

*Bob*

OFFICIAL TRANSCRIPT

COMMITTEE ON FINANCE

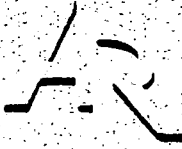
UNITED STATES SENATE

EXECUTIVE SESSION

AFTERNOON SESSION

Tuesday, August 19, 1980

Washington, D. C.

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EXECUTIVE SESSION

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TUESDAY, AUGUST 19, 1980

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

The committee met, pursuant to adjournment, at 2:40 p.m. in room S-206, The Capitol, the Hon. Russell B. Long, (chairman of the committee) presiding.

Present: Senators Long, Byrd, Nelson, Bentsen, Matsunaga, Moynihan, Boren, Bradley, Dole, Roth, and Chafee.

The Chairman. I have been urging that we try to vote on the individual tax cut first. I don't believe the staff is going to be able to show us the charts that depict how you arrive at those. We have given you a pretty good indication of what we have in mind. We would like to have rate cuts, increase in the exemption. I think that to take care of low income people we need some increase in the ZBA, don't we, in order to take care of them for inflation and cost of living, and also an increase in the earned income tax credit.

I think that we have about decided that we want to do something about the marriage penalty in connection with

1 that.

2 Senator Roth. May I ask the Chairman. I understand  
3 this morning that you did indicate on the rate cuts that  
4 there is a growing consensus on some kind of an  
5 across-the-board tax cut.

6 The Chairman. I suggested, and there was no objection  
7 to it, that we strike out the proposal V for smaller rate  
8 cuts, and that we think in terms of having more in rate cuts  
9 if we can.

10 What was the larger rate cut, what did you mean by  
11 that?

12 Mr. Shapiro. This was all rate. You do not have an  
13 increase in personal exemption, or an increase in the zero  
14 bracket amount. It was just a rate reduction.

15 The Chairman. That might be awkward. What we are  
16 asking the staff to bring up is not that. I would think  
17 that the staff might come up with something that might  
18 acceptable, if possible, by combining what you have in I  
19 and II.

20 Mr. Shapiro. That is correct.

21 The Chairman. Maybe we ought to talk a little about  
22 this item down here. How about the suggestion about doing  
23 something with the \$1,000 limited employment retirement  
24 account. Would you somebody explain some of that, too?

25 Senator Bentsen. May I, Mr. Chairman, on that.

1           Senator Dole and I both have been working on that one  
2 for some time. We passed Senator Dole's, as I recall, in  
3 the last tax bill in 1978, and that was dropped in  
4 conference. I have had one, S.557, along with Senator Dole,  
5 for a \$1,500 contribution by the employee to the company  
6 plan, or to an individual retirement account.

7           We should try to do something, obviously, to encourage  
8 savings. The savings rate in Japan is 22 percent, in  
9 Germany it is 13, and in France it is 13. In this country  
10 it was down to three, and now it is back up to about five.  
11 Senator Roth has also been deeply concerned about that.

12           What this would do would be to increase the savings  
13 rate in this country, and would be a major contribution, I  
14 think, in capital formation in helping people save for their  
15 retirement. This approach has already been approved by the  
16 Senate Finance Committee and the full Senate. I think there  
17 is strong support for our approach in the House this year.  
18 There is broad bipartisan support for the need for  
19 additional incentives for savings.

20           This would provide greater retirement security,  
21 particularly for employees who don't remain with a company  
22 long enough to get their minimum vesting provisions. In  
23 effect, it provides some portability for them. It has been  
24 a very difficult problem for people like scientists and  
25 engineers in the past, and this would help meet that. They

1 don't earn the private pension benefits, and this would be a  
2 very important supplement to Social Security.

3 There would be some penalties for early withdrawal in  
4 that type of a situation.

5 The Chairman. We have got three different  
6 suggestions. We would hope to come down on one of them.

7 Mr. Shapiro. Mr. Chairman, the basic ones that you  
8 have there, a and b, the problem existed in that the  
9 Congress in ERISA enacted the IRA, the individual retirement  
10 account. It had a \$1,500 amount, and if you had a spousal  
11 account, if you included your spouse, you could go up to  
12 \$1,750. However, if you were covered under any other  
13 retirement program, you could not have an IRA.

14 Subsequent to the enactment of ERISA, the situation was  
15 brought to the attention of the members that there were  
16 cases where individuals were covered by profit sharing  
17 plans, or pension plans, where they got very little. For  
18 example, in a profit sharing plan, there were cases where an  
19 individual actually got a couple of dollars a year, and lost  
20 a deduction of \$1,500 or \$1,750 because they were covered by  
21 a profit sharing plan.

22 On a number of occasions there has been interest in  
23 both the Ways and Means Committee and in the Finance  
24 Committee to provide what is referred to as a LIRA, a  
25 limited IRA, to allow individuals who are covered by another

1 plan to have some form of individual retirement plan. The  
2 problem has always been revenues.

3 Each time you have had a revenue bill, the Finance  
4 Committee has included this LIRA in the bill. When you have  
5 gotten to conference, and you have had priorities, it has  
6 always been right below where you cut off, and you have not  
7 had the revenue for it.

8 There has been agreement both in the Ways and Means  
9 Committee and the conferees, and the Finance Committee and  
10 the conferees, that you want to do it from an equity point  
11 of view, but you have not had the revenue. You needed to  
12 have a bigger bill to have the revenue to do it.

13 What this proposal is in b is to increase the \$1,500  
14 IRA to \$2,000 and eliminate the spousal. You do not have a  
15 separate one where you go up to \$1,750, you just have the  
16 IRA going to a flat \$2,00, and allow a LIRA up to \$1,000  
17 without any limitation.

18 The Chairman. Would that be "b"?

19 Mr. Shapiro. That would be "b."

20 The problem that we have had in the past in putting one  
21 together, and the members have tried to pass a rule that you  
22 don't get double dipping, and you try to coordinate your IRA  
23 and your pension fund, and it cannot be above a certain  
24 amount. We have run into so many complexities and problems  
25 with it that that has also dragged down the proposal.

1           The simplicity of this one, just to say that an IRA  
2 would be \$2,000, but if you are covered under another  
3 pension program, profit sharing or other deferred  
4 compensation payment program, you will be eligible for at  
5 least \$1,000, without any offset. It has real simplicity in  
6 this respect.

7           Senator Nelson. I had thought that the proposal made  
8 was that you limited IRA would be the difference between  
9 what you are receiving from the private plan and the maximum  
10 of IRA. Under this circumstance, if you had \$1,000 under  
11 the private plan, you would have \$1,000 under the limited  
12 IRA.

13           Mr. Shapiro. You are correct, Senator, and that is  
14 what the members have been trying to work out. The problem  
15 is that to determine the difference has been very  
16 difficult. If you know you had a profit sharing plan, and  
17 in one year you have got \$100 or \$3.00, you can make the  
18 difference. In a pension plan you don't always know the  
19 benefits.

20           It is difficult to make the determination, to define  
21 the pension plan, to define the benefit plans. It was very  
22 difficult, and as a result, simplicity and rough justice  
23 seemed to call for just having a flat \$1,000, without having  
24 to get into all the computations to make that distinction.

25           Senator Dole. I wanted to second what Senator Bentsen

1 has said. I don't think that the Treasury objected. I  
2 think that it was a question of how we could work it out.

3 Mr. Lubick: We had tried to work with you. I think  
4 that we had worked out a way of running it through the  
5 company's plan, so that we could make sure that we would  
6 continue to have broad coverage, and that it was not an  
7 incentive to hold the operation of the plans down in their  
8 generosity because higher paid employees would take  
9 advantage of these contributions.

10 I think we had worked out something at the tail-end of  
11 the 1978 Act. Since then we have also worked on another  
12 approach that would seem to accomplish that, which if it  
13 were to be done -- we don't think that it should be, but it  
14 is the notion of a credit rather than a deduction. If you  
15 had a 15 percent credit for your contributions up to a  
16 certain amount that would be of greater benefit to the lower  
17 paid employees. When the money comes out, it is all  
18 taxable, therefore, somebody in the 70 percent bracket might  
19 find it not advantageous to do this, whereas it might  
20 encourage a broader based coverage.

21 Senator Roth. Mr. Chairman.

22 The Chairman. Senator Roth.

23 Senator Roth. Mr. Chairman, I am sympathetic to these  
24 retirement accounts. I would like to see them enlarged, but  
25 I have two concerns.



1 First of all, I oppose eliminating the spouse. That is  
2 something that we especially created two or three years  
3 ago. Many of them have been formed. I think that it would  
4 be a step backward to not offer some opportunity to the  
5 housewife, which was the purpose of that legislation earlier  
6 adopted. So I would very strenuously oppose that aspect of  
7 it.

8 But in considering the savings, I wonder whether we  
9 want to limit ourselves to proposals that promote savings  
10 for limited purposes. I have to admit that I think all  
11 three are valid suggestions, and I am somewhat supportive.  
12 But if we go back to our basic concern that we need more  
13 individual savings for capital formation to help new small  
14 businesses, new ideas, and new concepts, it seems to me that  
15 we ought to at least take a look at some other proposals.

16 For example, before our Joint Economic Committee two or  
17 three weeks ago, Dr. Martin Feldstein testified that it  
18 would be a very favorable thing if we would treat savings  
19 somewhat the same as we do capital gains.

20 I think one suggestion introduced by Jack Smith would  
21 exclude from tax 25 percent of interest and dividend income  
22 up to a maximum of \$50,000. I am not saying necessarily  
23 that this is the form it should take, but I wonder if it  
24 would not be advisable to ask the committee, or the staff,  
25 to come up with something that was within our limits of the

1 first year that would genuinely promote savings on a much  
2 broader basis than this.

3 To me there is a lot of merit in this suggestion that  
4 we treat interest, for example, pretty much the same as we  
5 do capital gains. It would provide a real incentive to the  
6 little saver -- you could put a cap on it of \$50,000 or  
7 something, or maybe less -- that would begin to promote  
8 savings the way that is necessary.

9 If we are really going to talk about  
10 reindustrialization of America, and promote small business,  
11 which is most creative of jobs and that has to be one of our  
12 concerns, then we ought to give some thought to one of these  
13 other proposals. They still can save for yet these other  
14 purposes. They can save for their retirement. They can  
15 save to buy a home, or for any of those which are worthy  
16 goals.

17 What I am suggesting is that we could begin to phase  
18 in, let us say, roughly the same figure, \$1 billion, in some  
19 kind of a savings incentive that would be broader gauged.

20 The Chairman. It is a good idea. But how much would  
21 it cost?

22 Mr. Shapiro. The exclusion of \$200 for the single  
23 return, and \$400 for joint returns on interest and dividends  
24 is approximately \$2 billion.

25 Senator Roth. I understand the proposals that would

1 permit taxpayers to exclude from tax 25 percent of interest  
2 and dividend income up to a maximum of \$50,000 would cost in  
3 the first fiscal year \$1 billion.

4 The Chairman. To exclude what?

5 Senator Roth. Twenty-five percent of your interest and  
6 dividend income up to a maximum of \$50,000.

7 Senator Bradley. Mr. Chairman, I think that the  
8 proposal that the document here reflects on savings is the  
9 proper approach. If we are going to try to go at generally  
10 increasing savings across-the-board, you also have to look  
11 at the whole component of savings, a big chunk of which is  
12 retained earnings.

13 One person before the committee said that 40 to 50  
14 percent of all savings in this country is retained earnings,  
15 and that is what is reinvested to reindustrialize America.  
16 The thought that if you are going to increase the exemption  
17 on interest for individuals that somehow or other that is  
18 going to translate into a reindustrialization of America, I  
19 just don't think is correct.

20 If you eliminate retained earnings as a percentage of  
21 savings, eliminate what part of savings goes into housing,  
22 you don't have a whole lot left that is going to be used to  
23 reindustrialize America. So I think that if we allocate a  
24 certain part here to housing, you are moving in the right  
25 direction, and for certain other sectors.

1 I understand the appeal of saying we want to give my  
2 Aunt Alice another \$100 of tax exemption for interest, but I  
3 don't think that you can demonstrate that it directly  
4 translates into increased investments specifically in those  
5 areas of the economy that are going to increase our  
6 productivity.

7 The Chairman. As I understand your answer to the  
8 argument about the spouse is by going to \$2,000, anybody who  
9 would get the benefit of it with the spouse in there, would  
10 be covered. Is that the idea?

11 Mr. Shapiro. Yes. You put aside \$1,500 a year into  
12 IRA, if you include your spouse, you can include \$1,750, and  
13 this means that your spouse gets one-third rights in all  
14 respects of the account. In some cases that causes some  
15 complexity, some question.

16 It does not present a necessary tax policy reason.  
17 There was also some justification as to why you can raise it  
18 from \$1,500 to \$1,750. It was a compromise that was made  
19 after ERISA was enacted.

20 What is being suggested here was to go to \$2,000, and  
21 allow you to have \$2,000 for an IRA, and \$1,000 for a LIRA,  
22 and to eliminate that part of it which requires you to  
23 include your spouse as an incentive to go up to \$1,750. So  
24 if the committee wants to keep the spousal part of it, there  
25 is certainly not a strong policy against it. This was simply

1 an effort to try to simplify it.

2 The Chairman. Would that increase the cost if you put  
3 the spouse in there?

4 Mr. Shapiro. You can keep it without increasing the  
5 cost because you can just say, you get \$1,750, and if you  
6 include your spouse, you go up to \$2,000. So you can keep  
7 it, and it would not increase the revenue. The idea of  
8 eliminating the spouse was not to save revenue, it was just  
9 to try to say that you would have a simplified IRA, without  
10 having a special rule for the spouse.

11 Senator Roth. But there are already a number of these  
12 spousal accounts set up, and I think that it would be a  
13 mistake for us at this stage to back off of that.

14 Senator Chafee. Mr. Chairman, I need a little  
15 explanation here.

16 First, I don't see why somebody who is getting a very,  
17 very generous pension from a company, a high executive,  
18 should be able to set aside \$1,000 or \$2,000, or whatever  
19 you say, a year tax free, when it would be deducted from his  
20 income, and he would draw on it at his income bracket after  
21 he is retired. That is the proposal, isn't it?

22 Mr. Shapiro. That is one of the problems with the  
23 proposal. Senator Nelson has brought up the way the  
24 committee has approached it in the past, and that is to try  
25 to make up the difference. It got so complicated that it

1 got bogged down. But you are correct, that is one of the  
2 problems with the proposal.

3 Senator Chafee. The other question I have is, the  
4 accounts that you are permitted to put your money into under  
5 Keogh or IRA are hardly venture capital accounts. I am not  
6 sure how that is going to reindustrialize America. It may  
7 help the housing in America. But it is limited to savings  
8 accounts, isn't it.

9 Senator Bentsen. No. You can go into the insurance  
10 companies, and lots of other places, and there you are  
11 getting into a situatio where they obviously do buy  
12 industrial bonds. So it does talk about  
13 reindustrialization.

14 Senator Chafee. But it is not the individual who is  
15 going to be putting his money into some venture capital  
16 thing. He is setting his money aside.

17 Mr. Shapiro. You can use the IRA to buy and sell, and  
18 roll it over.

19 Senator Bentsen. Also, on ERISA, we made a change in  
20 the prudent man rule to try to assure that more money could  
21 go into venture capital by these pension funds where the  
22 contributions were made to insurance companies.

23 Senator Roth. Lloyd, you were out, I think, when I was  
24 mentioning the testimony of Martin Feldstein before our  
25 Joint Economic Committee.

1           The only question I raise, and as you know I have  
2 always been very supportive of these kinds of steps, I think  
3 that we have to go back to what is our basic purpose. It  
4 seems to me that the basic purpose is what John Chafee is  
5 talking about, to promote savings generally among the  
6 people.

7           Some people will want to save for retirement. Some  
8 will want to save for houses. Others will want to invest.  
9 For that reason, I would at least like to have the staff  
10 look at a broader proposal. For example, I think that one  
11 of the things that Martin recommended is if you ultimately  
12 exempt 25 percent of your interest and dividends from  
13 taxation, you try to treat it the same as you do capital  
14 gains. You may only want to do it for interest. I don't  
15 know whether we want to do it for dividends this year.

16           My suggestion is that we make it broader. You can  
17 phase it in the first year at 5 percent, and try to get  
18 maximum savings. It seems to me that one of the principal  
19 purposes of our legislation this year should be to again  
20 provide incentives that will promote savings among all  
21 people. What we are trying to do is to use these funds that  
22 are saved for capital formation, and some of them will go  
23 through that. But you have to maximize that, and for  
24 America to be more like the Japanese and others, and work  
25 some broader tax incentives.

1 I would suggest that we ought to ask the staff to take  
2 a look at, let us say, the first year and exempt 5 percent  
3 of your interest and dividends, and phase it into 25 percent  
4 over five years, or some other such formula. I realize that  
5 we have to keep within \$1 billion or so the first year.

6 I do think that there is great merit in trying to  
7 develop a long-term savings policy of this sort that will  
8 add to the capital formation of this country, and gives us  
9 the opportunity to incorporate the results of our research  
10 and development. I would like to see that as one option  
11 before we make a final decision.

12 The Chairman. We are going to have to decide if we  
13 want to commit ourselves to a particular figure, a  
14 particular amount of money, and if we want to recommend  
15 that as a tax cut. I think the committee, both in the  
16 short-term and the long-term, we have to look at that. It  
17 is not the most substantial item by any means, but it is a  
18 substantial item.

19 Let me ask Mr. Lubick to give us the Treasury position  
20 with regard to these items here, the LIRA and IRA  
21 proposals.

22 Mr. Lubick. We were concerned, first of all, Mr.  
23 Chairman, that our experience has been under IRAs that the  
24 utilization rates have been heavily weighted to the higher  
25 income employees. We have found that they have discouraged



1 the adoption, or restricted the incentive to adopt the  
2 broad-based pension plans which we think are such an  
3 important part of our retirement policy.

4 We would not like to see an expansion of individual  
5 accounts, which we think would lead to a lessening of the  
6 incentive to maintain the broad-based plan. That would be  
7 counter-productive.

8 We had worked with the committee to try to counter that  
9 along the lines that Senator Chafee had mentioned by taking  
10 into account employer contributions in measuring the  
11 non-discriminatory aspect of the proportion of contributions  
12 that were made. We think that some approach like that, or  
13 some approach that would not provide this disincentive to  
14 the broad-based plan is important.

15 We think that in dealing with any kind of savings  
16 incentive, it is important that it be designed to provide a  
17 natural incentive for savings, and that requires that it be  
18 limited to an net amount over and above the deductible  
19 interest. If you allow someone to borrow money, deduct the  
20 interest and then pay it into one of these accounts tax  
21 free, you are not encouraging savings.

22 Just as an exclusion along the lines that Senator Roth  
23 proposes, you are dealing with a gaming situation that  
24 allows people to make no additional savings, but simply to  
25 borrow, deduct the interest, and then have tax exempt or tax

1 deductible income. You have not encouraged savings, you  
2 have simply encouraged a gaming system.

3 We think that it is important that any incentive be  
4 limited to net investment income. We have had discussions  
5 with Senator Bentsen along those lines, and we talked with  
6 you about it at the time you added to the Windfall Profits  
7 Tax bill the recent exclusion.

8 At that time, I think, there was a general recognition  
9 of the problem of gaming, and it was felt that as long as it  
10 was limited to the very small amount that perhaps that  
11 problem was not so serious. But if you get to larger  
12 amounts, and you have expanded the incentive, you have  
13 encouraged a very significant amount of incentive to borrow  
14 the amount you are going to deduct, and you have not  
15 increased savings at all.

16 Senator Bentsen. Mr. Chairman, Mr. Lubick makes a  
17 valid point, certainly one that is of concern. But in the  
18 practicality of enforcement, you run into incredible  
19 problems. Did the person borrow the money to do this, or  
20 did they borrow the money to buy a car, or to pay off part  
21 of it. You try to get into nets. I think that you run into  
22 real problems.

23 Mr. Lubick: We had drafted, Senator Bentsen, a very  
24 simple tax bill that would be a mechanical question. If you  
25 are dealing with exclusions, for example, you would simply

1 take the interest income, and subtract the interest  
2 deductions, or the interest deductions aside from the home  
3 mortgage interest, and you would have a net amount. You  
4 would be able to measure it on a mechanical basis.

5 There is no policing or tracing problem is you do it  
6 mechanically. You would be right if you had a test that  
7 turned on whether the subjective intent of the borrowing was  
8 for this purpose. I don't think that you can have such a  
9 test. I think that you have to have a mechanical test, and  
10 apply the rule to net investment income that you give the  
11 benefit to, as opposed to measuring any intent for which the  
12 borrowing was undertaken.

13 Senator Bentsen. You run into the problem of the  
14 fellow who is rich and does not have to borrow, and some  
15 young fellow who is mortgaged up to the hill to try to make  
16 it, and you have the problem of how you apply it. I would  
17 really be concerned, and I would certainly want to study at  
18 length any so-called mechanical test for measuring it.

19 I don't want to get into the situation where, in  
20 effect, we favor the fellow who has all the cash and has all  
21 the money, and are not going to let a fellow work his way up  
22 by borrowing the money.

23 Senator Roth. If I might add a word to what Senator  
24 Bentsen has said. Sometimes, I think that we are so afraid  
25 of creating incentives to save because somebody may take

1 advantage that we end up doing nothing. I think there is  
2 general consensus here that savings to help reindustrialize  
3 this country is extremely important.

4 I don't care what we adopt, there is always somebody  
5 who is smart enough to exploit it in some way. But we are  
6 trying to make a very basic change. If we err, I think that  
7 we ought to err on the side of promoting savings.

8 It seems to me that in this section, our principal  
9 goal, whatever we finally adopt, should be to get more  
10 savings on the part of the American people. But we should  
11 not get so concerned about the technicalities, and the fact  
12 that one person or another may exploit it that we don't do  
13 anything.

14 I think that there is a certain amount of advantage in  
15 what I was suggesting Dr. Feldstein recommended. One of our  
16 proposals, Mr. Chairman, is that we move the capital gains  
17 to 70 percent exclusion, and it may be very desirable. At  
18 the same time, I would like to give the little people, who  
19 cannot utilize capital gains as much, some real incentive to  
20 begin saving. By getting millions to save, we can make a  
21 real difference in capital formation.

22 The Chairman. Let ask you. With regard to the  
23 depreciation, we have heard some discussion about Senator  
24 Bentsen's suggestion. That is on page 1. I did not hear  
25 any objection to it. At least, it does not cost near as

1 much in the long run as the 10-5-3, and if the 10-5-3 should  
2 prove to be a better way to do it, you could decide after  
3 about the third year whether you do it.

4 If you look at the figures there, the third year would  
5 be when the 10-5-3 would start to cost a great deal more  
6 than the Bentsen proposal. I would like to ask if we could  
7 agree on the Bentsen proposal for saving just on that  
8 basis. If it should be proved subsequently that the 10-5-3  
9 is a better way to do, we would have three years that we  
10 could look at that, and the cost would be about the same  
11 between the two in the first three years.

12 Senator Bentsen has modified his figures so that it  
13 would cost about \$4 billion the first year. After that the  
14 cost figures come down some.

15 Mr. Shapiro. Mr. Chairman, Senator Dole is not here  
16 yet. I was talking with the staff, and they want to go over  
17 some of the details of Senator Bentsen's proposal. They  
18 asked if that could be put off until Senator Dole is here,  
19 which would be tomorrow, when they think that they could  
20 probably study some of it and be in a position act.

21 Senator Roth. Could we ask the staff to do this in  
22 preparation for that, because I think it makes sense,  
23 before we adopt any proposal, I think that it would be  
24 worthwhile showing what the difference in treatment is,  
25 where it is making a difference with respect to buildings,

1 agriculture, equipment and so forth.

2       The first year, the phase-in of 10-5-3 is cheaper than  
3 even the Bentsen approach. I am not ruling anything out,  
4 but I think it would be helpful if we knew exactly where it  
5 was going to make a difference because that is one of our  
6 principal thrusts, doing something now about productivity.  
7 I would just ask that the staff compare where the  
8 differences are.

9       Mr. Shapiro. We will have that. Senator Bentsen  
10 proposal may have a little more impact in the first year, to  
11 try to get something up front to do what you indicated. We  
12 will have the comparisons for you, and we can have that in  
13 the morning as well.

14       The Chairman. Let me ask Senator Nelson about a small  
15 business proposal. Is he here?

16       Senator Matsunaga. He is not here.

17       Senator Bradley. Mr. Chairman, while they are  
18 preparing that for tomorrow, if they could also give us some  
19 idea of what kind of industries are in each of those four  
20 categories in 10-7-4-2?

21       Mr. Shapiro. Yes, we can.

22       The Chairman. I want to get the Treasury on record as  
23 to why the Treasury opposes the provision. I have some  
24 idea, but I want Mr. Lubick to explain it to me. Why does  
25 the Treasury oppose this idea of allowing the people who

1 take a shortfall to deduct their charitable contributions.

2 Why don't you stand up when you say that.

3 (Laughter.)

4 The Chairman. I don't see any clergymen in the room at  
5 the moment.

6 Mr. Lubick. Mr. Chairman, when you start right off the  
7 bat with a revenue loss of about \$3.5 billion to give tax  
8 relief to those people who are already getting and claiming  
9 the standard deduction. The standard deduction was intended  
10 as a simplification measure for taking into account the  
11 average amount of charitable giving.

12 We have had a lot of discussion about whether or not  
13 the incentive to give is there because of the tax system and  
14 the showings in the lowest brackets. There has been some  
15 controversy on that. We believe that basically most people  
16 will give a certain amount anyway, and that was the purpose  
17 of the deduction, to give to the church or to give to the  
18 United Fund. It is very large gifts to universities, where  
19 people in the 70 percent bracket are highly motivated by the  
20 tax deduction.

21 Basically, we went the route of moving to the standard  
22 deduction in order to enable the average person to avoid  
23 itemizing. If we go back and undo that, there will be 43  
24 million additional persons who will now become itemizers.  
25 It will be very difficult for the Internal Revenue Service

1 to police this area.

2 It is an area where there are a lot of estimates. It  
3 is impossible for the Service to go out and audit 43 million  
4 returns to see if, in fact, that amount was given. You  
5 would be taking a very gigantic step backward at very great  
6 cost, with very little additional productive benefit to  
7 charities.

8 The Chairman. I heard a preacher make a strong sermon  
9 in favor of tithing. He contended in his speech that that  
10 money for religion that is your obligation. That 10 percent  
11 of tithing is God's money. It is not yours at all, it is  
12 God's. If you don't put that 10 percent up, you are not  
13 paying your part to his share of the profits.

14 Based on his argument now, Mr. Lubick, what you people  
15 at Treasury down there are doing, you are taxing God.

16 (Laughter.)

17 The Chairman. Under the separation of Church and  
18 State, that is supposed to be contrary to anything we  
19 believe in here in this country, if you are going to tax God  
20 Almighty. How do you explain that, when you say that you  
21 are going to tax these charitable contributions, and you  
22 can't get a deduction.

23 Mr. Lubick. I understand that God was willing to take  
24 his share after taxes.

25 (Laughter.)



1           The Chairman. God will take whatever he can get, I  
2 suppose. But these preachers are pretty well convinced that  
3 there ought to be more money available for God to work with,  
4 and they would have it if you allowed this deduction.

5           Senator Moynihan is not here, and he is very upset. He  
6 will be very eloquent. I am a Protestant, you know, and he  
7 is a Catholic. By the time Mr. Moynihan gets through with  
8 this thing, he will have made a pretty strong argument.

9           Mr. Lubick. Forty-three million additional persons  
10 claiming these deduction, I think that some of it may be  
11 finding its way to places other than God's Place. It really  
12 is a gigantic problem in enforcement, and that is the reason  
13 that we put the standard deduction in in the first place.

14           In fact, in 1944, when the standard deduction was  
15 adopted, it was argued that it was going to discourage  
16 charitable giving. In point of fact, following the  
17 enactment of the standard deduction, when we had a  
18 simplification and non-itemization, the charitable giving  
19 increased.

20           I think the figures have shown that charitable giving  
21 is generally a percentage of disposable income. If you are  
22 going to reduce taxes for individuals, and put more money in  
23 their pockets, a large portion of that is going to end up  
24 doing God's Work. I think that it will not be necessary to  
25 give a special itemized deduction in addition to the

1 standard deduction for that.

2 The Chairman. You contend that if a preacher makes a  
3 good enough sermon, he will not need any tax advantage in  
4 order to get the contributions in.

5 Mr. Lubick: I think that he can ask for the  
6 contribution on the basis of the additional after-tax income  
7 which you will be giving with this tax reduction.

8 The Chairman. I don't know if that is going to go over  
9 very well among my preacher friends. I don't believe that  
10 they are going to be sold by that argument. I think that I  
11 will have to clear it with a couple of them between now and  
12 the time we vote on this measure. They seem to feel as  
13 though they are entitled to that deduction.

14 I really believe, and I suggested at the beginning,  
15 that I think it would be well if we could vote first on the  
16 individual rate cuts. In view of the fact that you are not  
17 in a position to give the back-up information we want on  
18 that right now, I think that we would be better advised to  
19 wait until we can.

20 There are some of the other items that we could vote  
21 on, but I would like to proceed on the basis of first seeing  
22 what the rank and file Americans are going to get. After  
23 that we are going to say what we will do about these people  
24 who, for one reason or another, have a very meritorious case  
25 to be considered.

1           If someone wants to ask for a vote at this moment on  
2 one of the items, I will be glad to accommodate them, but I  
3 think that it would be better to wait.

4           Senator Roth. Mr. Chairman, as we discussed earlier  
5 today, it had been my plan to offer the Republican tax cut,  
6 which would consist of 10 percent across the board, and the  
7 10-5-3 with respect to depreciation. After listening to the  
8 discussions today, it is now my feeling that I would wait  
9 because I think we are making some substantial progress.

10           I think that it is very important, if possible, that we  
11 come out as united as we can on a tax cut that would do  
12 something about long-term economic growth, and something  
13 about productivity. I think the fact that for the first  
14 time this year, in a bipartisan spirit, the Finance  
15 Committee has agreed that there ought to be a \$30 billion  
16 tax cut is most encouraging.

17           I think the fact that there is a growing consensus that  
18 we ought to provide tax cuts for individual taxpayers, that  
19 the chairman has talked about them being across the board,  
20 which I would again point out Jack Kennedy did in the early  
21 '60s, is encouraging.

22           I don't have any question that it will go as far as I  
23 would like, but at least I think that we are moving in the  
24 right direction. I think the same thing is true on  
25 depreciation. I am encouraged by the fact that, while we

1 have not agreed whether it should be Lloyd Bentsen's  
2 approach or 10-5-3 which has been a bipartisan approach,  
3 that we are going to do something in that area that perhaps  
4 can have the swiftest effect on productivity.

5 I would emphasize again that I think it is extremely  
6 important that we build broad gauged incentives to get the  
7 American people saving, because I think that is long-term  
8 one of the most important changes that can be brought about  
9 if we are really coming to become competitive in the world  
10 markets.

11 I do want to emphasize once more the importance I  
12 attach to individual tax cuts because I think sometimes the  
13 importance of that is overlooked. I think as a matter of  
14 equity, we have to do something for the people on the  
15 lower-end of the economic scale.

16 They are already hit with inflation and other  
17 problems. Their taxes are going up. Their Social Security  
18 costs are going up. So I think as a matter of equity, it is  
19 important that we give them some significant tax cuts in  
20 their rates.

21 I also think that it is important that we carry that  
22 across the board because when it really comes right down to  
23 it what we are trying to do is create jobs. The only way we  
24 are going to create jobs, meaningful jobs -- I think the  
25 Joint Economic Committee agrees on this -- is that it should

1 be done in the private sector. If we are going to do it in  
2 the private sector, then we have got to have savings.

3 Those on the lower end of the economic scale, they are  
4 going to spend probably what they get in tax cuts right  
5 now. There are not going to be a lot of savings there. But  
6 as we get to the middle-class, and the more affluent, then  
7 we are going to have savings.

8 As Jack Kennedy eloquently said, "That is for the good  
9 because the ultimate goal is to create jobs for those who  
10 are unemployed."

11 So as one step to maybe expedite what we are talking  
12 about, it is now my intent not to offer this at the  
13 beginning. I would prefer to sit back and help shape and  
14 develop what I hope is a sound approach. But I do, as I  
15 said this morning, reserve the right if I don't feel that  
16 the end package does enough to improve productivity and  
17 savings.

18 Senator Bentsen. Mr. Chairman, if I might comment on  
19 that.

20 I am one of the early sponsors of 10-5-3, and I agree  
21 very much with the objectives of 10-5-3. As we listened to  
22 the testimony, and as we studied the application of it, some  
23 of us came to the conclusion that there was a distortion  
24 that took place in the allocation of capital, and that there  
25 was a heavy favoritism towards long-lived assets. We had to

1 take care of that by trying to bring about a neutrality in  
2 the tax system where you did not favor one class of assets  
3 above another, and where you tried to make the return after  
4 taxes on assets equate. That is what we have tried to do  
5 with 2-4-7-10.

6 We have taken the open-ended accounting of the Canadian  
7 system, which vastly simplifies the accounting practices  
8 and what has to be done. 10-5-3, for example, has a  
9 carry-forward basis on assets that goes on ad infinitum, and  
10 could give you very serious accounting problems in tracking  
11 the assets through that period of time.

12 This does not occur in open-ended accounting. The  
13 asset goes in. You take the asset out, and the way you  
14 account for it is by lowering the total amount in that  
15 classification so that your depreciation is effected on a  
16 lower base. That is a very great simplification that we  
17 have tried to bring about.

18 In addition, there were deep concerns about this  
19 perhaps moving industry to the Sunbelt. We have tried to  
20 address that with the 25 percent investment tax credit. I  
21 think that we tear down too many buildings, and we don't do  
22 enough for rehabilitation in this country. So this helps  
23 address that.

24 We then went to small business to try to help them by  
25 going to a \$25,000 charge off if that is what they want to

1 do. On new equipment purchase, charge it all off the first  
2 year, or they can have the alternative of going into the  
3 2-4-7-10.

4 We were deeply concerned about the 10 years on  
5 buildings, and the question of whether that was to just to  
6 build shopping centers or office buildings, so we went to 20  
7 years straight-line, which I believe treats the situation  
8 with fairness, but gives some additional incentive there,  
9 too.

10 So overall the package has been one that has profited  
11 by some creative, innovative thinking in the very beginning  
12 in trying to do some of these things. We have listened to  
13 the objections, and we have tried to correct them here. We  
14 have had a great deal of assistance in this regard from the  
15 staff of this committee, the Joint Economic Committee, and  
16 many others.

17 Senator Byrd. Mr. Chairman, I think a great deal of  
18 progress has been made in clarifying the thinking of the  
19 committee today. I think that the papers that have been  
20 developed have been very helpful. I am inclined toward the  
21 Bentsen approach on the depreciation, although I don't  
22 totally write off the other.

23 I think that the capital gains proposal has a great  
24 deal of merit. In the individual field, I think that it is  
25 very important that it be an across the board reduction. I

1 would hope that this committee could work out some proposal  
2 for a reasonable and appropriate across the board  
3 reduction. If it doesn't, I am prepared to support Senator  
4 Roth's proposal. But before voting on his proposal, we  
5 ought to have the opportunity to know the details of the  
6 staff proposal.

7 I would hope that we would not get into a lot of  
8 gimmicks, but a straight across-the-board reduction.  
9 Gimmicks is what has gotten us in trouble in the past, as I  
10 see it. We have been going too much in the past to  
11 gimmicks, and that has caused some of the problems, as I see  
12 it.

13 So I am flexible, and I would hope that this committee  
14 could agree on the personal reduction being across the  
15 board.

16 Senator Chafee. Mr. Chairman, as I see, we have got  
17 five sessions left. Two tomorrow, two Thursday, and one  
18 Friday morning. In order to get to digest this, is it  
19 possible to say that at such a such a session, we shall vote  
20 on the depreciation, let us say, tomorrow, or whenever you  
21 say.

22 The Chairman. I would like to vote on the depreciation  
23 tomorrow. Is that all right with you, Senator Bentsen?

24 Senator Bentsen. That is fine.

25 Senator Chafee. Then at such and such a session, we



1 will consider the individual tax because they are a  
2 complicated matter, and will require some study.

3 The Chairman. I would like to vote on the individual  
4 tax cut if we can, depending on how soon you can be ready.

5 Mr. Shapiro. We will try to have as much as we can in  
6 the morning. We would like to suggest that you start your  
7 morning session at 10:00 o'clock with depreciation. Then we  
8 will try to have what we have on the computer, if there is  
9 any problem, because most of the time it takes us into the  
10 night because sometimes others are using the computer as  
11 well.

12 So we will give you what we have in the morning. It  
13 should all be available to you in time for the afternoon  
14 session tomorrow.

15 Senator Chafee. Could we say that tomorrow afternoon  
16 we would vote, or whatever you say.

17 Mr. Shapiro. I think you are saying the depreciation  
18 in the morning, and the individual in the afternoon.

19 Senator Bentsen. That is all right with me.

20 The Chairman. Do you think that you can have the  
21 materials ready in the morning.

22 Mr. Shapiro. We will try. Unless there is a problem  
23 that develops that is not anticipated, we should be able  
24 to.

25 Senator Matsunaga. I agree with that.

1           Two other matters. We have been talking about  
2 increasing productivity, and I think we are all agreed on  
3 that. We have been thinking more in terms of expansion of  
4 business for productivity. There is an area which I would  
5 like to have the staff make a study of, and it is the  
6 increase of productivity per manhour.

7           I find in my study of profit sharing that the profit  
8 sharing firm on the average makes anywhere close to 20  
9 percent greater productivity per manhour than one which has  
10 no profit sharing comparing the same type of industry. Let  
11 us say, a company in the clothing or garment industry, one  
12 with profit sharing and the other without, you will find  
13 that the one with profit sharing, the individual produces 20  
14 percent more.

15           If we could have the staff look up what it would cost  
16 to provide the incentives for companies to go into profit  
17 sharing -- When I was in the House, I led the fight to  
18 increase the credits for profit sharing, and to postpone the  
19 taxes on profit sharing until some such time as they  
20 withdrew those profits.

21           If the staff could work up something in that regard, I  
22 think productivity would be greatly helped even with the  
23 expansion of existing business.

24           Secondly, I think that we need to do something about  
25 credits for the elderly. We have not had any increase for

1 quite some time. Maybe the staff can work up something in  
2 that area.

3 The Chairman. Maybe we ought to just go ahead and vote  
4 on the capital gains provision. I don't think that there is  
5 any objection to it. Is there any objection at all to the  
6 70 percent exclusion for capital gains?

7 Senator Chafee. Mr. Chairman, I just heard that  
8 Senator Wallop was interested in a 75 percent on capital  
9 gains. I presume that he would like an opportunity to  
10 present his argument on that.

11 The Chairman. You mean a 75 percent exclusion?

12 Senator Chafee. Yes. I have just heard that.

13 Senator Roth. I would point out also, Mr. Chairman,  
14 that if we reduce the tax rates that automatically has an  
15 impact on the capital gains, which I don't think should be  
16 overlooked. It may come closer to what Senator Wallop is  
17 looking for.

18 Senator Chafee. It may satisfy him.

19 The Chairman. Let me just see if I recall correctly.  
20 I want you to try to recall with me, Mr. Shapiro. If I  
21 recall correctly, the Kennedy recommendation, when John  
22 Kennedy was President, was that we drop the top rate down to  
23 65 percent, and the exclusion to 70 percent. Is that right.

24 Mr. Lubick. I was with you here, then, Senator Long.  
25 We joined together in proposing the 70 percent exclusion for

1 capital gains, and allowing for taxation of gains at death.  
2 Those two were tied together.

3 (Laughter.)

4 The Chairman. I am glad you brought that up. Mr.  
5 Lubick, you have demonstrated beyond any doubt to me that  
6 you have a way of being right, and you also have a way of  
7 being wrong.

8 (Laughter.)

9 The Chairman. Just because you show up with an idea  
10 that is not any good, when the public thinks it over they  
11 are convinced that they should not do it, it does not mean  
12 that we should not go along with it when we think that you  
13 are right.

14 (Laughter.)

15 The Chairman. It seems to me that if we should, in the  
16 course of this, agree that we will have some across the  
17 board reduction, which would affect the capital gains of  
18 couse, but if you did it would still be on about all fours  
19 with what the Kennedy recommendation was, which was  
20 basically what we were looking at at the time that we came  
21 out of the committee the last time.

22 As I recall, what we came down on was a 21 percent on  
23 capital gains, wasn't it?

24 Mr. Shapiro. That is correct. You had a 70 percent  
25 exclusion, which amounted to a maximum tax on capital gains

1 of 21 percent.

2 The Chairman. After the Senate got through hearings,  
3 and persuasive debate and some eloquence, and all sorts of  
4 demagoguery, it showed good judgment by adopting the 21  
5 percent. Then we went to the polls, and those who voted for  
6 the 21 percent had a good day out there, and those who did  
7 not agree did not do so hot.

8 So it seems to me that the matter has been thoroughly  
9 considered by all concerned. But if someone wants to offer  
10 some other suggestion, I will wait and hear from them.

11 Senator Bradley. Mr. Chairman, is there any objection  
12 to dealing with the research and development tax credit  
13 now. Is there anyone opposed to that.

14 Senator Chafee. I know that Senator Danforth is very  
15 enthusiastic about it.

16 Senator Bentsen. So am I.

17 Senator Chafee. I know that Senator Danforth is for  
18 it. I don't see him here.

19 Senator Bradley. He is in the other committee  
20 meeting.

21 Senator Bentsen. That provides for a running average  
22 which has to be a percentage of increase over the last three  
23 years. Then your tax credit goes against that. That is  
24 pretty comparable to what the Japanese do on theirs.

25 Senator Bradley. It is also much improved over last

1 year's approach, which was incremental only over one year  
2 instead of the three years.

3 Senator Bentsen. That is right.

4 The Chairman. In view of the fact that we are not  
5 ready to vote on the things that are going to be generally  
6 applicable across the board to taxpayers, I think that it  
7 would be better to wait and vote on that later.

8 I don't like to start out voting for something that is  
9 going to affect a small minority of taxpayers. I think that  
10 it will be better to start voting tomorrow. We will plan  
11 that tomorrow we will vote on depreciation, and then after  
12 voting on depreciation, we will vote on the individual tax  
13 cut.

14 Senator Roth. It was not clear to me, Mr. Chairman,  
15 whether as one of our options it would be possible to get  
16 the staff to look at this phasing of the Felstein idea.  
17 What I am suggesting is that we exclude from tax 25 percent  
18 of savings up to a maximum of \$50,000, and that it be phased  
19 in at 5 percent a year over a period of five years. Maybe  
20 we don't want to adopt it the first year, although I think  
21 it would have a much less substantial effect. It is my  
22 understanding that it would cost roughly \$1 billion in 1981,  
23 which I think is in the ballpark of what we are talking  
24 about.

25 Mr. Shapiro. We will provide an analysis.

1           Senator Chafee. Mr. Chairman, could I ask one quick  
2 question?

3           The Chairman. By all means.

4           Senator Chafee. I notice in this list you have a  
5 reduction of the corporate rate to 44 percent, which is a  
6 two percent drop. Can we accommodate that with the  
7 depreciation efforts we are making?

8           Mr. Shapiro. Along the lines of Senator Bentsen's  
9 proposal, you can accommodate that. It is one of the  
10 reasons for the suggestion that it is an across-the-board  
11 cut for all businesses, and in addition to just  
12 depreciation. If you were to increase other business  
13 incentives, however, then maybe we would have a problem. As  
14 of now there is ample room to accommodate that proposal.

15           Senator Chafee. Thank you.

16           The Chairman. Thank you very much.

17           (Whereupon, at 3:35 p.m., the committee adjourned, to  
18 reconvene at 10:00 o'clock a.m., Wednesday, August 20, 1980.)

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