed. It has long been seen that individuals have not had incentives or encouragement to meet their own needs for retirement because of the present tax laws. A tax deduction of at least a significant part of employee contributions to private pension plans will encourage this development and reduce reliance on such programs as Social Security, Supplemental Security Income and welfare.

This aim would be accomplished through a non-inflationary tax deferral, non-inflationary because the money would be immediately used for investment capital and could not be spent or withdrawn by the individual without

significant tax penalties.

Passage of the bill would produce a source of investment capital as pension plan assets are invested through various financial intermediaries. Retirement savings are an important source of long-term investments so essential for a growing and dynamic economy. Today, private pension assets total over $360 billion. Additional capital created by this bill is estimated to exceed $10 billion annually.

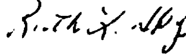
By encouraging employee contributions, moreover, employers who would not heretofore entertain the possibility of establishing a plan, would now find the idea a feasible one. This would be particularly true among small employers who find it difficult to form plans because of costs. While such plans may be small now, enhancements and benefit increases traditionally occur as the employer's economic position improves.

In addition to these advantages, S.12, by encouraging individuals to save more for their retirement, and employers to establish qualified plans, would alleviate escalating pressures on the Social Security system. These pressures would otherwise become overwhelming during the next few decades as fewer workers are required to fund benefits for a greater number of recipients.

We believe, however, that the deductible limit for employee contributions should be at least equal to the limit for Individual Retirement Annuities (presently $1500 or 15% of compensation, if less.) This would eliminate any potential confusion on the part of employees as to the maximum amount that could be contributed for retirement savings. It would also eliminate the present inequity between participants in a qualified plan and non-participants as to the available tax deductions.

In sum, S.12 is a good bill that encourages individual self-reliance, increases the creation of investment capital and stimulates the formation of new plans. For these reasons, therefore, we urge the Committee to seriously consider S.12 or any similar bill with a higher deductible limit.

Sincerely yours,



Ruth L. Sky
Governmental Affairs Associate

RLS:kah

UNION CARBIDE CORPORATION
270 PARK AVENUE
NEW YORK, N. Y. 10017

C. S. HOFFMAN
CORPORATE DIRECTOR - INDUSTRIAL RELATIONS

March 3, 1981

Robert E. Lighthizer, Esq.
Chief Counsel, Committee on Finance
Room 2227
Dirksen Senate Office Building
Washington, D. C. 20510

Dear Mr. Lighthizer:

My purpose in writing this letter directly to you in your capacity as the Chief Counsel of the Senate Committee on Finance is to voice my support and the support of Union Carbide Corporation for legislation concerning deductible retirement savings contributions to qualified retirement plans.

The specific legislation, the Employee Retirement Savings Contribution Act (similar to HR 8302 introduced by Congressman Pickle in 1980), has considerable support from a broad group of employees and employer groups, banks, insurance companies, manufacturers, and pension plan consultants. By providing current tax relief for employee contributions to qualified retirement plans, this legislation would both foster capital formation and enhance an employee's retirement security, dual objectives of considerable merit and interest to all of us.

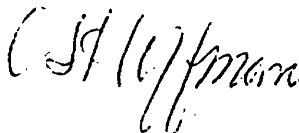
We strongly believe that such legislation would enable individual employees to secure an orderly personal savings program on a tax effective basis which can be effectively used to satisfy his own

R. E. Lighthizer, Esq. March 3, 1981

personal retirement aims. The legislation would also provide identical tax deductible treatment to retirement savings contributions from employees covered by qualified retirement plans as the treatment afforded those not covered but who contribute to an IRA, thus removing the present inequity in this regard.

This legislation has our strongest support.

Very truly yours,



CSH/mps

84-19 51st Avenue
Elmhurst, New York 11373
February 27, 1981

Mr. Robert E. Lighthizer
Chief Counsel
Committee on Finance
Room 2227
Dirksen Senate Office Building
Washington, D.C. 20510

S.12

Dear Sir:

Please accept this as a written statement as to my views on S.12.

The adoption of S.12 would contribute to greater equity in retirement planning for many individuals in the lower and middle income classes and promote capital development.

Currently, many individuals are "active participants" in profit sharing and pension plans that are carefully designed to include these individuals to meet the coverage requirements of Code Section 401 without actually providing more than a minimal amount of benefits to the individuals. These plans are carefully designed to ensure large benefits to the highly compensated while only superficially providing any benefits to the middle level and lower level corporate employees.

For example, I know of the following situations personally:

> A profit sharing plan, where an employee earning $10,000 per year, and terminating employment in 1980 after working 11 years, had the right to receive $1,500 in 1991.
>
> A pension plan, where an employee who worked 7 years and left employment in 1977, will receive $90 a month - after the year 2000.
>
> A pension plan, covering employees of a profession where most individuals who remain 10 years become partners, that has 10 year cliff vesting under a 1975 determination letter.

In each of these situations, and millions more throughout our country, employees are "active participants" in "qualified plans" which upon the employee's termination or retirement, will provide minimal benefits. Inflation further reduces the value of these benefits. Yet these

Mr. Robert E. Lighthizer
Chief Counsel

page two
February 27, 1981

employees cannot provide for their own retirement, because by being covered by a plan in which an employer may be contributing $100 per year or less on their behalf, or by a plan which will not provide them any benefits if they don't become a partner after 9 years, they are "active participants" in a qualfied plan.

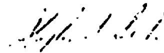
The enactment of ERISA was intended in part to expand pension coverage and, recognizing the increasing mobility of our nation's work force, to increase the portability of pension benefits.

Yet millions of hard working Americans - secretaries, clerks, technicians, accountants, nurses, attorneys - are covered by plans especially designed to benefit, in reality, only the highly compensated. At the same time many professionals incorporate their practices to obtain the full benefit of the ceiling limitation on contributions. Unfortunately, most employees cannot resort to this form of self help. They cannot even contribute to their own Individual Retirement Accounts because their employers have designed plans which mandate their technical inclusion without providing any real benefits.

S.12, if enacted, would provide an opportunity for many of these Americans to provide at least something for their own retirement, besides a $1,500 lump sum payment. If 10,000,000 individuals utilize its provision in 1981, $10 billion of additional funds will be provided for capital development this year alone.

I humbly request that this bill be seriously considered and enacted. The provision of real retirement income for the average non-unionized wage earner is long overdue.

Sincerely,



Stephen A. Sacks
Member: State Bar
of Georgia

national
employee
benefits
institute

NEBI

March 6, 1981

Robert E. Lighthizer,
Chief Counsel
Committee of Finance,
Room 2227
Dirksen Senate Office Building
Washington, DC 20510

Dear Mr. Lighthizer:

On behalf of the National Employee Benefits Institute, we submit the following comments on S. 12, S. 24, and S. 243, for consideration of the Subcommittee on Savings, Pensions and Investment Policy. This statement expresses our strong support of the concept common to S. 12 and S. 243, i.e., authorizing employees to make tax-deductible contributions to IRAs or qualified employer-sponsored plans regardless of whether an employee is an "active participant" in an employer-sponsored plan. This statement also expresses our views on matters over which the bills differ.

NEBI was established in December, 1977, to act as a national voice for employers affected by Federal and State employee benefits legislation and regulation. NEBI is an institute composed of major companies throughout the country which pay the bills for employee benefits. In order to maintain a solid community of interest, membership is restricted to those who do not provide employee benefit services or who do not stand to gain financially by federal regulations in this field. The Institute is dedicated to the overall goal of ensuring the enactment of sound, rational employee benefits policy.

515 National Press Building, Washington, DC 20045 202/638-1316

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Robert E. Lighthizer,
Chief Counsel
March 6, 1981
Page 2

I. THE IMPORTANCE OF PERMITTING DEDUCTIBLE EMPLOYEE CONTRIBUTIONS TO QUALIFIED PLANS OR IRAS.

The provision in S. 12 and S. 243 for deductible employee contributions to qualified employer plans or IRAs offers a significant improvement over current law governing tax treatment of retirement savings. It corrects serious deficiencies in current tax law which limit deductible IRA contributions to individuals who are not "active participants" in qualified plans. It also creates badly-needed additional incentives for individual retirement savings.

A. Unfair Results of Current IRA "Active Participant" Rules. The "active participant" rules of Internal Revenue Code section 219 and Treasury Regulation section 1.219-2 have been the subject of many lawsuits, revenue rulings and private letter rulings which illustrate the hardships and unfair results that frequently follow the application of the rules. Chief among the unfair results is the rule that an active participant need not have a vested right to a benefit from his employer's retirement plan. The Tax Court applied this rule in the case of Orzechowski, 69 T.C. No. 62 (1978). Thus, even if an individual never earns a vested retirement benefit under his employer's plan, participation in the employer's plan prevents deductible IRA contributions. Obviously, this rule presents serious problems for mobile employees who wish to save for retirement.

Another unfair result of the "active participant" rules is that an individual who qualifies as a participant under the eligibility rules of a defined benefit plan may not make a tax deductible IRA contribution even though the individual does not accrue any benefits under the plan. Treas. Reg. § 1.219-2(h). Again, this rule may prevent the individual from accumulating retirement income under either an employer-sponsored plan or an IRA.

In addition, the active participant rules commonly present difficulties for individuals who enter or leave their employer's plan during a tax year. Internal

Revenue Code section 219(b) does not permit an IRA deduction for a taxable year during "any part" of which the individual is an active participant in a qualified plan.

The careful attempt in the Code and Treasury Regulations to limit IRA deductions to individuals who clearly will never benefit from an employer-sponsored plan for the tax year involved has resulted in excessive exclusion of worthy candidates for IRA deductions. Even if one accepts the assumption that it is undesirable to permit an individual to enjoy a deductible IRA contribution and a deductible employer retirement contribution for a single tax year, the current law is unduly restrictive, because an individual may be excluded from both types of retirement savings.

B. The Need For Additional Incentives for Individual Retirement Savings. We do not accept the premise underlying current tax law governing employee deductions for retirement savings, which is that deductions should not be permitted on behalf of both employer and employee contributions for a single individual.[1] Additional tax incentives for retirement savings are vital to the future retirement income needs of the nation. The recent report of the President's Commission on Pension Policy reveals the gaps in present retirement plan coverage and the inadequacy of benefits for current retirees. As the Commission's Options Paper on Tax Policy dated January 21, 1981 notes, the "low rate of increase" in the proportion of the work force covered by private pension plans since 1960 "raises doubts about whether there will be substantial voluntary gains in the future without considerably more or different economic incentives or new retirement income policies." The Commission recommended a combined approach of new tax policies, permitting

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1 (One exception to this rule now in the Tax Code permits an employee to make up the difference between an employer contribution to an IRA and the maximum deductible employee contribution to the IRA for a tax year. Internal Revenue Code section 219(b)(7). We do not consider this a significant exception.)

deductible employee contributions somewhat similar to those described in S. 12 and S. 243, and a mandatory universal pension system.

We believe that the warnings of the President's Commission regarding inadequate retirement income savings must be addressed as soon as possible by changes in tax policy along the lines provided for in S. 12 and S. 243. It is important to act quickly on these tax incentives so that the effect of voluntary incentives on retirement savings can be determined before giving any further consideration to a mandatory approach to this problem.

In addition, we consider the need for additional incentives for retirement income savings particularly critical at this time because of the increasing financial problems facing Social Security, the effect of current inflation rates as a disincentive to save and the increasing unwillingness of employers to adopt defined benefit plans in light of potential PBGC liabilities and FASB reporting requirements.

C. Additional Benefits From the Proposed Legislation. The enactment of a deductible employee contribution provision similar to S. 12 or S. 243 deserves support not only for the direct result it would have in increasing individual savings for retirement, but also the "spillover" benefits it would provide to the retirement system as a whole and to the economy. Deductible retirement savings provide an entry point for attacking the vicious circle of inflation, which not only acts as a disincentive to save but also is fueled by a low savings rate. To the extent that tax policy may induce higher retirement savings rates, spending may be lowered and capital investment increased. The anti-inflationary effects of this tax policy may in turn create a more favorable climate for savings. In addition, tax deductible individual retirement savings offer a means to decrease reliance on Social Security as a source of retirement income. If, as some economists maintain, Social Security is a depressant on personal savings, this result could also have an accelerating effect, as declining reliance on Social Security increases reliance on personal savings.

II. SPECIFIC RECOMMENDATIONS.

With this general statement of support for deductible employee contributions to IRAs and retirement plans as a background, we wish to point out our preferences among the specific alternatives outlined in the bills.

A. Deduction For Mandatory Employee Contributions. S. 243 excludes mandatory employee contributions from deductible contributions.[2] We support the inclusion of mandatory contributions in the deductible amount for the following reasons:

1. Mandatory employee contributions are commonly used by small employers with newly adopted plans. The use of mandatory employee contributions is an important mechanism in promoting plan growth.

2. The IRS recently clarified in Rev. Rul. 80-307, I.R.B. 1980-46, 8, the stringent standards it will apply to determine whether mandatory employee contributions under a qualified plan result in discrimination. These nondiscrimination rules provide adequate safeguards against abuse of mandatory contributions in qualified plans. They also make the survival of mandatory contribution plans dependent on the ability of the plan to attract contributions from lower-paid employees. Making mandatory contributions deductible could strengthen these plans by encouraging lower-paid employees to make mandatory contributions.

3. Although we appreciate the attempt to distinguish voluntary from mandatory contributions on the

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2 According to T.I.R. No. 1403, September 17, 1975, Item D-29, "mandatory contributions are employee contributions which are required as a condition of employment, as a condition of participation in the plan, or as a condition of obtaining benefits under the plan attributable to employer contributions." We assume that this definition would apply to S. 243.

principle that tax incentives are intended to encourage only voluntary retirement savings, we note that the plan sponsor may easily reclassify a "mandatory" contribution as a "voluntary" contribution, simply by separating the cost of the employee-financed portion of the benefit from the employer-financed benefit and permitting employees to "voluntarily" finance that additional benefit through their own contributions.

In short, the additional retirement savings incentive which would be provided by including mandatory employee contributions in the class of deductible contributions is desirable.

B. Different Contribution Limits For Regular IRA Contributions and Deductible Contributions of Active Plan Participants. S. 12 limits the deduction for individuals who are active plan participants to the lesser of $1,000 or 15% of compensation, an amount smaller than the normal IRA limit for individuals who are not active plan participants. In comparison, S. 243 increases the normal IRA deduction to $2,000 per year and provides an equivalent deduction for contributions to a qualified plan or to an IRA by an individual who is an active plan participant. We support the approach of S. 243, which equalizes the deductible amount for both normal IRA contributions and plan or IRA contributions by active plan participants. The application of a different limit for these two situations would breed numerous complications in administering and communicating the new rules. It would also perpetuate inequitable treatment of individuals who do not qualify for regular IRA deductions because they are plan participants. It is not desirable to continue tax policies that encourage employers to abandon qualified plans in order to permit employees to take advantage of higher IRA contribution limits.

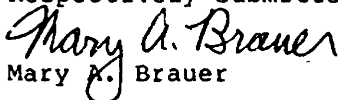
C. Use of IRAs For Non-Retirement Savings. S. 243 would permit withdrawals from an IRA for educational expenses or for purchase of a first dwelling of the taxpayer. S. 24 provides for a separate deduction for contributions to an education savings account or a housing savings account, which would be maintained separately from an IRA. We are concerned that the withdrawal provisions of S. 243 could have two adverse

results. First, the more liberal withdrawal rules for IRAs would encourage employees to make voluntary contributions to IRAs instead of their employer's qualified plan. Many qualified plans could not incorporate comparable withdrawal rules without causing constructive receipt of income by plan participants. Because qualified plans generally offer greater flexibility in investment alternatives and in the overall coordination of the employee's retirement income planning, we do not believe that this artificial incentive to contribute to IRAs rather than qualified plans is desirable. Second, use of IRAs for non-retirement savings jeopardizes the goal of encouraging individual savings for retirement, rather than for other purposes. Therefore, we prefer the use of separate accounts for non-retirement savings, as provided in S. 24.

D. Non-Deductible Contributions. S. 243 would permit non-deductible contributions to an IRA in excess of the deductible limits, subject to an $8,000 limit and a $2,000 annual limit. The earnings on these non-deductible contributions would remain tax-free. We support this provision, assuming that it would not adversely affect the continued availability of non-deductible contributions to qualified plans, which are now permitted in accordance with the limitations stated in Internal Revenue Code section 415 and Rev. Rul. 69-217.

We are pleased to have this opportunity to express our position on the significant policy issues raised by these tax bills.

Respectively submitted,



Mary A. Brauer

MAB:DK

GITLIN, CAMPISE & COMPANY
Certified Public Accountants

JOSEPH A. GITLIN, C.P.A.
JOSEPH A. CAMPISE, C.P.A.
MORTON I. BLUM, C.P.A.
JOHN A. KENNEDY, JR., C.P.A.

62 LASALLE ROAD
WEST HARTFORD, CONNECTICUT 06107
(203) 236-5833

March 2, 1981

Robert E. Lighthizer, Chief Counsel
Committee on Finance, Room 2227
Dirksen Senate Office Building
Washington, D.C. 20510

Re: Individual Retirement Account

Gentlemen:

It seems to me that individuals who want to provide for their own retirement have been treated very badly.

In 1975 a maximum of $75,000 was provided for pension plan participants and a maximum of $25,000 was provided for profit sharing plan participants. Every year these maximums have been increased: in 1976 to $80,475 and $26,825; in 1977 to $84,525 and $28,175; in 1978 to $90,150 and $30,050; and now in 1981 to $124,500 and $41,500.

During all of these years the maximum for Individual Retirement Accounts has stayed at $1,500.00 (with a modification for a spousal account of $1,750.00 maximum). Now isn't that a most inequitable situation! Especially when you consider all of the speeches being made that the individuals should provide for their own retirement.

I would suggest that the maximum for the Individual Retirement Account should be automatically increased each year. The same way that the maximums for Pension and Profit Sharing maximums have been increased. Why the discrimination? Also, I would suggest that the maximum for 1981 should be $2,500.00.

Very truly yours,

Joseph A. Gitlin
Certified Public Accountant

JAG:ove

VERNON PROFESSIONAL BUILDING • VERNON, CONNECTICUT 06066 • PHONE (203) 871-0883

March 5, 1981

Mr. Robert E. Lighthizer
Chief Counsel
Committee on Finance
Room 2227
Dirksen Senate Office Building
Washington, D. C. 20510

Dear Mr. Lighthizer:

I have just received a copy of a recent article from "The Research Institute of America, Inc." concerning pending hearings on several savings incentive tax bills. At the end of the article your address was listed for persons wishing to present their views on these very important issues. With inflation rising almost daily, everyone should be vitally concerned with providing themselves with an adequate income for their retirement years as well as with providing their children with funds for higher education.

Following are my views on each of these bills.

S.12 - Even though I am currently employed by a company which does provide an employer-sponsored retirement plan, I would also be interested in opening an individual retirement account with a tax-deductible contribution if I were allowed to do so. I feel that if I wish to contribute to an individual retirement account to protect my retirement years I should not be penalized because my employer provides me with retirement benefits and that I should be provided with the same tax benefits on this contribution as persons who are not covered by an employer-sponsored plan. There is also the possibility that you may not work for an employer who provides this benefit long enough to be qualified to actually receive any retirement funds while at the same time remaining ineligible for the individual retirement account tax deduction. In my opinion, this is discouraging people who are currently employed by a company which provides retirement benefits from making any other provisions for their retirement.

S.24 - With the current costs of purchasing a home and of higher education, this could be a "lifesaver" for many families. The tax deduction for this type savings account would be an incentive for many people who wish to save for these expenditures. Also, with the tax deduction some families might

continued -

Mr. Robert E. Lighthizer
Committee on Finance - 2 - March 5, 1981

be able to set aside a little more of their income than anticipated because of the tax deduction, in effect, returning a portion of that money to them.

S.243- I am also in favor of this bill. The more individuals are encouraged to set aside to provide for themselves, the less money our government will eventually have to pay to support them which will also eventually (or should I say hopefully) reduce the amount of taxes we pay to support the government. I also think withdrawals without penalty should be allowed for the purchase of a home or higher education since this is also a means of investing in your future.

I certainly appreciate the opportunity of presenting my views and hope you will take them into consideration.

Sincerely,

Thad H Lane