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EXECUTIVE SESSION

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WEDNESDAY, SEPTEMBER 20, 1978

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United States Senate,
Committee on Finance,
Washington, D.C.

The Committee met, pursuant to notice, at 10:25 a.m. in room 2221, Dirksen Senate Office Building, Hon. Russell B. Long (Chairman of the Committee) presiding.

Present: Senators Long, Talmadge, Byrd, Nelson, Gravel, Bentsen, Hathaway, Matsunaga, Moynihan, Curtis, Hansen, Dole, Packwood, and Danforth.

The Chairman. The Committee will come to order.

Senator Danforth. Mr. Chairman, is this an appropriate time to raise the question of corporate rate reductions?

The Chairman. Go ahead.

Senator Danforth. Mr. Chairman, I know that we have a problem with the Budget Committee on exactly how we view the out-year tax cuts. I think that we, at some time, will have to face the question, if indeed we agree to the concept about your tax cuts, whether we take on the Budget Committee directly or whether we finesse the question by adjusting the rates on a time table which gets around the whole Budget Act problem, which is possible to do.

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1 So what I would like to do at this point is to offer an
2 amendment to the bill which will present the concept that I want
3 to get to with a view to whatever is necessary with respect to
4 the Budget Acq can be worked out at some later point.

5 I would like to propose a phased reduction in the corporate
6 rates over a period of approximately three years to 42 percent
7 maximum corporate tax rate.

8 The reason that I am making this proposal is that I really
9 think that we have to think in terms of what a tax cut can do for
10 the health of the economy. We cannot just view this as a numbers
11 game or what table will appear to be attractive when it appears
12 in the newspaper, but what can we do by way of a tax reduction
13 which is a positive benefit to the very sluggish economy in this
14 country.

15 I just heard, as a matter of fact, on the radio this morn-
16 ing the fact that in the poll of business people right now there
17 is a very low level of confidence in the future of the economy in
18 general and in the future of their particular industries in par-
19 ticular. I think that is a very dangerous kind of a thing to
20 happen when we have this decline in confidence.

21 We heard from a number of witnesses who appeared before our
22 Committee and, one after another, talked about the problem of
23 capital formation and the problem of productivity, indicating that
24 this really is the problem with the economy and, if we can increase
25 capital formation and increase productivity, we can expand the

1 pie, so to speak. We can expand the real wealth of America and
2 increase the opportunities for people in the future.

3 So that it appears to me that we really have to look in
4 terms of future growth. We have to look in terms of future oppor-
5 tunity as we are developing a tax cut plan.

6 Several of us, about six months ago, proposed a package of
7 business tax cuts and I, at that time, really did not have any
8 particular feeling on how you would go about cutting business
9 taxes -- should you do it in the form of rate reduction, or should
10 you do it in the form of expanding the asset depreciation range,
11 or should you do it in the form of increasing the investment tax
12 credit.

13 But it appeared, from listening to the witnesses before this
14 Committee, that the great majority of them, economists and business
15 types who appeared before the Committee, preferred a corporate
16 rate reduction.

17 Furthermore, in other inquiries that I made, and meetings
18 that I attended with people who were knowledgeable in the area,
19 economists and businessmen both, it appeared to me that really a
20 very clear majority preferred a corporate rate reduction and,
21 from the standpoint of capital formation, their argument is that
22 business investments are made with a view towards the long-term
23 return on that investment, and the long-term return is the amount
24 that they will realize after payment of taxes. And therefore,
25 they would prefer a long-term business tax reduction, rate

1 reduction, as opposed to, say, accelerated depreciation, which
2 would tend to stack their tax benefit in the early years after
3 Congress has acted.

4 So that my view is, whatever we do in business taxes, we
5 should go farther than the House did in rate reductions.

6 The President, when he originally proposed a tax reduction
7 for business, he proposed a 45 percent corporate rate phased down
8 to a 44 percent corporate rate. The House bill had a 46 percent
9 corporate rate which did not go as far as the President's original
10 proposal.

11 The President had nothing in his proposal for ADR and he
12 maintained the investment credit at 10 percent with some modifica-
13 tions, as you know. But what I would like to do now is to propose
14 a phasing down of the corporate rate to 42 percent. It all does
15 not have to occur immediately. In fact, the testimony we had
16 was that the first year rate reduction really is not all that
17 important. What the business people are looking at is not the
18 first year corporate rates, but what the corporate rates will be
19 three, four, five years down the road.

20 So what I would like to do is see us now tell the business
21 community and tell the economy in general that by the year 1981
22 the corporate tax rate, maximum rate, will be 42 percent.

23 Senator Packwood. Mr. Chairman?

24 The Chairman. Yes, sir.

25 Senator Packwood. I would like to join with Jack. I recall,

1 ever since 1976 when we had the Tax Reform Bill, in talking with
2 business leaders, if they had their choice they would rather have
3 a corporate rate reduction than the maintenance of DISC, if they
4 had a choice. They do not want to lose DISC and get nothing in
5 exchange, but if they could have a choice between DISC and asset
6 depreciation or investment tax credit and a guaranteed corporate
7 rate reduction, they would choose the latter.

8 It gives them more mobility. They are not forced into some
9 narrow decisions where they can take advantage of specific tax
10 law to get a tax benefit, and Jack is right. They will be
11 perfectly happy if the corporate tax rate were 48, 48 and dropped
12 to 42 percent the third year, as long as they know that it is
13 coming, that in that year their profits will be taxed at 42
14 percent. They will plan accordingly to take the best advantage of
15 it. They are going to have to make expenditures now.

16 One economist suggested if you want to get the most for
17 your money, what you should do is keep the corporate tax rate
18 at 48 percent until the third year and, at the same time, indicate
19 that you are going to phase the investment tax credit out at the
20 third year. Then everyone would make as much investment as they
21 could now, taking advantage of the investment tax credit, looking
22 towards its elimination and looking towards the lower corporate
23 rate.

24 I think Jack's position is very sound.

25 Senator Gravel. I am lost. What is the phasedown? 46,

1 44 down to 42?

2 Senator Danforth. My proposal? Correct. 46 the first year
3 44 percent the second year, 42 percent the third year, with the
4 proviso that if adjustments have to be made, for example,
5 between the fiscal year and calendar year in order to satisfy the
6 Budget Act, that would be done.

7 The Chairman. Let me give the Treasury a chance to have a
8 say about this matter, and then I will call on Senator Moynihan
9 and then we will call on others.

10 It is my understanding when the Treasury first sent their
11 bill up, they were asking for a rate cut to 46 percent. Then,
12 in the following year, a rate cut to 44. So since they asked for
13 it, my thought was we ought to be able to vote for it. Why not?

14 Then the Secretary of Treasury came by and said no, we are
15 not asking for it. I said why not? I thought you were?

16 They said, as I understand it, he said, we thought we were
17 going to get \$9 billion worth of reform with the corporations
18 paying a great deal of it. That is gone, or most of it is gone.
19 Practically all of it gone.

20 That being the case, all we want now is just the 2 percent
21 that is in this bill.

22 Is that the Treasury position?

23 Mr. Lubick. That is correct, Mr. Chairman. With revenue
24 recouping reforms, we would certainly be very pleased to support
25 additional corporate rate cuts. As Senator Packwood suggested --

1 DISC, for example. That was the equivalent of a point in the
2 corporate rate, in terms of revenue.

3 The President's proposals for rate reductions were inte-
4 grally tied into a recoupment of the revenue from a portion of
5 them by the reforms, and we would regard the 46 percent as
6 presently in the House bill as the limit to which one can go
7 within the budget constraints that the Administration faces both
8 for current year and for the next three or four years unless
9 other sources of revenue are found.

10 The Chairman. Do you care to say anything more about it?

11 Mr. Lubick. I think you have stated the Secretary's
12 position.

13 Senator Curtis. Do you support the House action on the
14 corporate rate reduction, the brackets and over \$100,000 going
15 to 46?

16 Mr. Lubick. Senator Curtis, we were opposed to that in the
17 House. I think the Secretary suggested that, in his testimony
18 before you, The question of corporate graduation does present
19 some problems for us in terms of the fact that the reductions to
20 lower corporate rates in the lower brackets do not take into
21 account the actual tax burden on the owners of capital.

22 In effect, reductions are being given in those lower brackets
23 without regard to the income of the underlying owners of the
24 shares and, in very many cases, the owners of those shares of
25 corporations that pay regular tax, as opposed to avoiding it

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1 altogether through Subchapter S or conducting their business
2 through a proprietorship or a partnership to a very great extent
3 those owners are persons in high brackets.

4 So that, when you take into account the actual underlying
5 ownership and the income of the persons owning those shares,
6 these additional rate reductions between \$50,000 and \$100,000
7 in corporate income would seem to give reductions to persons who
8 have very high income.

9 We are concerned about the availability of the corporation
10 as a tax shelter. On the other hand, we do recognize that there
11 is some great importance of this type of program for small
12 business to enable it to accumulate additional funds to compete,
13 and to remain independent and viable.

14 It is a question of balancing those constraints. I think
15 that we would prefer to help small business in other ways, but
16 if there is going to be a rise in the exemption level, I think
17 the way the House had done it is probably the more satisfactory
18 way.

19 The Chairman. Senator Moynihan?

20 Senator Moynihan. Mr. Chairman, I would like to first
21 state my general agreement with Senator Danforth about the
22 importance of getting the corporate tax rate reduction. We have
23 heard some very impressive testimony on this. It has been my
24 purpose to propose that we set, as an effort to set the business
25 climate for 1980, that we undertake in this tax bill to bring

1 the corporate rate down 40 percent at a one point a year, beginning
2 in fiscal '81. That one point is about \$2 billion.

3 I would like either to offer that as a substitute for
4 Senator Danforth, following Senator Danforth.

5 Senator Hansen. If the Senator would yield, where do you
6 propose to start? In what year?

7 Senator Moynihan. I think we should take the idea that
8 we are going to 46 percent as the House bill proposes and keep
9 it there until 1980 and in 1981, go to 45, 44, 43.

10 Senator Hansen. Going down to 40 percent?

11 Senator Moynihan. Going down to 40 percent.

12 Martin Feldstein, who testified very persuasively -- I do
13 not know that there is anything doctrinal about why 40 percent
14 is right, 39 percent is wrong. The idea is bringing the general
15 rate down and having it as a knowable event coming along in the
16 corporation experience.

17 I would like to ask Senator Danforth how he would do that

18 Senator Packwood. I would like to make a suggestion, ask
19 I am convinced of what the business leaders said, that they do not
20 within reason, care what the corporate rate is right now as long
21 as they know where it is in 1981. Why not leave it at 48 percent
22 now through '79 and '80 and change it to 44 percent, or 42,
23 wherever you want to start your 1 percent progression in 1981?

24 That will alleviate some of the objections to revenue loss
25 next fiscal year. And frankly, business cannot plan to spend and

1 invest quickly enough to take advantage of a corporate rate
2 reduction next year anyway.

3 Senator Moynihan. Maybe we could agree on something like
4 that. We probably have a lot of agreement about this, the
5 general proposition.

6 Senator Danforth. I agree with the general proposition. I
7 do not have a clear view of how fast it should go or what steps.
8 I think that we are certainly talking about the same thing.

9 Senator Moynihan. Why do we not offer something jointly?

10 Senator Danforth. Good.

11 Senator Nelson. Mr. Chairman, we all want to take a look
12 at the final proposals to be included in the package. I listened
13 to the testimony on this issue, as with everyone else. It does
14 seem to me that if that is the direction that it is better to go.
15 I think that we have to take a look at Senator Bentsen's ADR to
16 see if you want to include that.

17 Secondly, it seems to me that it would be helpful in the
18 package if we picked up the few of those loophole eliminators
19 that the President put in there -- the yachts and the club dues
20 and the lunches and a few other items like that and incorporate
21 it all in one package. It might be more palatable and more
22 equitable.

23 Senator Gravel. Mr. Chairman, I will be offering club dues
24 and yachts.

25 Senator Nelson. It would be nice to put it in a very

1 attractive package.

2 The Chairman. Any further discussion? Let's vote on this

3 one.

4 Senator Byrd. Would someone state the exact proposal that

5 we are preparing to vote on?

6 The Chairman. Here is the way I propose to do business

7 around here, gentlemen. Here is how I suggest we do business.

8 When somebody has a proposition to offer, I think we would

9 make greater headway to go ahead and vote on the proposition.

10 If somebody wants to amend it or change it, and he is willing to

11 have the change, to have it changed, then I would suggest -- sure,

12 he can modify it. We will vote on it on how he wants to modify

13 it.

14 We would be better off, when someone comes in with a

15 proposition, let him have a vote on his proposition, and if you

16 have something you think is better, say I move to substitute

17 after it has been agreed to. Substitute after it is voted down.

18 I think I have a better substitution, let's try this -- then we

19 can vote on this thing.

20 Otherwise we get in this kind of thing of first degree,

21 second degree and all the rest of it, an amendment in the nature

22 of a substitute. As long as we are voting, making decisions on,

23 in fact, where we stand, I think that we are making progress.

24 Senator Byrd. One comment to that, Mr. Chairman. I think

25 you are 100 percent right, but I think it would be a good idea

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1 if, before the vote is taken, someone would state the precise
2 issue.

3 The Chairman. By all means. I guarantee you that that
4 will happen.

5 Senator Curtis. I would modify that, to state the proposi-
6 tion, if he knows.

7 Senator Nelson. Let me say, Mr. Chairman, in the first place
8 on what Senator Byrd said about the Chairman being 100 percent
9 right -- nobody is 100 percent right, now even the Chairman.
10 It does seem to me that it is a perfectly logical approach, to
11 take the package including the tax reductions on dues and a number
12 of other things that the President proposed and included.

13 That way you may have more votes than anything else. If
14 that fails, then it could be submitted without it. I think that
15 is a better approach. Otherwise, leaving these proposals of the
16 President sitting there all alone, and they were tied together
17 when the President made the proposal.

18 The Chairman. Senator, I am going to let you just vote.
19 You are a very important man on this Committee. You are the
20 champion of small business and you also are the champion of all
21 of the Social Security people, and you are the champion of the
22 people who have these private pensions.

23 Senator Nelson. Do not say any more.

24 The Chairman. I am getting around to saying that, as far
25 as I am concerned, you can just offer any kind of package you

1 want to and we will vote on it.

2 Mr. Lubick. Mr. Chairman, I just want to make it clear
3 that the President's concern with the movement towards budget
4 balance applies both to the accelerated depreciation and the
5 rate cuts and any additional revenue losses that might be
6 involved.

7 Basically, the President proposed a reduction of about
8 \$20 billion for calendar year 1979 and any exceeding of that
9 amount would cause very grave consequences for the ability to
10 balance the budget in later years, be it 1980, 1981 or 1982. And
11 I think that the Administration's suggestion is that we ought
12 to stay within the constraints of what a \$20 billion cut in
13 calendar 1979 would expand to through normal growth in the out-
14 years, and that it would be imprudent in this bill to add any
15 of these measures for large reductions in the out-year and, in
16 effect, would very seriously cripple our ability to arrive at
17 that fiscal responsibility in the out years.

18 The Chairman. Any further discussion?

19 Mr. Stern. I assume that you are talking about the rates on
20 income above \$1,000.

21 Senator Byrd. We are talking about corporate income taxes
22 and that the maximum tax rate above \$100,000 would be reduced
23 from the current 48 percent down to --

24 Mr. Stern. 46 percent in calendar year 1979, 45 percent in
25 calendar year 1981, 44 percent in calendar year --

1 Senator Moynihan. No. 46 percent, we go to 45 percent
2 in '81.

3 Mr. Stern. Right, then 44 in '82 and so on down until
4 40 percent in 1986 and thereafter -- 1 percent a year.

5 Senator Byrd. Mr. Chairman, I would like to address that
6 issue.

7 The Chairman. Hold on, let me make sure I understand.
8 You go to 46 percent --

9 Mr. Stern. In calendar year '79. Then 45 percent in
10 calendar year 1981; 44 percent in 1982; 43 percent in 1983; 42
11 percent in 1984; 41 percent in 1985; and 40 percent in 1986 and
12 thereafter.

13 Mr. Shapiro. In a sense what this is, it takes the House
14 bill as its structure, reduces the 46 percent, which is the top
15 level of the House bill down 1 percentage point a year and after
16 1986, all income above \$75,000 will be taxed at 40 percent.

17 Mr. Stern. No motion has been made on any rates below.

18 Senator Curtis. We will leave that open.

19 Mr. Stern. It says the rates from \$75,000 goes to 100
20 percent, goes to 40 percent in the House bill. It is 40 percent
21 above \$75,000.

22 Senator Talmadge. What is the revenue loss per percentage
23 of reduction?

24 Mr. Shapiro. Per percentage point, approximately \$1.7
25 billion at 1979 levels.

1 Senator Byrd. Mr. Chairman?

2 The Chairman. Senator Byrd.

3 Senator Byrd. I am not concerned as a high tax Senator.
4 I would support reductions in corporate rates for this coming year
5 of 46 percent or 45 percent, one or the other. I think somebody
6 has to pay for all of the spending that Congress is doing and
7 I do not think I could sit here today and vote to take corporate
8 rates down to 40 percent.

9 As a matter of fact, I am not even sure they should be
10 reduced as low as 40 percent. I would like to see a reduction in
11 rates, but to talk about going down to 40 percent -- I need to
12 give that a great deal more thought than I have been able to give
13 it today.

14 Also, I would like to know what would happen to the
15 depreciation schedule if the rates are to be made that low. I
16 think there should be a reasonable corporate income tax. I think
17 that 48 percent is too high. I am willing to go to 46 percent
18 this year, or maybe 45.

19 I do not think I can vote on this proposal today on 40
20 percent.

21 The Chairman. Gentlemen, let me just remind you that if
22 this should become law, think of all the joy you would be missing
23 for voting in tax cuts for the future. There just would not be
24 that much to cut.

25 I would hope that you will vote to cut some taxes in future

1 years. If you do it all now, there will not be anything left
2 to do. There will not be anything to cut to do it with.

3 For example, every year we have to improve on the investment
4 tax credit and the asset depreciation range and do a little some-
5 thing about various other problems that business has. If we do
6 not have anybody paying any taxes, there will be nothing to take
7 credits against.

8 Senator Danforth. Mr. Chairman, two points in response to
9 that. The first one, which has already been made, that according
10 to the testimony that we have, the important thing for businesses
11 to know is what their rate of return is going to be in the future
12 in order to plan today's investments. So that knowledge of the
13 future is very important, rather than just waiting and finding
14 out what we are going to do the next year or the year after.

15 We have had so many tax bills in the 1970's in the Congress
16 fiddling around with the taxes that a degree of certainty is
17 called for.

18 Secondly, the fact of the matter is, without doing anything,
19 the corporate taxes go up because they are being taxed on
20 inflation. From the figures that I have, the effective tax rate
21 in 1966 on corporations was 40.8 percent. In 1977, it was 51.4
22 percent. That was just taxing inflation.

23 I think, as a practical matter, it is not all that joyful.
24 It just provides a degree of certainty that this continuing trend
25 of higher and higher effective tax rates is not going to continue.

1 Senator Curtis. Mr. Chairman, I am really torn. I think
2 that it does contribute to future planning and expansion. You
3 have the assurance of lower tax rates down the line. I do not
4 want those promises to be excessive so that the Congress would be
5 compelled to come in and, by resolution or act just merely by
6 delaying it.

7 On the other side of the coin, we have done that for years.
8 The law called for an increase in Social Security taxes during a
9 period when we were taking in more money and the Congress would
10 take action to delay the increase.

11 We have found harsh things in the tax law that need to be
12 thought through a little bit more, so that we would delay the
13 effective date of some increase.

14 If we could go to 40 percent with the full assurance that
15 we would never have to come in and say we are going to pass an
16 act delaying this next reduction. It might have a very adverse
17 effect upon the business community, if we provide for successive
18 tax reductions in the future. I think that we should have the
19 facts well enough in hand that we would never have to retract
20 them.

21 Once we promise a tax reduction in the future, we just have
22 to nullify it once. From then on we will not be taken seriously
23 by those who make those real, hard business decisions of great
24 significance.

25 Mr. Chairman, you spoke of the glory of voting for future

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1 tax relief --

2 Senator Hansen. Joy.

3 Senator Curtis. Yes. I will not be here to share it.

4 That is not one of my considerations.

5 I would like to promise individuals in the business community
6 reductions clear down the line, but I would not want it to go so
7 far that there was a fair chance in world events and local events
8 and failures to reduce expenditures or this or that that it would
9 cause us to change it.

10 Because, once we promise a tax reduction and pass a subse-
11 quent measure to nullify it, I think at that point the sophistica-
12 ted people who are making the hard decisions that determine the
13 future of our economy are going to write us off, that we are
14 making political speeches, not reducing taxes. I am still in a
15 quandry about what to do about it.

16 Senator Hansen. It seems to me that what Senator Curtis
17 is saying is that he proposed to take the joy out of future
18 decision-making to take all the fun out of politics. Take what
19 it would have done to President Carter if he had been unable to
20 go out in Louisiana and Texas and Oklahoma and write the Governors
21 that he is going to deregulate natural gas. You are being
22 altogether too practical, Carl, and I hate to oppose you, but
23 the game is played differently.

24 Senator Bentsen. Mr. Chairman?

25 The Chairman. Senator Bentsen.

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Senator Bentsen. Yesterday I voted against a staged cut over a period of three years on the income tax of individuals. I cannot turn around now and vote for a staged cut over a period of years in a tax cut for corporations, and I am concerned about the balance as to how much corporations carry of this burden of our budget in the future.

I understand the argument that the businessman would much prefer a corporate tax cut which does give them all their options rather than accelerated depreciation, but I think this country is in real trouble on productivity and that we have to do some dramatic and profound things to turn it around and I am very hopeful that this Administration will be forthcoming with some of those things next year, that we will make some very substantive changes in encouraging the modernization of the manufacturing capacity of this country. Otherwise, we are going to see this dollar continue to go down hill, and we are going to see inflation continue to be the overwhelming problem that this country has.

So, with that in mind, I am going to have to vote against this particular proposal.

Senator Gravel. Mr. Chairman?
The Chariman. Senator Gravel.
Senator Gravel. I share my colleague from Texas view about

the accelerated depreciation, but I think we have to recognize -- and I would support that and continue to support it, because I think we do need that extra. There is a compelling argument for

1 the broad-gauge approach used by simple accounting, because a
2 lot of the problems in productivity is a redefinition of going
3 through a productive machinery type economy to a service type
4 economy. And, so as not to permit the corporations to make that
5 individual decision with respect to machines or expansion of the
6 labor force, I think this is too narrow.

7 I see nothing wrong with projecting. This is about seven
8 years down the road here. There is nothing disastrous that is
9 going to happen.

10 As Senator Curtis pointed out, of course it is no joy. We
11 can take away, the next Congress which hopefully we will all be
12 in, most of us, except for those who are retiring, can take away
13 what this Congress has given and vice versa. It is not unusual.

14 I think the business community knows they are not bound from
15 Congress to Congress and that the economics of the nation may
16 change and we may want a new policy, but right now, what we need
17 is a very, very strong signal to the productive elements of our
18 society that we want them to step out smartly.

19 This is very beneficial, and I will vote for it.

20 Senator Talmadge. Mr. Chairman?

21 The Chairman. Senator Talmadge?

22 Senator Talmadge. I thank Senator Bentsen and others who
23 have stated the situation well. We cannot tell what the needs
24 for revenue are going to be in 1986. This phased reduction over
25 a period of several years would have corporations at \$1.7 billion

1 in a percentage point in that decision to reduce this burden
2 of corporate rates by \$13.6 billion by the year 1986.

3 I hope that future Congresses can do that, but I think to
4 try to pledge that at this point, we would have a deficit of
5 \$42 billion this year, and it is unrealistic. If we can reduce
6 spending along the same lines, I would be delighted to vote for
7 it, but I could not vote for something eight years in the future.

8 If we reduce the burdens on corporations by \$13.6 billion
9 a year --

10 The Chairman. Let's call the roll.

11 Mr. Stern. Mr. Talmadge?

12 Senator Talmadge. No.

13 Mr. Stern. Mr. Ribicoff?

14 (No response)

15 Mr. Stern. Mr. Byrd?

16 Senator Byrd. No.

17 Mr. Stern. Mr. Nelson?

18 Senator Nelson. No.

19 Mr. Stern. Mr. Gravel?

20 Senator Gravel. Aye.

21 Mr. Stern. Mr. Bentsen?

22 Senator Bentsen. No.

23 Mr. Stern. Mr. Hathaway?

24 (No response)

25 Mr. Stern. Mr. Haskell?

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1 (No response)
2 Mr. Stern. Mr. Matsunaga?

3 Senator Matsunaga. No.

4 Mr. Stern. Mr. Moynihan?

5 Senator Moynihan. Aye.

6 Mr. Stern. Mr. Curtis?

7 Senator Curtis. Aye.

8 Mr. Stern. Mr. Hansen?

9 Senator Hansen. No.

10 Mr. Stern. Mr. Dole?

11 Senator Dole. Aye.

12 Mr. Stern. Mr. Packwood?

13 Senator Packwood. Aye.

14 Mr. Stern. Mr. Roth?

15 Senator Dole. Aye.

16 Mr. Stern. Mr. Laxalt?

17 Senator Danforth. Aye.

18 Mr. Stern. Mr. Danforth?

19 Senator Danforth. Aye.

20 Mr. Stern. Mr. Chairman?

21 The Chairman. No.

22 Senator Hathaway wants to be recorded no. We will have to

23 poll the absentees. The way I read it, we will have to poll

24 the absentees. I am counting Mr. Roth and I am counting Mr.

25 Hathaway on no. That would be eight yea and eight nays, and we

1 will have to check with Mr. Ribicoff and Mr. Laxalt.

2 Senator Danforth. Mr. Laxalt votes aye.

3 Mr. Stern. Mr. Haskell and Mr. Ribicoff are the two I do
4 not have. I have Senator Laxalt recorded as aye. I do not have
5 Senators Ribicoff or Haskell.

6 Senator Bentsen. I have a proxy from Senator Ribicoff, but
7 I want to be sure that the Chairman interprets it the same way
8 I do.

9 (Pause)

10 Senator Ribicoff votes no.

11 Senator Dole. I am not certain about Roth.

12 Senator Danforth. Mr. Chairman, am I correct that we have
13 failed in this at the moment?

14 Mr. Stern. It is eight to nine.

15 The Chairman. nine nays. It will take ten to make a
16 majority.

17 Mr. Stern. That is correct. Even if Mr. Haskell voted
18 for it, it would still fail on a tie vote.

19 Senator Packwood. Mr. Chairman?

20 The Chairman. Senator Packwood.

21 Senator Packwood. I would now like to offer a variation of
22 that amendment which would be 48 percent, 48 percent and 42
23 percent in 1981. I would keep the corporate rate where it is
24 until 1981 and I would drop it to 42 percent.

25 Senator Hansen. 48 for the first two years and then drop

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1 it to 42 in '81.

2 Senator Packwood. I think it is more important for the
3 corporations to know that it is going to be 42 in 1981, if you
4 have to make a choice, and looking on the argument of revenue
5 choices, it is more important that they know that now for two
6 years down the road than if it would be 46, 46, 44, 46, 46.

7 Mr. Shapiro. Do you keep the House schedule with the
8 graduated rates but, instead of going down to 46 above \$100,000
9 you stay at 48 percent and then go down?

10 Senator Packwood. 42 percent in 1981 and no suggested
11 cuts after that.

12 Senator Danforth. Mr. Chairman?

13 Senator Curtis. This is without regard to anything below
14 \$100,000?

15 Senator Packwood. That is right.

16 The Chairman. Senator Danforth?

17 Senator Danforth. It seems to me that on the last vote
18 going down to 40, maybe we were asking for too much, but I do
19 think that it seems to me that there is a fairly strong feeling
20 around the table that a reduction of the corporate rate to 42
21 percent over a period of years is something that would be very
22 desirable, and I do not know what rate of phasedown would be
23 satisfactory to Senator Hansen or Senator Byrd, but it would
24 appear to me that we are kind of working in the same context here
25 and maybe Senator Packwood's proposal is the best. Maybe if we

1 just modified Senator Moynihan's proposal down to where it reached
2 42 percent and that got there by '84, that that would be the
3 best, with a few steps in between.

4 I think that it is probably, to me --

5 Senator Packwood. A second reason why I suggest this, is
6 the House has 46 percent but nothing lower. If we pass this at
7 48, 48, 42 and go to the Floor with that and it passes, we have
8 ample room in conference between now and when we make the final
9 decision if we want to go to the House bill, and ample time to
10 consult with the leaders of business in the country as to which
11 they prefer -- the House provision, or whether they want 48, 48
12 and 42.

13 I think it is an ideal bargaining position, and I think it
14 makes logical sense and gives us ample time to reach the exact
15 conclusion that we want.

16 The Chairman. Is there any further discussion?

17 Call the roll.

18 Mr. Stern. Mr. Talmadge?

19 Senator Talmadge. No.

20 Mr. Stern. Mr. Ribicoff?

21 Senator Bentsen. No.

22 Mr. Stern. Mr. Byrd?

23 Senator Byrd. No.

24 Mr. Stern. Mr. Nelson?

25 Senator Nelson. No.

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Mr. Stern. Mr. Gravel?

Senator Gravel. Aye.

Mr. Stern. Mr. Bentsen?

Senator Bentsen. No.

Mr. Stern. Mr. Hathaway?

(No response)

Mr. Stern. Mr. Haskell?

(No response)

Mr. Stern. Mr. Matsunaga?

Senator Matsunaga. No.

Mr. Stern. Mr. Moynihan?

Senator Moynihan. Aye.

Mr. Stern. Mr. Curtis?

Senator Curtis. No.

Mr. Stern. Mr. Hansen?

Senator Hansen. No.

Mr. Stern. Mr. Dole?

Senator Dole. Aye.

Mr. Stern. Mr. Roth?

(No response)

Mr. Stern. Mr. Laxalt?

Senator Danforth. Aye.

Mr. Stern. Mr. Danforth?

Senator Danforth. Aye.

Mr. Stern. Mr. Chairman?

1 The Chairman. No.

2 I have Mr. Hathaway's proxy -- no.

3 Six yeas and ten nays.

4 Senator Danforth. Mr. Chairman, I would like to offer
5 Senator Moynihan's proposal except cutting it off where it
6 reaches 42 percent.

7 The Chairman. What year?

8 Mr. Shapiro. 1984.

9 Senator Hansen. This would be to drop the rate to 46 percent
10 in 1979, Senator Moynihan, 45 in '81, 44 in '82 and 43 in '83.
11 Is that right?

12 Senator Moynihan. That is right.

13 Mr. Stern. In 1984 and thereafter, 42 percent.

14 Senator Hansen. It would stay at 42 percent after that?

15 Mr. Stern. Beginning in 1984...

16 Senator Curtis. 46, 45, 44, 43, 42.

17 Mr. Shapiro. That is correct, Senator.

18 It is a one percentage point reduction in each year. In
19 '81, it would be 45; 1982, 44 percent; 1983 would be '83 and
20 1984 and thereafter it would be 42 percent.

21 The Chairman. Gentleman, I am frank to say that I think
22 Senator Bentsen is correct. I do not see how we can justify
23 going out there with a phased reduction that is going to cost
24 many billions of dollars for corporations without doing the same
25 thing for the individuals, and if we do so, we are not going to

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1 have a bill.

2 If it gets to the President's desk it would fail with a big
3 veto and it would be sustained. We have a lot of things in here.
4 We are hoping to have a cut in the capital gains tax, hoping to
5 have a better treatment in the rates. Even with what we have
6 here, 47 percent. Better treatment on depreciation, that we do
7 not go to this future stage of cuts.

8 Call the roll.

9 Mr. Stern. Mr. Talmadge?

10 (No response)

11 Mr. Stern. Mr. Ribicoff?

12 Senator Bentsen. No, by proxy.

13 Mr. Stern. Mr. Byrd?

14 Senator Byrd. No.

15 Mr. Stern. Mr. Nelson?

16 Senator Nelson. No.

17 Mr. Stern. Mr. Gravel?

18 Senator Gravel. Aye.

19 Mr. Stern. Mr. Bentsen?

20 Senator Bentsen. No.

21 Mr. Stern. Mr. Hathaway?

22 (No response)

23 Mr. Stern. Mr. Haskell?

24 (No response)

25 Mr. Stern. Mr. Matsunaga?

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1 Mr. Matsunaga. No.
2 Mr. Stern. Mr. Moynihan.
3 The Chairman. Aye.
4 Mr. Stern. Mr. Curtis?
5 Senator Curtis. Aye.
6 Mr. Stern. Mr. Hansen?
7 Senator Hansen. Aye.
8 Mr. Stern. Mr. Dole?
9 Senator Dole. Aye.
10 Mr. Stern. Mr. Packwood?
11 Senator Packwood. Aye.
12 Mr. Stern. Mr. Roth?
13 (No response)
14 Mr. Stern. Mr. Laxalt?
15 Senator Danforth. Aye.
16 Mr. Stern. Mr. Danforth?
17 Senator Danforth. Aye.
18 Mr. Stern. Mr. Chairman?
19 The Chairman. No.

20 Mr. Hathaway votes no.

21 (Pause)

22 That is eight yeas and seven nays. Mr. Talmadge is absent,
23 I think. He ought to be recorded. And Mr. Roth is not recorded
24 here.

25 Senator Dole. He is going to call in later.

1 The Chairman. As of now, it is eight to seven.

2 Senator Dole. Mr. Chairman?

3 The Chairman. Senator Dole?

4 Senator Dole. Are we finished with that one?

5 The Chairman. For the time being.

6 Senator Gravel. Senator Nelson made the suggestion that
7 it might be very salutary for everybody maybe to vote on the
8 entertainment recommendations. It would have an effect on my
9 vote, and I have been supporting this proposal, and I would like
10 to put forward a moderate proposal.

11 Senator Packwood. What is it?

12 Senator Gravel. This is a reduction for expenses for
13 yachts, hunting lodges and country clubs. It is not, by far,
14 the whole Administration package, but it does focus on these
15 areas and I think these areas are a little gross and indeed
16 excessive. I would like to sustain the Treasury on these
17 specific areas -- yachts, hunting lodges and country clubs.

18 Senator Dole. You are for yachts, or against?

19 Senator Packwood. The elimination of these as business
20 deductions, the dues and whatnot for initiation fees.

21 Senator Gravel. Right. This should not be confused with
22 the three-martini lunch.

23 Senator Packwood. If you take someone to lunch at the
24 club, you cannot deduct the lunch, not the dues and initiation
25 fees.

1 Senator Dole. And the yacht.

2 Senator Gravel. You can deduct the lunch.

3 Am I correct, Mr. Lubick, in making that statement, that
4 even though we would deny him the dues for the country club, but

5 if he chose to take a guest to the country club it would be no
6 more than taking him to Morocco's. If it were a true business
7 sense, he could write it off.

8 Mr. Lubick. That is right, Senator Gravel. The Code
9 defines facilities, special rules with respect to deductions

10 for facilities which have a triple test as to their deductibility.
11 One is that they be ordinary and necessary business expenses.

12 Another is that the facility be used more than 50 percent of the
13 time for business. A third is that he be entitled only to a

14 reduction for the portion of the use which is directly related
15 to the conduct of the trade or business.

16 A facility is defined as beyond yachts and hunting lodges
17 to include the club dues; the actual cost of the meals during

18 entertainment is the same whether it is a public restaurant or a
19 private club. There is no difference in that regard.

20 Senator Curtis. If I may ask a question of the author,
21 this will not be difficult for my constituents, but for a matter

22 of clarity, I want to ask a question or two.

23 In reference to the hunting lodges, I am sure there are
24 abuses. Suppose someone is in the business of selling guns and

25 ammunitions. That is his total business -- manufacturing.

1 Would he be precluded from, in any way in their promotions,
2 taking a deduction on what might be classified as a hunting
3 lodge?

4 Senator Gravel. I would have to defer to Mr. Lubick on that.
5 Mr. Lubick. I anticipated the question. I am consulting
6 with my expert here.

7 I think that if it is a demonstration of the product, it
8 would not be a problem, but if essentially they are furnishing
9 entertainment through providing the use of a facility, whether
10 it be the use of a hunting lodge, the proposal, I think, would
11 disallow it.

12 The underlying rationale of the proposal is that these,
13 indeed, are expenses where it is very difficult to differentiate
14 between the personal and the business as far as the entertainment
15 is concerned and, for that reason, they would be disallowed. I
16 am not sure I see a distinction.

17 I can see it in the yacht case, I suppose, if you are taking
18 somebody out for a demonstration ride as an attempt to sell. That
19 would be a different proposition.

20 Senator Curtis. If I may --

21 Mr. Lubick. In the hunting lodge, you are not demonstrating
22 the weapons in the hunting lodge. The hunting lodge is furnish-
23 ing you with the after the demonstration --

24 Senator Curtis. I will say why I have problems with this
25 from the standpoint of workmanship on our legislation. When we

1 outlaw certain kinds of public relations and permit others, we
2 may not be doing a good job. For instance, it is conceivable
3 that there is some person in the business, whether small or large,
4 and he wants to promote sales so he makes more money and pays more
5 taxes. He can run an ad in the paper and say, come by my goods.

6 Conceivably somebody else may have their business on deal-
7 ing with a fewer number and he knows that his good customer likes
8 to see a ballgame so he takes his good customer to a ballgame and
9 buys him dinner, possibly less than an ad in the paper, but it is
10 his public relations in selling, and lunches and all of these
11 things.

12 I happen to know an individual who does a sizable portion
13 of his business -- which is both manufacturing and selling certain
14 items that is related to boats. He lives in an area where it is
15 year-round, and taking people on his boat -- he is not engaged
16 in direct selling, but it is a matter of knowing and public rela-
17 tions with the whole community that are involved in the activity
18 that he wants to reach. He does that.

19 That is why I have problems with these amendments that
20 zero in on one particular type of expenditure and say that is out.
21 We do not settle the problems across the board.

22 Senator Gravel. Senator it is not. It really gives it a
23 lot of teeth. Here is the language, the specific language: "A
24 type generally considered to constitute entertainment, amuse-
25 ment or recreation unless the taxpayer establishes that the item

1 directly related to, or in the case of the item directly preceding,
2 is a bona fide business deduction."

3 The person you are referring to, I would interpret that is
4 his business. He goes out and promotes it, and that is bona fide.
5 But a corporation having a nice large lodge somewheres and carry-
6 ing the cost of this on the books and the people who work there
7 on the books and then going there every week-end, the President
8 and Chairman and a few of the high-paid brass, that, to me, is
9 really not a promotional expense.

10 Senator Curtis. Takes a salesman who sells a big piece of
11 machinery, and it costs \$50,000 or \$100,000 or \$200,000. For
12 him to do mass advertising, he could buy ads in every publication
13 in the country and under our rules they would be charged off as
14 a business deduction. He sells, with a few individuals, and he
15 does entertain the individuals, but he does other things in various
16 modes of entertainment, if he sees he is going to make some money
17 on it and pay some taxes.

18 He has to make the acquaintance of his perspective customer
19 and that is why I have very serious problems with this.

20 Senator Byrd. Could I ask Mr. Shapiro if he would indicate
21 whether the House considered it and, if so, what reasoning it
22 took?

23 Mr. Shpario. The House considered this, Senator, and in
24 an indirect manner -- let me say the House started off with a
25 schedule of tax reform items. They did not formally get to this

1 item item as such in the schedule, but if I recall correctly,
2 these matters were discussed and, as you know, the House put
3 together a compromise proposal and at one time or another this
4 provision was in the compromise proposal but was subsequently
5 taken out and whenever it was discussed in the Committee, I do
6 not recall that there was a specific vote on it, but there was
7 not an agreement in the House bill.

8 Senator Byrd. Under the present law, does not the taxpayer
9 have to justify it being a business expense before it can be
10 considered deducted?

11 Mr. Shapiro. Under present law, there has to be the sole
12 test that it is an ordinary and necessary business expense, and
13 the Internal Revenue Service could audit that and if it determines
14 it was not an ordinary and necessary business expense could allow
15 it.

16 Senator Byrd. That is a part of present law.

17 Mr. Lubick. To go further, Senator Byrd, this is in answer
18 to Senator Curtis' illustration. For a facility to be deductible,
19 it must be directly related to the conduct of the business. I
20 think the general promotional use of yachts and hunting lodges
21 does not qualify for deduction under the law as it stands today.

22 Basically, I do not th-nk you are doing anything, Senator
23 Curtis, by voting for this proposal that denies a deduction in
24 a situation to which you were referring. It would only be the
25 case where he was actually engaged in the direct selling of the

1 customer on the yacht. That is the only case that is allowable
2 under the law today. That does not mean that many people are
3 not fighting the deductions beyond that because, indeed, this is
4 an area where it is very difficult for the Service to enforce
5 the rules.

6 Senator Byrd. The Treasury has the authority to go into
7 the matter and make a determination under present law.

8 Mr. Lubick. Well, it would require, I guess, some very
9 sophisticated eavesdropping devices to be able to carry out that
10 authority. Technically it is there, but as a practical matter,
11 I think the Service finds it very difficult to audit.

12 Senator Byrd. Did you not say, under the present law, that
13 yachts are disallowed anyway?

14 Mr. Lubick. They are disallowed unless they are used more
15 than 50 percent for business in a general sense and specifically
16 with respect to that particular portion for which a deduction is
17 being claimed, the use of the facility must be directly related
18 to the conduct of that business and the illustrations in the
19 Committee Report is that it is actual conduct of business activity
20 in or on the facility.

21 Senator Nelson. Mr. Chairman, there were a number of reforms
22 that were suggested by the President. I have about thirteen here,
23 some of them quite minor, most of which I would support.

24 I think that it is pretty clear to everybody who is
25 knowledgeable about it that a large percentage of the use of

1 hunting lodges and yachts are for the personal convenience of
2 the corporate people who own it. Everybody I know of is; I do not
3 know of any exception.

4 There is one additional provision that the President had
5 that would tie into the proposal by Senator Gravel, who may or
6 may not want to include it in this proposed amendment. This
7 proposal of the President was to disallow deductions for expenses
8 of entertainment in which only members of the host organization
9 and/or their families are present.

10 Now you are talking about deductible entertainment only for
11 members of the corporation or their families. Surely that should
12 not be allowed, and that would save \$123 million in calendar year
13 '79, according to the estimates on the sheet I have got. So I
14 wonder if the Treasury would wish to comment on that item.

15 Mr. Lubick. I think, Senator Nelson, that that proposal,
16 while as not as far-reaching as the original proposal was, in
17 response to Senator Long's suggestion that some of the entertain-
18 ment expenses is to selling as fertilizer is to agriculture, indeed
19 the proposal you are talking about is one where there is no outsider
20 or any prospective customer present. It is internal organization.

21 For example, if four partners of a prosperous law firm go
22 out to lunch every day and happen to be talking about affairs of
23 the office, they, in many cases, would claim deductions for their
24 meals which are not concerned with influencing customer relations
25 or activity, but are really simply a way of writing off what, for

1 most persons are their personal eating expenses. I think it is
2 a limited proposal that is limited to that situation. It is not
3 intended, in any way, to deal with those situations where the
4 entertainment is related to the stimulation of business with
5 outsiders.

6 Senator Bentsen. Let me ask about that, because you have
7 obviously pointed out an abuse that ought to be corrected. Let
8 us suppose that an insurance company takes all of its salesmen
9 to a place that they enjoy and they have a seminar and a program,
10 but they make the serious mistake of taking them to someplace where
11 it is pleasant and they like to be there and they are having a
12 good time. Would that be a deduction?

13 The idea is you are trying to get your salesmen all turned
14 on and you are trying to sell a program to them. You have to
15 allow that type of thing, it seems to me.

16 Mr. Lubick. May I say first, Senator Bentsen, that no
17 convention entertainment is covered by this proposal. You are
18 dealing in that situation with travel away from home, and that
19 comes under a separate section of the Code.

20 Senator Bentsen. Suppose it is a place in town you take
21 them?

22 Mr. Lubick. There are also, in the law, exceptions today
23 from the entertainment provision with respect to the very broadly
24 based employee activity and it seems to me that a company picnic,
25 for example, I do not think that anyone would contend --

1 Senator Bentsen. This does not hit the company picnic?

2 Mr. Lubick. I think one would draft it so it would cover
3 that situation.

4 Senator Bentsen. There are certain things for employee
5 morale in the company that are proper, it seems to me, and
6 certainly we should not be striking at that.

7 Mr. Lubick. I can agree with you on that situation, but
8 that does not present the same type of abuse as the illustration
9 that I gave. So that when you are dealing on a very broad basis,
10 and what essentially is not an entertainment situation, a working
11 seminar, one could draw a distinction between those cases.

12 There is a provision already in Section 274 to cover the
13 entertainment provided across the company on a nondiscriminatory
14 basis.

15 Senator Danforth. Supposing there is a Christmas party?

16 Mr. Lubick. I think that is the sort of thing that is
17 already covered, Senator Danforth. I am assuming that the
18 Christmas party is a general office brawl.

19 Senator Danforth. Maybe it is, maybe it is not. Does the
20 IRS intend to monitor that kind of thing?

21 Supposing that at Christmastime there is a dinner for sort
22 of middle management and their wives.

23 Mr. Lubick. I think that would probably be covered by the
24 proposal.

25 Senator Danforth. That would not be deductible?

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1 Mr. Lubick. I think that is correct.
2 Senator Danforth. Supposing that there is a law firm and
3 they have an annual Christmas party and all of the partners and
4 the associates of the law firm and their wives come, but not
5 the secretaries or the receptionists?

6 Mr. Lubick. I would say that is probably not deductible,
7 at least within the scope of the present exception that is written
8 in Section 274.

9 Senator Danforth. Would not be deductible under this
10 proposal that Senator Nelson is talking about, or under the bill,
11 or under the Code now?

12 Mr. Lubick. It is deductible under the Code today and I
13 think the question is, how far do you want to draw the line.
14 I guess everybody sees the situation of the four or five people
15 going out to lunch every day, and I think on the other hand that
16 if you have a companywide picnic, I think that nobody is concerned
17 about deductions in that situation.

18 Now, we are posing some difficult questions as the lines
19 converge, and there are always very difficult questions when lines
20 converge. One can, as far as I can -- we want to draw lines
21 to cover these situations to which you and Senator Bentsen allude.
22 I do not think that we would have any problem. I think that there
23 is a drafting problem and we would be glad to work it out with
24 staff in drawing such a line.
25 Senator Danforth. Could I ask you some more questions on

1 this?

2 Let us suppose that there is a prize given. The effect of
3 it is that a fairly small percentage, maybe 10 percent of the
4 employees of the company, get to go to the ballgame at night.
5 Would that be covered by it?

6 Mr. Lubick. I think that is already taxable under present
7 law as compensation if you are giving it as a prize.

8 Senator Danforth. They are not going to report that. It
9 is deductible by the company?

10 Mr. Lubick. Yes, it is deductible by the company as
11 compensation. Probably they are required to withhold on it.

12 Senator Danforth. If you provide that twenty of your
13 employees get free baseball tickets, that is deductible as
14 compensation and includable as income by the employees?

15 Mr. Lubick. That is the law to date.

16 Senator Danforth. I would be surprised if anybody did
17 that.

18 Mr. Lubick. I think you are correct. The Administration
19 is less than 100 percent sure.

20 Senator Danforth. Is it my understanding that Senator
21 Nelson's proposal does not cover any kind of, say, prizes in the
22 form of travel?

23 Mr. Lubick. That is correct. That is already under
24 present law, and Senator Nelson's proposal does not deal with
25 that situation, or the ball situation you referred to at all.

1 Senator Danforth. If a company provides a prize to salesmen
 2 for extraordinary effort by sending them to, say, Hawaii or
 3 New York City or Luchenbach, Texas --

4 Senator Hansen. It would be New York if they lose.

5 Senator Danforth. That would or would not be deductible?

6 Mr. Lubick. That would still be deductible. Anything that

7 is compensation continues to be deductible.

8 Senator Moynihan. But it is taxable for the individual.

9 Senator Curtis. Mr. Chairman, I just want to make this

10 point. As I understand the present law, it is drafted as well as
 11 anybody can. You are only permitted to allow a deduction that

12 is a necessary and ordinary expense of doing business.

13 Mr. Lubick. That is the threshold test.

14 Senator Curtis. I do not see how you can improve on it.

15 I think that the problem of these abuses has to be one of
 16 administration and enforcement. I am aware that there is a limit

17 of how far you can go in adding personnel to get the job done.

18 Apparently there is a point of diminishing returns. But I do

19 not think that we can say what one taxpayer does is ruled out.

20 I think it depends upon a common sense enforcement of the neces-

21 sary and ordinary expenses of doing business.

22 I do not think we can improve on the present rules.

23 Senator Packwood. Let me understand what Gaylord's amend-

24 ment is. The cost of purchasing the yacht?

25 Senator Gravel. It is my amendment. The cost of purchasing

1 or the use of a yacht. You could lease one or rent one. Hunting
2 lodge, same thing; country club dues, the same thing.

3 Senator Packwood. I want to come back again to the point
4 that we have been talking about. You are just talking about
5 the acquisition or leasing cost, not the cost of taking somebody
6 to lunch? You are not talking about the cost of legitimately
7 renting the hunting lodge for a week-end if it is a legitimate
8 business expense?

9 It seems to me we are talking about two different things.
10 To the extent that we could see a redraft of this that simply
11 said, for those people who are involved in the business of sell-
12 ing hunting lodges, phrase it principal trade or business, they
13 could deduct the cost of it as their business, and that could be,
14 I think, relatively easily drafted. But I do not see how it
15 relates to the partners going to lunch or the annual office party
16 which I do not think your amendmat touches that at all.

17 Senator Gravel. No, and I had not agreed to accept that.

18 I think you are quite right, but what this gives the
19 Treasury are targets on those specific areas, but if you have a
20 lodge and it is your business -- we have a lot of lodges in
21 Alaska. They are still going to stay in business, but if somebody
22 comes up to that lodge, he is not going to come up at the tax-
23 payers' expense unless it is a bona fide business situation.

24 Senator Talmadge. I thought that was the law now?

25 Senator Gravel. Apparently it is not enough law.

1 Mr. Lubick. As far as the entertainment facilities are
2 concerned, we have examples of very conspicuous personal consump-
3 tion which are being deducted. There are areas where I think
4 members of the Committee are quite correct -- if the members of
5 the Internal Revenue Service were able to actually eavesdrop on
6 all of the conversations and get transcripts, that you would find
7 that a very small percentage of what is being claimed is deducti-
8 ble.

9 I do not think it is practical to have the IRS enforcing
10 this situation. We have a situation where the relationship to
11 business except in a miniscule number of cases is tenuous indeed,
12 and I think that what is happening is that entertainment in the
13 Internal Revenue Code generally is getting a black eye. It is
14 very differnt from the business meal entertainment.

15 You have a situation where the general public views persons
16 who are in a position of owning yachts and hunting lodges and
17 belonging to expensive clubs as getting a write-off of their
18 personal activities at the general taxpayers' expense.

19 In areas where the direct connection with the conduct of
20 business is very rare -- and I think that is why these things
21 are targetted. I think that you are quite right. If one were
22 able to have a transcript of the conversations that went on --

23 Senator Gravel. It is even simpler than that. If a
24 corporation owns a yacht, they will bring some business people
25 out on it and they will charge it off as an expense. But when

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1 the corporate president's wife and kids go out on it, nothing is
2 said, but they sure as heck would not be able to have that yacht
3 if it were not owned by the corporation. So you get a hidden cost
4 there that goes back to the capital cost of the item, which goes
5 back to you and I and the rest of the taxpayers paying for that.

6 What this would do by singling out these areas, the
7 corporations will sell their yachts, sell their lodges. What
8 they are going to have to do, if they want to take someone on a
9 yacht or a lodge, they are going to have to lease it for a week
10 and document it. But you will not have a hidden capital expense
11 that the rest of the taxpayers are carrying, which is a little
12 excessive, and I think exaggerated.

13 Senator Talmadge. May I ask about how much money we are
14 talking about here?

15 Senator Gravel. \$114 million.

16 Senator Nelson. I will offer that amendment next.

17 Senator Long. Do you want a roll call?

18 Senator Gravel. A voice vote.

19 Senator Nelson. I think we ought to have a roll call.

20 Let's find where everybody stands on this.

21 Senator Curtis. May we have the amendment stated by the
22 staff?

23 Mr. Shapiro. What the amendment would do is to disallow
24 the deductions for expenses for certain entertainment facilities
25 and specifically these are country club dues, hunting lodges,

1 yachts and any fees that may be paid to any type of athletic or
2 sporting clubs.

3 Essentially what you are doing is disallowing any expenses
4 that are paid for facilities, maintaining the facilities.

5 Mr. Stern. Individuals as well as corporations.

6 Senator Gravel. Yes.

7 The Chairman. Call the roll.

8 Mr. Stern. Mr. Talmadge?

9 Senator Talmadge. No.

10 Mr. Stern. Mr. Ribicoff?

11 (No response)

12 Mr. Stern. Mr. Byrd?

13 Senator Byrd. No.

14 Mr. Stern. Mr. Nelson?

15 Senator Nelson. Aye.

16 Mr. Stern. Mr. Gravel?

17 Senator Gravel. Aye.

18 Mr. Stern. Mr. Bentsen?

19 (No response)

20 Mr. Stern. Mr. Hathaway?

21 (No response)

22 Mr. Stern. Mr. Haskell?

23 (No response)

24 Mr. Stern. Mr. Matsunaga?

25 (No response)

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1 Mr. Stern. Mr. Moynihan?

2 Senator Moynihan. Aye.

3 Mr. Stern. Mr. Curtis?

4 Senator Curtis. No.

5 Mr. Stern. Mr. Hansen?

6 Senator Hansen. Aye.

7 Mr. Stern. Mr. Dole?

8 Senator Dole. Aye.

9 Mr. Stern. Mr. Packwood?

10 Senator Packwood. Aye.

11 Mr. Stern. Mr. Roth?

12 (No response)

13 Mr. Stern. Mr. Laxalt?

14 (No response)

15 Mr. Stern. Mr. Danforth?

16 Senator Danforth. Aye.

17 Mr. Stern. Mr. Chairman?

18 The Chairman. No.

19 Mr. Hathaway wants to be recorded aye.

20 (Pause)

21 Eight yeas, four nays. I think we ought to let the
22 absentees record themselves.

23 Senator Nelson. Mr. Chairman, we discussed the other ones.

24 I will not take any more time.

25 Senator Packwood. I got it confused. Could you tell me

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again?

Senator Nelson. The deductions would be disallowed for expenses of entertainment at which only members of the host organization and/or their families are present. The savings are \$123 million and I just read you one interesting example.

On May 5th, in the Wall Street Journal, the occasion Wednesday night was one of the semi-annual meetings Sperry Rand Corporation holds for its Board of Directors and International Advisory Board. The total tab for thirty guests was \$6,000 -- \$200 a person.

Is that the kind of deductible expenses we want?

The Chairman. How much?

Senator Nelson. \$200 apiece.

The Chairman. \$200 apiece.

Senator Nelson. \$6,000 for thirty people. That was for entertainment of the Executive Board, Advisory Board, International Advisory Board. It is one of their semi-annual ones.

Senator Gravel. Mr. Chairman, also caught up in this net would be if you have a business of 50 people and you take these people to a resort area to have a seminar, a working seminar for two days to really work over your organization which is one of the most important things to do to make your organization effective. This would get wrapped up in this net, too.

There is no question when we deal with excesses like this it is great to cut them out, if you can cut them out, but it is

1 a question of the fine-tuning and we are not, in Treasury, doing
2 the fine-tuning. If I felt we could do that fine-tuning with
3 some equity and proper decision-making, fine, I would be for it.
4 But just to throw out a net --

5 Senator Nelson. Maybe Treasury, with its expertise, would
6 comment on this. The language here in the proposed subsection
7 ends up saying however, the preceding sentence shall not apply
8 in the case of an employer to any extent described in paragraph
9 3 of Subsection (d) and shall not apply in the case of a person
10 performing the services to any extent described in paragraph 4
11 of Subsection (e).

12 Would the Treasury comment on that, so that we could see what
13 the exceptions are?

14 Mr. Lubick. An amdnemtn to Section 274?

15 Senator Nelson. 274(i).

16 Mr. Lubick. (e)(5) is the exception for recreational,
17 social or similar activities primarily for the benefit of
18 employees, other than employees who are officers, shareholders
19 or other owners or other highly-compensated employees.

20 Basically, the situation to which Senator Bentsen and
21 Senator Gravel are alluded, those of the working meeting of
22 salesman and middle management, would be excluded from coverage
23 by the amendment as it is drafted.

24 Senator Curtis. That deduction would be denied?

25 Mr. Lubick. Allowed.

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1 Senator Curtis. The amendment he read here --
2 Mr. Lubick. I am sorry, Senator Nelson. (3) and (4) deal
3 with a compensatory situation. Those are the ones that Senator
4 Danforth was talking about. The question is whether you want to
5 extend it to (5) as well which is the situation they are dealing
6 with.

7 Senator Gravel. If you extend it to (5) I could vote for
8 it.

9 The Chairman. Is this the Treasury recommendation?
10 Mr. Lubick. We would support this, Senator Long.

11 The Chairman. Would you explain what the Treasury position
12 is?

13 Senator Bentsen. I would like to see the amendment. Is
14 there a copy of the amendment someplace?

15 Senator Nelson. You certainly are demanding more than
16 anybody else around here.

17 The Chairman. The rule is, if you have it in writing, you
18 are entitled to see it. If you do not have it in writing,
19 nobody is entitled to see it.

20 Senator Bentsen. They made a mistake by putting it in
21 writing.

22 Mr. Lubick. Senator Long, I do not know if you want a
23 description of it.

24 The Chairman. I want you to explain what this is all
25 about and why Treasury is for it, that is all.

1 Mr. Lubick. Basically, this deals with the disallowance
2 of entertainment expenses where there are no outsiders present.
3 It is basically, I think, in response to your analogy, of
4 fertilizer to sales. There are no sales present here so no
5 fertilizer need be applied in the situation.

6 Basically what we are talking about is the situation where
7 the President and Vice President of the company go out for lunch
8 at noon and they make a passing reference to the days' activities
9 and therefore deduct it as a business luncheon. The four or
10 five partners in the law firm go out on their daily lunch, but
11 since they happen to talk about a case in the office, they
12 deduct the lunch. No outsider is present, no potential customer
13 is present, only members of the host organization are present.

14 Senator Nelson. Or the \$6,000 dinner for the executives
15 of the Advisory Board for Sperry Rand.

16 Mr. Lubick. Right. They would not come within the
17 exception for expenses for the benefit of employees other than
18 those who are officers, shareholders or highly-compensated
19 employees.

20 Senator Talmadge. Suppose Prudential Insurance Company
21 wants to give a dinner honoring those who are winners of the
22 Million Dollar Roundtable. Would that be deductible?

23 Mr. Lubick. They are probably fairly highly-compensated
24 if they belong to the Million Dollar Roundtable.

25 Senator Talmadge. Commissions, not salary.

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Mr. Lubick. They are not employees, Senator Talmadge. As a matter of fact, they are independent contractors. Senator Bentsen. Is that for the record? Senator Talmadge. It would be deductible? Mr. Lubick. It does not apply because they are not members of the host organization.

Senator Bentsen. The trouble with these things -- and I certainly agree with Don when he talks about the President and Chairman of the Board going out, that that is an abuse and we should try to find a way of stopping it. But when you pass one that reads like this one does, the history of Treasury is to interpret that in the toughest way they can, and I am very concerned when you are trying to do things with the employees and you try to have entertainment at the same time that you are going to negate some of those things, and I think that is a serious mistake.

We get into this question of the Million Dollar Roundtable and how highly they are compensated and whether they are wage earners or independent contractors or employees. I think the law is quite well-drawn at the present time to stop these abuses.

The Chairman. Let me get at the kind of thing that concerns me. It is not at all clear right now whether a Senator can deduct or not deduct the situation I am going to discuss here. Let's assume that you are working hard -- which you have to do with

1 these long hours -- so you keep your administrative assistant
2 on until about 8:00 or 9:00 at night working and in the course
3 of it, people get hungry, so you take the fellow out and you
4 have a bite to eat and come back and work some more. A situation
5 like that, you pick up the tab for the meal. Somebody ought
6 to pay for it, so you do.

7 Senator Nelson. Your administrative assistant should pay
8 for it.

9 Senator Bentsen. That administrative assistant is not
10 there because he enjoys it. He is there because he is afraid
11 not to show up.

12 The Chairman. Most of those type employees are willing to
13 work long hours and, like most of our staff works long hours.
14 My impression is that in the business world that type of situation
15 is clearly deductible, the way it stands now.

16 It is sort of a fringe benefit. You deduct it -- it is a
17 fringe benefit to him.

18 What would that situation be, if that were the business
19 world? Say the president of the company takes out one of his
20 top executives, his public relations man working with him, and
21 they are working long hours and he takes them out to get a bite
22 to eat and then they come back in and he picks up the tab for
23 that.

24 Can he deduct that or not?

25 Mr. Lubick. The company is paying for it, not the president?

1 Is that right?

2 The Chairman. Assume the company is paying for it or, if
3 he is the boss, assume he is paying for it.

4 Mr. Lubick. At the present time, first of all, we are not
5 dealing, Senator Long, with the question of the employee who has
6 to work late and deducts his own supper. If I stayed down at
7 the Treasury until 10:00 o'clock, and had to go out for dinner,
8 I could not deduct my meal. That is perfectly clear.

9 If I am in a private law firm and I go out for dinner or
10 lunch, I cannot deduct my meal. If I am in private industry and
11 there is a supper money allowance for staying late, the basic
12 question that has come up is whether -- not whether that is
13 deductible, but whether the amount is includable in the income
14 of the employee for reimbursement.

15 The law has been administered to the effect that the
16 reimbursement has not been included for a reasonable amount of
17 supper money in the employee's income and I do not think that
18 the question of the deductibility to the employer has come up
19 or there has been a question.

20 When you are talking about taking out your administrative
21 assistant and picking up the tab, I think it is essentially the
22 same type of situation under the law that has been interpreted
23 today -- the administrative assistant would not realize income
24 for having his supper paid for.

25 I think that the problem you would run into on the deduction

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1 is that they are not regarded as your employees but rather
2 employees of the United States government and I think someone
3 could make the argument that you are not the employer and that
4 would be something that could give you a problem, on the basis
5 that it has been decided.

6 The Chairman. That is one of the gray areas, as far as
7 Senators are concerned, too. As I understand it, some Senators --
8 at least one and perhaps more -- were handling their expense
9 accounts the same way that they did when they were lawyers, and
10 they are going to be in a gray area and what Treasury is going
11 to do about it, I do not know, or what IRS is going to do about
12 it, I do not know.

13 But where a person takes his office staff out to eat or
14 picks up the tab just like a company providing dinner on the
15 grounds for an employee for some little occasion, you usually get
16 a better performance out of those employees because you do that
17 type thing once in awhile, and I would think you have a lot of
18 situations where it is deductible. When you start picking and
19 choosing, some employees you can and some you cannot, I have
20 some difficulty following the rule or the justification for
21 it.

22 The company could on a picnic for their employees and deduct
23 it, could they not?

24 Mr. Lubick. Yes, sir. There is a specific exception for
25 these activities, primarily for the benefit of the employees other

1 than the officers, shareholders and owners or the highly-compensa-
2 ted class.

3 The Chairman. You separate how they are compensated so
4 you cannot deduct it if they are involved?

5 Mr. Lubick. That is correct.

6 Senator Talmadge. If I may ask a question at that point --

7 Mr. Lubick. They could be involved along with everybody
8 else.

9 The Chairman. If it is just for them, you just take your
10 highly-compensated employees -- if those people, though, you are
11 counting on to get better production and will run the companies
12 better, there could be a legitimate basis, could there not?

13 Mr. Lubick. I think in all of these situations it is
14 legitimate. I think the basic question is one of compensation.
15 I think you are going to get a lot more out of your president if
16 he is highly-compensated and the question is whether you want to
17 take part of that compensation and put it into emoluments that
18 are not subjected to taxation.

19 Senator Talmadge. If the Chairman would yield for a question
20 at that point, suppose it is the annual stockholders meeting
21 the corporation. Is that deductible?

22 Mr. Lubick. There is a special provision dealing with
23 expenses dealing with business meetings of stockholders, agents
24 or directors -- subparagraph (6), if (5) and (6) were --

25 Senator Nelson. (5) would be the educational expenses of

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1 an educational meeting for employees?

2 Mr. Lubick. Similarly for employees under the highly-paid.

3 Senator Packwood. What is the exception?

4 Mr. Lubick. Expenses incurred by a taxpayer which are
5 directly related to business meetings of its employees, stock-
6 holders, agents and directors. You can cover stockholders if
7 you have a business meeting with employees -- you have the
8 problem of the two employees sitting down at lunch as a business
9 meeting.

10 If you exclude -- if you have some exclusion --

11 Senator Gravel. Is there a (7)?

12 Mr. Lubick. Meeting of a business league.

13 Senator Packwood. Let me ask you this question. I am
14 intrigued. You can have your shareholders and stockholders in for
15 a two-day meeting, pay for the room and board and dinner, that
16 is an apparent exception -- exceptions number 5 and 6?

17 Mr. Lubick. The present law is what I am reading.

18 Senator Packwood. What you mentioned about the lawyers
19 going to lunch, it seems to me what you are writing off, the
20 annual or monthly business dinner that most law partnerships that
21 have five or six or more partners do consistently as a legitimate
22 evening to discuss the management of their partnership affairs.

23 Mr. Lubick. It covers, I think, more than that. I think
24 it covers the daily luncheons to discuss the partnership affairs.

25 Senator Packwood. That is what I am curious about. It is

1 all right to have it for Harvard University Corporation or General
2 Motors to have in their directors and officers, all highly-paid
3 for a day's meeting or two-days' meeting. That is a deductible
4 expense apparently.

5 Mr. Lubick. They are a tax-exempt organization.

6 Senator Packwood. General Motors has the right to have
7 their board of directors in, ten or twelve people, along with
8 their half a dozen highly-paid officers for a day or two's meeting,
9 no outsiders, no effort in the sense to be entertaining somebody
10 to attract business, but that is a legitimate deductible expense.
11 Is that correct?

12 Mr. Lubick. It is, under the law today, yes.

13 Senator Talmadge. He is asking, I think, about the Nelson
14 amendment. What would it be under the Nelson amendment?

15 Mr. Lubick. Under the amendment, it would not be, unless
16 you put in a special exception. I think that is correct.

17 Senator Packwood. In that case, I am going to vote against
18 the amendment. The more I listen to it now, the more confused
19 I get. You cannot have a legitimate business meeting of your
20 highly-paid employees because it is a luxury, not business.

21 Mr. Lubick. I think there is one differentiation,
22 actually. The General Motors Directors case you gave, I think
23 would qualify because most of the directors presumably are from
24 outside Detroit. If you travel away from home, they would
25 qualify.

1 Senator Packwood. If their officers were from the National
2 Bank of Portland, that would not qualify?

3 Mr. Lubick. That would be a different situation.

4 The Chairman. Call the roll.

5 Mr. Stern. Mr. Talmadge?

6 Senator Talmadge. No.

7 Mr. Stern. Mr. Byrd?

8 (No response)

9 Mr. Stern. Mr. Nelson?

10 Senator Nelson. Aye.

11 Mr. Stern. Mr. Gravel?

12 Senator Gravel. No.

13 Mr. Stern. Mr. Bentsen?

14 Senator Bentsen. No.

15 Mr. Stern. Mr. Hathaway?

16 (No response)

17 Mr. Stern. Mr. Haskell?

18 (No response)

19 Mr. Stern. Mr. Matsunaga?

20 Senator Matsunaga. No.

21 Mr. Stern. Mr. Moynihan?

22 (No response)

23 Mr. Stern. Mr. Curtis?

24 Senator Curtis. No.

25 Mr. Stern. Mr. Hansen?

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Senator Hansen. No.

Mr. Stern. Mr. Dole?

Senator Dole. No.

Mr. Stern. Mr. Packwood?

Senator Packwood. No.

Mr. Stern. Mr. Roth?

Senator Dole; No.

Mr. Stern. Mr. Laxalt?

(No response)

Mr. Stern. Mr. Danforth?

(No response)

Mr. Stern. Mr. Chairman?

The Chairman. No.

Two yeas, eleven nays.

Senator Matsunaga. I offered an amendment yesterday. We

did not have a quorum. Could I take it up now?

The Chairman. I already have recognized Senator Dole. I

will recognize you next.

Senator Dole. I passed out a little explanatory sheet on

tax indexing. I am not talking about tax cuts. It is a piece

of information that we have heard many times, keeping the taxpayer

whole. All I suggest is that we make inflation adjustments

effective for two years, effective 1980.

It applies to three areas -- the personal exemption, the

tax bracket and the zero bracket -- and it gives some examples

1 at the bottom of the page. For example, if the inflation rate
2 in '79 was 6 percent, that would increase the personal exemption
3 by \$60; assuming it is \$1,000, it would be \$1,060. You would
4 widen the tax brackets to reflect the bracket creeps and the
5 zero bracket would increase \$200 if we added a \$3,400 zero
6 bracket.

7 It would also take care of a problem mentioned yesterday --
8 people coming off and on the tax rolls because of inflation. I
9 think Mr. Shapiro said 1 million people a year come back on the
10 tax rolls because of inflation and we take them off through
11 legislation and they are back again because of inflation.

12 I might suggest there has been a lot of focus on the so-called
13 Roth-Kemp proposals that other tax-cutting proposals. I do not
14 suggest that this is a tax cut. I suggest that all we are saying
15 is we are not going to tax the American people on inflation.

16 It is very simple. It applies to all individual taxpayers.
17 It takes care of the tax increase that the American people assume
18 without any legislation just because of inflation, and I cited
19 with some examples that would probably make the point. It does
20 prevent this Committee to still have the right to cut taxes,
21 because we are talking about real tax cuts instead of some
22 illusory tax cut that is taking care of inflation -- in most
23 cases, merely enough this year to cover the Social Security
24 increases.

25 It has a widespread support. It has been passed in the

1 state of Colorado in a modified form; in California, on a state
2 level. I would predict within the next six to eight years, if
3 it does not happen this year, it is going to happen in the
4 Congress of the United States. I do not know how anybody could
5 oppose it, unless you want the American people to pay taxes on
6 inflation.

7 It does not take away discipline. The American people will
8 still demand we do something about inflation, and it just seems
9 to many of us that we are not talking about tax cuts, we are not
10 talking about any gimmicks, we are just suggesting that the
11 American people should not pay taxes on inflation, and I think
12 that it is understood by most everyone on the Committee and I
13 would assume the Treasury Department probably opposes it, is
14 that correct?

15 Mr. Lubick. Yes, sir, we do oppose it.

16 Senator Dole. I understood that you were opposed to it.

17 Again, Professor Feldstein, he is a strong proponent of
18 this, as is Milton Friedman. It was an idea that former Senator
19 Buckley discussed at great length and sponsored when he was in
20 the Congress. Senator Griffin is very interested in this amend-
21 ment and will be offering it on the Floor, and I offer it this
22 morning for myself and Senator Griffin of Michigan.

23 Senator Danforth. Mr. Chairman?

24 The Chairman. Senator Danforth.

25 Senator Danforth. I would like to strongly support

1 Senator Dole's amendment. This is not a proposal for a tax cut.
2 It would not cut taxes a single penny for anybody.

3 What it would do is simply provide that we are not going
4 to increase people's taxes simply by virtue of inflation. I
5 think the figures now are when inflation increases 6 percent that
6 the Federal revenues increase 10 percent. It is a windfall for
7 the Federal government to have inflation because tax revenues
8 go up because people are pushed into higher and higher brackets,
9 and it is absolutely wrong.

10 People argue, if we did not make it hurt for people, how
11 could we ever control inflation? And this would stop inflation
12 from hurting people. I think that is a lot of baloney.

13 Inflation hurts people regardless of what taxes do, so
14 people are still going to be hurt. The fact of the matter is,
15 what causes inflation is not people, it is government -- it is
16 government and governmental policies.

17 I do not see why we should have a system of inflation that
18 increases Federal revenue higher than the rate of inflation,
19 thereby providing this fiscal dividend for government.

20 Really, the issue here is a very simple question and it has
21 to do with what portion of the total economy is government going
22 to consume and what portion is going to be left in the pockets
23 of the American people and all Senator Dole is saying is let's
24 hold the American people harmless from putting them in higher
25 brackets, let's not have inflation cause a situation where the

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1 government portion of the pie automatically increases and the
2 people's portion of the pie is automatically reduced without any
3 tax bill being passed by the Congress.

4 Senator Dole. May I add that it is not a new concept.
5 According to the Congressional Budget Office, 63 percent of
6 Federal expenditures are now indexed, and we are even talking
7 about in the recent ones in excise tax on the industrial use of
8 oil and natural gas that is currently pending in the energy tax
9 conference. We have done it in this Committee as recently as
10 a year ago -- a little more than a year ago -- and we recognize
11 indexing as having merits, so it is not a gimmick. It is not
12 politics. It is not a tax cut.

13 It does say to the American people that we are not going
14 to require you to pay taxes on inflation and the biggest profiteer,
15 as Senator Danforth pointed out, is the Federal government. That
16 is why the Federal government opposes indexing in this area,
17 because they are the beneficiary. The only beneficiary is the
18 Federal government.

19 It just seems to me we are talking about taxflation, or
20 whatever. It is going to cost the American taxpayer about \$9
21 billion in 1979 and when all the stories are written about all
22 of the different tax proposals, I would predict that, in the
23 long-run, tax indexing will become law -- maybe not this year,
24 maybe not next year, but I guess in the next four, five or six
25 years.

1 Senator Curtis. If the Senator would yield for a question,
2 is it or is it not true that Congress has provided indexing for
3 retirement pay for Congress?

4 Senator Dole. I think that is correct. I think we index
5 food stamps. We index Civil Service salaries.

6 Senator Curtis. I think the taxpayers are entitled to
7 some kind of consideration.

8 The Chairman. Let me just speak to it for a moment, because
9 I find a lot of appeal to indexing.

10 Senator Dole. It does not start until '80, so it just
11 complements what you are trying to do. It really fits in very
12 much with the Long proposal.

13 The Chairman. I found a lot of appeal to indexing. I even
14 suggested awhile back that we index the minimum tax with regard
15 to capital gains. But the Treasury has made a very strong case,
16 and so have other witnesses who have appeared here, against the
17 indexing proposal on our taxation.

18 I hope everybody heard it, because I think the Secretary
19 of Tr-asury and various other witnesses made a tremendously
20 impressive case.

21 If we do this, it will be much more difficult to resist
22 inflation than it is now, and it is tough enough to resist
23 inflation that way it is now. If you had this in the law, we
24 would not be talking about cutting taxes here today. We would
25 be talking about raising taxes.

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1 Senator Dole. You would really be talking about cutting
2 taxes if you had this in the law, because you would not have to
3 cut taxes to take care of inflation.

4 The Chairman. I understand, but if the indexing system
5 were in the law and we had this thing considered before, instead
6 of meeting to cut taxes because we have had some inflation, we
7 would be doing it just the other way around. We would be talking
8 about raising taxes because of the government's fiscal plight.

9 It is a lot easier to persuade the Senate to vote for a
10 tax cut than it is to vote for a tax increase.

11 I really think that the case has been made by the witnesses,
12 particularly the Secretary of the Treasury, that it is better for
13 us to take a look at the revenue we have and take it in terms of
14 who most deserves the tax cut and who is most adversely affected
15 rather than have the revenues automatically reduced and then
16 have to have a tax increase.

17 I would think, Mr. Lubick, on behalf of the Treasury you
18 may want to put a few words in. You might want to say a word
19 or two about the Treasury. I do not think you can improve on
20 what the Secretary had to say, but I think he made an impressive
21 statement, but not everybody heard the Secretary.

22 Mr. Lubick. Nor can I improve on what you said, Mr.
23 Chairman. Basically you stated it.

24 I think it is important to keep control over the fiscal
25 situation. I think to the extent that you built in an automatic

1 reduction you make it that much more difficult to reduce infla-
2 tion by closing the deficit and I think that this provision
3 will give us the same problem that we have with stepping up
4 corporate and individual cuts for the out-years. I think we should
5 judge the situation as it exists when we know all the facts and
6 not try to build in an automatic reduction that is going to make
7 it extremely difficult for us to maintain a budget deficit that
8 is manageable or move to a budget balance that is so essential
9 to lick the inflationary problem.

10 I do not think we should, as the Secretary said, surrender
11 to inflation. It makes it that much easier to accept.

12 Senator Dole. Mr. Chairman, I think the Treasury supported
13 indexing in Social Security benefits. Is that correct?

14 Mr. Lubick. I do not know.

15 Senator Dole. Are you opposed to indexing Social Security
16 benefits?

17 Mr. Lubick. I do not know that this is a matter that Treasury
18 has a position on.

19 Senator Dole. I do not want to belabor the point, but I
20 can understand why the government would be against this, because it
21 is going to require discipline in spending. It is going to take
22 away, in 1983 alone, the tax revenue receipts just from inflation
23 are going to amount to \$43 billion and it seems to me that you
24 would have discipline if you did not have all this money coming
25 in, not on real income, but on inflation.

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I do not understand the government -- I do not care which Administration it is. We offered it in the Ford Administration. I did on the Senate Floor. It is not something we are trying to embarrass this Administration with.

I could not get Ford to support it either -- it might have helped.

It is hard to ask the American people to pay taxes on inflation. That is what we are voting on.

Mr. Lubick. Senator, I think the Congress has responded to inflation and it has reduced taxes through successive tax bills ever since the 1960s and has faced up to the problem and has done it on an ad hoc basis in putting the tax reductions in the areas where they are most needed. I think you have acted responsibly, periodically, and I have every evidence that you will continue that way.

Senator Nelson. May I ask two quick questions?

How would this impact on the low-income tax credit?

In other words, as inflation goes along that bracket for a tax cut for low income remains now at \$4,000. Senator Long's proposal is \$6,000.

Was this designed so that you would raise that ceiling for the low-income tax credit? If you did not, they would be the ones who would be eating up the inflation with no benefit.

Senator Dole. That was not addressed, but we do increase the personal exemptions. We also increase the zero bracket, which

1 would keep them off the tax rolls to start with.

2 How many were added because of inflation?

3 Mr. Shapiro. Approximately \$3 million taxpayers a year.

4 Senator Dole. Then if we act and we take 3 million off
5 we would not have that yo-yo policy of indexing. We do
6 increase the personal exemption. We do increase the zero bracket
7 \$200, assuming the zero bracket is \$3,400.

8 Senator Nelson. I cannot quite visualize it exactly.

9 My second question is, is this a substitute for the tax
10 cuts, personal tax cuts that we are addressing here?

11 Senator Dole. This is not effective for 1980. It is for
12 a two-year period. It does not affect what we are discussing.

13 The Chairman. It seems to me when we start indexing for
14 Social Security, when we got into that trap -- it seems to me
15 when we got into this trap where we were then projecting the
16 bankruptcy of the Social Security fund. Now, we finally managed
17 to vote enough taxes where we are now projecting a solid Social
18 Security fund, but we have not yet made it over the hump,
19 because there are going to be a lot of complaints when that tax
20 goes into effect come January, and we will be hard put to stand
21 our ground and insist that those tax increases go down through
22 to keep this thing solvent.

23 Senator Danforth. Mr. Chairman, George Pritts is good
24 enough to be passing out a chart now that indicates the historic
25 tax burden by income categories and really to review the point

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1 that I understand Treasury has made. By specific tax cuts, we
2 have tended to offset them. We have not tended to offset them
3 as this chart indicates, in almost every income category.

4 For example, before 1950 and where we are now, in 1978,
5 the historic average within incomes within \$15,000 was 12.2
6 percent. It is now up to 14.9 percent and it is heading up.
7 Similarly, people with \$25,000 incomes, the historic average was
8 14.8 percent. It is now at 17.7 percent and it is going up.

9 So it is simply not true that these one-shot tax cuts are
10 doing an adequate job today in offsetting inflation.

11 Over a period of years, over most of the periods in our
12 history, we did not have these high rates of inflation. Now we
13 are in an entirely different ballgame, so the effect of specific
14 tax reductions is not as satisfactory as it used to be.

15 What we are getting ourselves into is an annual tax bill.
16 Now, the Administration is talking about coming to us next
17 year with another tax bill. Who knows what is going to be in
18 that bill?

19 The point here, rather than wait and see what happens in a
20 year, and maybe it will do something about what inflation has
21 done probably a year late, as we are doing it with this bill.
22 Let's get something in our tax system that will make it possible
23 for people not to be steadily moved into higher tax brackets by
24 inflation.

25 The second sheet here is an alternate proposal to Senator

1 Dole's proposal -- I will not offer it here, I will offer it
2 if he fails.

3 This covers a point that Senator Nelson made. It would
4 include the earned income tax credit. It would set a flat
5 rate of 6 percent for six years.

6 If the inflation exceeds 6 percent, the average would not
7 be covered by it, and it would be, as Senator Dole's, for a
8 limited period of time. It is not quite indexing, as there is a
9 flat percentage figure involved with it.

10 It seems to me that the basic point is a very simple concept.
11 The basic point is, should government be able to reap the benefit
12 of inflation, and that benefit is an unlegislated tax increase
13 simply by the fact that people have moved into higher brackets
14 and are taxed at higher marginal tax rates.

15 The Chairman. Inflation does all kinds of harms to all
16 kinds of things. There are things about inflation that -- that
17 there are some offsets on the favorable side. One is that it
18 tends to help the government deficit, as long as you have a
19 graduated income tax. Of course, we take that into considera-
20 tion.

21 But, goodness knows, the government itself is a loser in
22 many respects. Costs go up with inflation.

23 Senator Danforth. But tax revenues go up at a rate of
24 one and a half times the CPI.

25 The Chairman. There is nothing new about this proposal.

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1 We have had it around here for quite awhile. We just had a
2 Republican Administration. Were they advocating that we index?

3 Mr. Shapiro. No.

4 Senator Dole. We worked on it.

5 The Chairman. You sure did not persuade them.

6 Senator Dole. We thought this was a more enlightened
7 Administration.

8 The Chairman. The people who have the responsibility
9 rather uniformly say no, you should not do this.

10 Senator Dole. Mr. Sunley is on record that if we had
11 indexing in '74 and '75 that it would have helped to avert the
12 economic problems at that time. I read that somewhere.

13 Mr. Sunley. I believe, Mr. Dole, I was making the point
14 in testimony before your Committee that, in general, that if
15 all I knew about an economy was that it was experiencing a period
16 of inflation, we would want taxes going up for countercyclical
17 reasons. There are exceptions to that. I said 1974 and '75, it
18 probably would have been better at the beginning of '75 if we
19 had had an automatic tax reduction due to inflation or whatever,
20 rather than be faced with a proposal by the then-Administration
21 for a tax increase.

22 But, in general, obviously why we needed was a tax reduction
23 at that time, was that we had high unemployment and high infla-
24 tion.

25 If I may make one additional comment at this time, I believe

1 that the effects of the table, the chart that has been passed
2 out, a major portion of the pattern is due to the rapidly rising
3 Social Security taxes. This chart includes both Federal income
4 taxes and Social Security taxes. At least at the very lowest
5 income levels, the increase in the lowest effective tax rates,
6 over time, have not been due to the Federal income tax not being
7 indexed because we, in fact, have reduced the Federal income
8 taxes periodically to offset that effect. Instead, it is due to
9 the increases in Social Security taxes that Congress has periodi-
10 cally passed.

11 Senator Danforth. I think that it is fair to say that, as
12 far as the wage earner is concerned, it is of little comfort to
13 him to tell him, do not worry about what Uncle Sam is taking out
14 of your pocket because we are calling it Social Security taxes
15 and not income taxes. As far as the wage earner is concerned, he
16 is worse off by virtue of what government is doing to him and
17 what government is doing to him is increasing his tax burden.

18 Part of the increase is by virtue of legislative tax
19 increases. Part of it is due to the effect of inflation.

20 The fact of the matter is, as far as the taxpayer is
21 concerned, by every 1 percent the CPI goes up, his taxes increase
22 by 1.5 percent. His Federal taxes increase by 1.5 percent, and
23 the simple point we are making here is that that is wrong, that
24 it is absolutely wrong, and that the whole issue that is before
25 us, I think, in this tax bill -- really, it can be conceived as a

1 pie and the argument on the business tax is how big is the pie
2 going to be? What is going to happen to growth and GNP? And
3 the argument with respect to this question of indexing, whether
4 it is the real indexing that Senator Dole is talking about or
5 the effect of the 6 percent indexing I am talking about, the
6 question is how big of a wedge is government going to take and
7 how big a wedge are the American people going to retain?

8 Right now, the government wedge is somewhat like 23 percent
9 of gross national product, and it is climbing, and it is going to
10 continue to climb and continue to climb in large measure by virtue
11 of the fact that inflation is putting people into higher tax
12 brackets.

13 The point we are making is that it is wrong for government
14 to benefit by inflation than for the American people to be
15 penalized.

16 The Chairman. Might I suggest that we vote on this matter,
17 because we are losing members. I think the nation would like
18 to know how the Committee feels.

19 Senator Dole. If I could ask Senator Nelson, would that
20 persuade you, if we included indexing in the earned income credit
21 in my proposal?

22 Senator Nelson. I want to take another look at it. I
23 treat it as a serious proposal. I think, as of now, I vote no,
24 but I reserve the right to change my mind.

25 Senator Gravel. Mr. Chairman, I will be very brief. I want

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1 to explain my vote on this, because this is the first time that
2 I have really found out where we have been making our errors in
3 Alaska. We are always talking about cost of living. Ever since
4 I have been here I have been trying to get a cost of living
5 differential. What we really should do is get in tune with the
6 Nation and call it inflation, because it is not cost of living,
7 although it translates that way.

8 The example, you make average income in the state of Alaska
9 is 159 percent; in Hawaii, 126 percent. Of that 159 percent,
10 we pay 221 percent taxes. That is how we get murdered, by step-
11 ping up in those brackets in that regard. So I will be support-
12 ing this, and I am glad to see that someone is taking indexing
13 seriously and the next time I ask for a cost of living differen-
14 tial, I will call it indexing.

15 The Chairman. Call the roll.

16 Mr. Stern. Mr. Talmadge?

17 The Chairman. No.

18 Mr. Stern. Mr. Ribicoff?

19 The Chairman. No.

20 Mr. Stern. Mr. Byrd?

21 Senator Byrd. No.

22 Mr. Stern. Mr. Nelson?

23 Senator Nelson. No, for the time being.

24 Mr. Stern. Mr. Gravel?

25 Senator Gravel. Yes.

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1 Mr. Stern. Mr. Bentsen?
2 The Chairman. No.
3 Mr. Stern. Mr. Hathaway?
4 (No response)
5 Mr. Stern. Mr. Haskell?
6 (No response)
7 Mr. Stern. Mr. Matsunaga?
8 Senator Matsunaga. Aye.
9 Mr. Stern. Mr. Moynihan?
10 (No response)
11 Mr. Stern. Mr. Curtis?
12 Senator Curtis. Aye.
13 Mr. Stern. Mr. Hansen?
14 Senator Hansen. Aye.
15 Mr. Stern. Mr. Dole?
16 Senator Dole. Aye.
17 Mr. Stern. Mr. Packwood?
18 Senator Packwood. Aye.
19 Mr. Stern. Mr. Roth?
20 Senator Dole. Aye.
21 Mr. Stern. Mr. Laxalt?
22 Senator Dole. Aye.
23 Mr. Stern. Mr. Danforth?
24 Senator Danforth. Aye.
25 Mr. Stern. Mr. Chairman?

1 The Chairman. No.

2 (Pause)

3 Mr. Hathaway wants to be recorded no.

4 Nine yeas, seven nays.

5 Mr. Stern. Senators Haskell and Moynihan are not recorded.

6 The Chairman. We will have to have them be recorded this

7 afternoon. As of now, the vote is nine yeas, seven nays.

8 Senator Packwood. What time are we meeting this afternoon?

9 The Chairman. I am not planning to meet this afternoon.

10 I have to do some other things. We will meet tomorrow at 10:00.

11 Senator Packwood. Mr. Chairman, that is fine. I cancelled

12 a trip to be here; I do not mind that. I hope we are not aiming

13 for a deadling of finishing this bill Thursday afternoon and we

14 rush through it Friday morning and we rush through a lot of

15 things that will require some consideration. I think I will object

16 to that.

17 I have no hesitancy in staying all next week to do it.

18 The Chairman. Senator, I am not counting on reporting this

19 bill Thursday. Frankly, I press awfully hard on these bills.

20 There just comes a time when our Committee needs a little time

21 to think about something itself, to do justice to the proposals.

22 The House takes four tiems as much time as we take on a

23 tax bill and we get over here and people complain -- and quite

24 rightly -- that the Chairman and everybody is pressing the

25 Leadership, pressing us, to get an answer yesterday on something

1 that is a problem, and it deserves some thought and some
2 consideration.

3 Senator Packwood. I agree. I am delighted. I did not
4 want us to get in a bind where we are all of a sudden pushed
5 along with a lot of proposals that we have vague language on and
6 have to vote up or down on the allegation that we have to
7 finish by today or tomorrow afternoon.

8 Senator Nelson. I just want to say I agree with Sendor
9 Packwood. I assume we will have a reconsideration today. We have
10 been taking this up piecemeal and someday we would have some
11 kind of a package. I would like to see what the impact is of
12 some kind of final package and see whether there should be recon-
13 sideration, whether I would vote differently.

14 Senator Curtis. Mr. Chairman, I will do my very best to
15 cooperate with the Chairman. I think we need to move it out
16 without delay, but I want to concur with what Senators Packwood
17 and Nelson have said.

18 I will do my very best. I cannot be here Friday, but
19 otherwise I will be on hand any time you want to call me.

20 The Chairman. I think we have a very good rule with
21 regard to proxies. Senators can communicate their judgment and
22 be voted as long as we can muster a quorum here we can do
23 business, and sometimes without a quorum we can do our business
24 and make it official when we do get the quorum.

25 Senator Byrd. These tax matters are so important to so

1 important to so many people that I think we had best take
2 whatever time is necessary to be sure of what type of bill we
3 are going to send out of this Committee.

4 The Chairman. Senator, that is one reason I know that I
5 am going to have to ask for afternoon sessions before this is
6 over.

7 To me, this is a very important thing that we are voting
8 on, and we should take enough time.

9 Senator Danforth. Mr. Chairman, Senator Roth votes aye
10 on that corporate tax cut down to 42.

11 The Chairman. We will meet at 10:00 tomorrow morning.

12 (Thereupon, at 12:30 p.m, the Committee recessed, to
13 reconvene at 10:00 a.m. on Thursday, September 21, 1978.)
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