THE REVENUE ACT OF 1971

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-SECOND CONGRESS

FIRST SESSION

ON

H.R. 10947

AN ACT TO PROVIDE A JOB DEVELOPMENT INVESTMENT CREDIT, TO REDUCE INDIVIDUAL INCOME TAXES, TO REDUCE CERTAIN EXCISE TAXES, AND FOR OTHER PURPOSES

OCTOBER 7, 12, 13, 14, 15, AND 18, 1971

Part 2 of 2 Parts
Oral Testimony
October 14, 15, and 18, 1971
and
Written Testimony

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

[illegible] WASHINGTON : 1971

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402 - Price $4.25

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THE REVENUE ACT OF 1971

THURSDAY, OCTOBER 14, 1971

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 10 a.m. in Room 2221, New Senate Office Building, Senator Russell B. Long (chairman) presiding.

Present: Senators Long, Anderson, Talmadge, Byrd of Virginia, Nelson, Bennett, Curtis, Miller, Jordan of Idaho, Fannin, and Hansen.

The CHAIRMAN. This hearing will come to order. The committee is pleased to have before us today the Honorable Jacob K. Javits, U.S. Senator from New York. Senator Javits has down through the years demonstrated a very thorough and sophisticated interest in all matters involving foreign trade and economic problems generally, and we are pleased to have your views, Senator Javits.

STATEMENT OF HON. JACOB K. JAVITS, U.S. SENATOR FROM THE STATE OF NEW YORK

Senator JAVITS. Thank you very much. Mr. Chairman, I am here to present what a group of my colleagues and I consider an innovative idea to the committee in respect of whatever it may decide to do on the investment tax credit. I have a prepared statement which I ask to have printed in the record.

On October 1, 1971, together with 12 other Senators, I introduced S. 2632, which has been referred to the committee. The idea behind S. 2632 is to establish a tax credit for the creation of additional jobs—a direct increased employment tax credit. The cosponsors of S. 2632 are Senators Brooke, Cook, Hatfield, Mathias, Packwood, Percy, Randolph, Saxbe, Schweiker, Stafford, Taft, and Williams.

The tax credit proposed by S. 2632 would be in addition to, not in substitution for, the investment tax credit which has come over to us from the other body and is sought by the administration.

The fundamental brief which we have, my cosponsors and I, is twofold. One, that generally speaking, through the economy the investment tax credit as asked for by the administration is not a job development tax incentive, essentially, it is a modernization incentive, and I would say I certainly am all for that, and I believe that those cosponsoring this measure with me are for that, but we do have a serious unemployment situation in the country, and about half of all employment is in service fields, which is not heavily capital impacted, and, therefore, the idea of having a direct tax initiative for job creation seems to us to be attractive.

This is the essence of the idea.

The techniques which we use, the technical situation which we present to the committee in the bill, can very well be worked out by the committee.

This should be put in the category of a suggestion. The basic idea which we present to you is, will you or will you not crank into the package a proposal which will have a direct effect in initiating because of tax advantages the creation of new jobs?

That is the essence of what I would like to present.

Senator TALMADGE. Will the Senator yield at that point? Last year during the consideration of the family assistance plan in the Senate, I offered a somewhat similar amendment, primarily to implement the WIN program in which people of limited skill and limited education had difficulty in procuring jobs.

This committee approved the amendment at that time unanimously. The Senate also approved it by a vote of 81 to zero. We never went to conference with the House on the bill last year, and, as the Senator knows, my amendment never had an opportunity of becoming law. Therefore, I intend to offer the same amendment to this bill.

As the Senator also knows, President Nixon in his campaign in 1968 strongly urged such a program.

Senator BENNETT. May I ask the Senator a question?

Are you going to offer it to this bill or the welfare bill?

Senator TALMADGE. I intend to offer it to this bill.

Senator BENNETT. Senator Talmadge, this proposal of yours is directed essentially and primarily to low-income people; is it not?

Senator TALMADGE. That is correct.

Senator JAVITS. The measure which we present to you is directed across the board to an increase in the opportunity for jobs regardless and without regard to economic status of the individual who would get such a job.

I would hope, Senator Talmadge, in view of your interest in the subject, that you would study this carefully.

Senator TALMADGE. I will be glad to take a look at it. My interest was primarily in those people with few skills and limited education, who have made a career of welfare. They are able bodied and capable of working, but they lack the necessary skills. I am of the opinion that this is where we ought to make the first thrust.

As the Senator knows, we have some 19 different Federal agencies and subagencies conducting some 39 job training programs. Many of them consist of classroom training for nonexistent jobs, and they have not been very successful.

I share fully the Senator's concern. The way to make a productive employee is to put him on a piece of machinery or equipment and teach him how to use it.

Once he learns to use it, he is a self-sufficient citizen and a taxpayer.

Senator JAVITS. As I say, I am very pleased with the Senator's continuing interest in this field. I think we will find that the bias of the idea we have in mind is to favor the relatively low skilled, and, therefore, I am rather hopeful when he studies this he may decide that it rolls into a broader pattern of what he himself had in mind, and I was going to add substantively that no one would be happier than

I, and I believe the cosponsors of our bill would feel the same way, if the Senator decided as a member of the committee to espouse the whole theses.

So I welcome very much the Senator's interest and the Senator's thoughtful utilization perhaps of this design.

Now, the bill seeks to accomplish its purpose by giving a credit of $4 per man-day for additional employment which is created over and above the employment in a base period.

Now, again I repeat, the various scales of how much and the techniques are a suggestion. The basic idea is to give a credit for job creation. Our scheme is 4 dollars per man-day, which comes to about a thousand dollars per man-year, and we estimate, and we ran it through computerized estimates in the Joint Economic Committee's facilities, which has a computer available to it, we estimate based upon what I have just told you that 500,000 additional jobs can be created by the end of the fiscal year; that that would involve the first year cost of the tax rolls of $1,800 million, and that would taper off very sharply thereafter.

Now, we've juxtaposed that concept of the $4 per man-day credit to other proposals now in the mill. My credit, for example, has been calculated as a constructive 4 percent corporate tax rate reduction. So what would happen if you reduce the corporate income tax by 4 points, and channeled the additional cash flow into let us say, capital spending? On that assumption we find that 300,000 jobs would probably be encouraged, which would cost us about $2 billion.

So we juxtaposed a $3,600 cost per job on our basis as against a $6,600 cost per job if you reduced the income tax by say 4 points with a corresponding rise in capital spending.

Now our thought is to complement, not to replace, the tax credit which the administration seeks. And we believe that the approach which we have is very likely to encourage employment rather than overtime because we lay the credit on the basis of a 7-hour day. So that you could not get the credit by working people overtime, which is a big consideration.

Also we feel that it has a very strong effect of getting people in the less skilled and lower paid levels because a flat rate benefit is greater for low-wage employees and I think that goes very much to Senator Talmadge's point in giving an inducement to get people who may need some training because you have a benefit with which to give them some training, carry them along even for a short time. Their work may be uneconomic in terms of production.

Finally, naturally, we are deeply interested in increasing productivity and I am, as I think you all know, one of the prime movers of that idea including a major bill to establish local and plant productivity councils.

It is logical to assume that this type of employment would not be as productive as normal employment. There would be a certain discount which an employer could avail himself of because these people are not as productive. But you have to balance that off against the fact that we are materially underusing our facilities today and that we are anxious to have a direct impact for social reasons upon employing more people, and, therefore, in the trade off we believe that it is very much to the advantage of this kind of inducement, even though I am the first to say that these people may be somewhat less productive.

That is the matter we would like to lay before you and hope very much that it may stimulate thinking in the committee.

Senator Talmadge already has indicated his interest so that we have a balance in the Senate to the administration emphasis.

I will say this: It is so obvious it almost surprises me. Half of our economy is capital goods impacted industries, relatively speaking blue collar workers. Half of our economy is in the relatively speaking service industries. We are trying to encourage, says the President, job development in the capital impacted industries.

It certainly seems to me that to balance out the package you have to do something about encouraging employment in the service industries where you don't have the input of capital goods and, therefore, where they will really get very little, if anything, except perhaps for typewriters and things like that, out of the capital goods tax credit.

I have just one other piece of evidence, Mr. Chairman, I would like to lay before the committee and then I am through. Our researchers discovered a very interesting, not analogy, but parallel with our situation, in the United Kingdom.

The United Kingdom has passed a bill which is now in effect called the selective employment tax, which was introduced in 1966. This imposes a heavy tax on employment, all employment, but rebates the tax to employers in the manufacturing industries in depressed areas.

The theory being there to shift if they can employment from services to manufacturing, and the report which has been made on the operation of the bill indicates that it has been quite effective in its operations.

That was a problem for apparently the British economy. They were draining people away from the blue collar jobs to white collar jobs and they wanted to recapture some of them.

The analogy it seems to me is an interesting one with our own situation. It shows that a tax measure can be effective in a shift of employment and that is why I think that we have a right to consider seriously this tax measure if we want to build up employment in an area of the economy which contains half of the total employment.

That is all, Mr. Chairman, thank you very much.

The CHAIRMAN. Thank you very much. It is a very interesting idea, we will certainly look into it.

Senator CURTIS. Senator, I have read your statement even though I arrived late. I think it has interesting possibilities. I would like to ask you if you have an opinion with reference to a proposal that wages paid for nonbusiness purposes be regarded as a deductible item for the person who pays the wages?

Senator JAVITS. Wages paid for nonbusiness purposes?

Senator CURTIS. Yes; if you hire someone to work about your house or paint your house or to do anything else, build you a driveway, work inside, it is not a tax deduction. It is if it is a business. I am thinking of a great many retired people who might be employing individuals to perform work for them with this incentive.

Senator JAVITS. Senator Curtis——

Senator CURTIS. After all, they take part of their income and pay it to somebody else in wages.

Senator JAVITS. Theoretically I would say that sounds logical. Practically I see two great difficulties with it and I do have an opinion. One is that in that particular area of nonbusiness compensation one of the difficulties is in ability to get that kind of help. And the second problem as I see it, it does run counter to the whole philosophic concept of our tax system that you are entitled to deduct from what produces income.

In other words, you are in a sense as a taxpayer in business for yourself. If you produce income then you are entitled to deduct, generally speaking, whatever you spend in order to produce it.

That is not produced income which you have in mind. Whereas what I am testifying to does produce income, therefore, we give a special advantage to encourage a given result but it does produce income, it is counterbalanced on the other side.

I don't rule out what you said.

Senator CURTIS. We have not followed that theory absolutely. An individual taxpayer is entitled to a deduction for interest paid and the interest might have been paid for any kind of a debt, one foolishly incurred or even money borrowed to pay a gambling debt.

The interest is deductible.

Senator JAVITS. That is very valid. But the generality of borrowing is for, some constructive purpose or buying a house or some other purpose which contributes to the totality of the national resources.

So I can see some justification for that. But I might think it over and decide I am with you but immediately those two points came to mind.

The CHAIRMAN. Let me illustrate the same point where it appeals to me. We have had the good fortune right now to have somebody to help Mrs. Long with the housework. I think anybody ought to feel fortunate if he can get help these days. I would be perfectly content if I could deduct that expense and pass that savings in taxes along to that worker.

In other words, if you are in a 20-percent bracket you can afford to pay a person 30 or 35 percent more than you can pay otherwise, and the thought occurs to me that would be a desirable goal if we could find a way to assure that all or most of the tax advantages would go not to the employer but to the employee. There are a million and a half low-wage employees in this country who are working in domestic services where it is not deductible and you really can't help them by reducing their tax because they don't pay much in tax anyhow.

But if you reduce the other fellow's tax on condition he passed the tax savings on to them it could have some of the same advantages you are talking about here.

Insofar as we can help those less fortunate by reducing somebody else's tax provided that he would pass the tax advantage on to the employee that has some appeal to me and I am going to suggest something along that line which I think is parallel to what you are suggesting.

Senator JAVITS. I think the concept of an effort to use a credit for the purpose of stimulating increased employment is a very valid one and that is the essential idea that I want to lay for myself and the 12 other Senators before the committee.

We think that our plan, because it does follow the basic pattern of the tax system, to wit, it seeks additional credit but an incentive credit but in an area where income is produced is consistent with the tax scheme.

These other plans may very well, based on the facts, produce additional income. I think they are less advantageous rather than more because of that fundamental.

The CHAIRMAN. Thank you very much. You have made a very good presentation for your suggestion and it has a lot of merit.

Senator JAVITS. You were very kind, Mr. Chairman.

(Senator Javits' prepared statement and a subsequent statement of Senator Javits received by the committee follows:)

PREPARED STATEMENT OF JACOB K. JAVITS, A U.S. SENATOR FROM THE STATE OF NEW YORK

The full Employment Act of 1946 expresses the policy of the United States to provide "conditions under which there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work, and to promote maximum employment, production and purchasing power."

We are far short of the goal of full employment today—several million jobs short of it—and given the most optimistic estimates there is little chance that we shall achieve it in the near future if we must operate within the general parameters of the Administration's current economic and tax proposals.

My purpose in appearing here today is to urge you to include within the tax package you are shaping as a part of the President's New Economic Policy, a direct incentive to every businessman in America to increase his work force through the use of a tax credit based on net additional employment. The basic concept of such a tax credit is embodied in S. 2632, a bill which with 12 other Senators I introduced on October 1, 1971. Under it, during the next two years, any employer in America whose employees work more man-days in the current year than in the previous one will be eligible for a tax credit in the amount of $4 per man-day, or about $1000 per man-year. The credit is structured in such a way as to discourage use of overtime and part-time employees. Also, because it is fixed in amount at $4 per man-day rather than calculated as a percentage of wages, it would operate as a greater incentive in the case of low-wage, marginally skilled employees.

On the basis of computerized estimates prepared by the staff of the Joint Economic Committee, I believe that this kind of tax credit could be expected to generate at least 500,000 additional jobs by the end of the first full year, at a total cost to the government of $1.8-billion during the first year, tapering off sharply thereafter. That sounds like and is a great deal of money, but it is actually much less expensive ($3600 per additional man-year) than other proposals such as the investment tax credit ($6600 per additional man-year) or public service employment ($5000 to $7000 per man-year) designed to create additional employment.

This employment incentive credit is designed to complement, not to replace the investment tax credit. The latter may well be needed to encourage American business to modernize its facilities and as a general adjustment of the corporate tax rate in order to permit American businessmen to compete fairly with their foreign competitors. But at best—given the fact that our industrial plant is presently operating at only 73 percent of capacity—it will directly stimulate activity only in capital-intensive industries and in some cases may even encourage the elimination of jobs through automation. And, the investment tax credit will have very little effect on service industries which now employ about 50 percent of all American workers.

What is needed is a more broadly-based measure which is addressed directly to the creation of additional jobs in all industries, and that is the purpose of S. 2632.

To put the issue in its proper perspective, I think it is useful to focus on the number of additional jobs we need to create to reach an unemployment level of not over 4 percent. According to the Bureau of Labor Statistics, during the coming year over 2 million additional jobs will have to be created to reach 4 percent unemployment by the end of 1972.

That is the goal which we should seek, and my proposal is designed to fit in as part of an overall plan designed to achieve it.

I recognize, of course, that what I am suggesting is an entirely new approach to the problem of expanding employment. But I am convinced it is one which deserves a trial. I am submitting herewith a favorable report from the staff of the Joint Economic Committee, as well as a highly favorable study by economists at the University of California of a similar tax credit proposal. I have also asked the Council of Economic Advisors, as well as other economic forecasters, to examine our proposal and we should be able to submit additional economic analysis to you shortly.

Until very recently we have sought to achieve the goal of full employment, and at the same time contain inflation, primarily through the use of overall budgetary and fiscal policy. What the past decade has shown, however, is that these traditional weapons of economic management are inadequate or, at best, clumsy tools to achieve that objective. With them we have not been able to move to contain inflation without producing a substantial amount of unemployment; nor have we been able to reduce unemployment below about 4.5 percent without losing price stability.

We are now at the point of searching for more effective tools of economic management; in particular this Committee is concerned with shaping a new tax policy which will help to stimulate economic activity, yet assure the availability of the revenues which we will need to enable us to continue to deal with our pressing social problems. Indeed, the President's economic stabilization program offers a unique opportunity to take new economic initiatives.

A tax credit along the lines I have proposed can furnish a powerful new tool to stimulate additional employment without increasing inflationary pressures. It would provide a direct incentive for additional employment, yet because it would do so by *reducing costs* it would avoid putting any upward pressure on prices in the way that a simple increase in government spending would. Furthermore, it would have the added virtue of reducing costs in the one area—labor—where our foreign competitors generally have had their greatest advantage over us.

I urge this Committee to give the most serious consideration to including the kind of tax credit proposed in S. 2632 as an extremely powerful device to help us achieve full employment with price stability. I am not, of course, committed irrevocably to the exact terms of S. 2632, and I hope that the Committee will carefully examine possible variations on the same theme, including a credit based on a percentage of wages, and the possible use of a trigger device to end or reduce the credit as we approach full employment. In that connection, I and my staff have been working on some technical aspects of the credit, and I will be furnishing you with additional technical comments in the next few days.

Statement of Hon. Jacob K. Javits, a U.S. Senator From the State of New York

I urge the committee to include in the legislation it reports the provisions of S. 809, a bill I introduced on February 17th to provide the disabled for the current year an income tax deducation of up to $650 to cover transportation to and from work and to allow them the same additional $650 income tax deduction as is now given the blind. This amount would increase as the personal deduction sum increases under the law.

This measure is, in part, similar to the amendment to the Tax Reform Act of 1969 which was sponsored by the distinguished Senator from Arizona, Mr. Fannin, of which I was a cosponsor. The amendment provided for a tax deduction of up to $600 to the disabled for transportation and was approved by the Senate on December 4, 1969 Unfortunately, the provision was lost in conference.

This proposal is a logical sequence to a series of enactments by the Congress of legislation designed to help the handicapped become useful and productive citizens. The Civilian Vocational Rehabilitation Act of 1920 provided grants in aid for such services as job training and artificial limbs. The Vocational Rehabilitation Act Amendments of 1943 broadened the program to include, among other things, corrective surgery And the 1954 Amendments further broadened the law to enable Federal grants to be utilized for equipping rehabilitation facilities and for sheltered workshops. In 1968, the scope of the program was further broadened. My proposal is now a logical next step.

The nation is now expending more than $1 billion annually for rehabilitation programs. The economic incentive envisioned by S. 809 would further help these people to help themselves and aid them to achieve some personal independence from institutions, from overburdened families, and from local and State governments.

It has long been evident that our handicapped citizens are capable of being productive workers, contributing to the Nation's economy instead of being dependent upon it. But their disabilities impose upon them additional expenses in pursuit of their livelihoods which are not fully deductible, such as special orthopedic devices, extra travel costs because they are unable to utilize routine methods of transportation, expensive additions to shop or home to facilitate their movements, special prosthetic devices, higher insurance costs, and the costs of hiring help to perform the simple tasks which the nonhandicapped perform for themselves. In addition, rising costs of these items and services are particularly burdensome.

Hundreds of thousands of Americans have endeavored valiantly to transform their physical handicaps from stumbling blocks to building blocks. They wish to use their crutches to move on, not to lean on. This legislation will help them to do just that. It is as practical in economic terms as it is humanitarian. It is, in effect, a practical bill to benefit those who have no alternative than to be practical.

I ask that there be included in my statement a letter addressed to me from the Department of the Treasury giving estimates of the cost of this proposal and the numbers of individuals whom the Department deems would be eligible:

OFFICE OF THE SECRETARY OF THE TREASURY,
Washington, D.C., February 12, 1971.

Hon. JACOB K. JAVITS,
U.S. Senate,
Washington, D.C.

DEAR SENATOR JAVITS: Mr. Martin Klein of your staff requested estimates of the revenue loss and number of taxpayers affected by S. 1069, which you introduced February 18, 1969, if it were updated to reflect the provisions of the Tax Reform Act of 1969. The original bill provided an itemized deduction for transportation expenses to and from work, not to exceed $600, for persons who have lost, or lost the use of one or more extremities to such an extent that they could not use public transportation without undue danger or hardship, or who are blind. It further provided an extra personal exemption of $600 for persons who have lost, or lost the use of their extremities.

It is estimated that the itemized deduction would affect about 850,000 taxpayers, and would cost $65 million in 1971, $70 million in 1972, and $75 million in 1973. The exemption would be available for nonworking spouses and for retired persons as well as for those who would take the deduction, and would affect an estimated 1,250,000 taxpayers. The cost is estimated at $150 million in 1971, $165 million in 1972, and $180 million in 1973. Estimates reflect both changes in the size of the personal exemption, to which the maximum allowable deduction is also to be tied, and changes in population and income levels.

Sincerely,

JOEL SEGALL,
Deputy Assistant Secretary.

The CHAIRMAN. The next witness if he is here is the Honorable Ernest F. Hollings, Senator from South Carolina. Is Senator Hollings here?

(No response.)

The CHAIRMAN. Is the Honorable John G. Tower of Texas here?

(No response.)

They were scheduled to appear before us this morning. Perhaps they will be in shortly.

Mr. Joel Barlow, counsel of the National Machine Tool Builder's Association and American Machine Tool Distributor's Association.

We are pleased to have you here, Mr. Barlow.

STATEMENT OF JOEL BARLOW, COUNSEL, NATIONAL MACHINE TOOL BUILDERS ASSOCIATION AND AMERICAN MACHINE TOOL DISTRIBUTORS ASSOCIATION

Mr. BARLOW. My name is Joel Barlow and I am a partner in the Washington, D.C. law firm of Covington & Burling. I am pleased indeed to appear once again before this distinguished committee on the very important and perennial subject, the inadequacy of our depreciation allowances, which we have all discussed a number of times before.

It is my understanding, Mr. Chairman, that my entire statement will be included in the record.

The CHAIRMAN. That we do in all cases. It is not necessary for you to request it.

Mr. BARLOW. I am speaking today on behalf of the Machine Tool Industry which is represented by the National Machine Tool Builders Association and by the American Machine Tool Distributors Association.

First, Mr. Chairman, I want to commend the committee for expediting action on this very important tax bill, and I also want to commend the committee for its prohibition on reading long, repetitious statements.

I shall not even take the time of the committee to read all of my summary statements. Instead, I would like to reply, in the 10 minutes I have, to some of the charges against this tax bill that have been made within the past few days, and in addition refer to a few of the points in my statement that have not been emphasized in these hearings.

Throughout these tax hearings in the House and the Senate, assertions have repeatedly been made, and again yesterday by the AFL-CIO, that there is no sense at all in stimulating investment in productive facilities when 73 percent of our industrial capacity is excess and idle capacity.

These assertions, of course, beg the whole question. The fact of the matter is that we have all of this excess and idle capacity simply because so much of it is so obsolete and such high-cost capacity that U.S. industry can no longer compete effectively in world markets, or even in our own domestic market for that matter.

For example, the U.S. Department of Commerce has just reported that over 60 percent of the machine tools in the United States may be obsolete; and these tools, as nearly everyone now knows, are the basic and master tools that keep America competitive.

The AFL-CIO claimed yesterday that 50 percent of all machinery in the United States is less than 5 years old. This is very misleading. For example, numerically controlled machine tools that were the wonder of the world just 5 years ago are now obsolete. Computer-controlled machine tool technology has moved so fast as to make many machine tools only 5 years old completely obsolete.

Yesterday, I also listened to the AFL-CIO witnesses in what I have to characterize, unfortunately, as a wholly simplistic analysis of this critically serious problem.

Their misrepresentations and assertions were quite incredible. They used all of the familiar labels and characterizations of the "raids" this committee would be making on the Treasury by "favoring the rich" and opening loopholes of special tax privileges for the wealthy." But the plain fact of the matter is that they simply begged all of the questions that were asked by the committee as to just how U.S. industry will be able to compete and provide jobs with the most obsolete high-cost machinery of all of the industrial nations in the world, and with the highest labor rates in the world.

Their simplistic solutions, as I listened to them, would have the Government keep on using our inadequate depreciation allowances to discourage all investment in cost-reducing, job-making facilities, and, in addition, they would have the Government further reduce individual income taxes to increase consumer spending so that industry would have to use all of this obsolete, excess capacity, no matter how much money it lost or how it failed to compete with foreigners in our own and world markets.

This, of course, as we all know (and as a very distinquished and esteemed partner of mine, Dean Acheson, would have characterized it) is utterly silly and the sheerest nonsense.

These labor spokesmen simply do not seem to realize that we no longer live in a completely self-sufficient, insulated island economy in the United States, and they don't seem to understand that jobs depend on our ability to compete for our own domestic market, and for the other great markets of the world, including the European Economic Community.

We simply cannot compete unless we modernize our plants to overcome our much higher labor costs; and the evidence, it seems to me, is crystal clear that we cannot do this unless we have tax laws like those of other nations to encourage modernization and replacement of facilities.

The AFL–CIO yesterday talked about the inequity and unfairness to individuals and to the working man of the tax reduction provided in this bill. Secretary Connally and a host of witnesses have given a complete answer to this very irresponsible assertion. As we all know from the reliable statistics of the Treasury, for the 5 years 1969–73, tax payments for individuals will have been reduced by over $36 billion and tax payments for corporations under this bill and the 1969 Tax Reform Act, will actually have been increased over $3 billion.

Yesterday, the spokesman for the German and American Chamber of Commerce contended that U.S. machinery does not need the protection of the tax credit in excluding foreign made machinery.

He presented a great many statistics which purported to support this position, but he left out the single most important statistic which, it seems to me, thoroughly discredits his argument.

He failed to point out that West Germany and Japanese machine tools can be delivered in the United States at something like 60 or 70 percent of the cost of a comparable American-made machine tool, and that this is possible simply because of the lower labor rates in these foreign countries, and the tax and other subsidies these nations give to these exports.

The Department of Commerce Midyear 1971 Economic Report stresses the dependence of U.S. industry and the entire U.S. economy on the advanced technology of machine tools.

As you gentlemen know, the machine tool industry has increasingly come to be regarded by economists, by business publications and Government agencies as a kind of barometer or indicator of the industrial health of the United States.

If the present economic plight of the machine tool industry—and I have set out in detail in my statement the facts and statistics to show the serious depression in the machine tool industry—if this is any indication at all of the predicament that may befall other industries because of their inability under our tax laws to modernize, increase productivity, and met foreign competition, then the handwriting and the warning is on the wall.

I will have a word to say about that in just a minute, but first let me summarize for the committee very briefly the position of the machine tool industry on this pending bill.

We believe that this is a most essential transitional step, and I emphasize transitional step, toward a really effective, capital recovery tax system comparable to that of other industrial nations. But the reduction of the credit from 10 percent to 7 percent, and the adoption of a 20-percent class life reduction, instead of the 40-percent reduction that was recommended by the President's task force last September 1970, still leaves the United States with an inferior system that will continue to put U.S. industry at a disadvantage in world competition.

I want to point out also that the figures that Secretary Connally presented on the much higher after-tax cost of capital investment in the United States as compared with the cost in foreign countries is very conservative indeed and does not really tell the whole story.

Other nations in actual practice (and this is true also when U.S. companies go abroad) permit much faster writeoffs than are provided in their statutes and in their regulations, whereas in the United States, the opposite is true.

The comparisons in Secretary Connally's analysis assume, for example, that U.S. companies are all using the 1962 guidelines lives, when the fact of the matter is that surveys in some of the metalworking industries, show that more than 30 percent of the companies—principally small companies—do not and cannot use the guidelines because they cannot meet the reserve rate ratio test, or they were afraid in the beginning they could not meet the test. In many instances, they said the reserve ratio test was so complicated that they couldn't understand it.

This bill before us does have the great merit of discrediting the unrealistic and unworkable reserve ratio test, which will help small companies particularly. It also has the merit of adopting a standardized class life system that moves toward the conventionalized capital recovery systems used so effectively by other industrial nations and recommended by the President's task force in 1970.

The failure of the bill to rid itself completely of the outmoded accounting depreciation concept and prohibit the application of the reserve ratio test to all years (and not just to 1971 and to future years) are deficiencies that sooner or later will have to be corrected.

The history of the 7-percent credit in the 1960's makes it clear that this bill will provide a very considerable stimulus to modernization and replacement. The graph of the machine tool industry experience (1962–71) which is included in the House report confirms this. It also shows very clearly that this bill must be enacted promptly to start orders flowing even if the 7-percent credit and the 20-percent class life reductions are not increased.

Mr. Chairman, is my 10 minutes now up on the ring of the bell?

The CHAIRMAN. Yes.

Mr. BARLOW. I will conclude my statement then, and I appreciate the opportunity to appear before the committee.

The CHAIRMAN. Thank you, Mr. Barlow.

I believe you were a little too critical of the labor people. After all, their beginning point for negotiations is everything for their crowd and nothing for anybody else. That is not unusual for someone representing his people, is it?

Don't you sometimes represent your client that way?

Mr. BARLOW. Mr. Chairman, I have a way of saying that we are all equally unselfish, but I think we have to speak the truth.

The CHAIRMAN. Thank you very much.

Senator FANNIN. Just one question, you are talking about what the Japanese can do as far as imports are concerned—that they can import comparable machine tools at 60 to 70 percent of our cost here in this country. Is that what you say?

Mr. BARLOW. Yes; I said that Japanese machine tools, for example, and other machinery and equipment, can be laid down dockside in New York City at 60 to 70 percent of the cost in this country to an American builder manufacturing and selling in competition with these foreign companies.

Senator FANNIN. That is what I understand. I was trying to complicate that. What is the labor percentage of production cost of machine tools? In other words, I am trying to determine how can we bring about a balance. We know that there are many other inequities, but we know there, their labor costs are one-fourth of ours. What percentage?

Mr. BARLOW. Your question is very significant because the machine tool industry has a very high percentage of labor content in cost. As much as 40 or 50 percent of the cost of the machine tool represents labor. You have underscored the very point that makes this kind of legislation very important to labor as well as to business in modernizing.

Senator FANNIN. I realize that, but our 10-percent surcharge and this 7-percent investment tax credit and a few items like that are not going to add up then to the differential we are talking about, so they would still be in a very enviable position as far as shipping into this country and underselling us.

Mr. BARLOW. I agree with you, we will still be at a disadvantage even with this new kind of tax structure; and I want to make it perfectly clear that the machine tool industry labors under no illusion that all of the productivity problems we face can be solved by this tax bill. But we think it is very important that we make a start here.

But there are other factors, as you know, Senator. For example, the capacity of the machine tool industry abroad is not unlimited, and when they are busy filling up their own markets, we have a better opportunity to compete with them. But they are increasing their capacity, and the opportunity for competing with them is less and less. There are times when our American machine tool industry is so busy trying to meet the demands at home, particularly in a wartime economy, that we can't exploit foreign markets to help our balance of payments and our balance of trade.

There are many other factors that enter into this. But the basic problem, it seems clear to me, is that if we keep this tax structure of ours the way it is, with depreciation allowances that represent only a fraction of the allowances provided by the principal industrial nations, we are in deep trouble, just as the machine tool industry is in trouble today.

Senator FANNIN. Well, thank you very much, Mr. Barlow.

In other words, you are talking about bringing costs down to where we would be in a competitive position. Do you feel that the labor percentage can be reduced if we modernize this equipment that we have here in the United States?

Mr. BARLOW. Yes, of course. That is precisely the thesis of the machine tool industry. Our only hope is to so modernize and so automate that we can reduce labor costs and be competitive.

If there is a transitional dislocation and unemployment, as there was, I guess, Mr. Chairman, when they stopped making buggy whips and stopped making wagons—if there is a dislocation, if people are put out of jobs, we have to do something about that, too.

Actually, employment in this relatively small machine tool industry of relatively small companies has gone from 118,000 in 1966 to 81,000 today. Unless we have this change in tax legislation to put together with the competitive ingenuity of the industry, reemployment of these workers will not take place. These special skills will be lost because those people are then permanently drained off to larger companies that are not as depressed as the capital-intensive, cyclical machine tool industry.

On the point of increasing jobs and reemploying people, if the machine tool industry moves once again into its upward cycle with a benevolent tax law, you will find there will be 118,000 people or more employed once again. Some are being reemployed at the present time with the passage of the bill in the House.

Senator BENNETT. Mr. Chairman, in the preceding colloquy, I think the words "cost" and "price" got mixed up. I would like to make the record clear.

When you say that Japanese machine tools laid down in New York are at a cost of 60 to 70 percent of American tools, you mean that the prices for those tools are 60 to 70 percent of the prices for the same American tools, not that they are 60 to 70 percent of the cost of producing the tools?

Mr. BARLOW. What I mean is that they can be laid down at a lower cost. I am talking about cost and not price.

Senator BENNETT. Cost to whom?

Mr. BARLOW. Cost to the Japanese and cost to the Germans. Their cost is only 60 to 70 percent of the cost to American builders and American manufacturers. Thus, they can reduce their prices. Their prices are not necessarily lower by the same percentages because they can cut prices to get into this market and still set up new service organizations. They can sell much cheaper, that is my point, because their cost is only 60 or 70 percent.

Senator BENNETT. I wanted to make sure you were comparing the same things in both cases. You are comparing cost of production to the American manufacturer as related to the German manufacturer?

Mr. BARLOW. Yes.

Senator BENNETT. And not the prices at which they sell here.

Mr. BARLOW. I am not talking about prices because they will sell it at any price they need to, with such low costs, to invade our markets and set up service organizations. I should say this: The machine tool industry is not a protectionist industry. Many of the U.S. companies in the machine tool industry are producing abroad, but they do believe that free trade ought to be fair trade, that we ought to get rid of non-tariff barriers, and we ought to have an opportunity to compete on an equal footing.

Senator BENNETT. That is fine. Thank you, Mr. Chairman.

(Mr. Barlow's prepared statement follows. Hearing continues.

PREPARED STATEMENT OF JOEL BARLOW, ON BEHALF OF THE NATIONAL MACHINE TOOL BUILDERS' ASSOCIATION AND THE AMERICAN MACHINE TOOL DISTRIBUTORS' ASSOCIATION

My name is Joel Barlow. I am a partner in Covington & Burling, a law firm in Washington, D.C.

I am speaking today on behalf of the United States machine tool industry[1] which is represented by the National Machine Tool Builders' Association (NMTBA) and the American Machine Tool Distributors' Association (AMTDA). These two national organizations have 550 member companies located in 40 states of the Union.[2]

THE MACHINE TOOL INDUSTRY'S POSITION ON H.R. 10947

Briefly stated, it is the position of the industry that H.R. 10947 is a most essential, transitional step toward a really effective capital recovery tax system comparable to that of other industrial nations.

But it also is the industry's position that the reduction of the credit from 10% to 7%, and the adoption of a 20% class life reduction instead of the 40% reduction recommended in 1970 by the President's Task Force,[3] still leaves the United States with an inferior system that will continue to put U.S. industry at a disadvantage in world competition.

However, H.R. 10947 does have the great merit of discrediting the unrealistic and unworkable reserve ratio test, and of adopting a standardized class life system that moves toward the conventionalized capital recovery systems used so effectively by other industrial nations and recommended by the President's Task Force.

The failure of the bill to rid itself completely of the outmoded depreciation life concept, and prohibit the application of the reserve ratio test to all years (instead of just to 1971 and future years) are deficiencies that sooner or later will have to be corrected.

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[1] The Department of Commerce in its August, 1971 *"The Economy at Midyear 1971 with Industry Projections for 1972"* (pp. 25–28) stresses the dependence of U.S. industry and the entire U.S. economy on the advanced technology of machine tools (the "master tools of all industry"), to achieve the productivity required to meet foreign competition with its much lower labor and material costs. The report points to the high cost of industrial obsolescence in the U.S., the slowdown in facility investment, the deterrent to modernization in our tax laws, the economic plight of the machine tool industry and the threat this poses to national defense. See pp. 570–572, *Hearings Before the Committee on Ways and Means*, 92nd Cong., 1st Session, September 14, 1971.

[2] The NMTBA has 300 members building machine tools in the United States, Europe and Japan. The AMTDA has 250 members distributing both U.S. and foreign machine tools in the United States.

Practically all distributors and many builders fall within the Government's classification of "small business." Sixty-seven percent of the builders have sales of $10 million or less. Only 7% have sales above $50 million.

As one indication of the recent inroads of foreign competition, in 1955 there were 32 AMTDA distributors representing foreign builders. In 1971, 164 AMTDA distributors were representing 145 foreign builders. Imports of machine tools decreased in 1970 and exports increased because consumption of machine tools decreased in the United States and continued at a relatively high level in Europe and Japan.

[3] The Report of the President's Task Force on Business Taxation (September 1970) at pages 10, 11, 28 and 29 shows in detail just how much smaller capital recovery allowances are in the United States than in other industrial nations. The Report recommended the adoption of a conventionalized capital cost recovery system to replace our individualized depreciation allowances, with 40% shorter periods than those in the 1962 Guidelines.

The history of the 7% credit in the 1960's makes it clear that H.R. 10947 will provide a very considerable stimulus to modernization and replacement, and thus it should be enacted promptly even if the 7% and 20% allowances are not increased.[1]

It is, of course, absolutely essential as the Treasury has proposed (and as the Treasury earlier proposed and promised in the Kennedy and Johnson Administrations) that the tax credit be made a permanent part of our capital recovery tax structure, and not just a spigot to be turned off and on with every change in the political and economic winds.

If, as the House Committee has suggested, a basis adjustment is ultimately required to give permanence to the credit (and silence those who cry "subsidy" because of a write-off in excess of cost), basis adjustment may ultimately be a sensible solution. However, as the House Committee has also suggested, no adjustment should be made in the first two years since this would blunt the intended impact of the credit. Actually, no subsidy is really involved, since the credit allowance amounts to nothing more than a partial "catch up" on the inadequate depreciation allowances of prior years.

The Committee is to be commended for expediting action on the bill. America's competitive posture in world markets is so desperate, and this corrective tax change is so urgent, that it would be tragic if H.R. 10947 is delayed or lighted up on the Senate floor into a Christmas tree full of tax relief amendments with the usual green lights for individuals and red lights for business. This would thwart the singleness of purpose of H.R. 10947 to increase plant investment, jobs and productivity to make America fully competitive. It would also postpone the day of return to a free market economy and the end of wage and price controls.

Increased productivity is the only effective antidote for inflation; and until that productivity is achieved, increased consumer spending from further tax reductions can raise the temperature of a renewed inflation. Secretary Connally in his testimony has made a conclusive case that the equity and balance of the tax reduction in the bill should not be changed to favor individuals.

Finally, it is the industry's position that unless we make a start in H.R. 10947 to improve the economic health and strength of America, there is no hope at all that solutions will be found for the distressingly long list of social and political problems that confront us. That is the machine tool industry's greatest concern.

The Plight of the Industry as an Economic Indicator

The machine tool industry has increasingly come to be regarded by economists, business publications and government agencies as a kind of barometer or indicator of the industrial health of the U.S. economy.[2] If the present economic plight of the machine tool industry is any indication at all of the predicament facing other industries because of their inability under our tax laws to modernize, increase productivity, and meet foreign competition, then the handwriting and the warning is clearly on the wall.

Loss of Jobs and Skills Is Critical Problem

Although U.S. machine tool manufacturing companies (better known throughout the industrial world as "machine tool builders") are leaders in advanced engineering and production technology, they are nevertheless relatively small companies, usually with less than 500 employees. One of the industry's greatest concerns is that following the repeal of the 7% credit more than ⅓ of its highly trained and highly skilled production workers have had to be laid off in 1970 and 1971 because of the "sagging" expeditures for machine tools referred to in House Report 92–533.[3]

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[1] The machine tool industry is under no illusion that the inadequate depreciation allowances of our tax laws are solely to blame for our productivity crisis, or that changes in these laws will alone solve our problems of inflation, productivity, and foreign competition. But the evidence is conclusive that our tax laws are a principal cause of our economic crisis, and that their immediate revision is mandatory if we hope to avoid repeated extensions of our Government-controlled economy.

[2] The House Report on H.R. 10947 uses a machine tool industry graph at page 6 to show the impact of the enactment and repeal of the 7% investment credit on the machine tool industry from 1962 to 1971, and "the close correlation of machinery orders and the availability of the investment credit." H. Rep. 92–533 (pp. 5–6).

[3] Total industry employment has dropped from 116,000 in 1967 to 81,000 in 1971. In the major metal cutting sector of the industry, employment fell from 79,000 in January 1970 to 49,600 in July 1971. U.S. Bureau of Labor Statistics, "Employment and Earnings Statistics." (1971)

It is not only concerned for its workers, and for the economic health of the many small local communities dependent on these machine tool jobs, but it is also concerned that, after years of costly special training, this unique reservoir of skilled workers, so absolutely essential to an advanced technology industry, may once again be permanently lost to larger companies not so depressed at the present time.

Thus the tax proposals of the President and the House as set out in H.R. 10947, to spur job development, job training, and rapid reemployment, become tremendously important to this small but vital industry, and to the whole spectrum of the metalworking industries so dependent upon its tools and technology to stay competitive with foreign manufacturers.

U.S. Industrial and Defense Base Is Threatened

As concerned as the machine tool industry is with the losses it has already sustained in the past two years in jobs, markets, sales and profits,[1] and as disastrous as these losses have been for the industry, its workers and the many industries dependent upon it, its greatest concern at the moment is for the bleak tomorrow that threatens not only this industry but all U.S. industry, and even the defense posture of the United States.[2] With the highest labor rates in the world, the prospect is hopelessly bleak unless tax allowances are made available to U.S. industry comparable to those provided by our foreign competitors.

Consider for a moment just what has happened to U.S. industry principally as a consequence of the lowest capital recovery tax allowances of any of the principal nations:

1. The United States has the lowest rate of investment in new plant and equipment in relation to GNP of any of the leading industrial nations.
2. The United States has the highest percentage of over-age, obsolete production facilities of any of the leading industrial nations. Sixty percent of all machine tools are obsolete.
3. The United States in 1970 had a smaller percentage increase in investment in production facilities than Japan or West Germany, our principal competitors in world trade.
4. The United States now ranks 20th (Japan is first) in productivity growth, with less than a 3% average annual growth rate of gross domestic product per employee for the period 1959–1969. Japan's growth rate was 10%.

Our basic tax problem is, of course, that we rely more than any of these other industrial nations on the income tax which puts a premium on inefficiency—on high-cost production. The higher the costs, the lower the tax. Inefficient, marginal companies, losing money with obsolete facilities, are rewarded. They pay no income tax at all.[3]

Foreign Nations Have Been Giving Us a Tax Lesson

Foreign nations have been wise enough to discard outworn depreciation accounting concepts and procedures that chain taxpayers to their "historical replacement practices," and to the tax collectors' arbitrary guesses about "an-

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[1] Machine tool shipments for 1971 are estimated at $1.1 billion, a 27% decrease from 1970 shipments of $1.5 billion. The backlog of orders in 1970 was $706,000,000 as compared with $1.701,000,000 in 1966, a decrease of 60%. The industry for the year to date has received orders totaling $550,850,000, off 23% from last year's 8-month total of $1,009,-650,000. Shipments for the year 1971 to date were $668,850,000, down 34% from the previous year's total of $1,009,650,000.

After-tax profits in the industry averaged less than 2% on both sales and investment in 1970, with many companies, large and small, sustaining severe losses.

[2] The Department of Commerce states in its 1971 mid-year review of the machine tool industry (See Exhibit A, p. 26):

> "The industry faces a dilemma of continuing or abandoning the manufacture of some machine tools it can no longer produce economically. This possibility is of serious concern to industry and Government, which recognize that some basic machine tools necessary to the country's future defense needs could be put in jeopardy because of the import impact."

[3] Sooner or later the United States to stay competitive will be forced to rely less on the income tax and follow more closely the realistic patterns of taxation of other industrial nations, particularly those in the European Economic Community which now provides a greater market than the United States. Basic tax revision will almost certainly mean the adoption of a value-added tax to put a premium on efficiency, and to permit a tax rebate on exports and a border tax on imports. Under GATT this is not possible with the income tax.

It is most important to note that purchases of machine tools and other production equipment are almost invariably exempt from the value-added tax. This has given our foreign competitors another tax advantage by providing a further stimulus to investment.

ticipated useful life"—a concept that still remains, unfortunately, in H.R. 10947. These nations have been well aware for a long time of the unpredictable impact of technological change; and they have been entirely realistic about the absolute necessity of providing tax allowances that will insure the installation of all the industrial facilities they require. Accordingly, nearly all of them adopted some years ago the same kind of conventionalized capital recovery tax system that the President's Task Force recommended in 1970.[1]

For some time now foreign nations have been giving us a tax lesson in just how capital cost allowances can stimulate productivity at home and exports abroad. In 1970, the President's Task Force made a diligent effort to get the Government to heed the lesson, but to no avail. Not until the ADR proposal, and the President finally took emergency action in August was there any indication that anyone in Government really understood the tax lesson and the reason we were losing out in world markets. Just 20 months earlier in December 1969, Congress had repealed the 7% credit upon its expressed conviction and the prior Treasury Secretary's quite ridiculous representation that inflation could be slowed by discouraging investment in the very facilities that would have reduced costs, increased productivity and fought inflation in 1970 and 1971.[2]

Understanding this tax lesson has seemed to be completely beyond the competence of those who so bitterly fought the ADR system tooth and nail on every conceivable political and legal ground, no matter how flimsy. They seem to have the mistaken notion that somehow or other U.S. industry will be resourceful and ingenious enough to work miracles of competition even in a straitjacket of inequitable taxation. They simply do not realize that the age of such miracles is over, that we can no longer be complacent, and that industry, to a very considerable extent, has run out of capital and the investment momentum provided by the 7% credit in the 1960's.

The necessity for economic growth, and even survival, has taught our foreign competitors another lesson—that they can no longer afford to play politics with their tax structures by pitting individuals against business. Even the more socialist nations have learned that in a ruthlessly competitive world, individuals and business, labor and management, have a common interest in evolving a tax structure that will assure the requisite private investment for full employment and maximum productivity.

PLANT INVESTMENT AND JOBS ARE MOVING ABROAD

If essential industries like the machine tool industry continue to be shackled by U.S. tax laws in their efforts to increase their productivity and meet the competition of Europe and Japan, there will be a continuing loss of traditional world markets, and a loss of thousands of jobs that will continue to be "exported" abroad as this and other industries keep on transferring their industrial base abroad.[1] Unless the job development credit and the class life reduction are adopted immediately, American industry will simply have to continue to move abroad to overcome the double handicap of the highest labor rates in the world.[3]

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[1] Some of those who continue to oppose the ADR system and H.R. 10947 in these hearings do not seem to realize that we no longer live in a self-sufficient domestic economy. Whether or not we favor or oppose tax credits, or initial allowances, or amortization, or accelerated depreciation, or asset depreciation ranges, or class lives, or accelerated capital recovery allowances—or even tax subsidies, the United States really has no choice but to adopt a system, or a combination of systems, of tax allowances equivalent to those allowed in other industrial nations if U.S. industry is to compete on equal terms. This is as true for research and development allowances as it is for capital cost allowances.

[2] A strong case can be made that the repeal of the 7% credit in the Tax Reform Act of 1969 not only had no counterinflationary effect, but actually marked the beginning of the end of the free market system as we have known it, and the advent for the first time in peacetime of Government controls over wages and prices. Many believe it triggered the events that led to the capital famine and crunch. Business confidence was severely shaken by the loss of the 7% credit and the bias against investment in the 1969 Tax Reform Act.

[1] Thirty-one U.S. machine tool companies had plants in Europe in 1970 as compared with nine companies in 1965.

Sixty-two U.S. machine tool companies had granted licenses covering patents and know-how to European and Japanese companies in 1970 as compared to 28 in 1965.

[3] The 1970 schedule of comparable machine tool industry wage rates compiled by the U.S. Bureau of Labor Statistics shows that total hourly compensation in the United States was $4.84 as compared with $2.18 in West Germany and $1.11 in Japan. See also *Industry Week* for October 4, 1971, "The Wage Gap Widens . . ." (pp. 5–17) and graphs comparing the average total hourly cost per worker (1970) in the principal industrial nations.

and the lowest capital recovery tax allowances.[1]

During the past ten years, a very high percentage of the machine tool industry's new plant expansion has had to be installed abroad to meet the growing competition of foreign builders, not only for foreign markets, but also for our own U.S. market as well.

Under the more realistic and benevolent tax laws of these foreign countries, much of this recent U.S. investment abroad in both buildings and machinery has already been completely written off. For example, instead of writing off machine tools over a 12-year period as in the United States, U.S. builders abroad write them off over five years or even much shorter periods—and more often than not, on an entirely optional basis so as to synchronize write-offs with earnings.[2]

It will be evident that it is the inducement in the foreign tax laws, and not just the lower labor rates and the avoidance of non-tariff barriers, that has persuaded U.S. industry that it must move abroad.

There are knowledgeable people who have been predicting for some time that unless this 92nd Congress changes our income tax structure to encourage investment in industrial facilities, just as other leading nations do, the United States will fast become a service-oriented nation instead of a manufacturing nation, and inevitably a second-class industrial and military power.[3]

Foreign Nations Are Outstanding the United States[4]

Foreign governments and our own Government have been well aware for many years that a strong machine tool industry is absolutely indispensable to an industrial nation and its defense base. The Soviet five-year economic plan after World War II, and the industrial rehabilitation of Japan, West Germany and the other European nations, all focused very sharply on the establishment of a strong, sophisticated and self-sufficient machine tool industry. Aided initially by hundreds of millions of dollars in Marshall Plan funds, these foreign nations have been dramatically successful in their programs to be self-sufficient both in the quantity and quality of their machine tool production.

The tremendously increased productivity and accelerated technological advances that the Russian, German and Japanese machine tool industries generated, has enabled these nations to become fully competitive with the United States across the whole spectrum of commercial products and military hardware. Now they are actually beginning to outdistance us; and principally because their governments have consistently adopted tax policies and tax laws that make possible the constant replacement of machine tools and other productive facilities in all industries. They have learned very quickly, indeed, the lesson the United States once knew so well in its formative years, that encouraging the consumption of machine tools at home is just as essential as encouraging the sale of machine tools abroad.

The preeminent position that the United States has held throughout this century in the production and consumption of machine tools, and in machine tool technology, has now been seriously threatened by West Germany, Japan and the Soviet Union.

Russians and W. Germans Pass U.S. in Machine Tool Production

In 1970 for the first time West Germany produced a larger volume of machine tools than the United States.[5] Present statistics indicate that Russia will pass

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[1] See footnote 1, page 1, *supra*.

[2] Although Section 167 of our tax law provides for "a reasonable allowance for wear and tear and obsolescence" it has seldom been granted. From the standpoint of "wear and tear" taxpayers are put in the straitjacket of their past depreciation practices, no matter how enlightened or what the cause. The obsolescence resulting from the rapid pace of technological change gets scant recognition. For example, many numerically controlled machines that were the wonder of the world five years ago are now obsolete. Yet their depreciable lives under the 1962 Guidelines will continue to be 12 years, or approximately 9½ years under the new class life system.

[3] See "Is There Still Time to Save U.S. Industry," *Industry Week*, October 4, 1971 (p. S–1).

[4] "The U.S. share of world automobile production in 1960 was 76%; last year it dropped to 33%. And the plunge is continuing. Our share of world steel production was 47% in 1950. Last year it was only 20%." These are only two examples; the list is long. *Industry Week*, October 4, 1971, p. S–1. See also "Why the Japanese Prosper," *The Washington Post*, October 7, 1971, p. 11.

[5] "For decades the U.S. was No. 1 builder of machine tools—the master tools of industry. By the end of this year we likely will be in fourth place—behind Russia, Japan and West Germany." *Industry Week*, October 4, 1971, p. S–1.

See also *American Machinist*, March 8, 1971, p. 72, "Germany Edges Into Tool Lead" reproduced at page 575, *Hearings Before the Committee on Ways and Means*, 92nd Cong., 1st Sess., September 14, 1971.

the United States in the total production of machine tools in 1971, and Japan may very well be in third place by 1972. Thus, it is almost a certainty that the United States will soon be relegated to fourth place in this most essential defense and peacetime industry unless this 92nd Congress changes its tax policies and tax laws to enable industry to get rid of its obsolete and high-cost facilities.

Excess U.S. Capacity Is Largely Obsolete High-Cost Capacity

Throughout these tax hearings in the House and Senate assertions have repeatedly been made that there is no sense in stimulating investment in productive facilities when 73% of our industrial capacity is excess and idle capacity. These assertions, of course, beg the whole question. The fact of the matter is that we have all of this excess and idle capacity (particularly in heavy industry) simply because so much of it is so obsolete and such high-cost capacity that U.S. industry can no longer compete effectively in world markets or even in our own market. For example, the U.S. Department of Commerce has reported that over 60% of the machine tools in the United States are obsolete, and these are the basic and master tools that keep America competitive. The even higher level of obsolescence in the steel industry, and many other industries, is so well known that it needs no documentation. The whole purpose of the tax legislation before us is to turn that obsolete, excess capacity into modern cost-saving productive capacity to make the United States fully competitive once again.

Eliminating the Reserve Ratio Test for All Years Is Essential

One of the principal reasons for stressing the immediate and urgent need for enacting H.R. 10947 is that the day of reckoning for applying the restrictive reserve ratio test has finally come despite the understandable and admirable efforts of this Administration, and the Kennedy and Johnson Administrations, to postpone and avoid enforcing the test. They have all been concerned, and properly so, at the prospect of a complete administrative breakdown if the test has to be mathematically applied. The Treasury is now uncomfortably on the verge of disallowing millions of dollars in depreciation allowances (that are already inadequate), and determining millions of dollars in tax deficiencies by applying the test. Revenue agents are telling taxpayers they have no choice but to apply the test for years prior to 1971.

No one can have any doubt at all that assessing all these tax deficiencies will clearly have the effect of blunting the intended stimulation of H.R. 10947. This, of course, can be avoided if the Treasury decides (perhaps on the basis of the legislative history now being made) that it can rely principally on the "facts and circumstances" provided in the 1962 Guidelines, and bypass a rigid application of the test. Thus, the prompt enactment of H.R. 10947 is of the greatest importance to clarify this question, and to lay the dust on the political controversy over the ADR, thus foreclosing any further argument on the application of the reserve ratio test to 1971 and future years.

New Class Life System Will Improve Tax Administration

Even with the elimination of the reserve ratio test, the requisite degree of permanence and comparability to foreign systems will not be built into the U.S. system until outmoded accounting concepts of "depreciation," "depreciable lives," and even "class lives" are finally relegated to the ash heap, and the conventionalized capital recovery tax system recommended by the President's Task Force in 1970 is adopted.

Perhaps the greatest weakness of H.R. 10947 is this rentention of the depreciation concept, and the authority and latitude the Treasury is given to change class lives from time to time by engaging once again in the guessing game of determining "anticipated useful lives," on the basis of studies of taxpayer experience in industry groups. In this age of unpredictable and accelerating technological change the past is seldom, if ever, prologue to the future.

Nevertheless, despite this weakness, the adoption of the class life system in H.R. 10947, will mean that, for the first time, U.S. industry will have statutory allowances that are not tied to each individual taxpayer's replacement practices. These have almost invariably been very bad, and principally because of the inadequacy of the depreciation tax allowances themselves. For the first time, depreciation deductions for industry will not depend entirely on guestimates by revenue agents and horsetrading upon audit. This will mean a tremendous improvement in audit procedures and the administration of the tax laws.

NEW CLASS LIFE STANDARD IS ENTIRELY REASONABLE

Despite all the furor and legal arguments over the ADR, and the criticism that has subsequently been leveled at the new class life system, the plain fact of the matter is that no Supreme Court decision has held or implied that the individual taxpayer's past experience must always be determinative; nor has the Court held that the Treasury cannot change its regulations (as it did in 1962 and 1971, and as it is authorized to do in H.R. 10947) to set a sensible standard in an industry-wide range or class life, to provide the "reasonable allowance" to which industry is entitled under Section 167.[1]

The proof of the pudding that the 20% reduction in guideline lives in the ADR, and in the new class life system, is an entirely reasonable standard and allowance from the standpoint of protecting the revenues, rests solidly on the fact that many enlightened managements are already replacing and depreciating on that basis. The principal merit of the 20% reduction in the new class life system, and the elimination of the reserve ratio test, may very well be the opportunity this gives to companies with traditionally bad depreciation and replacement practices, and particularly smaller and medium-size companies, to get out of the straitjacket of their bad practices and become more competitive.

The Committee on Ways and Means and the House of Representatives are to be commended for resolving the controversy over the ADR by adopting its essential elements to reassure the business community that some certainty and permanence has finally been built into our depreciation tax structure.

AN EXCESS PROFITS TAX WOULD NULLIFY THE CREDIT

The intended stimulus of H.R. 10947 would be largely nullified if Congress were to listen to some of the current speeches of labor and political leaders and adopt the worst of all taxes for an industrial economy—the so-called excess profits tax. It puts a premium on high costs and inefficiency, and it is notoriously unfair to the capital-intensive cyclical industries. It tends to skim off the top layer of profit periodically realized at the top of the cycle, that would otherwise be used for modernization and for research and development.

As the Treasury and the tax-writing Committees have repeatedly acknowledged over the years, the excess profits tax is practically impossible of administration. It has to be so cluttered with complicated relief and appeal provisions that only lawyers and accountants get any real benefit out of its enactment. Only in wartime when industry is operating under forced draft with fortuitous volume, fortuitous profits and labor shortages, is there any justification at all for an excess profits tax. That is certainly not the situation today.

THE LIMITATION ON FOREIGN-MADE FACILITIES IS NECESSARY

The proposed limitation of the credit to American-made property will be very helpful to the machine tool industry and many other industries injured by foreign competition. The machine tool industry is not a "protectionist" industry, but it believes that free trade must be fair trade, and that U.S. industry should not be constantly barred by unreasonable non-tariff barriers abroad. There are those in the machine tool industry who have great conviction that the limitation on foreign-made property should be continued until our foreign competitors remove the many non-tariff barriers that arbitrarily shut out American machine tools and other products.

However, the industry supports the transitional limitation in H.R. 10947 because it believes that the President's surcharge and tax proposals may be persuading our foreign competitors that their unreasonable non-tariff barriers must come down. For the first time there seems to be some prospect that this will happen. The machine tool industry also is persuaded that the accelerated modernization of U.S. industrial capacity which will result from the combined

[1] The transcript of the *Hearings Before the Committee on Ways and Means* sets out at pp. 579–589 the legal brief on the ADR system prepared by Covington & Burling and submitted to the Treasury on April 12, 1971 by the National Machine Tool Builders' Association and the American Machine Tool Distributors' Association. The brief supports the Treasury's position that it had ample authority under Section 167 to adopt the ADR system.

effect of the proposed tax credit and the class life reduction, may obviate the need for any permanent preferential treatment for U.S. manufacturers.

Used Machinery Should Be Excluded

As Secretary Connally pointed out in his testimony before the Committee on Ways and Means, the whole purpose of the tax credit is to get rid of industrial obsolescence so as to increase productivity and jobs. Encouraging the acquisition of less efficient used machinery will not serve this purpose, even on the limited basis proposed in H.R. 10947.

The House report states that the purpose of the limited inclusion of used property "is to make the credit available to small business that does not have the financial ability to acquire new property." Although the machine tool industry does not strenuously oppose this limited eligibility for used property, it feels constrained to have the record show that many small businesses are unable to compete effectively, principally because they buy obsolete, high-cost, used machinery on the basis of its lower initial price, when they actually do have the financial ability to buy new, efficient, cost-reducing machinery that would keep them competitive.

The Industry Supports the Treasury Proposals

I will not comment at length on the remaining tax proposals before this Committee. We support repeal of the automobile excise tax for the many reasons that have been stated so ably by Secretary Connally and others.

We also support the individual income tax relief provided in the bill because it will minimize hardship to the lower income group, and will result in increased consumer purchasing power which will in turn create jobs and stimulate business activity in general. We oppose any further tax reduction for individuals in this bill for all the reasons we have mentioned and Secretary Connally explained so well in his testimony.

Finally, we support the DISC proposal as originally presented by Secretary Connally instead of the almost meaningless version in H.R. 10947. The Treasury's proposal would provide the requisite tax deferral for export sales to enable U.S. companies to compete more effectively with foreign companies which already enjoy DISC-like tax benefits with respect to their export activities. In addition, a DISC with a substantial tax deferral provision would encourage U.S. companies which might otherwise establish or maintain manufacturing facilities abroad, to retain their manufacturing activities in the United States and sell their products abroad through the DISC mechanism. The limited DISC in H.R. 10947 will not achieve the intended goal of substantially increasing investment and jobs in the United States.

We see in the enactment of a truly meaningful DISC as proposed by the Treasury, an opportunity for our Government to improve its bargaining position in persuading foreign governments to make the subsidies and inducements in their tax laws less prejudicial to the interest of the United States. The DISC in H.R. 10947 would be of little help on this score.

Addendum Illustrating the Adverse Impact of Inadequate Depreciation Allowances on the Relatively Small Companies in the Machine Tool Industry

Traditionally, machine tool companies have opposed mergers and acquisitions, and until recently they strenuously resisted take-overs by conglomerates and other larger corporations.

However, in the 1960's many machine tool companies have been acquired by larger companies, principally because of the adverse impact of the income tax and the estate tax laws. As the Committee is well aware, this has happened in many other industries, too.

Most of these relatively small companies—many of them closely held—were faced with the prospect of liquidation of assets or stock to pay death taxes. Also, they were, in effect, in gradual liquidation as a consequence of being forced year after year to pay taxes on income that was unavoidably overstated as a result of the Treasury's insistence on inadequate and unrealistic depreciation allowances.

Cash flow and profits were gradually drying up. These relatively small companies were running out of the funds that were critically needed for replacement of obsolete facilities, and for research and development, the life blood of this high technology industry.

Their overstated profits—phantom profits—also put these companies at a great disadvantage in wage negotiations with union leaders who pointed to these overstated profits as clear justification for wage increases. The spiraling wage rates that resulted made it difficult or impossible for these U.S. companies to compete with their foreign competitors, or even with their more formidable competitors at home. Costs went up, productivity and profits went down.

Like most of the companies in the capital-intensive industries, these smaller companies were caught in the capital "crunch." They had been running out of capital for years. Too often Section 531 of the tax law (or just the fear of it) had forced them to distribute dividends that should have been retained for modernization. Twice in the 1940's and 1950's under the excess profits tax laws, and repeatedly under the Renegotiation Act, their profits had been taxed away as "excessive" when in fact they actually were the only reasonable or adequate profits they had earned in years.

Finally in the 1960's, and particularly after the 7% credit repeal in 1966, it became crystal clear to many of them that they would no longer be able to provide from cash flow and profits the funds needed to meet the tremendously increased and inflated costs of research and development and plant modernization. They would not be able to meet the reserve ratio test (which would mean substantial tax deficiencies),[1] and they would not be able to meet the competition of the larger companies at home and abroad. These companies had extensive research and engineering capabilities, more modern plants, and ready access to bank credit and the security markets.

More of these companies will have to merge, liquidate or move abroad unless (a) the job development investment credit is quickly adopted to "make up" for the inadequate tax allowances of prior years, and (b) the new class life system (with at least a 20% life reduction) is also adopted to prevent the application of the reserve ratio test and the assessment of hundreds of millions of dollars in tax deficiencies.

Some of the remaining small companies in the industry are now looking for merger partners, some of them are drawing plans for foreign plants to move abroad, and others are already breaking ground for new plants in Europe and Japan. This means a further and critical loss of U.S. machine tool capacity and skilled jobs so essential to our defense base and the entire U.S. economy.

The CHAIRMAN. Thank you very much. While Mr. Barlow was testifying, Senator Hollings appeared in the room. We will call him at this point.

STATEMENT OF HON. ERNEST F. HOLLINGS, U.S. SENATOR FROM THE STATE OF SOUTH CAROLINA

Senator HOLLINGS. I have 15 minutes at least?

The CHAIRMAN. You have 10.

Senator HOLLINGS. Just trying to cut it short and get right to the point, I wish some of the folks could see my mail, because the preceding witness just brings in scope how you talk about an investment credit and creating jobs at the same time is just impossible to me. I have been studying it and watching it closely.

In investment credit, I just can't help but remember back in July, just 2 years ago, a former member of this committee and the distinguished minority leader, Everett Dirksen, took the well in the floor of the Senate and said, "Get rid of this thing, it is really causing us trouble, it is aggravating inflation and cutting out jobs." I can't for-

[1] Surveys at the time in the metalworking industry revealed that more than half of these small companies could not meet the reserve ratio test because of a lack of funds to replace; and that nearly ⅓ of the companies had not even elected the 1962 Guidelines because of the complexity of the test, their concern that they would not be able to meet it, and that they would be involved in tax controversies precipitating other disallowances.

get that. Your Government one minute says investment credit is causing inflation and the next minute says since it is job investment credit, it is going to create jobs. And, gentlemen, one witness said, let's do it for German machinery and to create jobs over there. He gives us the horse-and-buggy example and tells us something has to be done.

I believe if you and I and the President want to make sure we can eliminate jobs fast, the quickest way to do it is put in investment credit to buy all of those computers to eliminate all of the jobs as fast as we can.

The only reason we have progressed from the horse-and-buggy days is that we always develop technology, but in the last 15 to 20 years in America, we have exported all of this technology to Germany and Japan and elsewhere. Therefore, it has not created new jobs at home in order to compete.

But this is what disturbs me about the President's program. The ox was in the ditch. Someone had to act. The President acted, and I support his wage-and-price freezes. I support his cutback on spending, his cutback of Government employment, the 10-percent surtax, and all the other parts of the program. With respect to two parts, I don't say you have to take either or, but I do have a substitution for the investment credit and automobile excise tax. You can pass a House version. Let me emphasize this. You can pass the House version of the investment credit and automobile excise tax and still be within the President's proposed budget cuts with the adoption of the recommendations I have.

Specifically on the investment credit, about 2 years after it was instituted in 1962, the Council of Economic Advisers said, and I quote, the "Credit was still to be realized because of substantial lags in the investment decisionmaking and spending process."

I wonder if we are going to wait around until 1974 for business to get this multibillion-dollar tax break and then have no real measurable impact in the next 24 months? That is what we are trying to do. Of course, this investment tax credit has been in for some 7 of the past 9 years; we just repealed it in late 1969. The Finance Committee said in their report that year:

> After careful consideration of the sources of the present inflationary pressures, the committee concluded that the stimulus to investment which is provided by the credit contributes directly to these pressures.

Now, looking at the automible excise tax, the idea is that you have to buy a $3,000 car in order to get a $200 tax break. Isn't that a great plan? We are going around with the distinguished Senator from Wisconsin, trying to eliminate pollution, and he says the greatest cause of pollution is the American automobile, so what we want to do here is sell more automobiles to cause more pollution, to appropriate more money to eliminate the pollution.

That is the vicious circle and that is supposed to stimulate the economy, Newsweek says, but if you look at it this morning, they have not employed anyone extra in Detroit. They put out a lot of nice stories in Life magazine, but unemployment there is still 8.9 percent. The industry would rather give overtime than employ anybody else.

That is where we find ourselves, unfortunately, involved in the argument between AFL-CIO and the chamber of commerce. The haves and have-somes, not the have-nots. The have-nots have yet to come to bat. They never got a chance at all on the House side, and that is what we want to speak to this morning.

Specifically, I propose first, a direct payment to each poverty household in the form of sales tax relief based upon the amount of sales tax paid in the purchase of food. That is just reimbursing them for the tax paid.

Second, I propose property tax relief to every poor household to reimburse it for State and local property taxes paid either as a homeowner or as a renter. Third, I propose tax relief for American families in the form of reimbursement for the cost of trying to provide for a child's trade school or other higher education. I travel, as you do, to different countries where they have education free, but in the land of education, the United States, we are still paying through the nose. I am trying to catch up with this, the highest cost we have, and at the same time, I am trying to get to the heart of the problem, develop consumerism, develop purchasing power to get to the American man operating not at 73-percent capacity, but nearer to 100-percent capacity. When you put this money into these low-income and poverty groups, when you put that money into the family paying for that postsecondary education, you are really putting spending power there that will have an immediate impact on the economy. This completes the President's well-intended program of August 15.

This is a program of human investment. I believe it forms the basis of a program which the Congress and the American people can support. I would like to go over each aspect of the plan.

The first aspect of this plan would provide food sales tax relief to every household whose income is at or below the poverty level as determined annually by the Bureau of the Census. The impact of sales taxes is far greater on those in poverty, since a great percentage of their income is used to provide food and shelter. Indeed, in 1965, sales taxes took a 6.1-percent bite out of family incomes that were less than $2,000, whereas a family of over $15,000 pays approximately 1 percent in sales tax.

A State and/or local sales tax is levied on all food purchased for consumption off the premises in 30 States, including Alaska, where the tax is solely local. Sales taxes on food, therefore, cost those poor persons who live in three-fifths of the States, between 2 and 6 percent of their limited funds for food. The food sales taxes eats into their ability to purchase an adequate diet. Food stamp program families in New York, who are informed by the Department of Agriculture that they need $108 to purchase the barest nutritional minimum, find instead that they can buy as little as $100 worth of food. The State and local government pockets the remaining $8, which was intended to alleviate human malnutrition.

Against this background, it is reasonable and just for the Federal Government to assume the responsibility for guaranteeing that the poor have enough purchasing power (in stamps or money) to afford the food they must have to subsist. This should be after, and not merely before, taxation by other levels of government. Any attempt to eliminate hunger before taxes must fail by definition.

At the same time, State and local governments are hard pressed. They ought not to be deprived of such a valuable source of revenue.

The food sales tax relief proposal would eliminate fiscal dependence on the poor, without impairing State and local sales tax receipts. To this extent, the relief contained in this proposal would represent indirect revenue sharing.

The sales tax relief would be in the form of an annual Federal payment equivalent to the State and local sales taxes on food consumed at home by members of poor households. Beginning taxable year 1971, an application would be filed by each family at or below the poverty level. The Internal Revenue Service would first determine the combined State and local sales tax rates effective in the household's area of residence, assuming a 4-percent rate in the four States having no sales tax. This 4-percent rate for no-tax jurisdiction is based on the fact that the rate in 23 States falls between 4 and 6 percent, while the tax rate in the 12 other States with a tax lies between 2 and 4 percent. The IRS would multiply the tax rate by the cost of the U.S. Department of Agriculture low-cost food plan for that household's composition. The resulting amount would be sent to the household by check.

The low-cost food plan, $138 per month for a family of four, is the most reliable measure of food expenditure because of the administrative difficulties involved in requiring poor persons to retain all of their receipts for food purchases. The Department of Agriculture labels this plan "a reasonable measure of basic money needs for a good diet."

Going right down to exactly how it would work, I will include, if there is no objection, my entire statement for the record.

A family of four living in Detroit, Mich., would receive $66. Because the tax bite is greater in Jackson, Miss., the same family would get approximately $100. A young couple anticipating a child would be entitled to $75 in New York City, while the same family in Butte, Mont., would receive $43. The relief for a household of eight persons, including six children, would amount to $112 throughout South Carolina.

For those poor persons not actually subjected to food sales taxes, the relief would be a modest, but vital, boost for their food budgets. In California, which does not impose a tax on food, the relief contemplated would be $84. Assuming that every eligible household applies, we would be turning an additional $420 million of direct tax relief back into the economy. This is based on an average tax rate of 4 percent and 25.5 million recipient poor persons.

The second aspect of my plan would provide property tax relief to every household whose income is at or below the Census Bureau's poverty level. As with the sales tax relief, it would take the form of an annual payment through the Internal Revenue Service. The payments would be equal to the State and local property taxes actually paid by homeowner households. We all know that persons who pay rent pay property taxes indirectly. Consequently, for those who pay rent the relief would be 20 percent of their annual payments. In operation, this proposal would mean that a household of four paying $80 in rent per month ($960 per year) would receive a $192 payment.

The property tax is universal. It accounts for more than one-fourth of the revenues raised by State and local governments from their own sources. But its impact is inequitable, falling hardest upon the poor. Families with over $15,000 in total annual income require only 1.4 percent of their income to meet property taxes. Families whose income is less than $2,000 are compelled to spend an average of 8.5 percent of their meager incomes on property taxes, while 3.1 million low-income nonfarm homeowners pay over 10 percent of their income for this purpose.

Already in several States to offset the regressive nature of the property tax, California, Kansas, Minnesota, Vermont, Wisconsin, they have adopted so-called "circuit-breaker" statutes, which has been recommended by the Advisory Commission on Intergovernmental Relations.

Assuming that all eligible households apply, this form of tax relief would total approximately $1.25 billion. This projects an average rent for a family of four of $80 per month, or slightly over $190 in annual relief per family.

We have written in to both payments a phaseout provision.

The third aspect of my plan provides relief to families trying to provide higher education for their children. A tax credit would be given for part of the expenses paid by the taxpayer for his dependent's school tuition, books, and equipment. The credit would be calculated on a sliding scale with a $325 maximum.

You have had hours and weeks of hearings on this particular proposal. I sponsored it this year, Senator Ribicoff sponsored it in 1969, the last time the Senate passed it. You are completely familiar with this proposal. It was unfortunately knocked out by the House both times it passed the Senate. The cost would be $1.8 billion.

This really is the human investment, rather than automobile excise tax and investment credit. This is how to get money directly back, deservedly back, to the people—on the basis of the sales tax, property tax, and education costs that they have paid.

Now, Mr. Chairman, let's look at the whole picture. The revenue effects of my plan are entirely in keeping with what the President has suggested as an economic program. Even if you adopt it on top of H.R. 10947, the total over the next 3 years, would still not cost the Treasury any more than what the President has already indicated he wants to have deducted from the tax liability of businesses and individuals.

Back in January he announced changes in the calculation of depreciation that would save business $11.7 billion through 1973; $40 billion by the end of the decade. In August he proposed another $17 billion in tax savings for a total of approximately $29 billion over the next 3 years.

Now, the House Ways and Means bill is under $27 billion. So if you add my plan's maximum cost, slightly in excess of $3 billion, you would still be within the President's budget. You don't have to eliminate. It is not an either/or proposition of excise or investment credit, but certainly my proposal is a positive way to start the American machine going again. It makes human and economic sense.

I would be glad to try to answer any questions that you may have.

The CHAIRMAN. Well, thank you very much, Senator. I think you have made a very interesting suggestion to us.

(Senator Hollings' prepared statement follows:)

PREPARED STATEMENT OF ERNEST F. HOLLINGS, A U.S. SENATOR FROM THE STATE OF SOUTH CAROLINA

Mr. Chairman, I appreciate the opportunity to appear before this distinguished committee this morning.

Since the end of the Second World War, the United States has spent $130 billion in reconstructing the world, and $1 trillion 200 billion to defend it. During that time, our gold supply has dwindled from $24 billion to $10 billion, and the demands have increased to $51 billion.

While the dollar has thus been jeopardized, the American economy was further weakened by imports increasing and then overtaking our exports. America's long-standing trade surplus—the surplus which helped finance all those efforts at rebuilding after the war—has vanished. And until now, the problem has not been faced up to in the Executive Branch. Instead, the focus has consistently been on the politics of the problem rather than on the problems themsevles.

While our former advantages have disappeared, the countries who were rebuilt thanks to American largess have spurted ahead. Generally speaking, their financial position is sound. And comparatively speaking, the are not faced with the urban, welfare, crime, drug and other problems that we in this country must contend with every day. Nor do they have the problem of war to contend with.

It was long since time, Mr. Chairman, that someone acted. On August 15th, President Nixon did act.

Generally, I support his initiatives. I support the surcharge. I support the wage and price freeze. I support the cut in government spending, although not the discrimination against government employes.

I disagree, however, that the business incentives proposed by the President will encourage the speedy restoration of prosperity. I am of the school of thought that the battle against inflation was being won, and that the only real spurt the economy needed was public confidence that someone in Washington was minding the store. The President's speech of August 15th helped revive confidence. The decisions to forego the volunteer army at a cost of $8 billion, to delay welfare reform at a cost of another $8 billion, and to postpone revenue-sharing at $5 billion demonstrated that fiscal restraint and responsibility had not entirely disappeared. The wage and price arrangements envisioned by the President have already helped alleviate the dangerous psychology of inflation from which we have suffered so long.

But in facing up to the problem of unemployment and under-utilization of our industrial potential, the President has not gone forward—but backward. He has shown himself to be the prisoner of that old shibboleth—the Percolator Theory of economic progress. According to that shopworn and antiquated concept, the way to prosperity is to enrich the wealthy few at the top and then wait until the wealth slowly filters down to the rest of the population. Look at the President's program for 1972—the depreciation allowance of $3.9 billion. The investment credit of $4.5 billion. The elimination of the automobile excise tax, which will benefit big business far more than the consumer, at a cost of $2.2 billion. With these we are supposed to create jobs. With these we are supposed to increase the wealth and well-being of the country.

The need, Mr. Chairman, is not so much the stimulation of the business machine through tax incentives. The need is to get those factory furnaces burning because of increased consumer demand. Our American business machine is operating at 73% of capacity. How modernizing that machinery and making it more productive is going to restore prosperity is beyond me. Are we going to enlarge our productive capacity so that instead of 27% of it standing idle, we can have 40% or 50% of it unused?

The investment tax credit was put into effect in 1962. Two years later, the President's Council of Economic Advisors reported to the American people that the full effect of the credit was still to be realized because of "substantial lags in the investment decision-making and spending process." Will we be told in 1974 that we gave business a multi-billion dollar tax break without any measurable economic impact? Will we have to wait another two years to discover that we have legislated in vain once again?

The investment tax credit has been a part of our tax laws for seven of the past nine years. That is almost a decade in which business has supposedly been encouraged to modernize by the lure of tax incentive. But the economic problems remain. Unemployment is at 6 per cent. Inflation has gobbled up wage increases.

I remember well when our late and esteemed Minority Leader, Everett Dirksen of Illinois, led the fight to repeal the investment credit. Now Mr. Nixon changes the name to "job development tax credit" and says it will solve our problems. That is like using "full employment budget" to disguise a deficit. Or "Family Assistance Plan" to camouflage a guaranteed annual income. You cannot run an economy simply by changing the definition of words.

Mr. Nixon also proposed repeal of the excise tax on automobiles. To help the tax-payer? Hardly. Why should the tax-payer be put in the position of having to buy a $3000 car in order to take advantage of a $200 tax break? That may help the high income taxpayers who can afford a new car. But it provides no relief to the people who have been really hurt by our inflationary ills. And besides not helping them, we are creating a ridiculous vicious circle. On the one hand, we are encouraging the public to buy more cars, which in turn creates more pollution, so that we then can turn around and appropriate more money to clean the environment of the automobile's pollution. That may make sense to someone else—but the logic of it escapes me!

There is nothing new for the taxpayer in the bill before this committee. Except for the low income allowance, the tax reductions for the average taxpayer provided in this bill are simply speed-ups of changes passed by Congress in 1969. And I would suggest that we look a little more closely at that $300 increase in the low income allowance. What that does is establish that families living in poverty simply will not have to pay income taxes in 1972 and thereafter. That is all well and good, Mr. Chairman—but as you know so well, that principle was agreed to three years ago.

And when you clear away all the rhetoric, you can see that for a family of four with an income of $4300—the poverty level—this bill is only going to save that family $20 this year. For meaningful tax relief and a boost for the economy, $20 is a drop in the bucket.

If Mr. Nixon is looking for a meaningful investment in the future, he ought to take a look at developing a sound oceans program. The oceans offer not only a challenge, but the potential of the Last Frontier. The development of the oceans means food, jobs, industry—and even survival for the species. Earlier this year, I introduced the National Oceanic Act of 1971. It would authorize an immediate infusion of $1 billion over Administration requests for FY 1972. This would prime the pump and set the stage for much larger infusions in the years ahead. How much better to create a meaningful job, where a job can do some real good, than to create made-work that offers little in the way of personal fulfillment and nothing in the way of planning for our nation's future well-being. Either we will meet the challenge of the oceans and harness them to the future—or others will reap the rewards and leave us far behind. We are already behind in the exploitation and utilization of the seven seas. We dare not remain behind.

But I am obviously not here today, Mr. Chairman, to attach an oceans bill to the revenue bill pending before this committee. I am here to propose for your consideration meaures which will redress the harsh imbalance of the President's proposals, which will eliminate the big business favoritism that runs through the Chief Executive's plan. I am convinced that we must develop maximum consumer buying power. And I am convinced this cannot be accomplished unless substantial modifications are made in the proposed legislation.

My proposals are on behalf of a large segment of Americans completely forgotten in the President's economic package. I am talking about direct financial relief for the little man, the wage earner, those for whom there is no work, and the poor. In all the debate the compromises and trade-offs have been between the haves and the have somes. The have nots have been cruelly forgotten.

My tax plan is a major step toward direct, immediate relief for the most hard pressed segment of the American population—the poor and the low income American citizen. My tax plan will stimulate more demand for goods and services. In turn, this will stoke the fires of our productive capacity and get them burning again. My program focuses on three of man's basic needs—food, shelter and education. And to accomplish our goals, this plan would return cash to eligible households for expenditures on these necessities. I have therefore developed the following plan of positive relief.

First, I propose a direct payment to each poverty household in the form of sales tax relief based upon the amount of sales taxes paid in the purchase of food.

Second, I propose property tax relief to every poor household to reimburse it for state and local property taxes paid either as a homeowner or as a renter.

Third, I propose tax-relief to American families in the form of partial reimbursements for the cost of providing for a child's trade school or higher education.

I call this a program of human investment. I believe it forms the basis of a program which the Congress and the American people can support.

If I may, I would like to take each aspect of my plan, and explain how I envision it would work. I will submit for the record the specific legislative language to accomplish this.

The first aspect of this plan would provide food sales tax relief to every household whose income is at or below the poverty level as determined annually by the Bureau of the Census. The impact of sales taxes is far greater on those in poverty, since a great percentage of their income is used to provide food and shelter. Indeed, in 1965, sales taxes took a 6.1% bite out of family incomes that were less than $2,000, whereas a family of over $15,000 pays approximately 1% in all sales tax.

A state and/or local sales tax is levied on all food purchased for consumption off the premises in 30 states, including Alaska, where the tax is solely local. Sales taxes on food, therefore, cost those poor persons who live in three-fifths of the states between two and six percent of their limited funds for food. The food sales tax eats into their ability to purchase an adequate diet. Food stamp program families in N.Y., who are informed by the Department of Agriculture that they need $108 to purchase the barest nutritional minimum, find instead that they can buy as little as $100 worth of food. The state and local government pockets the remaining $8, which was intended to alleviate human malnutrition.

Against this background, it is reasonable and just for the Federal government to assume the responsibility for guaranteeing that the poor have enough purchasing power (in stamps or money) to afford the food they must have to subsist. This should be after, and not merely before, taxation by other levels of government. Any attempt to eliminate hunger before taxes must fail by definition.

At the same time, state and local governments are hard pressed. They ought not to be deprived of such a valuable source of revenue. The food sales tax relief proposal would eliminate fiscal dependence on the poor, without impairing state and local sales tax receipts. To this extent, the relief contained in this proposal would represent indirect revenue-sharing.

The sales tax relief would be in the form of an annual Federal payment equivalent to the state and local sales taxes on food consumed at home by members of poor households. Beginning taxable year 1971, an application would be field by each family at or below the poverty level. The Internal Revenue Service would first determine the combined state and local sales tax rates effective in the household's area of residence, assuming a four percent rate in the four states having no sales tax. This four percent rate for no-tax jurisdictions is based on the fact that the rate in 23 states falls between four and six percent, while the rate in the 23 other states with a tax lies between two and four percent. The IRS would multiply the tax rate by the cost of the U.S. Department of Agriculture Low-Cost Food Plan for that household's composition. The resulting amount would be sent to the household by check.

The Low-Cost Food Plan, $138 per month for a family of four, is the most reliable measure of food expenditure because of the administrative difficulties involved in requiring poor persons to retain all of their receipts for food purchases. The Department of Agriculture labels this Plan "a reasonable measure of basic money needs for a good diet." It counsels rejecting any lower level of food spending as not conducive to nutritional well-being. Moreover, there are differences in the plan based on the sex and age composition of the family. Accordingly, the application would set forth the household's address, income, and the sex and age of each household member, including a notation as to whether a member was expecting a child or nursing an infant during the year. The relief under this and the other two proposals would not constitute income for Federal income tax purposes, or for determining eligibility or assistance level in connection with any federally subsidized benefit program.

As an example of the result this sales tax payment would have, a family of four living in Detroit, Michigan, would receive $66. Because the tax bite is greater in Jackson, Mississippi, the same family would get approximately $100.

A young couple anticipating a child would be entitled to $75 in New York City while the same family in Butte Montana would receive $43. The relief for a household of eight persons, including six children, would amount to $112 throughout South Carolina.

For those poor persons not actually subjected to food sales taxes, the relief would be a modest, but vital, boost for their food budgets. In California, which does not impose a tax on food the relief contemplated would be $84. Assuming that every eligible household applies, we would be turning an additional $420 million of direct tax relief back into the economy. This is based on an average tax rate of four percent and 25.5 million recipient poor persons.

The second aspect of my plan would provide property tax relief to every household whose income is at or below the Census Bureau's poverty level. As with the sales tax relief, it would take the form of an annual payment through the Internal Revenue Service. The payment would be equal to the state and local property taxes actually paid by homeowner households. We all know that persons who rent pay property taxes indirectly. Consequently, for those who pay rent the relief would be 20 percent of their annual payments. In operation, this proposal would mean that a household of four paying $80 in rent per month ($960 per year) would receive a $192 payment.

The property tax is universal. It accounts for more than one-fourth of all revenues raised by state and local governments from their own sources. But its impact is inequitable, falling hardest upon the poor. Families with over $15,000 in total annual income require only 1.4 percent of their income to meet property taxes. Families whose income is less than $2,000 are compelled to spend an average of 8.5 percent of their meager incomes on property taxes, while 3.1 million low-income non-farm homeowners pay over 10 percent of their income for this purpose.

To offset the regressive nature of the property tax, particularly where the low-income elderly are concerned, five states—California, Kansas, Minnesota, Vermont and Wisconsin—have adopted so-called "circuit-breaker" statutes. These statutes provide a variety of income tax credits or rebates for elderly homeowners and in some instances renters, whose incomes fall below fixed levels. In no case, however, is full relief granted.

In other attempts to protect impoverished homeowners from property loss due to nonpayment of taxes, seven states have homestead exemptions and sixteen states have a modified homestead exemption tailored to veterans, frequently limited to the disabled. However, none of these methods of relief is free of discriminating characteristics.

The Advisory Commission on Intergovernmental Relations advocates the "circuit-breaker" approach as introducing "a badly needed element of modern economic realism and social justice into the administration of the property tax." There is no reason for not extending such relief to a widow with a houseful of children or an unemployed father with a family since they, too, are forced to carry extraordinary residential tax loads in relation to their income.

The 20 percent figure assigned in connection with rent was selected to guarantee all renters relatively complete relief. All the same time calculation of the relief would be administratively simple. The Wisconsin "circuitbreaker" law assumes that 25 percent of the rental payment goes for property taxes, while the other four states apply the 20 percent factor.

Assuming that all eligible households apply, this form of tax relief would total approximately $1.25 billion. This projects an average rent for a family of four of $80 per month, or slightly over $190 in annual relief per family.

Written into my proposed legislation is a phase out provision whereby the relief payment for sales and property taxes would be reduced by 50 cents for every $1.00 in income over the poverty level.

The third aspect of my plan provides relief to families trying to provide higher education for their children. A tax credit would be given for part of the expenses paid by the taxpayer for his dependent's school tuition, books, and equipment. The credit would be calculated on a sliding scale with a $325 maximum. Should the credit exceed the tax liability, a positive payment would be received by the taxpayer. Room and board expenses are excluded and scholarship assistance would be deducted.

The sliding scale favors those whose children attend low tuition schools. Credit is given for a maximum of $1,500 as follows: 75 percent of the first $200, 25 percent of the next $300, and only 10 percent of the remainder. The maximum credit would be $325.

The credit also favors those in the lower tax brackets by providing for a reduction in the credit by one dollar for each $100 of income over $25,000.

To illustrate, a family earning $4,000 and spending $300 to put a child through a trade school or a public institution, would receive a $175 credit. Since this family would not pay income tax, it would receive a payment in this amount. A family which earns $15,000 and pays $1,200 toward a child's higher education, would receive a credit of $295.

A similar provision has passed the Senate on two separate occasions. The most recent was in December 1969, when the distinguished Senator from Connecticut, Senator Ribicoff, sponsored it as an amendment to the tax reform act. Regrettably it was deleted in conference.

The cost of that proposal was estimated to be $1.8 billion. To that provision, I have added the positive payment where the credit exceeds the tax. The inclusion of these low income fmailies should have only a slight impact on the cost.

We must recognize the heavy financial burden borne by families in providing this vital education for their children. This burden falls particularly hard on low and middle income families. It is appropriate for the federal government to provide some measure of relief, and in doing so we will also provide an incentive for more students to extend their education beyond high school.

This, Mr. Chairman, is my plan. It goes to the heart of the problem and provides direct stimulus to our ailing economy. It represents positive methods of putting revenue in the hands of consumers who can use it and who will spend it. We can be certain that amounts paid out by the government will be turned back into the economy through the purchase of consumer goods. This, I maintain, is the road to recovery.

In addition, the revenue effects of my plan are entirely in keeping with what the President has suggested is appropriate. My plan, even if added on top of H.R. 10947, would, over the next three years still not cost the Treasury much more than the President has already indicated he wants to have deducted for the tax liability of businesses and individuals. Back in January, he announced changes in the calculation of depreciation that would save business $11.7 billion through 1973 and $40 billion by the end of the decade. In August, he proposed another $17 billion in tax savings for a total of approximately $29 billion over the next three years. The House Ways and Means Committee has reduced this overall package to under $27 billion, including the depreciation changes already implemented by regulation.

My plan, at the outside, assuming 100% participation by every eligible family, which highly is doutful where the poor are concerned, would add $3.7 billion in tax relief. A more realistic cost estimate would be in the neighborhood of $2.5. This, when added to the House's cost, would approximately equal the cost approved, indeed ardently desired, by the President.

My plan thus makes fiscal as well as human and economic sense. I urge its adoption.

The CHAIRMAN. The next witness will be Mr. N. R. Danielian, president of the International Economic Policy Association.

STATEMENT OF N. R. DANIELIAN, PRESIDENT, INTERNATIONAL ECONOMIC POLICY ASSOCIATION

Mr. DANIELIAN. I would like to have your permission to place my full statement in the record and highlight its salient points.

The CHAIRMAN. That we do in all cases.

Mr. DANIELIAN. We support the President's program as submitted to Congress, with certain further suggestions of our own.

With respect to the investment tax credit, we approve the 7 percent allowed in the House bill, but would respectfully suggest the restoration of the 10 percent credit for the first years in order to give a particular stimulus to investments in the immediate future.

The repeal of the automobile excise tax is desirable at this time. It would redress a serious cost disadvantage of the domestic producers and offset the large contribution that imports of passenger cars and parts have been making to our balance of payments deficits. In 1970 this was $2.8 billion, and it was running at a $3.7 billion annual rate up to June 30 of this year. The elimination of the excise tax, the adoption of the 10 percent surcharge on imports, and the investment tax credit should go a long way to redress this imbalance. I should say I disagree with Senator Hollings, with all due respect. One way of reducing costs and fighting inflation is to produce increased amounts of goods at lower costs and not buy the demand pool theory that has been tried in the past and has proved rather unhelpful.

On the DISC proposal, we support the administration's recommendations with certain amendments, but have reservations on the changes made in the House. The House version tries to limit the advantages of DISC to incremental exports. This is not practical. All it will do is encourage new and untried ventures, which most likely will take business away from established exporters who have done so much in the past to maintain our export position. We suggest, therefore, that the committee restore the administration's proposal.

We are in favor of expanding the concept of DISC to include service industries. The House of Representatives included among qualified export receipts engineering and construction services. We suggest very strongly that this principle should also be extended by amendment to cover travel and tourism, including equipment used in bringing foreign tourists to the United States. Our deficit on tourist account is still $2 billion a year. It is better to deal with this problem, not by restricting the right of Americans to travel abroad, but by giving incentives to encourage foreigners to visit the United States. I suggest, therefore, in section 993(a)(1) of H.R. 10947 on "Qualified Export Receipts," a new subsection (I) as follows:

> Gross receipts from the performance of tourist and travel services for foreign visitors to and within the United States not in excess of the foreign exchange earnings of such services.

In addition to these measures, we would recommend that the Internal Revenue Code be amended to permit repatriation of earnings from abroad for eligible investments in the United States without immediately incurring tax liabilities under the constructive dividend concept. This will probably bring more funds back to the United States than will all the bureaucratic redtape of OFDI. It will also create jobs here in this country.

Mr. Chairman, this committee will remember that over the past decade our organization has warned, before this committee as well as others, that if we persisted along the policy lines of the postwar era and ignored the balance-of-payments effects of those policies, we would have a crisis and something would have to give—the value of the dollar, or liberal trade policy, or foreign aid, or military expenditures abroad. All four of these things have now happened. IMF and GATT are in disarray. The dollar has depreciated in world markets, we are forced to cut foreign aid and retreat from our worldwide commitments. Those who recently recommended benign neglect must now have second thoughts.

The danger that we confront is of two kinds: on this one hand, a retreat into a self-contained, autarchic, fortress American economic and military nationalism; and on the other hand, continued complacency and repetition of old mistakes.

Most of us would have preferred that the measures undertaken on August 15 would not have been necessary; but they were necessary and the President must be commended for the courage he showed in undertaking them.

S. 2592, which is before this committee, raises the first danger. With respect to the second danger, there are already voices in the country who would like to force the President to give up the 10 percent surcharge merely in exchange for revaluation of other currencies abroad. If we settle for so little, without changing other policies, we could have another crisis within the decade.

Our studies indicate that a revaluation of a few selected foreign currencies in terms of dollars by 10 or even 15 percent would not redress our trade position and would simply increase the dollar cost of our military expenditures. The deterioration of our trade position is due to cost differentials higher than any contemplated currency revaluations; but more importantly, the causes are not price sensitive, such as the EEC common agricultural policy, the Japanese reluctance to import our manufactured goods, and the evolution of common markets, which by their very nature discriminate against us.

We must, therefore, focus on other issues beyond trade and exchange rates. Minimum conditions for more stable arrangements should include: An agreement on access for our agricultural products to foreign markets; an agreement for elimination of nontariff barriers and border taxes and rebates; an agreement for nondiscriminatory, reciprocal and national treatment of foreign investments, which in the case of the United States is the major breadwinner abroad; and an agreement for a more equitable distribution of the cost of mutual defense. To achieve this last point, we have proposed setting up an International Security Fund to neutralize the balance of payments effects of U.S. troop deployment in NATO. I hope in time this principle can also be extended in the Pacific with our allies, Australia, New Zealand, and Japan. Cost sharing in defense is a better alternative than withdrawal of American protection and better than unilateral rearmament by other countries; and, in addition, it will ameliorate our balance-of-payments deficits and contribute to monetary as well as military stability.

Finally, Mr. Chairman, a word on the international financial crisis itself. The $60 billion in Euro-dollars, much of it created by U.S. deficits, splashes around from country to country for quick speculative gains in exchange rate gyrations or to benefit from interest rate differentials. It is a new factor, and it will not be eliminated by any increase in the price of gold, floating rates, crawling pegs, or currency revaluations. The international financial community faces one of the most important challenges of our time to determine how this huge reservoir of investable funds will be neutralized as a speculative force and guided into worthwhile and productive uses. Private companies borrowing in this market for investment purposes are probably making the best use of these funds. It should be a negotiating posture of the U.S. Government that American companies should not be discriminated against in their access to this market, and that exchange rates agreed up should be the same for current account as well as capital account transactions.

The question of devaluing the dollar by a change in the price of gold may come to the Congress sooner or later. I hope our negotiators will not accept an increase in the price of gold in addition to dropping the 10 percent surcharge, to get some revaluations of other currencies. That would really be a bad bargain. What will be the actual effects of an increase in the price of gold? We know that the gold producers and hoarders (the committee knows the countries that are involved) would be rewarded. They have probably $50 billion, both public and private. We have $10 billion. Any increase in the gold price would be 5 to 1 against us.

Even beyond this, it would be well to know if we have "gold content" guarantees in various swap arrangements and "offset" paper such as the "Roosa" type bonds. Such information in the "fine print" of Treasury and Federal Reserve obligations, so far as I know, is not available publicly. But it should be available to Congress. Any gold price increase would up these obligations. Our capital subscriptions to international financial institutions, by the very charter, such as the World Bank, involve maintenance of value guarantees in terms of gold.

In short, if the dollar price of gold is raised, the Congress will sooner or later be called on to authorize and appropriate billions of dollars to make good on these commitments. All the arguments in favor of a gold price increase are self-serving for those who have it; but it is of no conceivable benefit to us. If other countries want to raise the price of gold, let them; and then they can merrily exchange gold amongst themselves. We should stay out of it.

Thank you.

The CHAIRMAN. Thank you very much, sir.

Senator BYRD. Could I ask a question?

The CHAIRMAN. Yes.

Senator BYRD. Doctor, the total world supply of gold is $50 billion; is that correct?

Mr. DANIELIAN. It is about $60 billion. The official reserves are about $40 billion. But it is estimated there may be another $20 billion in Soviet Russia, in private holdings in France and Switzerland, and, of course, some stockpile in South Africa, and in India.

Senator BYRD. The free world supply of gold is how much, $40 billion?

Mr. DANIELIAN. The reserves, the official reserves in the possession of central banks is about $40 billion, $40 or $41.

Senator BYRD. That includes the $10 billion that the United States has?

Mr. DANIELIAN. Yes, sir.

Senator BYRD. As President of the International Economic Policy Association you have kept up rather closely, I assume, with conditions in Latin America?

Mr. DANIELIAN. Yes; I travel there every once in awhile to look at conditions.

Senator BYRD. Someone mentioned to me the other day that in addition to the United States, they now have some similarity with conditions that existed in Argentina at one point. I didn't fully understand that. Would you comment on that?

Mr. DANIELIAN. Well, in my travels I have observed that the economic theory that one hears among very serious students there is the echo of theories that used to prevail in this country in the 1930's; namely, if you put purchasing powers in the hands of people they will go to the marketplace and buy the products, industry will expand to supply them, and then you are going to have prosperity. This has become an article of faith in Latin American governmental policies. They raise wages without regard to productivity in the hopes that that is going to create demand for industrial products and lead to industrialization. Instead, it has led to inflation. It seems to me in this country, too, the wage spiral that we have gotten into without regard to productivity is pushing us in the same direction.

In another respect, one might say that those who are engaged in this power play in economic and wage negotiations are almost politicised because they are really confronting the national interest as a whole. This is exactly what has happened in the case of Argentina where they demand higher wages and they go on strike if the government doesn't yield. It is almost a confrontation between organized labor and government.

Senator BYRD. Thank you very much. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, sir.

(Mr. Danielian's prepared statement follows:)

PREPARED STATEMENT OF DR. N. R. DANIELIAN, PRESIDENT, INTERNATIONAL ECONOMIC POLICY ASSOCIATION

SUMMARY

1. The International Economic Policy Association supports the President's economic program.

2. The problems facing the U.S. economy which these measures are designed to correct are of serious proportions.

3. The Administration's DISC proposal should be supported and made applicable to all exports (rather than primarily for incremental exports), and expanded to include additional export rebates of all direct and some indirect taxes.

4. Considered in the broader international context, the specific legislative items in H.R. 10947, the investment credit and excise tax elimination, are useful and should be enacted.

5. Continued access of U.S. companies to Euro-dollars should be assured, but ways found to stabilize the Euro-dollar market.

6. Foreign direct investment controls should be eliminated and new restrictions avoided.

7. Section 956 of the Internal Revenue Code should be amended to encourage repatriation of earnings abroad for reinvestment in the United States in eligible facilities.

8. The price of gold should not be increased, and the consequences of any change studied carefully by Congress.

Mr. Chairman: It is a privilege to appear again before this Committee; and in keeping with your request, my remarks will be brief.

I. INTRODUCTION

The International Economic Policy Association analyzes international economic problems—especially as they affect U.S. public policy issues. I will not comment in any detail, therefore, on the wage-price actions which are closely related to the parts of the President's overall program included in the Revenue Act of 1971.

There is one obvious point, however, which needs to be made. Controlling U.S. internal inflation is vital to our international policy in two respects: first, the inflation we have suffered has contributed to a loss of competitiveness and to the deterioration in our trade balance; second, the erosion of the purchasing power of the dollar is one of the reasons why other countries are not willing to accept or hold dollars. Those who have advocated benign neglect of our balance of payments deficits have had their comeuppance on this issue.

Both of these points are obvious; but I would like to add a caveat to the first one about the role of inflation in our deteriorating trade balance. Our research to date tends to show that many of the commodity groups which figure most critically in our trade deterioration are not highly sensitive to price—whether price is seen as a result of inflation or of the need for adjustment in foreign exchange rates, or of costs of production. Various means of discrimination against our exports limit them often without regard to their price; for example, the EEC's variable levy system on agricultural imports and nontariff barriers of various kinds.

With regard to imports, the level is often determined by limitations on domestic supply, mostly on industrial raw materials. Even in categories where demand is relatively elastic, the differential between U.S. and foreign prices for many items is so large that an improved U.S. performance in controlling inflation, exchange rate adjustments, or even the 10 percent surcharge may not make too much difference. Those who want French wines probably will buy them anyway. And the buyer of, say, a $4.00 Japanese shirt will not be likely to shift to a $7.00 American shirt because the former's price increases to $4.40—or even $5.00!

The point I want to make to this Committee is the danger of "any single factor" analysis of the cause of our problems and to emphasize the need for remedies to cover a broad spectrum. For the most part, the President's program courageously takes a broad-gauge approach. I am concerned, however, that in the negotiations with our allies we may concentrate too much on obtaining a re-evaluation of foreign currencies in relation to the dollar. The belief that this alone will solve our problems negates the importance of other vital questions, such as sharing the foreign exchange costs of U.S. military expenditures abroad, minimizing the balance of payment effects of our foreign aid programs, and negotiating the framework for genuinely reciprocal trade which accords with the realities of the 1970's. Additional problems include reciprocal, national, nondiscriminatory treatment of U.S. investments abroad, for this is the brightest spot in our international accounts.

Historically, as I have pointed out to this Committee in the past, the private sector—including foreign investment—has earned a surplus. The very large deficits in the public sector—mostly military and foreign aid—have created the overall deficits which in turn have brought on the current U.S. and world financial crisis.

II. PROBLEMS FACING THE ECONOMY

Let me briefly recapitulate the problems which led to the U.S. situation and forced the President's actions of August 15.

Domestically, we face:

1. A continuing rate of inflation of 4 to 5 percent per year.
2. An unemployment level of 5.8 to 6 percent.
3. A plant capacity utilization rate of about 74 percent.
4. A slow rate of real economic growth of —0.6 percent in 1970 and about 0.2 percent over the past eighteen months.
5. A stagnant level of investment in new plant and equipment since late 1969 and a low rate of productivity increase.

Internationally, we confront:

1. A basic balance of payments deficit in the current year running at an annual level of $9 billion.
2. A trade deficit running at the annual rate of $1½ billion which, if you eliminate aid-financed exports, would probably reach $3⅓ to $4 billion.
3. Liquid liabilities held by foreigners of nearly $60 billion, of which $40 billion are in official reserves constituting claims upon our total reserves of $12 billion.
4. A skittish international financial community which has lost confidence in the stability of the dollar.

One must admit that in the various elements of the President's program are designed to make a contribution in each of these areas. The question we must ask ourselves is whether the President's program as announced will be sufficient to reverse these conditions and restore stability of prices, improve productivity, expand the economy in real terms, restore our competitiveness in international markets, eliminate the deficit on trade and balance of payments accounts and re-establish faith in the value of the dollar.

The means to these ends will have to involve bilateral negotiotions with Europe and Japan on a number of outstanding issues, such as: an agreement on access for agricultural products to foreign markets; an agreement for elimination of nontariff barriers against our goods; an agreement for nondiscriminatory, reciprocal and national treatment of foreign investments; and an agreement for a more equitable distribution in the costs of mutual defense. To achieve the last, the Administration may well adopt the proposal to establish an International Security Fund to neutralize the balance of payments effects of U.S. troop deployments in NATO.

I hope that as occasion's present themselves, this Committee will remind the Administration of the need to pursue our international objectives on a broad front. But within this context, I do support the President's economic program in general and the proposed Revenue Act in particular. Let me now turn to the specifics of H.R. 10947 and comment briefly on the investment tax credit, the automobile excise taxes and DISC.

III. THE INVESTMENT TAX CREDIT

The investment tax credit should have the salutary effect of increasing plant investment at a time when it is vitally necessary to create employment in enterprise, to improve productivity and expand production. To yield to foreign complaints about the discriminatory effects of the requirement of U.S. sourcing, without negotiating a suitable quid pro quo, would defeat the key objective—making U.S. industry more competitive. On the principal ways of fighting inflation is to increase production at a lower level of cost; and the investment tax credit will serve this purpose. One might raise the question, however, as to whether it is necessary to reduce this credit to a 7 percent level in the first year. I hope the Committee will retain the long range program for a 7 percent credit, but authorize for the first year a 10 percent rate as a temporary and much needed shot in the arm.

We also support the proposed earlier application of the higher exemption allowance from personal income taxes. This would have a desirable effect in stimulating consumer purchasing power. I hope the Committee will not find it necessary to curtail the investment tax credit to achieve this desirable result.

Presidential action to freeze wages and prices was necessary, and an effective Phase II program to ensure relative stability of prices must be implemented. No wage and price control system will long survive, however, under the inflationary pressures of a greatly unbalanced budget. One of the most important actions this Committee and Congress can take, therefore, is to set an overall Federal expenditure ceiling.

IV. AUTOMOBILE EXCISE TAXES

The automobile industry, a large employer, has been particularly beset by price inflation and import competition. The deficit in the balance of trade in passenger cars and parts was $2.8 billion in 1970 and is running at a projected annual deficit of $3.7 billion this year. The elimination of the excise tax and the adoption of a 10 percent surchrage on imports should go some way towards offsetting the imbalance in cost of production. If we can hold the line on cost during Phase II of the President's program, the investment tax credit may help the industry retain the advantages provided by these actions.

V. THE DISC PROPOSAL

This Committee is well aware that our exports are at a disadvantage in a world organized into trading blocs with their tariff and nontariff barriers against the external world, as well as their export subsidies and tax rebates. The DISC proposal, which we favor, is but a small contribution to rectify this imbalance. Even if all of the income of a DISC is exempted from taxation by virtue of being invested in qualified export-related activities, the advantage to the exporter of 5 cents on the dollar is not enough to overcome the average 12 or 15 percent tax rebates of the EEC countries. We urge, therefore, that the Committee give consideration to a more liberal and a more permanent treatment of exports. This can be done in several ways: an export rebate on all the indirect state and local excise and sales taxes which may be attributable in the cost of exported goods at the water's edge; making a direct rebate of a portion of direct income taxes; or establishing a lower rate of taxation on profits derived from exports.

The action of the House in limiting this incentive in DISC largely to additional or incremental export sales still further dilutes its effectiveness. As this Committee well knows, our exporters are having difficulty maintaining current levels of exports in the face of foreign competition. As Secretary Connally has already pointed out to this Committee, to allow deferral primarily for incremental exports would penalize those companies which contributed most to the U.S. trade balance in the past by exporting, and it may only result in shifting exports from well established export operations to new outfits without an increase in exports. We therefore recommend that this Committee permit deferral of all exports qualifying under the DISC proposal, as originally proposed by the Administration.

We do not understand the objections of those who insist that the solution to our export problem and to domestic unemployment is to keep industry in the United States and export from here, but at the same time oppose this measure.

We are in favor of expanding the concept of DISC to include service industries. The House of Representatives again this year, in its good judgment, approved an amendment extending the DISC proposal to export of engineering and construction services. We suggest very strongly that this principle should also be extended by amendment to cover travel and tourism, including equipment used in bringing foreign tourists to the United States.[1] Our deficit on tourist account is still $2 billion a year. It is better to deal with this, not by restricting the right of Americans to travel abroad, but by giving incentives to encourage foreigners to visit the United States. I suggest, therefore, in section 993 (a)(1) of H.R. 10947 on "Qualified Export Receipts," a new subsection (I) as follows: "Gross receipts from the performance of tourist and travel services for foreign visitors to and within the United States not in excess of the foreign exchange earnings of such services."

VI. CONCLUSION

The bill which this Committee is called upon to approve is an essential part of the President's program. We therefore support H.R. 10947, except that we prefer the original version of the DISC proposal for the reasons just explained.

These specific legislative items, and ineed the package as a whole, must be considered in the broader international context. As you know, we do not live in an ideal economic world. It is true that the classical concepts of free trade have been outmoded by the rise of trading blocs and the growth of nontariff barriers; divergent labor conditions and wages are exacerbated by government subsidies and monetary management limiting the applicability of "comparative advantage." But what we do not need in seeking the necessary adjustments to reality is a return to mercantilism, autarchy and an economic fortress America. Legislation recently introduced in Congress (S. 2592—referred to this Committee—and H.R. 10914, H.R. 11057, H.R. 11094 and H.R. 11115) would be a long step in this direction if enacted, even in part.

For example: the United States is in trouble because of our balance of payments deficits. One of the few bright spots still remaining is the income from foreign direct investments—even when matched against capital outflows—plus royalties, patents and fees. Yet S. 2592 would have the effect of sharply curtailing this national breadwinner! Even the present foreign direct investment controls—in effect voluntary since 1965 and mandatory since 1968—are hurting both U.S. investment income and exports. They should be eliminated.

The Internal Revenue Code should also be amended to permit repatriation of earnings from abroad for eligible investments in the United States without immediately incurring tax liabilities under the constructive dividend concept. This will probably bring more funds back to the United States than will all the bureaucratic red tape of OFDI. It will also create jobs here in this country.

Finally, Mr. Chairman, a word on the international financial crisis itself. The $60 billion in Euro-dollars, much of it created by U.S. deficits, splashes around

[1] We now sell American aircraft to a foreign airline with a 6 percent Export-Import Bank loan, and under the provisions of DISC, would allow a tax deferral on it as well. An American airline, however, serving exactly the same market must borrow money at 10 or 11 percent as has happened in the past year, without the advantage of any tax concessions.

from country to country for quick speculative gains in exchange rate gyrations or to benefit from interest rate differentials. It is a new factor, and it will not be eliminated by any increase in the price of gold, floating rates, crawling pegs, or currency reevaluations. The international financial community faces one of the most important challenges of our time to determine how this huge reservoir of investable funds will be neutralized as a speculative force and guided into worthwhile and productive uses. Private companies borrowing in this market for investment purposes are probably making the best use of these funds. It should be a negotiating posture of the U.S. Government that American companies should not be discriminated against in their access to this market, and that exchange rates agreed upon should be the same for current account as well as capital account transactions.

The question of devaluing the dollar by a change in the price of gold may come to the Congress sooner or later. I hope our negotiators will not at any stage of the negotiations accept an increase in the price of gold as a measure of settlement of our problems, because I do not see how this could help the U.S. position in any manner whatsoever. As a minimum, this Committee should obtain from the Treasury Department, on a confidential basis if necessary, information on the actual effects of such a change in the price of gold. We know that the gold producers and hoarders (the Committee knows the countries that are involved) would be rewarded, that official reserves of gold would become larger in terms of dollars and hence potential claims on U.S. resources. Even beyond this, it would be well to know if we have "gold content" guarantees in various swap arrangements and "offset" paper such as the "Roosa" type bonds. Such information in the "fine print" of Treasury and Federal Reserve obligations, so far as I know, is not available publicly. But it should be available to Congress. Our capital obligations to international financial institutions, such as the World Bank, involve maintenance of currency value guarantees in terms of gold. If the dollar price of gold is raised, the Congress will sooner or later be called on to authorize and appropriate billions of dollars to make good these commitments. To what end, I fail to see.

Thank you.

The CHAIRMAN. The next witness will be Mr. Paul D. Seghers, president of the International Tax Institute.

STATEMENT OF PAUL D. SEGHERS, PRESIDENT, INTERNATIONAL TAX INSTITUTE, INC.

Mr. SEGHERS. I thank you, Mr. Chairman and the other members of the committee, for this opportunity to appear here and speak on the subject which is very close to my heart. Let me ask you if you would kindly, on the summary of the statement, the last paragraph, there is an error. After the word "penalizes" should be inserted penalizes the U.S. owners of.

The CHAIRMAN. Right.

Mr. SEGHERS. If I may continue with my statement.

This institute is an organization of almost 400 members throughout the United States. These members are business executives, attorneys, and accountants, who are specialists in the taxation of overseas income. All are united by a common concern regarding the economic success of the overseas commerce of this country.

This institute was organized in 1961 to meet the tax threat to U.S. exports and foreign trade. That threat came, not from foreign governments, but from the U.S. Treasury.

In 1962, the Congress was misled by a brilliant theorist into imposing a hitherto-unheard-of tax penalty on the export of U.S. products and other income earned by foreign subsidiaries of U.S. manufacturers selling their products abroad.

The DISC proposal, which has been fully explained to this committee by others, is designed to remove, to some extent, those penalties on U.S. exports and to provide help to U.S. manufacturers to meet the ever-growing competition of foreign manufacturers in foreign markets.

SPECIFIC RECOMMENDATIONS

(*a*) We urge prompt enactment of DISC, without the "incremental" limitation.

(*b*) We recommend repeal of section 954(d) of the Internal Revenue Code, or at least its amendment, so as not to penalize the export of U.S. products.

What this institute asks of your committee is to enact tax legislation which would stimulate rather than penalize the export of U.S. manufactured products. What is needed is the removal of penalties and the enactment of incentives to help U.S. manufacturers to overcome the obstacles with which they must contend in selling U.S. goods in foreign markets. In addition to the competition of foreign manufacturers, these obstacles include ever-higher U.S. labor costs per unit of production; transportation costs to overseas markets, and increased foreign taxes.

To be effective, any tax incentive must confer a real benefit. DISC would require the U.S. manufacturer to report a fair share of the income realized on exports through a DISC. The DISC would be allowed to defer payments of the tax on a portion of such income as long as the funds representing that income continued to be employed in the export of U.S. products. This seems to be fair to both parties—to the manufacturer that risks loss of capital as well as income in exporting or expanding the volume of its exports, and fair to the government that defers collecting the tax on a portion of that income as long as the resulting profits are being used to produce more income.

DISC INCREASES EXPORTS

DISC would work—it would increase exports.

When we say that DISC will increase exports, we speak from knowledge and experience in this field. Experience with Panama corporations prior to 1963 dramaticaly demonstrated that U.S. manufacturers would eagerly grasp at the benefits to be obtained by deferring the tax on profits realized by exporting their products.

The ultimate result was an increase in the volume of their exports; an increase in their activities abroad in order to increase the volume of sales of these U.S. products; an increase in their total export profits and, eventually, an inflow of dividends to the United States far greater than the original cash outlay made to start these export businesses.

The trend to exporting through Panama was snowballing when it was suddenly checked and largely destroyed by the 1962 U.S. tax legislation.

In this institute's testimony before the Ways and Means Committee on June 4, 1961, we stated that then existing law had: "influenced many smaller U.S. manufacturers to engage actively in exporting. This has, especially in the past few years, resulted in increased exports of U.S. products, in the face of competition by increasingly efficient foreign producers."

Remember—we said this in 1961—10 years ago.

ATTACKS AGAINST DISC

This committee undoubtedly has heard and will hear brilliant theoretical arguments against DISC. Do those who spin these theories know what they are talking about—that is, business?

American manufacturers have demonstrated the requisite skill and organizing ability to sell great volumes of U.S. products abroad, in the face of many obstacles and keen competition.

Academic theorists will not, cannot produce the increased exports we need. Only competent business organizations can produce that result.

False statements about DISC are being made by its enemies in their attacks on it.

They say DISC would exempt from U.S. tax all income from exports. This is doubly false.

DISC would not exempt from tax one penny of income. It would postpone the time for payment of tax, but only so long as the DISC earns 95 percent of its income from exports and 95 percent of its assets are employed in producing export income.

It is false to say that DISC would exempt from U.S. tax all the profit on exports. As originally proposed and passed by the House last year, DISC would postpone the time for payment of tax on about half the net, after-tax profit from exports of U.S. products. As cut down by the Ways and Means Committee, the deferral would be reduced to only 12½ percent of income from exports not in excess of a 1968–70 base period average, and plus about 50 percent of any increase over that average. Meanwhile, the balance of the profit would continue to be subject to immediate U.S. taxation.

THE IMMEDIATE VISIBLE LOSS OF TAX REVENUE

Those who theorize about the "loss of tax revenue" from DISC throw around billions so carelessly as to contradict themselves.

One billion dollars of exports adds that much to the prosperity of our country.

All of it goes to labor and to the owners of the property that is used to produce the goods exported—most of it to labor. This is fact—not theory.

One billion dollars of exports produces more than that amount of taxable income, because of the multiplying effect of payments to labor and stockholders, who in turn spend most of it, creating income for others. This is not a "trickle-down" theory, but fact as to the taxation of personal income.

One billion dollars of exports probably results in no more than 10 percent of taxable net income after deduction of all allowable costs and expenses.

Failure to collect income tax immediately on that profit makes our country no poorer—but the billion dollars of exports has added most of that amount to U.S. payrolls.

The enemies of DISC say that it would be ineffective in increasing U.S. exports, and they say it would lead to retaliation against U.S. goods entering foreign markets. This is self-contradictory. If DISC would not be effective in increasing U.S. exports, would European governments and industrialists be so concerned about it? The New York Times—September 17—reports from Paris that DISC "* * * is seen as an essentially powerful stimulus that would intensify U.S. competition in the European market." This clearly indicates that those most concerned and in a position to know, are convinced that DISC would be effective in increasing exports of U.S. products.

WHAT THE RECORD SHOWS

Let us look at the record of exports of U.S. products since 1963. Is this committee happy with it? As this institute and others predicted in 1961 and 1962, our then very favorable balance of trade has gradually shrunk until it has disappeared. No longer are American factories able to export more of their products than we buy from foreign factories. If U.S. manufacturers cannot overcome their foreign competition here at home, think what it means for them to compete in foreign markets.

THE INCREMENTAL LIMITATION

We disagree with the theory that DISC benefits should be allowed only or almost exclusively to those U.S. manufacturers that have not heretofore been doing their best to export their products. That theory is founded on the uninformed assumption that those U.S. factories that have been exporting their products will "naturally" continue to do so and need no help to increase the volume of their exports. This theory ignores the facts. More than one-third of the 100 U.S. producers that export the greatest amount of U.S. products showed no increase or a drop in the volume of their exports for the years 1965–67. Since then, the trend of exports has declined, because of ever-increasing difficulties of U.S. manufacturers in exporting their products in the face of European and Japanese competition.

INEQUITIES, DISCRIMINATION AND DIFFICULTIES OF ANY INCREMENTAL LIMITATION

Obvious, glaring inequities that would result from any "simple" formula for computing a base-period average would make relief provisions essential. That would impose further burdens on those in need of relief, and involve complex administrative problems.

Inequity would result from the fact that most U.S. manufacturers that have been substantial exporters in the past will have great difficulty in even equaling their 1968–70 export sales.

Granting more DISC benefit to those manufacturers who had exported less in the base period would give them a discriminatory advantage over their competitors who had contributed more in past years to employment and prosperity in the United States by exporting more.

The administrative difficulties of any "incremental" limitation scheme would be staggering.

The complexities of the original DISC proposal would be of concern only in connection with unusual situations. An "incremental" limitation, however, would cause numerous, burdensome and unpredictable difficulties in very case.

When the Congress, in 1961, considered an "incremental" limitation on the investment credit, it was dropped for just those reasons—inequities, competitive disparities, and complexities.

A lack of confidence in the intention of Congress to enact a genuine and meaningful tax incentive for U.S. exports would cause businessmen to hesitate in relying on any promised benefits. This would lessen the value of DISC as an incentive to U.S. manufacturers to expend the necessary effort and money to enter the export field or to increase the volume of their exports.

U.S. INCOME TAX PENALTIES ON THE EXPORT OF U.S. PRODUCTS SHOULD BE REMOVED

Since 1963, there have been U.S income tax penalties on the export of U.S. products. Internal Revenue Code section 954(d) has that effect.

Before 1963, a U.S. manufacturer could use a single foreign corporation to sell its products worldwide and U.S. tax would be payable on the overseas selling profit realized by that foreign corporation only when distributed by it to its U.S. parent corporation. This permitted the foreign selling corporation to use its retained profits to expand its sales promotion activities through employment of increased personnel, more extensive advertising, carrying and warehousing larger inventories, and other means.

Such activities of course resulted in increased volume of export sales of the U.S. manufacturers' products, on which the entire manufacturing profit was subject to immediate U.S. income tax—only the payment of U.S. tax on the overseas selling profit of the foreign selling subsidiary could be deferred.

Since 1963 Internal Revenue Code section 954(d) taxes such profits to the U.S. parent company as imaginary dividends, even though such profits are earned abroad by a foreign corporation and retained and used abroad by it in its business.

This tax result can be avoided by incorporating a separate selling subsidiary in each country where sales are to be made. Only very large U.S. manufacturers can afford this and even they are handicapped by this provision. They are subject to the penalty tax if they use, in the normal way, distribution and warehousing points, such as Panama, Brussels, Amsterdam, Hamburg, and Hong Kong to supply buyers in other countries.

It is clear that this is a powerful deterrent to the distribution of U.S. products abroad. Section 954(d) has had that effect. It should be repealed, or at least amended so as not to be applicable to goods produced in the United States.

HOW WILL THIS COMMITTEE DECIDE?

Unless something is done to remove the U.S. tax and regulatory burdens on U.S. exports and to help U.S. manufacturers to meet foreign competition, the downward trend of our exports will be worse in the 1970's than it was in the 1960's.

Look at the record of our balance of trade for the 1960's. Is this committee happy with it?

This institute and others predicted in 1961 and 1962 this result of the tax policies so forcefully and effectively urged upon the Congress by the then Assistant Secretary of the Treasury, the Honorable Stanley Surrey.

That brilliant advocate of ivory tower theories is the most persuasively eloquent opponent of DISC.

Do you intend to continue to accept his theories, as you watch the continuing decline in the volume of our exports? Or will you now decide for yourselves how to increase the export of the products of U.S. factories—and their payrolls?

Will you heed the message of U.S. manufacturers who have been exporting their products despite European and Japanese competition in foreign markets?

SUMMARY

DISC, without the "incremental" limitation, would be a powerful and effective incentive to increase the export of U.S. products.

DISC should be enacted and made fully effective without delay.

Section 954(d) of the Internal Revenue Code imposes a senseless and needless U.S. tax burden on the export of U.S. products.

It should be repealed, or at least amended, so as not to apply to the sale abroad of U.S. products.

These two measures are not the only steps the Congress could take to increase the export of U.S. products. However, they are the simplest and most desirable tax measures available for immediate enactment.

They would increase exports, and thereby help our economy, result in increased payrolls, and improve our balance of trade position in world markets. There should be no delay in enacting these measures. They are urgently needed.

We ask permission to have the entire statement published and I thank you for the opportunity. I hope that some of the Senators will have a question.

The CHAIRMAN. We will certainly study it, Mr. Seghers, and we appreciate your statement here today.

Senator BENNETT. Before you leave, Mr. Seghers, was his last statement the answer to the question he raised, that our present laws penalize U.S. exporters?

Mr. SEGHERS. Well, under 954(d), if a U.S. manufacturer sells to a foreign subsidiary for resale in the foreign country where that corporation is incorporated, then there is no U.S. tax until the profits are brought home. However, if the U.S. corporation sells to a U.S. manufacturer, sells to a single corporation, for example, in Panama, and that Panama corporation has branches all around, then immediately because it is a Panama corporation selling to various countries in Latin America or selling, shipping in the Far East, or shipping even to Europe, then the U.S. manufacturer is taxed on an imaginary dividend measured by the profits on the resale of U.S. products abroad.

Senator BENNETT. That is the explanation you gave us in the last paragraph?

Mr. SEGHERS. Yes.

Senator BENNETT. And that is the answer to your statement?

Mr. SEGHERS. That is the fact and no one has questioned the truth of my statement that this is a U.S. income tax penalty on the export of U.S. products.

Senator BENNETT. Thank you very much.

(Mr. Seghers prepared statement follows:)

PREPARED STATEMENT OF PAUL D. SEGHERS, PRESIDENT, INTERNATIONAL TAX INSTITUTE, INC., (FORMERLY, INSTITUTE ON U.S. TAXATION OF FOREIGN INCOME INC.)

INTRODUCTION

Since 1962, U.S. tax policies have discouraged foreign trade, even penalized exports of U.S. products. The DISC proposal is designed to remove to some extent those penalties. We know DISC would work—on the basis of knowledge and experience.

SPECIFIC RECOMMENDATIONS

(a) Prompt enactment of DISC without the "incremental" limitation; and

(b) Repeal or amendment of I.R.C. Sec. 954(d), so as not to penalize the export of U.S. products.

To be effective, any tax incentive must confer a real benefit. DISC would permit deferral of the time of payment of tax on a portion of export profit. The U.S. manufacturer would be taxed at once on a fair share of the income realized on exports through a DISC. This seems fair to both parties.

ATTACKS AGAINST DISC

Do those who make brilliant theories against DISC know what they are talking about—that is, business? Academic theorists can not produce the exports we need. Only competent business organizations can produce that result. The immediate visible loss of tax revenue from DISC would be offset by indirect increases in revenue due to the multiple effects of payments to labor and stockholders.

Is the committee happy with the record of U.S. exports since 1963?

"Incremental theory"—is based on the uninformed assumption that U.S. factories will "naturally" continue to increase their exports. Any "incremental" limitation would create inequities, competitive disparities and staggering complexities.

U.S. TAX PENALTY ON EXPORTS

I.R.C. Sec. 954(d) penalizes the U.S. owner of any foreign corporation which sells U.S. products in any country except the one in which it is incorporated. It should be repealed or amended so as not to apply to U.S. products.

INTRODUCTION

This institute is an organization of almost 400 members throughout the United States. These members are business executives, attorneys and accountants, who are specialists in the taxation of overseas income. *All* are united by a common concern regarding the *economic* success of the overseas commerce of this country. Taxes, foreign and domestic, constitute the heaviest expense of business today. We are concerned by the fact that, since 1962, the *actual* tax policy of this country has been to discourage foreign trade—even to penalize exports of U.S. products. We hope that we now see a light on the horizon for a brighter day—a *clearer* vision on the part of those wielding the power to tax.

In 1961, when the shape of things to come could be seen, this institute was organized to meet the tax threat to U.S. exports and foreign trade. That threat came, not from foreign governments, but from the U.S. Treasury.

In 1962, the Congress was misled by a brilliant theorist into imposing a hitherto-unheard-of tax penalty on the export of U.S. products and other income earned by foreign subsidiaries of U.S. manufacturers selling their products abroad.

The DISC proposal, which has been fully explained to this Committee by others, is designed to remove, to some extent, those penalties on U.S. exports and to provide help to U.S. manufacturers to meet the ever-stronger competition of foreign manufacturers in foreign markets. This would increase payrolls in U.S. factories.

SPECIFIC RECOMMENDATIONS

(*a*) We urge prompt enactment of DISC, without the "incremental" limitation.

(*b*) We recommend repeal of Sec. 954(d) of the Internal Revenue Code, or at least its *amendment*, so as not to penalize the export of U.S. products.

What this institute asks of your Committee is to enact tax legislation which would stimulate rather than penalize the export of U.S. manufactured products. There is no question about the need to increase exports—there has been plenty of talk, talk, and talk about it. Government has urged business to enter the export field and to expand its exports. However, what we need is action—not talk—the removal of penalties and the enactment of incentives to help U.S. manufacturers to overcome the obstacles with which they must contend in selling U.S. goods in foreign markets. In addition to the competition of foreign manufacturers, these obstacles include (but are not limited to) ever-higher U.S. labor costs per unit of production; transportation costs to overseas markets, and increased foreign taxes (which, in part, reflect the effect of U.S. tax policies.)

We stress that since 1962 the U.S. income tax law has penalized exports of U.S. products. The 1962 U.S. income tax measures directed against foreign trade have helped to wipe out our favorable balance of trade position and to increase our terrible balance of payments deficits. This result was predicted by this institute in its testimony before this Committee when that unfortunate legislation was under consideration.

ARGUMENTS IN FAVOR OF DISC

It is our opinion, based on our experience and knowledge in this field, that DISC (without the "incremental" limitation) would be an effective incentive to large U.S. manufacturers to increase the volume of their exports and would induce relatively small U.S. manufacturers to engage actively in exporting their products.

To be effective, any tax incentive must confer a real benefit. DISC would not reduce the amount of tax payable on the entire profit realized from the export of U.S. products, but would permit deferral of the time of payment of the tax on a portion of such profits. The U.S. manufacturer would be required to report a fair share of the income realized on exports through a DISC, and the DISC would be allowed to defer payment of the tax on a portion of such income as long as the funds representing that income continued to be employed in the export of U.S. products. This seems to be fair to both parties—to the manufacturer that risks loss of capital as well as income in exporting or expanding the volume of its exports, and fair to the government that defers tax on a portion of that income as long as the resulting profits are being used to produce more export income.

DISC WOULD INCREASE EXPORTS

DISC *would* work—it *would* increase exports.

When we say that DISC *will* increase exports, we speak from knowledge and experience in this field. Experience with Panama corporations prior to 1963 dramatically demonstrated that U.S. manufacturers would eagerly grasp at the benefits to be obtained by deferring the tax on profits realized by exporting their products. Many small U.S. manufacturers organized and made use of Panama corporations to *postpone* payment of U.S. income tax on the export of their products. Perhaps some of them *deferred* more tax than the law really allowed, but they did start to export and to increase the export of their products. At first, such a U.S. manufacturer would use the Panama corporation as a mere paper device. Soon the U.S. manufacturer would learn the advantages of carrying a stock of goods in Panama from which overnight air deliveries could be made to overseas customers. This reduced their customers' requirements for inventory stocks and thereby reduced the U.S. manufacturers' credit risks. The ultimate result was an *increase* in the volume of their exports; an *increase* in their activities abroad in order to increase the volume of sales of these U.S. products; an *increase* in their total export profits and, eventually, an *inflow* of dividends to the U.S. far greater than the original cash outlay made to start these export businesses.

The trend to exporting through Panama was snowballing when it was suddenly checked and largely destroyed by the 1962 U.S. tax legislation.

In this institute's *1961* testimony before the Ways and Means Committee (on June 4, 1961), we stated that:

"We *know* that our present system of taxing U.S. stockholders on income earned outside the United States only when received *has* influenced many smaller U.S. manufacturers to engage actively in exporting. This has, especially in the past few years, resulted in increased exports of U.S. products, in the face of competition by increasingly efficient foreign producers."

Remember—we said this in 1961—ten years ago!

ATTACKS AGAINST DISC

This Committee undoubtedly has heard and will hear brilliant theoretical arguments against DISC. Do those who spin these theories know what they are talking about—that is, business?

American manufacturers have demonstrated the requisite skill and organizing ability to sell great volumes of U.S. products abroad, in the face of many obstacles and keen competition.

Academic theorists will not, can not produce the increased exports we need. Only competent business organizations can produce that result.

Ameican business will respond if DISC is enacted as an incentive for increased exports.

Do you want theories—or increased exports?

False statements about DISC are being made by its enemies in their attacks on it. Would they not be content to rely upon the truth, if they could find sound arguments against DISC?

They say DISC would exempt from U.S. tax all income from exports. This is doubly false.

DISC would *not* exempt from tax one penny of income. If that were true, it would, indeed, rapidly and greatly increase the export of U.S. products. However, it is false—DISC does *not* provide any exemption from tax. It does *postpone* the time for payment of tax, but on only a *portion* of the income from exports, and only so long as the DISC earns 95% of its income from exports and 95% of its assets are employed in producing export income.

It is false to say that DISC would exempt from U.S. tax *all* the profit on exports. As originally proposed and passed by the House last year, DISC would postpone the time for payment of tax on about *half* the net, *after-tax* profit from exports of U.S. products. As cut down 75% by the Ways & Means Committee, the deferral would be reduced to 25% of 50%, or only 12½%, of income from exports not in excess of a 1968–1969–1970 base period average, plus about 50% of any increase over that average. Meanwhile, the balance of the profit would continue to be subject to immediate U.S. taxation.

Other statements of enemies of DISC, while misleading and believed to be unjustified, can not be branded as false, since they are only opinions, guesses and predictions—not asserted as facts.

THE IMMEDIATE VISIBLE LOSS OF TAX REVENUE

Those who theorize about the (immediate, direct, visible) "loss of tax revenue" from DISC throw around billions so carelessly as to contradict themselves.

One billion dollars of exports adds that much to the prosperity of our country.

All of it goes to labor and to the owners of the property that is used to produce the goods exported—most of it to labor. (This is fact—not theory.)

One billion dollars of exports produces more than that amount of taxable income, because of the multiplying effect of payments to labor and stockholders, who in turn spend most of it, creating income for others. (This is *not* a "trickle-down" theory, but *fact* as to the taxation of personal incomes.)

One billion dollars of exports probably results in no more than 10% of profit (after deduction of all allowable costs and expenses *other than* income taxes.)

Failure to collect income tax *immediately* on that profit makes our country no poorer—but the billion dollars of exports has added most of that amount to U.S. payrolls.

The enemies of DISC say that it would be ineffective in *increasing* U.S. exports, and they say it would lead to retaliation against U.S. goods entering foreign markets. This is self-contradictory. If DISC (as originally proposed) would *not* be effective in increasing U.S. exports, would European governments and industrialists be so concerned about it? The New York Times (Sept. 17th) reports from Paris that DISC "... is seen as an essentially powerful stimulus that would intensify [U.S.] competition in the European market." This clearly indicates that those most concerned and in a position to know, are convinced that DISC *would* be effective in increasing exports of U.S. products.

Those with knowledge and experience in the field of international business know that DISC *would* increase U.S. exports—quickly, in the case of smaller U.S. manufacturers that have not hitherto made much, if any effort to export, and more gradually, but in vastly greater volume in the case of larger U.S. manufacturers already selling widely in foreign markets.

WHAT THE RECORD SHOWS

Let us look at the record of exports of U.S. products since 1963: Is this Committee happy with it? As this INSTITUTE and others predicted in 1961 and 1962, our then very favorable balance of trade has gradually shrunk until it has disappeared. No longer are American factories able to export more of their products than we buy from foreign factories. If U.S. manufacturers can not overcome their foreign competition here at home, think what it means for them to compete in foreign markets.

THE "INCREMENTAL" LIMITATION

We disagree with the theory that DISC benefits should be allowed only or almost exclusively to those U.S. manufacturers that have not heretofore been doing their best to export their products. That theory is founded on the uninformed assumption that those U.S. factories that have been exporting their products will "naturally" continue to do so and need no help to increase the volume of their exports. This theory ignores the facts. More than one-third of the 100 U.S. producers that export the greatest amount of U.S. products showed *no* increase or a *drop* in the volume of their exports for the years 1964–5–6–7. It is generally recognized that, since then, the trend of exports has declined, because of ever-increasing difficulties of U.S. manufacturers in exporting their products in the face of European and Japanese competition. Many are unable to overcome that competition here in this country.

INEQUITIES, DISCRIMINATION, AND DIFFICULTIES OF ANY "INCREMENTAL" LIMITATION

Obvious, glaring inequities that would result from any "simple" formula for computing a base-period average would make relief provisions essential. That would impose further burdens on those in need of relief, and involve complex administrative problems.

A further inequity would result from the fact that most U.S. manufacturers that have been substantial exporters in the past will have great difficulty in even equaling their 1968–1969–1970 export sales.

Granting *more* DISC benefit to those manufacturers who had exported *less* in the base period would give them a discriminatory advantage over their competitors who had contributed more in past years to employment and prosperity in the United States by exporting more.

The administrative difficulties of any "incremental" limitation scheme would be staggering.

The complexities of the original DISC proposal would be of concern only in connection with unusual situations. An "incremental" limitation, however, would cause numerous, burdensome and unpredictable difficulties in every case.

When the Congress, in 1961, considered an "incremental" limitation on the investment credit, it was dropped for just those reasons—inequities, competitive disparities, and complexities.

A lack of confidence in the intention of Congress to enact a genuine and meaningful tax incentive for U.S. exports would cause businessmen to hesitate in relying on any promised benefits. This would lessen the value of DISC as an incentive to U.S. manufacturers to expend the necessary effort and money to enter the export field or to increase the volume of their exports.

U.S. INCOME TAX PENALTIES ON THE EXPORT OF U.S. PRODUCTS SHOULD BE REMOVED

Since 1963, there have been U.S. income tax penalties on the export of U.S. products. Internal Revenue Code Section 954(d) of the monstrous 1962 "Subpart F" has that effect.

Before 1963, a U.S. manufacturer could use a *single* foreign corporation to sell its products worldwide and U.S. tax would be payable on the overseas *selling profit* realized by that foreign corporation only when distributed by it to its U.S. parent corporation. This permitted the foreign selling corporation to use its retained profits to expand its sales promotion activities through employment of increased personnel, more extensive advertising, carrying and warehousing larger inventories, and other means.

Such activities of course resulted in increased volume of export sales of the U.S. manufacturer's products, on which the entire *manufacturing* profit was subject to immediate U.S. income tax—only the payment of U.S. tax on the overseas *selling* profit of the foreign selling subsidiary could be deferred.

That is no longer possible since 1963—I.R.C. Section 954(d) *really* taxes such profits to the U.S. parent company as *imaginary* dividends, even though such profits are earned abroad by a foreign corporation and retained and used abroad by it in its business.

This tax result can be avoided by incorporating a separate selling subsidiary in each country where sales are to be made. Only very large U.S. manufacturers can afford this and even they are handicapped by this provision. They are subject to the penalty tax if they use, in the normal way, distribution and warehousing points, such as Panama, Brussels, Amsterdam, Hamburg and Hong Kong to suply buyers in other countries.

It is clear that this is a powerful deterrent to the distribution of U.S. products abroad. Section 954(d) has had that effect. It should be repealed, or at least amended so as not to be applicable to goods produced in the United States.

HOW WILL THIS COMMITTEE DECIDE?

Unless something is done to remove the U.S. tax and regulatory burdens on U.S. exports and to help U.S. manufacturers to meet foreign competition, the downward trend of our exports will be worse in the '70's than it was in the '60's.

Look at the record of our balance of trade for the '60's. Is this Committee happy with it?

This is what this INSTITUTE and others predicted in 1961 and 1962 would be the result of the tax policies so forcefully and effectively urged upon the Congress by the then Assistant Secretary of the Treasury, the Hon. Stanely Surrey.

That brilliant advocate of ivory-tower theories is the most persuasively eloquent opponent of DISC.

Do you intend to continue to accept his theories, as you watch the continuing decline in the volume of our exports? Or will you now determine to act as statesmen, and decide for yourselves how to increase the export of the products of U.S. factories—and their payrolls?

Will you heed the message of U.S. manufacturers who have been exporting their products despite European and Japanese competition in foreign markets? Or, will you rely implicitly on fine theories spun by a brilliant college professor and others who feel and urge that business must be penalized if it is large, successful and profitable?

How much of the good things of life as we know it could be enjoyed by the people of this country, if not produced by business?

SUMMARY

DISC, without the "incremental" limitation, would be a powerful and effective incentive to increase the export of U.S. products.

DISC should be enacted and made fully effective without delay.

Section 954(d) of the Internal Revenue Code imposes a senseless and needless U.S. tax burden on the export of U.S. products.

It should be repealed, or at least amended, so as not to apply to the sale abroad of U.S. products.

These two measures are not the only steps the Congress could take to increase the export of U.S. products. However, they *are* the simplest and most desirable tax measures available for immediate enactment.

They would increase exports, and thereby help our economy, result in increased payrolls, and improve our balance of trade position in world markets. There should be no delay in enacting these measures. They are urgently needed.

The CHAIRMAN. Now, the next witness will be Mr. George B. Koch, chairman of the Federal Finance Committee of the Council of State Chambers of Commerce.

STATEMENT OF GEORGE S. KOCH, CHAIRMAN, FEDERAL FINANCE COMMITTEE OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE, ACCOMPANIED BY EUGENE F. RINTA, EXECUTIVE DIRECTOR

Mr. KOCH. My name is George S. Koch and I reside at 57 Church Lane, Scarsdale, N.Y. I am an attorney-at-law in New York and appear here today as chairman of the Federal Finance Committee of the Council of State Chambers of Commerce. I am accompanied by Eugene F. Rinta, executive director of the council. Our statement represents the views of the council's federal finance committee and the member State chambers of the council which to date have endorsed it. They are listed at the end of the statement.

We appreciate this opportunity to appear before you to emphasize the need for tax legislation as proposed by the President. We are certain that the economy needs the stimulus this program will provide; and this seems to be the overwhelming view in the Nation as well. A fundamental point here is that the anti-investment effects of the 1969 Revenue Act must be corrected. As stated in our paper, this would encourage improvements in productivity that are needed to maintain reasonable price stability and to improve the American competitive position in all markets, foreign as well as domestic.

We have recommended to you in our paper that a comprehensive study of the entire depreciation area be made by Congress and the Treasury to determine if there may be a better way to achieve the desired results of the ADR system and the restored investment credit. In the meantime we urge that the ADR system adopted by the Treasury remain essentially unchanged until it is clear we know a better way to accomplish the desired objective.

Something must be done to correct our large, chronic budget imbalances. In our judgment this makes imperative a program of effective spending control. We urge in our paper that Congress follow the pattern of control established in the Revenue and Expenditure Control Act of 1968 and bring the 1972 budget into reasonable balance, at least on the so-called full-employment budget basis.

We strongly disagree with the contention that the President's tax proposals and the House bill are too heavily weighted in favor of business. When one reviews the history of Federal tax legislation in the 1960's it becomes clear that a significant bias against business will still continue even if the President's proposals become law. We refer you to our statement for an analysis of the development and size of this bias.

Concerning specific issues which we see in the tax proposals, our statement reflects our comments. We would like to emphasize, however, that we believe the investment credit should begin at 10 percent and later drop to a minimum of 7 percent. As for the DISC proposal, the change made by the House, to limit the tax deferment essentially to new export business, seriously limits its potential. We urge that DISC be enacted but without the House limitation.

Although not included in our statement, I would refer you also to the foreign tax credit provisions in section 502(b) of the House version of DISC. Here is another example of how the purpose of DISC can be defeated through reduction of its application to multinational businesses.

We support the automobile excise tax provisions of the House bill. These changes will directly aid consumers and will stimulate economic activity and job creation in the automobile industry and its many suppliers.

We also support the President's proposals for acceleration of the personal exemption and standard deductions for individuals. These changes will improve purchasing power and increase economic activity.

Gentlemen, it may be difficult to admit but most of us now see the serious deterioration of American industrial efficiency that has developed. Our competitive position, both at home and abroad, has suffered as a result and the symptoms of further worsening are apparent. Why this is so includes a complex of fundamental elements. But one certain and major factor has been the slow pace of investment in new plant and equipment and it is imperative that this be changed.

Last Tuesday, October 12, the McGraw-Hill Publishing Co. ran an advertisement in the New York Times and the Washington Post, among other papers. I hope all members of the Finance Committee—indeed, all Senators—will read it because it very lucidly and convincingly develops the imperative need to stimulate an upturn in American capital investment. The conclusion they reach, with which we fully agree, is that the ADR depreciation system adopted by the Treasury earlier this year and the investment credit under consideration by your committee are both vitally needed to help create this stimulus for capital investment.

Thank you.

Senator MILLER. You recommend that the investment tax credit be permited in case of computing minimum tax?

Mr. KOCH. Yes.

Senator MILLER. I suggest to you that most businesses are not going to be paying minmium tax because our research indicated that there were only a comparatively small number that were not paying at least as much tax as they had preferences in excess of $30,000. So since most of them are not going to be paying minimum tax it would seem that the application of the investment tax credit isn't particularly necessary to most of them.

Mr. KOCH. Well, Senator Miller, this may be so but in canvassing the position of our committee we found at least one case where their normal income tax is going to be zero or practically equivalent because of the sustained lack of profitability but they will have minimum tax. I didn't see their calculations but they said this was so and I am sure it is. As a result you can see that there would be an effect on minimum tax.

Senator MILLER. Well, if they are in practically a zero regular tax position then they have no particular incentive for the investment tax credit.

Mr. KOCH. Well, with the carryover provisions they always hope for profit.

Senator MILLER. Well, they would still be permitted to carry over. I think maybe you are getting at a very minor problem here at the most and, then, of course, as you know, the Congress really adopted a policy in the case of the minimum tax that we want people to be paying tax at least equal to their tax preferences in excess of $30,000, and there has been some criticism that there shouldn't have been the $30,000 exemption in the first place, but that was a policy we adopted. And if you indeed do find some that would be affected adversely by this, we are talking about a rather small percentage, 10 percent or 4 percent, or 4/10 of 1 percent, so I think you may be swatting a pretty small fly.

Mr. KOCH. We would have to agree that this is a minor provision compared to some of the things we would like to see you do to this bill. We thought that it did represent an area in which there could be an impairment of the credit and we thought that such impairment would not be fair and, therefore, we thought we should point it out to you.

Senator MILLER. Well, if this had an application, in other words, if most taxpayers or even half of them were paying a minimum tax I think I would be inclined to go along with you, but I assure you that this minimum tax affects only a relatively small number in the overall picture and indeed in the example you put if they have a zero tax they are not going to get any benefit from the investment tax credit although they could carry over a carryover anyhow.

Mr. KOCH. Well, I think our purpose was simply to point out to you a possible area where the credit was diminished and it perhaps would be an inadvertence. This was our purpose.

Senator MILLER. I appreciate your doing that very much.

Mr. KOCH. Thank you very much.

(Mr. Koch's prepared statement follows:)

PREPARED STATEMENT OF GEORGE S. KOCH ON BEHALF OF THE FEDERAL FINANCE COMMITTEE AND MEMBER STATE CHAMBERS OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE

WITH RESPECT TO THE REVENUE ACT OF 1971, H.R. 10947

My name is George S. Koch and I reside at 57 Church Lane, Scarsdale, New York. I am an attorney-at-law in New York and appear here today as Chairman of the Federal Finance Committee of the Council of State Chambers of Commerce. I am accompanied by Eugene F. Rinta, Executive Director of the Council. Our statement represents the views of the Council's Federal Finance Committee and the member State Chambers of the Council which to date have endorsed it. They are listed at the end of the statement.

In general, we support the total fiscal program proposed by the President on August 15. We believe that his tax proposals would provide a desirable and substantial stimulus to the economy. Moreover, they would importantly correct the adverse effects of the Tax Reform Act of 1969 on job-creating business investments, and thus would encourage the improvements in productivity that are needed for maintaining reasonable price stability and for improving the American competitive position in world markets.

The expenditure reductions proposed by the President are, in our view, not only necessary but should be a very minimum if a resurgence of inflationary pressures is to be avoided. Even with the spending restraint proposed by the President a unified budget deficit of about $28 billion in the current year now appears probable, and even the so-called full-employment will be in a deficit position of some $8 billion.

While we believe that the House Committee on Ways and Means, and the House as a whole, did a commendable job in responding to the President's proposals, we do have some comments and recommendations to offer with respect to the bill, H.R. 10947, as passed by the House. First, however, we would like to respond to charges that the Presiden'ts proposals and H.R. 10947 as well are too heavily weighted in favor of business. This requires some review of Congressional tax decisions during the decade of the 1960's.

THE PRESENT BIAS AGAINST INVESTMENT IN THE TAX STRUCTURE

In enacting the Revenue Act of 1964 the Congress voted the largest tax reductions of all time. This Act had the effect of reducing income tax liabilities of individuals by an average of 20% while at the same time reducing corporate tax liabilities by less than 8%. This smaller tax reduction for corporations was justified in both the House and Senate reports on the legislation on the ground that the benefits from the investment credit enacted in 1962 and the liberalized depreciation provided administratively the same year served, together with the 8% reduction in the 1964 Act, to maintain the relative balance between individual and corporate tax burdens.

Actually, however, the cash flow benefits of the investment credit and the depreciation guidelines of 1962 were largely offset in every year through 1969 by accelerations in corporate tax payments required by the Revenue Act of 1964, the Tax Adjustment Act of 1966, and the Revenue and Expenditure Control Act of 1968. With completion of the speedups in corporate tax payments in 1970, corporation tax burdens would have been in the relative position of balance with individual tax burdens that was intended in the Revenue Act of 1964. This balance was changed drastically, however, by the Tax Reform Act of 1969 which reduced individual income taxes substantially and at the same time increased corporation income taxes sharply.

Data presented by Secretary Connally in his appearance before this Committee on October 7 indicates that by the end of calendar year 1973 the 1969 Act will have reduced individual income taxes in the net amount of $22.7 billion and will have increased corporation income taxes $15.1 billion. The effect of the 1969 Act in 1973 alone is a cut of $10.2 billion in individual tax liabilities and an increase of $4.2 billion in corporate tax liabilities. If a comparison were made of the impact of the 1969 Act on investment with its impact on consumption, the disparity of treatment would be even greater than the disparity between treatment of individuals and corporations. This greater disparity would be largely accounted for by the adverse effect on individual as well as corporate investments of repeal of the investment credit and changes in treatment of capital gains and real estate depreciation.

As the Treasury data submitted by Secretary Connally indicates, the provisions of H.R. 10947 would partially redress the gross imbalance caused by the 1969 Act in the relative tax burdens of individuals and corporations. Combining the revenue effects of the bill and the 1969 Act produces a net tax reduction of $36.4 billion for individuals and a net increase of $3.2 billion for corporations through 1973. The effect in calendar year 1973 is a reduction of $14.6 billion for individuals and a cut of $1.4 billion for corporations.

We believe that the tax bias against investment in the 1969 Act urgently needs to be redressed, both for the near-term and the long-term good of the economy. Toward this end we urge prompt restoration of the investment credit as a major step Additionally, for the long-term good of the economy, we urge the Congress in conjunction with the Treasury to undertake a comprehensive study of the whole area of depreciation, including the possibility of replacing the present concept of depreciation with a capital cost recovery allowance system. In the meantime, the ADR depreciation system as now in effect should not be changed materially.

THE JOB DEVELOPMENT INVESTMENT CREDIT

We were pleased by the action of the House in approving the President's recommendation for reenactment of an investment tax credit We strongly opposed its repeal in 1969 and we urge its restoration at this time for the same reasons that it was enacted in 1962.

The purposes of the investment credit were concisely stated by former Secretary of the Treasury Henry H. Fowler in April 1969 when its repeal was proposed by President Nixon. Mr. Fowler said that the investment credit "was designed, adopted and has proven effective as a permanent structural feature of our tax system—

"for increasing national productivity;

"for promoting competitive efficiency in our productive machinery on the scale practiced by the countries competing in our markets at home and abroad;

"for enabling business to offset rising costs that lead to cost-push inflation; and "for encouraging the development of new products, processes, services, and rewarding job opportunities."

When the investment credit was enacted in 1962, it was expected to provide a stable and continuing incentive for expansion and, particularly, modernization of productive capacity as the means for enhancing economic prosperity and supporting the growing commitments of government. The credit proved to be a vital stimulant to the installation of modern tools, machinery and equipment. The result was increased production of goods, a better balance between supply and demand, and lower production costs than would have been possible with old and obsolescent tools, machinery and equipment. The effect was less inflationary pressures than would otherwise have been encountered. We have no doubt that an adequate new investment credit would produce the same desirable results.

SUGGESTIONS WITH RESPECT TO INVESTMENT CREDIT PROVISIONS IN H.R. 10947

It should be made abundantly clear that the investment credit is intended to be a permanent part of the tax structure so that taxpayers can rely on it in making their investment plans.

Rate of the credit

We stated before the House Ways and Means Committee a month ago that a first year rate of 10% for the credit would be desirable but that a permanent rate of less than 7% would hardly be adequate to meet the objectives of the credit. We have noted that the Administration now takes the same position, with Secretary Connally supporting the permanent rate of 7% in the House bill but urging a first year rate of 10%. We fully support the Administration in this position.

Carryover credits

The provision of H.R. 10947 which removes the special 20% limitation on use of carryover credits that was imposed with repeal of the investment credit in 1969 is highly desirable, as is the provision requiring the use of pre-1971 credits ahead of current year credits in regard to the maximum allowable credits in the tax year. Without these provisions large amounts of these credits would be lost to taxpayers with low earnings in recent years or, on the other hand, the need to use the carry-over credits as soon as possible to avoid losing them could significantly reduce the economic stimulus of the restored credit.

Minimum tax

Under present law (Sec. 56 of the Code), for purposes of computing the 10% minimum tax, the regular income tax liability—after reduction by the amount of the investment credit as well as in certain other credits—offsets the items of tax preference. In order for the investment credit to fully serve its incentive purpose, the regular tax liability should not be reduced by the amount of the investment credit for the purpose of determining the minimum tax.

Also under present law the investment credit cannot be applied against the minimum tax which was adopted in the same (1969) Act that repealed the prior credit. The restored credit would provide little if any prompt investment incentive to the taxpayer with a minimum tax liability but a small, if any, regular income tax liability. Therefore, in order to preserve the full incentive value of the restored credit, it should be available to reduce the minimum tax as well as the regular income tax liability.

Pollution control facilities

In enacting five-year amortization for certified pollution control facilities, the Congress in the 1969 Act denied the investment credit for such facilities (Sec. 169 (h) of the Code). The House provided in H.R. 10947 for an election of either five-year amortization or the investment credit with respect to these facilities. We suggest that both the credit and rapid amortization should be available for certified pollution control facilities which add to costs but do not produce earnings.

Class life depreciation

We strongly support the action of the House in providing for a system of class life depreciation which combines the present ADR system and the guideline lives. The House did eliminate one major feature of the ADR system, namely, the three-quarter year convention which would permit nine-months depreciation for all property placed into service during the year. This action will tend to reduce the stimulative effect of the President's proposals and it should be reversed.

PRESIDENT'S DISC PROPOSAL SHOULD BE APPROVED

In dealing with the President's proposal to authorize deferment of income taxes on export sales made by qualified Domestic International Sales Corporations, the House in H.R. 10947 retained the concept but largely removed its incentive value. We believe the need for the DISC legislation, as passed by the House last year and recommended by the President on August 15 with one modification, is even more urgent now than it was a year ago.

Over the past decade we have frequently expressed our concern about the recurring large deficits in the U.S. balance of payments. And had it not been for our foreign trade surpluses, the international payments deficits would have been much larger. But, unfortunately, our trade surpluses have shrunk from an annual average of $5 billion in the 1960–67 period to a deficit in 1971, the first in this century.

We believe that revision of the U.S. tax rules relating to foreign source income is not only a desirable but also an essential action for long-term improvement of our foreign trade balance. Accordingly, we supported the Administration's DISC proposal last year and we continue to support it. We would prefer a more direct income tax incentive than the DISC approach but we recognize the obstacles posed under compliance with the GATT rules. On the other hand, the DISC proposal should provide a significant incentive for expansion of export sales of many companies and to arrest declines in export sales of others. Effective deferral of tax on the portion of export sales income allocated to a DISC would help export sales in three ways.

First, it would, in many instances, make possible price adjustments to meet foreign competition in overseas markets. Second, we are confident that it would bring actively into the export field many firms which are not now seeking foreign markets for their products. Third, it would encourage American firms to produce in this country for export markets instead of manufacturing abroad to get the benefits of lower costs. We suggest that, in limiting tax deferral of a DISC only to income from export sales in excess of 75% of average base period (1968–70) sales, the House bill would make the DISC concept far effective than is intended in the President's proposal. Accordingly, we urge amendment of the bill to remove this limitation.

REPEAL OF EXCISE TAX ON AUTOMOBILES ENDORSED

We heartily support repeal of the automotive excise taxes as provided in the House bill. Such action would produce broad economic benefits—directly to consumers and indirectly for a wide range of business and industry.

First, it would have a favorable effect on the cost-of-living index. The automobile manufacturers have promised that the tax saving from the excise tax repeal will be passed on to their customers. Lower prices for new cars will, in turn, tend to cause lower prices for used cars. The effect on the cost of living would be significant.

Second, reductions in new vehicle prices resulting from repeal of the excise tax would mean added sales. Higher sales will generate more jobs, not only in the motor vehicle industry but also in such major suppliers of the industry as steel, glass; and copper, and in related industries.

Third, repeal of the excise tax will accelerate the removal from service of older cars which lack modern safety and emission control equipment. By modernizing the automotive fleet, progress toward achieving the country's environmental quality and safety goals will be accelerated.

INDIVIDUAL INCOME TAX REDUCTIONS SUPPORTED

We support provisions in the House bill advancing the effective dates of presently scheduled increases in personal exemptions and the standard deductions. This action together with repeal of the automotive excise taxes would add substantially to consumer purchasing power and thus stimulate increased economic activity.

EXPENDITURE LIMITATION IS NEEDED

Estimates of the effects of the President's economic program on the 1972 budget indicate that expenditure reductions will exceed revenue reductions by $1.1 billion, with the prospective deficit being reduced by that amount. The data submitted by the Administration indicate that revenue reductions of $5.8 billion will be partially offset by a revenue increase of $2.0 billion from the 10%

import surcharge for a net revenue loss of $3.8 billion. Proposed expenditure reductions total $4.9 billion.

We strongly support a spending reduction of this magnitude as the very minimum. In addition, we urge rejection of the general revenue sharing program instead of merely deferring it for three months as proposed by the President on August 15. This would reduce 1972 expenditures an additional $2.6 billion beyond the $4.9 billion total in the President's program and raise the total reduction in 1972 to $7.5 billion. This spending reduction would exceed the $3.8 billion net loss in receipts from the various revenue measures by $3.7 billion and thus would reduce the prospective deficit by that amount.

The Administration now estimates that the 1972 unified budget deficit will be about $28 billion as compared to the original budget estimate of $11.6 billion. Moreover, even the so-called full-employment budget is now estimated to be in a deficit position of $8 billion instead of in balance as projected in the 1972 budget document.

In view of the prospective budget deficit of $28 billion in 1972 following a $23 billion deficit in 1971 and a full-employment budget deficit of $8 billion in 1972, we believe that an effective expenditure limitation is imperative. We suggest, therefore, that the tax reduction legislation include an expenditure limitation which will assure a spending reduction of at least $7.5 billion. This would include the $4.9 billion proposed by the President plus an additional $2.6 billion from rejection or tabling, instead of deferring, the general revenue sharing program.

We further suggest that the expenditure limitation be similar to the limitation included in the Revenue and Expenditure Control Act of 1968. Such a limitation would be far more effective in controlling outlays than would the highly flexible limitations enacted in subsequent years.

We should note here that our recommendations on budget reduction and the expenditure limitation represent the views of the Council's Federal Finance Committee. They have not been considered by and, consequently, cannot be ascribed to the State Chambers listed as endorsing this statement. We are confident, however, that most if not all of them subscribe to these views on expenditure control.

This completes our statement, Mr. Chairman. We appreciate very much having had this opportunity to present our suggestions for dealing with the program presented to you by the Administration and by the House of Representatives.

(Following is a list of State Chamber endorsements.)

Of the council's 31 member State chambers of commerce, the following 28 organizations have to date endorsed the positions taken in this statement with respect to the President's tax proposals and H.R. 10947. As the footnote below the list indicates, some of the State chambers did not have a position on one or more of the proposals.

Alabama Chamber of Commerce
Arkansas State Chamber of Commerce
Colorado Association of Commerce and Industry
Connecticut Business and Industry Association
Delaware State Chamber of Commerce, Inc.
Georgia Chamber of Commerce
Idaho State Chamber of Commerce
Indiana State Chamber of Commerce
Kansas State Chamber of Commerce
Kentucky Chamber of Commerce
Maine State Chamber of Commerce
Michigan State Chamber of Commerce
Minnesota State Chamber of Commerce and Industry
Mississippi State Chamber of Commerce
Montana State Chamber of Commerce
New Jersey State Chamber of Commerce
Empire State Chamber of Commerce (N.Y.)
Ohio Chamber of Commerce
Oklahoma State Chamber of Commerce
Pennsylvania Chamber of Commerce
South Carolina State Chamber of Commerce
Greater South Dakota Association
East Texas Chamber of Commerce
South Texas Chamber of Commerce
Lower Rio Grande Valley Chamber of Commerce (Tex.)
Virginia State Chamber of Commerce

West Virginia Chamber of Commerce
Wisconsin State Chamber of Commerce

NOTE: The following State chambers of commerce did not have a position as of October 12 on the proposal indicated:
Arkansas—Excise tax repeal and personal income tax proposals.
Idaho—DISC.
Mississippi and South Carolina—DISC, excise tax repeal, and personal income tax proposals.
Pennsylvania—DISC and personal income tax proposals.

The CHAIRMAN. Mr. Gerald Ostrowski, director of services for the National Constructors Association.

STATEMENT OF GERALD S. OSTROWSKI, DIRECTOR OF SERVICES, NATIONAL CONSTRUCTORS ASSOCIATION, ACCOMPANIED BY CHARLES E. GOLSON OF INTERNATIONAL ENGINEERING & CONSTRUCTION INDUSTRIES COUNCIL

Mr. OSTROWSKI. My name is Gerald S. Ostrowski, director of services for the National Constructors Association. Helping me is Charles E. Golson. He is a director of government relations for Arthur G. McKee, Co. He is appearing today in his representative capacity as spokesman for the International Engineering & Construction Industries Council.

In the interest of conserving time of this committee, we have submitted the statements yesterday and we would ask that they be submitted in the record.

The CHAIRMAN. They will be.

Mr. OSTROWSKI. And we will gladly answer any questions that the committee might have.

The CHAIRMAN. Thank you very much, sir.

You might just briefly summarize what your position is.

Mr. OSTROWSKI. Our position on the job development investment credit essentially is that the facts as they existed in 1969, when the investment credit was repealed, that is the economic facts, have changed. Today the economy is in a position where the unemployment is high, industry is facing increasing deterioration of its position in competition abroad with respect to foreign markets as well as domestic markets; therefore, from our point of view the enactment of the investment credit can do nothing but help in every respect. It would help industry, labor, consumers, as well as the investors. It would create an investment climate favorable to the attraction and retention of capital in the United States.

The CHAIRMAN. Thank you very much.

Mr. GOLSON. In relation to title V, the DISC proposal, we would like to summarize also on behalf not only of the National Constructors but this is the whole engineering construction industries.

DISC when proposed to you last year and when proposed to you, the Congress, by the administration this year was an attempt to obtain "fair treatment" for American export of goods and services. It would be very much similar to a measure which was passed by the Congress in its wisdom 21 years ago, Western Hemisphere Trading Corp. It would allow American exporters to face the competition created by the use of value added taxes or other taxes which in effect subsidize our competitors. As it has now reached you from the House this measure is just about nullified. It will result, I would say, probably, unfavorably for our industry and we ask you, and we recommend, and we urge that you restore it to its original intent of creating fair treatment for services industry which is quite sizable not only in itself but in the sales of goods which it entails.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Senator MILLER. Mr. Chairman.

Why don't you advocate expanding Western Hemisphere Trading Corp. provisions?

Mr. GOLSON. Apparently we have a treaty obligation under GATT which forbids the reduction of any or remittance of any tax on income or profits. However, GATT allows a remittance of tax on a product, value added tax on a product. Value added tax is applied to a product, such as services considered a product, and can be remitted when exported by value added tax countries. The DISC proposal does not propose and does not violate the GATT agreement to remit the taxes on profits derived from export of services but only to defer them while they are used for exports.

Senator MILLER. Well, that is the reason why I haven't been opposed but I haven't been particularly enthusiastic about this DISC proposal because it is a tax deferral. If it was a tax cut I could understand your position that it gives us a better competitive position. But if it is just a tax deferral, about the only advantage I can see is the savings on the interest on the money that would otherwise go for taxes, and that is not very much when you are dealing with value added tax competitors. That is why it seems to me that the Western Hemisphere Trading Corp. approach would be far more meaningful and I must say that I would like to get a good sound opinion on just what GATT means in some of these areas, they are very fuzzy, and I would think that you might advocate trying to get the Western Hemisphere Trading Corp. approach expanded as a preference.

Mr. GOLSON. Senator, we did request this when DISC was introduced last year. We did request it again when it was introduced before the Ways and Means Committee, or we mentioned it, but apparently we would run counter to treaty obligations that this country has.

If GATT is renegotiated, as apparently it may be, then we would very much prefer a Western Hemisphere Trading Corp. arrangement applied to exports.

Senator MILLER. Thank you.

The CHAIRMAN. Thank you very much, gentlemen.

(Mr. Ostrowski's prepared statement and attachments follow:)

PREPARED STATEMENT OF GERALD S. OSTROWSKI, NATIONAL CONSTRUCTORS ASSOCIATION

The National Constructors Association appreciates this opportunity to present its views in support of the proposed Job Development Investment Credit (Title I) and Domestic International Sales Corporations (Title V) of bill H.R. 10947.

The Association, known as NCA, is composed of 35 internationally known firms of engineers and constructors that design and erect large-scale industrial complexes within the United States and throughout the world, including oil refineries, chemical plants, steel mills and power generating plants. Attached to this statement is an informational folder describing the Association and listing its members, officers and major committees.

JOB DEVELOPMENT INVESTMENT CREDIT

The repeal of the investment credit in 1969 was based upon the premise that "sustained full employment has eliminated the need for this type of encouragement to investment." And, "in the period since the enactment of the credit, the economy has been brought to full employment, the level of business investment has been raised, productive capacity has been expanded, and efficiency of production has reached very high levels. Continuously expanding markets and high profit levels should provide sufficient investment incentive in the future even without investment credit." Page 11 of Report No. 91–321, Committee on Ways and Means.

The factual bases of the foregoing conclusions do not prevail today. Instead, the American economy faces problems of a continually declining balance of trade, lagging productivity, low profits and increased unemployment.

The proposed credit is not a panacea. It is equally true, in our judgment, that enactment of this incentive to investment would at least substantially resolve these correlated problems.

The encouragement to develop and utilize the latest technology would result in a more competitive American industry at home and abroad, in the light of increased foreign competition and competitors.

H.R. 10947 would create a healthier investment environment conductive to the attraction and retention of domestic and foreign capital. This factor should not be minimized in view of the existing fierce international competition for financing.

Unemployment would be alleviated, immediately and in the years ahead, by the creation of many jobs in the design, production, installation and operation of modern equipment, leading to better products, greater productivity and an increased standard of living throughout the world.

In summary, enactment of the Job Development Investment Credit would benefit industry, labor, consumers and investors.

DOMESTIC INTERNATIONAL SALES CORPORATIONS

The National Constructors Association is a member of the International Engineering and Construction Industries Council.

We endorse and submit herewith the statement of the Council, which generally supports the DISC proposal and respectfully recommends certain amendments thereto.

National Constructors Association

ENGINEERS-BUILDERS FOR INDUSTRY

DESIGNERS & CONSTRUCTORS

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STEEL MILLS
POWER PLANTS
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Serving Industrial Growth

Since its founding in 1947, the National Constructors Association has performed group activities designed to improve the services offered by its member companies at home and abroad.

The Association is composed of 35 internationally known engineering and construction contractors engaged primarily in designing and building chemical plants, steel mills, power generating facilities and oil refineries. It conducts concerted programs to improve and stabilize field labor relations. Acting through national and regional labor committees, it has made significant contributions in this field which have been recognized by industry, government and labor organizations.

Early this year the Association executed two historic national agreements with the Building and Construction Trades Department (AFL-CIO) designed to improve field labor productivity and eliminate strikes and picketing over jurisdictional disputes. In one agreement the General Presidents of the National and International Building Trades unions subscribed to a set of 11 standard work rules aimed at doing away with featherbedding, standby crews, local restrictions against use of tools and other costly work practices. The agreement on work jurisdiction sets up for the first time a system of heavy financial penalties against unions that fail to take vigorous action to halt work stoppages and picketing in jurisdictional disputes. Similar penalties are provided for employers making unreasonable work assignments. Both agreements provide that other contractors and contractor associations can become parties by a simple procedure of formal assent.

NCA has also sought to improve the industry in other ways. It has been a leader in efforts to halt the inflationary spiral of construction wage rates. Through membership on the President's Construction Industry Collective Bargaining Commission and the Construction Industry Stabilization Committee it supported moves leading to establishment of wage and price controls for the industry. It has also pushed for legislative or other reform of the bargaining process through area rather than local negotiations under multi-employer multi-craft arrangements.

Creation of safe working conditions on industrial construction projects is a special concern of NCA. Its Accident Prevention Committee annually carries out a number of programs to enhance the safety of workmen and the public. The Committee's work has been credited with achieving significantly lower accident frequency and severity rates in the operations of member companies.

Work of other NCA groups has proved beneficial to Association members, the industry and the public. The Labor Relations Committee includes representatives of all member companies. Other standing committees are Accident Prevention Committee, International Affairs, Employee Relations, Insurance and Government Affairs. NCA publications include a monthly Newsletter, a Safety Supplement and an International Directory of Engineering and Construction Services.

General direction of the Association is in the hands of a seven-member Executive Committee. The Ways & Means Committee, composed of former presidents, is responsible among other things for development of long-range policy.

NCA is an active participant in the International Engineering and Construction Industries Council, and the Council of Construction Employers, and it cooperates with other groups to improve the work of planning and building for the future.

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INTERNATIONAL ENGINEERING AND CONSTRUCTION INDUSTRIES COUNCIL

The International Engineering and Construction Industries Council welcomes this opportunity to present its comments on the subject of proposed legislation creating Domestic International Sales Corporations.

The Council is composed of the Associated General Contractors of America, the Consulting Engineers Council of the U.S. and the National Constructors Association. The first comprises almost 9,000 general contractors, the second includes approximately 8,000 consulting engineers, and the N.C.A. is composed of 34 firms of engineers and constructors. These three associations represent the engineering and construction industry in the U.S.A. and abroad, with a total annual volume of contracts approaching seventy billion dollars, 10% of which are performeed abroad. Of this amount, more than 60% are actual exports of goods, equipment and materials derived from U.S. engineering and construction services.

We wish to express our gratification of the House Ways and Means Committee report to the House of Representatives as to their intent in the formulation of Section 993(a)(1)(g) with respect to consideration of engineering and architectural services for construction projects located outside the United States. We hope that your concurrence will serve as guidelines for corresponding regulations to implement this intent.

We regret that income from royalties, license fees, or technical assistance fees derived from the use of proprietary patents or know-how connected with projects outside the United States has not been considered as qualified export receipts within the purview of the proposed DISC. In many cases such proprietary patents or know-how are a decisive factor in the choice of an United States engineer/architect or contractor by a foreign client.

The recent changes in the pending legislation have substantially reduced any possible benefit that this legislation might have for our industry. Similarity between this Bill and the one submitted to this Committee in 1970 appears to be limited to the name of the proposed Domestic International Sales Corporation. The House Ways and Means Committee report mentions the conditions which present legislation and regulations impose on U.S. corporations engaged in export trade and recognizes that discriminatory effects of U.S. taxes on foreign earnings has been one of the main handicaps which have had to be faced by exporters.

As early as 1950 the creation of Western Hemisphere Trading Corporations was an early recognition by the Congress that U.S. companies required an alleviation of these tax measures.

When the DISC was proposed by the Treasury in 1970, the fact that taxes on certain foreign earnings were to be deferred, not remitted, was understood to be necessary because of GATT provisions. Since our tax structure is a direct tax on income, or profits, while that of our main competitors is an indirect tax applicable to the sales of a product or service, the foreign tax could be remitted, while ours could not. However, the DISC proposal under consideration is no longer effective in restoring a measure of competition to our exports, and is so surrounded by so many limitations as to restrict its effectiveness as an incentive to maintaining, let alone expanding exports of goods and services.

We submit that the present Balance of Trade, and its consequent effect on the Balance of Payments require a return to the original concept of placing our exporters in a more competitive situation when facing foreign entities. We submit that even if this were to be considered by some as a form of subsidy, that the President of the United States in a recent statement recognized that such might be required.

Reduction in tax receipts, which have been purposely exaggerated, will be temporary and will be compensated by increased production and exports and by taxes derived from the income of employees profitably employed. This is a case where the economy of the country will profit greatly, as has been borne out in other countries where similar measures to promote exports have been adopted.

It appears to this Council that it is not only necessary at this time to promote the expansion of foreign exports over those of the base period years of 1968, 1969, and 1970, but a question of providing a life-line to exporters drowning in a sea of well-intentioned but discriminatory taxation. We therefore urge the committee to provide the necessary legislation to give "fair treatment" to one of America's largest service industries and the greatest potential factor to an improved Balance of Payments and return to the intent presented to the Senate last year.

We appreciate the privilege of presenting these views to the Senate Committee on Finance and hope that it will take the required action.

The CHAIRMAN. The next witness is Louis M. Stern, vice president of government affairs for the Machinery Dealers National Association. Is Mr. Stern here?

We will print your entire statement and we invite you to summarize it.

STATEMENT OF LOUIS M. STERN, VICE PRESIDENT OF THE MACHINERY DEALERS NATIONAL ASSOCIATION, ACCOMPANIED BY RICHARD L. STUDLEY, EXECUTIVE DIRECTOR OF MDNA

Mr. STERN. Mr. Chairman and members of the committee. My name is Louis M. Stern and I appear here today as a member of the small business community and as the first vice president of the Machinery Dealers National Association (MDNA). I am accompanied by Richard L. Studley, executive director of MDNA in Washington. On behalf of MDNA I wish to express our appreciation to the committee for extending us the opportunity to express our views on the President's economic policy, particularly the job development credit. I request that our prepared statement be entered in the record. MDNA is the spokesman for the used metalworking machinery industry. The 300 members of our association supply small and medium-sized metalworking businesses with modern used machinery and equipment. We are speaking on behalf of our Nation's 105,000 metalworking firms. More specifically, we are speaking on behalf of 90,000 of those firms who employ fewer than 100 persons. Yet they operate 43 percent of the 2.8 million machine tools in use in this industry which employs 10 million persons.

We agree with the House of Representatives action in approving an investment credit which we see as an essential step toward improving productivity. We endorse the House action in making used property eligible for the credit.

We vehemently disagree, however, with the action of the House which will reduce the amount of used property eligible for the credit. In the House measure, purchases of new property will offset purchases of used property, thereby reducing the amount of qualified used property dollar for dollar from a maximum of $65,000. This statement will outline reasons for eliminating the "offset" provision contained in H.R. 10947 as being discriminatory and contraproductive for it works to the detriment of small and medium-sized business firms. Used property was included to help these firms modernize, but the offset will negate much of this benefit.

The House recognized that used property plays a vital part in the modernization of smaller business firms. The administration accepted this position by the House and altered its original policy of total exclusion by recommending alternatives for including limited quantities of used property. The resultant action taken by the House in establishing this offset indicates its concern that competition exists between used and new machinery. This is not the case in most instances in the metalworking field, our field of expertise. Used and new machinery compete in separate markets based on price, function, size, and degree of sophistication.

To illustrate, most numerically controlled new machine tools cost in excess of $50,000 while some cost upward of $1 million. Few small and medium-sized metalworking firms are in the market for new machine tools requiring such a heavy investment. The purchaser must justify all capital equipment purchases in terms of the stability of his order backlog and his ability to obtain capital for such investment. Most small business firms are limited in both of these characteristics and must purchase used machine tools to increase productivity. Congress recognized this fact when the investment credit was enacted in 1962. At that time, $50,000 of used property was made available for the credit and with no offset involved.

We do not wish to convey the idea that smaller businesses purchase only used equipment, because this is not the case. There are items of machinery and equipment which are not available on the used market and must be purchased new. Treasury statistics bear this out. However, we have many testimonial letters from such manufacturers stating that the only way they can increase their basic productivity is with used machinery.

There are two types of equipment which firms must purchase new. Federal regulations under the Occupational Health and Safety Act of 1970 will require expenditure of capital funds to modify existing facilities just to remain in business. For example, the necessary but highly restrictive regulations will necessitate the replacement of every electric motor in existing machine tools and related industrial equipment today. Of the first 82 metal stamping plants inspected in Michigan, all were found to be in violation of the mandatory safety standards. Thus, plants must make the necessary modifications to their equipment, regardless of the expense, and these expenditures qualify as new property purchases which would be subject to the offset.

The second type of equipment normally purchased new includes furnaces and ovens, testing and inspection equipment, paint spray units, conveyor and material handling systems, cranes, plating and degreasing systems, air compressors, electrical switch gear, and environmental control equipment.

Much of the previously mentioned property is not productive and in some instances will be contraproductive. Each of these necessary, though nonproductive, new purchases will reduce the amount of credit remaining available for essential used machinery purchases which are the key to increase productivity.

In 1962 the investment credit allowed to used section 38 property was limited to $50,000 annually. The inequity was recognized by the House Select Committee on Small Business in 1964 when it reported that this limitation excluded many businessmen from the operation of the tax credit and recommended changes be considered so as to permit the investment credit to be used to a greater extent by small business.

Since small business is vital to the free enterprise system, its needs must be recognized and interests protected. The high capitalization requirement of metalworking and other manufacturing firms can permit them to qualify as small- and medium-sized businesses based on employment and share of the market, even though their assets may approach $5 million. These firms are part of the thousands of small business enterprises battling head to head for a small share of the market in fields dominated by a handful of giant corporations. When one thinks of the computer industry, the name IBM immediately comes to mind, yet there are 65 firms with assets under $1 million also making various types of computers. The metal can field has 93 firms in the same small asset bracket, fighting to remain competitive with three dominant corporations and there are 111 small businesses competing against five giants in the farm implement industry. These are only a few of the many cases of domination within our competitive system.

Modernization of a plant or development of a production line requires multiple purchase of machinery. Without a liberal investment credit for multiple used machine tool purchases, H.R. 10947 would take a long step in the direction of creating a corporate caste system and would strike a crippling blow at the small- and medium-sized manufacturer who wishes to grow and compete in a free and open market.

Finally, the recent emergence of more sophisticated machinery on the used market makes the $65,000 limit, even without an offset, totally unrealistic. A recent survey of our membership indicated that a substantial number of used machine tools in current inventory are valued in excess of $50,000 each.

We recognize that the House action was not an attempt to penalize smaller businesses, but rather a sincere desire to help them. However, the result is a serious penalty which provides a lesser degree of credit than these firms had in 1962. To rectify the error in H.R. 10947 will require at the very least a return to the investment credit for used property in 1962: $50,000 and no offset. To truly help small business will require at least $100,000 with no offset to cover used property purchases in a manner more adequate to meet small business modernization and expansion needs.

The Treasury Department has submitted a projected revenue impact in excess of $300 million by extending a $50,000 credit to used property. We are unable to comprehend Treasury's revenue estimates for the total revenue impact in 1965 was $51.6 million. We find it incredible for Treasury to project a sixfold increase in eligible used property purchases in 1972.

In summary, the MDNA strongly supports enactment of the 7-percent job development credit as a permanent addition to the tax law. We urge this committee to review the projected revenue loss caused by extending the credit to used property. In 1965 used property eligible for the credit accounted for only 2.6 percent of all eligible property. We urge you to help small business modernize and expand their productive capability by raising the limit to $100,000 with no offset.

Mr. Chairman, MDNA is fully prepared to assist the staff of this committee or the Treasury Department in any way to resolve this serious problem. Thank you.

The CHAIRMAN. Thank you very much, Mr. Stern, for your statement.

Mr. STERN. Thank you, sir.

(Mr. Stern's prepared statement follows:)

Prepared Statement of Louis M. Stern, Vice President, Machinery Dealers National Association

INTRODUCTION

This statement is submitted to the Senate Finance Committee by the Machinery Dealers National Association in connection with H.R. 10947, the Revenue Act of 1971.

The Machinery Dealers National Association (MDNA) represents the industry which supplies small and medium sized metalworking firms with modern used machinery and equipment. MDNA is composed of 300 members and is the spokesman for the used metalworking machinery industry. We are speaking on behalf of our nation's 105,000 metalworking firms. More specifically, we are speaking on behalf of 90,000 of those firms which employ fewer than 100 persons. Yet they operate 43% of the 2.8 million machine tools in use in this industry which employs 10 million people.[1]

In summary, we strongly support efforts to stabilize wages and prices, increase employment, stimulate additional production and improve productivity. Further, we agree with the House of Representatives' action in approving an investment credit which we see as an essential step toward improving productivity. We endorse the House's action in making used property eligible for the credit. We vehemently disagree, however, with the action of the House which will reduce the amount of used property eligible for the credit. In the House measure purchases of new property will offset purchases of used property thereby reducing the amount of qualified used property from a maximum $65,000. This statement will outline reasons for eliminating the "offset" provision now contained in H.R. 10947 as being discriminatory and counter productive because it works to the detriment of small and medium sized business firms. Used property was included to help these firms modernize, but the offset will negate much of this benefit.

BASIS FOR HOUSE ACTION INCLUDING OFFSET

The House recognized that used property plays a vital part in the Modernization of smaller business firms. The Administration accepted this position by the House and altered its original policy of total exclusion by recommending several alternatives for including limited quantities of used property. However, the resultant action taken by the House in establishing this offset indicates its concern that competition exists between used and new machinery. Such is not the case in most instances in the metalworking field, our field of expertise. Used and new machinery compete in separate markets based on price, function, size, and degree of sophistication.

To illustrate, most numerically controlled new machine tools cost in excess of $50,000 while some cost upwards of $1 million. Few small and medium sized metalworking firms are in the market for new machine tools requiring such a heavy investment. The additional productivity to be gained would so exceed their normal requirement that it cannot be economically justified. The purchaser must justify all capital equipment purchases in terms of the stability of his order backlog and his ability to obtain capital for such investment. Most small business firms are limited in both of these characteristics and must purchase used machine tools and other equipment to increase productivity. Congress recognized this fact when the investment credit was enacted in 1962; at that time, $50,000 of used propertly was made eligible for the credit and with no offset involved.

THE OFFSET IS DETRIMENTAL AND SHOULD BE REMOVED

There are items of machinery and equipment which are not available on the used market and must be purchased new. We do not wish to convey the idea that smaller businesses purchase only used equipment because this is not the case. However, we have many testimonial letters from such manufacturers stating that the only way they can increase their basic productivity is with used machinery. Treasury's own statistics for 1965, the last full year of the investment credit for which statistics are available, bears this out. For example, firms with assets less than $5 million claimed 88% of the credit taken on used property in 1965.[2] Those same firms claimed 19.4% of the new property purchases eligible for

[1] American Machinist, McGraw-Hill Publishing Co., Tenth Inventory of Metalworking Equipment—1968.

[2] Statistics of Income—1965, Corporation Income Tax Returns.

the credit. These statistics also demonstrate that smaller firms purchased both new and used property in order to modernize.

There are two types of equipment which firms must purchase new. Federal Regulations under the Occupational Health and Safety Act of 1970 will require the expenditure of capital funds to modify existing facilities just to remain in business. These necessary but highly restrictive regulations will necessitate the replacement of every electric motor in existing machine tools and related industrial equipment today. Of the first 82 metal stamping plants inspected in Michigan, all were found to be in violation of the mandatory safety standards. Thus, plants must make the necessary modifications to their equipment, regardless of the expense, within the next three years. These expenditures qualify as new property purchases which would be subject to the offset. Other examples can be cited such as: air and water pollution control facilities, waste disposal facilities, and other abatement machinery which can only be purchased new.

The second type of equipment would include unique single-purpose machinery which must be manufactured to satisfy the particular production requirement of the purchaser and such machinery is obviously not available on the used market. Additional equipment normally purchased new includes furnaces and ovens, testing and inspection equipment, paint spray units, conveyor and material handling systems, cranes, plating and degreasing systems air compressors, electrical switchgear and environmental control equipment.

Much of the previously mentioned property is not productive, and in some instances, will be contra-productive. Each of these necessary, though non-productive new purchases will reduce the amount of credit remaining available for essential use machinery purchases which are the key to increased productivity

It is wholly unreasonable to restrict these smaller firms by penalizing their efforts to modernize in the best way they can. The offset provision of H.R. 10947 provides such a penalty.

THE $65,000 LIMIT IS INADEQUATE

In 1962 the investment credit allowed to used Section 38 property was limited to $50,000 annually, with no offset and no provision for a carryback or carryforward on purchases of used property in excess of $50,000 annually. The inadequacy was recognized by the House Select Committee on Small Business in 1964 when it reported and recommended that—

"* * * the House Small Business Committee in it final report to the 87th Congress pointed out that the limitations of $50,000 for purchase of used property in any one year and a property with a useful life of at least four years, excludes many businessmen from the operation of the 7% tax credit. It was recommended the changes on these limitations be considered by the appropriate legislative committee so as to permit the investment credit to be used to a greater extent by small business."

Since small business is vital to the free enterprise system, its needs must be recognized and interests protected. The high capitalization requirement of metalworking and other manufacturing firms permits them to qualify as small and medium sized businesses based on employment and share of the market, even though their assets may approach $5 million. These firms are part of the thousands of small business enterprises battling head to head for a small share of the market in fields dominated by a handfull of giant corporations. When one thinks of the computer industry the name IBM immediately comes to mind, yet there are 65 firms with assets under $1 million also making various types of computers. The metal can field has 93 firms in the same small assets bracket fighting to remain competitive with 3 dominant corporations. There are 111 of the same small asset group competing against 5 giants in the farm implement industry. These are only a few of the many cases of domination within our competitive system.

Full modernization of a plant, or development of a production line, requires the purchase of multiple pieces of machinery. Without a liberal investment credit for multiple used machine tool purchases, this H.R. 10947 would take a long step in the direction of creating a corporate caste system and would strike a crippling blow at the small and medium sized manufacturer who wishes to grow and compete in a free and open market.

The recent emergence of more sophisticated machinery on the used market makes the $65,000 limit, even without an offset, totally unrealistic. A recent survey of our membership indicated that a substantial number of used machine tools in current inventory are valued in excess of $50,000 each.

We recognize that the House action was not an attempt to penalize smaller businesses, but rather a sincere desire to help them and concurrently protect against excessive revenue loss. However, the result is a serious penalty, one which provides a lesser degree of credit than these firms had in 1962 even if the factors of inflation and technological advance are ignored. If this Committee wants only to rectify the error in H.R. 10947, it should at the very least return the investment credit for used property to its status in 1962, $50,000 and no offset. If the Committee earnestly wants to help small business, it should provide at least $100,000 to cover used property purchases in a manner more adequate to meet small business modernization and expansion needs with no offset.

PROJECTED REVENUE IMPACT OF INCLUDING USED PROPERTY

The Treasury Department nas submitted projections covering the revenue impact in extending the credit to used property. As we understand it, Treasury has projected a revenue loss of $320 million if a limitation of $50,000 is placed on used property eligible for the credit. Further, Treasury estimates that a $50,000 limit with the offset established in the House Bill will produce a revenue loss of $300 million. Stated another way, Treasury estimates the effect of the offset at slightly less than 6½%.

We are unable to comprehend Treasury's revenue estimates. In 1965 corporations purchased $947 million worth of used property which was eligible for the investment credit.[4] Because many of those purchases were eligible for only partial credit due to abbreviated useful life, the total revenue impact in 1965 was $51.6 million. Although individuals entitled to the credit were not included in this Treasury analysis of actual returns for 1965, we find it incredible for Treasury to project a sixfold increase in eligible used property purchases in 1972.

Used machine tool sales in 1965 were $413.3 which, in terms of total qualified used Section 38 property, would represent 44% of eligible used property in 1965. Applying the same percentage figures to Treasury's projections, used machine tool sales in 1972 would reach $2.5 billion. Much as we would like to believe Treasury's projections, we cannot because the biggest sales year in the used machine tool industry was 1967 with sales of $525 million. It seems perfectly clear that Treasury's projections should be reviewed in light of past purchases of used property.

THE PROPOSED CREDIT SUPPLEMENTS THE ASSET DEPRECIATION RANGE SYSTEM

MDNA lauds the strong steps taken in recent months by the Administration to overcome previous inadequacies in capital investment recovery. The Asset Depreciation Range (ADR) system recognizes the need to maintain our productive capacity in a continuing regenerative cycle. We urge this Committee to reinstate fully the provisions of ADR for the long term benefit of our economy, military preparedness base and international trade position.

SUMMARY

MDNA strongly supports enactment of the 7% job development credit as a permanent addition to the tax law. We urge this Committee to review the projected revenue loss caused by extending the credit to used property. In light of the actual revenue loss in 1965 when used property eligible for the credit accounted for only 2.6% of all eligible property, we urge you to provide smaller businesses a reasonable mode for modernization and expansion by raising the limit to $100,000 with no offset. We feel that the revenue loss with the higher limit still will not approach the Treasury estimate of $300 million.

The CHAIRMAN. While we were hearing Mr. Stern, Senator Tower came in the room. I know you are busy, the Senate is in session. We will call you at this time if you are prepared to testify.

[4] Statistics on Income—1965, Corporation Income Tax Returns.

STATEMENT OF HON. JOHN TOWER, A U.S. SENATOR FROM THE STATE OF TEXAS

Senator TOWER. Yes, I am, Mr. Chairman.

The CHAIRMAN. I read your statement while I was hearing other witnesses but the committee will be pleased to hear you at this point.

Senator TOWER. Thank you.

Mr. Chairman, I am going to read a brief version of my statement and I would like to ask consent to have my full statement printed in the record.

The CHAIRMAN. That we always do.

Senator TOWER. Mr. Chairman and distinguished members, I am delighted to have the opportunity to appear. I am sorry I was late. I was detained with and by the Secretary of Defense, and I have more military installations in my State than any other State. That is very important.

The CHAIRMAN. At least you have this advantage over Georgia, you didn't have to double-deck the place to get them all in there. [Laughter.]

Senator TOWER. I am not Dick Russell either. I am presenting for your consideration today a bill, S. 2273, that I introduced on July 14 of this year along with Senators Hansen, Pearson, and Stevens. I have slightly modified this proposal, which will be presented to the committee in the form of an amendment to H.R. 10946, by my colleague from Wyoming, Senator Hansen. In the last few years, it has become apparent that the domestic oil industry is in a declining state not only in the capacity of the domestic industry to produce petroleum products in proportion to our needs, but also there are fewer and fewer jobs in this most vital industry. Where there used to be many seismograph and drilling crews operating in this country providing substantial employment, this number has in recent years declined substantially. As I will point out later, this is not due to the lack of petroleum reserves in this Nation, but rather is due to the declining return on the investment in the domestic petroleum industry.

In a study recently completed compiling figures through 1970, the Chase Manhattan Bank reviewed 28 selected petroleum companies. The result of this study on the 28 companies, which I shall refer to as the "group," is truly alarming. To quote from the report:

> For the past decade the growth of the net income has lagged substantially behind the expansion of both end market and capital spending and in the last two years while the market for oil increased by more than 18 percent the Group's net earnings declined.

To illustrate this point, the group's net income from domestic operation declined 4.4 percent between 1969 and 1970 and the rate of return on investment declined for the third consecutive year. The rate of return was 12.6 percent in 1968, 10.9 percent in 1969, and 9.9 percent in 1970. Thus, correspondingly, the investment donated to the search for new petroleum reserves in the United States was at the lowest level in 1970 of any of the past 4 years. And I have said before, the decline in exploration and production in this vital industry means the loss of jobs throughout the Nation, jobs that we can ill afford to lose.

Mr. Chairman, there is still another problem in the oil industry that is of great import to our continued economic health and our national security; that problem is the shortage of oil and gas.

I have warned repeatedly during the past few years that this Nation would experience dangerous shortages of energy resources unless corrective actions were taken. Much to my regret and alarm, few such actions have been taken and these few have been inadequate. Consequently, we continue on a collision course with dangerous energy shortages.

The causes and dimensions of these shortages have been abundantly documented in numerous recent reports and statements by representatives of Government and industry. Because of these reports, there has been a growing awareness that a serious national energy problem exists.

I would like to focus upon a particular consequence of our energy resource shortages which I find appalling. That is our increasing reliance upon Middle East sources of crude oil to make up the growing deficiency between our ability to produce and our consumer demand.

Estimates of the magnitude of our future reliance on Middle East sources vary. But, practically all the reports conclude that during the next 15 years we will be forced to rely increasingly upon imports of crude oil from the Middle East to meet larger portions of our burgeoning energy demands.

Secretary of Interior Rogers C. B. Morton reached this conclusion in his June 15 testimony before the Senate Committee on Interior and Insular Affairs. He estimated that by 1985 our total oil consumption would approach 24 million barrels per day and that the United States could be forced to import approximately 12 million barrels of crude oil per day from Middle East sources. He concluded that:

> Unless a marked and early improvement occurs in exploration and discovery success and * * * investment in oil producing activities in the United States, there appears little chance that domestic production can keep up with the strong upward trend in demand.

He further predicted that by 1985 we will be forced to rely upon the Middle East for at least 45 percent of our supply of crude oil.

A more pessimistic view of our growing reliance on Middle East oil was presented by Mr. M. A. Wright, chairman of the board of Humble Oil & Refining Co., on May 17. He told the Florida Governor's Conference on the Big Swamp that—

> After the next year or so, essentially all of the growth in U.S. petroleum demand will have to be met with imports from the Eastern Hemisphere. Unless we make a substantial effort to increase domestic supplies of all forms of energy, by 1985 foreign imports will supply over half our demand for petroleum and most of this will come from the Middle East.

We must not allow ourselves to rely on any foreign sources to meet our needs for one of the foundations of our national security.

Our national security objectives regarding supplies of crude oil were officially established in 1956 by Presidential Proclamation No. 3279. These criteria were reaffirmed by the President's Task Force on the Oil Import Question in February 1970, and more recently by the "Report on Crude Oil and Gasoline Price Increases of November 1970" issued by the Office of Emergency Preparedness in April 1971.

The criteria are as follows:

First. The need to guarantee supplies sufficiently to meet the needs of U.S. military forces and defense industries.

Second. The need for a sufficient supply of crude oil and its derivatives to meet essential civilian demands and sustain economic growth.

Third. The need to foster exploration and development so as to insure a depletion of reserves to an extent which would not jeopardize the capability of the petroleum industry to meet future demands, without undue reliance on foreign sources of questionable reliability.

The Cabinet Task Force Report of 1970 also recommended that imports from Eastern Hemisphere sources not exceed 10 percent of our domestic consumption.

In summary, then, these objectives explicitly recognize that we must encourage continued exploration in order to insure sufficient producing petroleum reserves to meet both our military and essential civilian needs; that we should maintain a producing capacity sufficient to guarantee future economic growth; and that we should not become overly dependent upon foreign sources of questionable reliability.

These objectives were hammered out over an extended period of time. They have been honored by several administrations. They recognize that petroleum is a vital ingredient to our national defense and to our continued economic health.

Secretary Morton, in his testimony on June 15, projected that by the year 2000, oil will still provide 35 percent of our energy needs, down from the present 44 percent. This translates into a volumetric increase in crude oil requirements from 15 million to 33 million barrels per day, since our energy needs will rise substantially.

Secretary Morton's projected decrease in the percentage of our energy requirements which will be met by crude oil may be overly optimistic, for his projections are based on assumptions which could be erroneous. The projections assume that we will have developed the necessary technology and machinery by the year 2000 to utilize various exotic means for energy production such as the breeder reactor, solar and thermal cells, oil shale, and coal gasification and liquefaction, to name a few of the possibilities. Past estimates of the speed of development of this type of technology and equipment have been notoriously inaccurate, and we have no basis for assuming the new estimates to be more accurate. Development of this type technology and equipment often requires more time than at first anticipated.

I can appreciate the difficulty in making such estimates. Many of the problems are unknown and unforeseen at the time. But we should be aware that these estimates may be too optimistic. If so, we may be forced to depend upon crude oil for longer periods of time and in greater quantities than presently estimated.

The essential point is that we are heading into an intolerable situation in which we are becoming increasingly dependent upon Middle East sources to supply our essential petroleum needs and that political realities in the Middle East make this source insecure.

A recent event which increases doubts about the reliability of Middle East oil was the signing of the 15-year treaty between the Soviet Union and the United Arab Republic. Dr. Fayez A. Sayegh, a permanent observer of the League of Arab States and a leading spokesman for the Arab world, recently warned that the signing of this treaty represented an indication of further deterioration of Arab-American relations. He stressed that the significant feature of this treaty was that the United Arab Republic had abandoned its policy of nonalinement, and he implied that other Arab countries may be tempted to do the same.

Perhaps the single most important development which highlighted the insecurity of Eastern Hemisphere oil was the dramatic display of bargaining strength and unity by the members of the Organization of Petroleum Exporting Countries in their recent negotiations with the oil company concessionaires. This organization is often referred to as OPEC, and is composed of the following countries: Abu Dhabi, Qatar, Kuwait, Saudia Arabia, Iraq, Iran, Algeria, Libya, Venezuela, Indonesia, and Nigeria.

This list includes practicaly all the major producers of crude oil in the free world besides the United States. The importance of this organization is exhibited by the fact that we presently draw 55 percent of our total imports, equivalent to about 11 percent of our total oil consumption, from these OPEC members.

The tough and unified bargaining stance taken by the OPEC countries represented a reversal of several of our traditional concepts concerning Middle East oil.

First, this was essentially the first time that these countries united to bargain for their common good. In the past, these countries had bargained on an individual basis, often exhibiting a lack of trust in each other. Their overall stance had made it relatively easy for the oil companies to bargain effectively with one at a time.

Second, the demands made by the OPEC countries and finally obtained by them were extremely tough. They extracted large percentage increases in their participation in the profits derived from the production and transportation of oil within their own countries.

Third, their main bargaining weapon was the threat of an embargo on all oil shipments from these countries. This was a most powerful and effective weapon. Until 1970, few believed that any Middle East country would voluntarily reduce or terminate its oil production. Most believed that none of these countries would deprive itself of the substantial revenues derived from this production. But in 1970, Libya stopped producing a sizable percentage of its oil, and the myth was shattered.

In order to appreciate the relative bargaining strength of the OPEC, it is necessary to examine the increased reliance of western Europe, Japan, and the United States on Middle East oil. In 1950, the primary source of energy for Western Europe and Japan was coal. Now, over one-half of the total energy supplies of these large industrial nations is supplied by Middle East oil. As to the magnitude of this source, the 10 OPEC countries control over 80 percent of the known oil reserves in the world.

The critical aspect of these negotiations was the use of the threat of embargo on oil shipments from these countries. This threat can, and probably will, be used again. Most of the oil-consuming countries will be powerless to do anything but to capitulate to the demands of the exporting countries.

The United States does not have to cower before threats of embargo. We have enough indigenous oil reserves to satisfy our needs for several decades to come at projected rates of consumption. It has been reliably estimated that there remains to be discovered more oil in the United States than we have yet discovered throughout our history. The U.S. Geologic Survey has estimated that approximately 430 billion barrels of recoverable oil await discovery in the United States. It has been estimated that we will consume an average of 21 million barrels of oil per day over the next 15 years. If this estimate is accurate, we will consume approximately 105 billion barrels of oil in the next 15 years. So, we have adequate undiscovered reserves of oil to meet all our needs.

But, the mere possession of undiscovered oil reserves does not give us a viable alternative to increasing reliance upon Middle East oil. Our undiscovered reserves must be converted into producing oil fields.

Converting undiscovered reserves into producing reserves can be accomplished only through massive investments in exploration. Estimates of the required investments range into the tens of billions of dollars.

Yet, at the present time, our exploration investment is minimal and the level of our domestic exploration activity is at a 28-year low.

The reason for the depressed level of exploration activity can be attributed to the overall negative attitude of the public and government toward the domestic petroleum industry. This negative attitude has been manifested by a combination of government policies which appear to have been especially designed to inhibit and discourage domestic exploration activity rather than encourage it.

For example, the Tax Reform Act of 1969 reduced the depletion allowance from 27½ to 22 percent. It has been estimated that this placed an additional cost on the industry of approximately $700 million per year. Thus, at the very time when the oil industry desperately needed help, this tremendous tax burden was added. This dampened domestic exploration.

At this very time, our producing reserves are declining more rapidly than they are being supplemented. Our surplus producing capacity is now less than our imports. Therefore, our own producing reserves are no longer sufficient to sustain normal consumption should our imports be disrupted. Our energy supply situation is bad and is worsening.

In providing policies designed to bring forth adequate supplies of this essential commodity, we must not be overly cautious. If the remedies we employ are later found to be overly effective in bringing forth supplies of crude oil, we can adjust them. I am proposing today a tax incentive program to encourage the domestic production of oil.

Tax incentives encourage exploration. Our history has shown that this form of incentive works. We must devise new and imaginative tax incentives designed to stimulate exploration for new reserves of oil and natural gas.

In this connection, the measure I am proposing today would establish a 7 percent domestic exploration investment tax credit. This tax credit would reduce a year's income taxes by 7 percent of any money spent that year in exploring for or developing new domestic reserves of oil and natural gas. The tax credit would be a temporary one and would expire automatically 10 years from enactment of this bill.

The intent of this legislation is to stimulate investments for exploration of new domestic reserves of oil and natural gas. It is intended to help reverse the present dangerous trends which would result in our growing reliance upon insecure Middle East sources of crude oil and to guarantee the consumer the energy supplies he requires.

May I add in addition to new exploration, I urge consideration of new secondary exploration, which is a very expensive process.

We must act now to reverse the depressed level of domestic exploration activity so this Nation will not be dependent upon insecure Middle East sources for the bulk of our crude oil supplies which are so vital to our national security and our economic health.

Mr. Chairman, members of the committe, I think you for the opportunity to testify.

The CHAIRMAN. Thank you very much for your statement. I agree with you and I hope we can do something about that.

Senator MILLER. I appreciated your statement, Senator. You alluded to the regressive approach by the Congress in the Tax Reform Act of 1969 with respect to domestic development of our oil resources.

You may recall that I sought to achieve that purpose that you have been talking about through my plowback amendment in which I proposed that the percentage depletion rate not be cut provided the amount of depletion allowance was plowed back into the exploration and development of oil reserves.

In the case of those that had not plowed it back, then of course, they would have to have a cut in the percentage depletion. I still think that this is a good policy to follow and I regret that we couldn't get enough support to get it passed.

Now you are proposing that we apply the investment tax credit to exploration and development and these, as I understand, are currently deductible expenses. The investment tax credit which we know has thus far been limited to capitalize the whole package of expenditures and I am wondering if we are getting into an area which may cause difficulty, because on the one hand industry can currently write off these expenditures.

In the case of the items to which the investment tax credit has heretofore applied and which are covered by the House-passed bill, those items have to be capitalized and it is true their lives may be 5, 10, 15, or 20 years, but it seems to me that the policy thus far has been to limit the investment tax credit to capitalizable type cost. If we move from that to cover currently deductible expenses, then there is a question of where do we stop?

I am wondering if we would be forced really, if we allowed the investment tax credit the way you propose, to allow the credit also in the case of research and development expenses which are currently deductible?

I think there is a great deal to be said for allowing the investment tax credit to apply in case of R. & D. expenses which have to be capitalized but, query, if they should go to all currently deductible R. & D. expenses?

Senator TOWER. What we are aiming here primarily is the independent producer. The independent explorer. Most of the major oil companies do capitalize exploration and as far as research and development is concerned there is very little research and development that goes on in the independent oil industry. This is largely by the majors.

Senator MILLER. I understand. But if we allow what might be called comparable type expenditures on the part of the independent oil companies, shouldn't we also allow the comparable expenditures for R. & D., currently deductible R. & D. for other types of businesses?

Senator TOWER. That is a matter that I haven't considered and would not be prepared to comment on it. I think it is a matter worthy of consideration and might be an equitable thing to do.

This is not a tried approach but I think we should try it. After all, we are experimenting quite a bit in some of our legislative activities. I felt that this was a better approach than trying to reraise the depletion allowance, go this route rather than trying to get the depletion allowance back to its original level.

The depletion allowance has become an emotional cry amongst those who thought the oil industry was getting some kind of windfall out of it. Domestic explorations are down, rigs are being stacked every day and we cannot, I think, allow ourselves to become inordinately dependent on Mideast sources of oil because the Arab sheiks can turn the screws on us at any time they want to.

Senator MILLER. It may be you are correct in your assessment of what is more possible than something else. Although I think that in view of what has happened in the record that can be built that a restoration of the cut in depletion allowances in the case of plowback people might be indicated. But in lieu of that, you are proposing an investment tax credit. I suggest to you that you might consider limiting that to those companies that do indeed plow back their percentage depletion, then you see we are putting them on all fours with the policy of Congress that the purpose of the depletion allowance is to get them to plow back to develop natural resources for the good of the public in this country and we are allowing further the investment tax credit to those who do so.

Senator TOWER. I think you want to go to a broader incentive because people go in the oil business to attempt to make money. There are some who go in with the intention perhaps of losing it for tax purposes. But we are interested in the ones that are genuinely trying to find oil and I think it should be made profitable to them.

I think you have to allow really a better prospect for profits in a very high risk venture of this type than you do in something that is relatively low risk, because you are virtually sure of a return, you have to have a little bit of pot of gold at the end of the rainbow to convince that guy he ought to go out and look for the end of the rainbow because he is spending a lot of capital trying to get there. Its high risky chances are better he will lose than he will win.

Senator MILLER. I thoroughly agree with that, as you know, but I am just suggesting consideration of drawing a line between a little better treatment of those who do indeed plow back and those who don't.

Senator TOWER. I would certainly be willing to give some consideration to studying that type of proposal and, of course, now in the committee this is going to be, I think, largely under the sponsorship of our distinguished colleague from Wyoming and I would be inclined to be influenced somewhat by his judgments on this matter too.

Senator MILLER. Thank you very much.

The CHAIRMAN. Thank you very much, Senator Tower.

Senator TOWER. Thank you, Mr. Chairman.

Senator HANSEN. I would like to ask unanimous consent that there could be included in the record at the conclusion of the remarks of our distinguished colleague two articles from newspapers I have. I would put the whole article from the Washington Post in the record, if I may, but I want to point out that under dateline of October 7, Vienna, the story says:

> The countries also demanded an increase in revenues from the oil companies, to offset what they called the "de facto" devaluation of the U.S. dollar.

And further on it points out that these OPEC countries account for 92.9 percent of all of the oil that is presently exported.

So I think that the testimony from our colleague from Texas is very much in order this morning. We do need to take some drastic steps, it occurs to me, if we are not to get into the situation that everyone fears where we have to become unduly dependent upon foreign sources of supply.

Here is another story from the Washington Evening Star dated June 18—that is a long time ago—but it tells what is contemplated in Venezuela. They are talking down there about confiscation. This is the kind of attitude that we are submitting ourselves to if we don't take steps to see that we firm up the domestic supplies and I think that I agree completely with my colleague from Iowa that we ought to study the ramifications of his proposal but I think, overall, our concern should be to see that we take every step we possibly can so as to assure ourselves of an adequate supply which will leave no question at all about the security of this country, a nation that depends more than 99 percent upon oil and natural gas for all of its motive supply.

More than half of the tonnage shipped to Vietnam, as the Senator from Texas knows, has been oil and gas, and this is the sort of thing that I know he wants to secure this Nation against just as you and I do. Thank you.

Senator TOWER. Thank you.

(Articles referred to and news release follows:)

OIL COUNTRIES DEMANDING MORE CONTROL

[From the Washington Post, Oct. 8, 1971]

VIENNA, Oct. 7 (UPI).—The countries which own 90 per cent of the world's oil exports demanded a share in the local property and operations of the western companies that extract the oil.

The countries also demanded an increase in revenues from the oil companies, to offset what they called the "de facto devaluation of the U.S. dollar."

In both cases, the countries called for negotiations with the oil companies—not outright nationalization or legislative fiat. But they threatened "concerted action" if the companies balk.

The demands—issued by the Vienna headquarters of the Organization of Petroleum Exporting Countries (OPEC)—were framed Sept. 22 at a meeting in Bierut of the 11 OPEC members. These members—Algeria, Libya, Indonesia, Iran, Iraq, Saudi Arabia, Qatar Kuwait, Abut Dhabi and Nigeria—account for 92.9 per cent of world oil exports and acting together, could throttle western industry.

Last February, OPEC won larger tax and royalty payments for its six Persian Gulf members by threatening a boycott. The threat nearly caused a world oil crisis.

[From the Washington Star, June 18, 1971]

CURRENT OUTLOOK—FOREIGN OIL FIRMS AWAITING CONFISCATION BY VENEZUELA

CARACAS (UPI).—The suspense has ended for foreign oil firms with facilities in Venezuela.

For years officials of the firms have wondered where they'd be when their 40-year concessions ended in the 1983–84 period.

Now they know where they'll be—out in the cold.

The way things look now, Venezuela is going to take over all the oil company installations without any compensation to the companies.

A bill along these lines is now under consideration in Congress with chances fair that it will become law by the end of the month.

Nationalization has always been a forbidden word in Venezuela, which owes much of its spectacular growth in oil to the vacuum caused when Mexico nationalized its industry in 1938 and saw it dwindle into relative oblivion.

LARGER SHARE GOAL

A larger share of profits, which rose from $54,000 in 1917 to $1.7 billion this year, always has been the goal of successive governments, but nationalization was vigorously rejected.

As a matter of fact, the country's oil, as well as other subsoil wealth, has been owned by the state, making nationalization a meaningless term in Venezuela.

Venezuela's role as a tax collector and overseer of the industry, however, did not satisfy many political sectors of the nation, most notably Accion Democratica, the country's grassroots party that began to challenge oil company power here as early as the 1940's, when most of the concessions due to expire were signed.

DICTATORSHIP REIGNS

When Accion Democratica came to rule in 1945 through a military coup, it announced no further concessions would be granted.

Three years later, a dictatorship under Gen. Marcos Perez Jimenez took over.

Output doubled in 1955 and again in 1957 when annual production topped a billion barrels. Perez Jimenez granted the nation's last concessions in 1956–57.

When Perez Jimenez was overthrown in 1958 and Accion Democratica's founder, Romulo Betancourt, was subsequently elected in free presidential elections, the call for no further concessions was renewed.

During the 10 years in which Betancourt and successor Raul Leoni, ruled they laid the groundwork for tipping the balance of power between the oil companies and the state.

Taxes were increased, a state oil company established and a new system of service contracts posed to replace the discarded concessions.

When Social-Christian Rafael Caldera defeated Accion Democratica candidate Gonsalo Barrios in the 1968 presidential elections, it was believed that a more moderate stand could be expected on oil.

Under Caldera however, latent nationalism finally found its voice in almost all political sectors.

In December, Venezuela increased oil income taxes. It also gave the chief executive unilateral powers to fix price levels used for taxing the companies.

OIL REVERSION BILL

Early this year, a former mines ministry expert who had studied the problem of reversion for years, finished the draft of an oil reversion bill which was submitted to Congress by the "Movimiento Electoral del Pueblo" party, an offshoot of Accion Democratica.

The bill lay in the 266-man parliament until last week when it came to life as it was put under debate with overwhelming possibilities of approval before the end of the month.

The measure provides that when the 40-year concessions end in 1983–84, all equipment, installations and even intangibles such as technical data used to exploit concessions go to the state without compensation.

The bill stipulates, moreover, the government may immediately inspect and control the properties to assure they revert in good working order. Additionally, to guarantee the companies will comply, they must deposit a special fund in the central bank.

The companies have called the bill confiscatory and "defacto nationalization."

DEPARTMENT OF THE INTERIOR NEWS RELEASE

DOMESTIC ENERGY DEVELOPMENT A POLITICAL DECISION, MINERALS CHIEF SAYS

The United States has within its boundaries all the energy resources it needs for any degree of self-sufficiency it chooses to maintain, but their development will be more costly than purchasing energy from abroad, stated Hollis M. Dole, Assistant Secretary of the Interior for Mineral Resources, before the National Energy Forum at a session held September 24 in Washington, D.C. Because of this added cost, "the choice of maintaining this self-sufficiency is overwhelmingly a political decision", he said.

Dole addressed the participants in the two-day meeting on the general subject of "Development and Utilization of the Nation's Energy Resources". He noted the extensive intrusion of the Federal government into the economics of energy production, transmission and use, and foresaw even greater government participation in the future, noting that in addition to controlling oil imports, the Federal government controls access to most of the remaining domestic energy resources.

The Interior official spoke of the need for early settlement of the environmental issues preventing development of the large oil discoveries made on the Alaskan North Slope and in the Santa Barbara Channel. He cited accelerated leasing of Outer Continental Shelf lands as being the most promising prospect for getting large quantities of oil and gas to market quickly, noting that oil and gas from coal and oil shale would not measurably affect the supply picture before 1980.

Dole expressed his concern over the fact that through a combination of circumstances, including the progressive failure of domestic natural gas supply and tightening environmental restrictions on coal usage, the nation would increase its dependence upon oil which could only be supplied by Eastern Hemisphere sources. If the United States became excessively dependent upon these sources, he predicted that foreign oil prices might well rise to levels above those in the United States. By that time, however, he added, it would be too late, for the domestic industry would have lost its capability to respond quickly to increased demand. He stressed the critical importance of time, and the need for public decisions now which would make it possible to bring the large submarginal energy resources of the United States to market when they are needed.

Dole held out small hope that significant reductions in the historic growth rate of energy could be achieved. He pointed out that both the work force and the general population will continue to rise for the next several decades, and that increased production of goods and services is essential to provide the material means for achieving the social goals the nation has set for itself, including restoring the environment.

The National Energy Forum is sponsored by the United States National Committee of the World Energy Conference, and was convened for the purpose of generating free discussion among government and energy policy makers involved in solving today's energy problems.

The CHAIRMAN. Senator Tower, recently while discussing some trade problems with one of our Canadian friends, he pointed out that if Canada wants to really put the pressure on the United States in this trade struggle that is going on at this moment, the best way to do it is to cut off the gas they are shipping into the United States. Of course they are getting a big price for it.

Senator TOWER. Yes, sir.

The CHAIRMAN. All they have to do is wait for the cold of winter and cut the gas off.

Senator TOWER. Yes, sir.

The CHAIRMAN. The people relying on it will come up screaming bloody murder and there is not much we can do about that.

Senator TOWER. Of course when they do, maybe some of our friends in the consuming States will understand what it's all about.

The CHAIRMAN. That is right. You and I know that our Arab friends know as much as our Canadian friends about how to put the pressure on us, if that is what they want to do, and let us become completely reliant on their fuel. Cutting it off, particularly in the cold of winter, is a good way to make this Nation see it their way.

Senator TOWER. As the Senator well knows, every foot of natural gas in this country is already on contract and committed. You have to go and find more new wants to serve new customers.

The CHAIRMAN. Thank you.

(Senator Tower's prepared statement follows. Hearing continues on p. 492.)

PREPARED STATEMENT OF HON. JOHN TOWER, A U.S. SENATOR FROM THE STATE OF TEXAS

It is my pleasure today to have the opportunity to speak before this most distinguished Committee. I am presenting for your consideration today a bill, S. 2273, that I introduced on July 14, of this year along with Senator Hansen, Pearson and Stevens. I have slightly modified this proposal, which will be presented to the Committee in the form of an amendment to H.R. 10947, by my colleague from Wyoming, Senator Hansen. In the last few years, it has become apparent that the domestic oil industry is in a declining state not only in the capacity of the domestic industry to produce petroleum products declining in proportion to our needs, but also there are fewer and fewer jobs in this most vital industry. Where there used to be many seismograph and drilling crews operating in this country providing substantial employment, this number has in recent years declined substantially. As I will point out later, this is not due to the lack of petroleum reserves in this nation, but rather is due to the declining return on the investment in the domestic petroleum industry.

In a study recently completed compiling figures through 1970, the Chase Manhattan Bank reviewed 28 selected petroleum companies. The result of this study on the 28 companies, which I shall refer to as the Group, is truly alarming. To quote from the report: "For the past decade the growth of the net income has lagged substantially behind the expansion of both end market and capital spending and in the last two years while the market for oil increased by more than 18 percent the Group's net earnings declined." To illustrate this point the Group's net income from domestic operation declined 4.4 percent between 1969 and 1970 and the rate of return on investment declined for the third consecutive year. The rate of return decreased by 12.6 percent in 1968, by 10.9 percent in 1969 and by 9.9 percent in 1970. Thus, correspondingly, the investment donated to the search for new petroleum reserves in the U.S. was at the lowest level in 1970 of any of the past four years. And I have said before, the decline in exploration and production in this vital industry means the loss of jobs throughout the nation, jobs that we can ill afford to lose.

Mr. Chairman, there is still another problem in the oil industry that is of great import to our continued economic health and our national security; that problem is the shortage of oil and gas.

I have warned repeatedly during the past few years that this Nation would experience dangerous shortages of energy resources unless corrective actions were taken. Much to my regret and alarm, few such actions have been taken and these few have been inadequate. Consequently, we continue on a collision course with dangerous energy shortages.

The causes and dimensions of these shortages have been abundantly documented in numerous recent reports and statements by representatives of government and industry. Because of these reports, there has been a growing awareness that a serious national energy problem exists.

I would like to focus upon a particular consequence of our energy resource shortages which I find appalling. That is our increasing reliance upon Middle East sources of crude oil to make up the growing deficiency between our ability to produce and our consumer demand.

Estimates of the magnitude of our future reliance on Middle East sources vary. But, practically all the reports conclude that during the next 15 years we will be forced to rely increasingly upon imports of crude oil from the Middle East to meet larger portions of our burgeoning energy demands.

Secretary of Interior Rogers C. B. Morton reached this conclusion in his June 15 testimony before the Senate Committee on Interior and Insular Affairs. He estimated that by 1985 our total oil consumption would approach 24 million barrels per day and that the United States could be forced to import approximately 12 million barrels of crude oil per day from Middle East sources. He concluded that:

"Unless a marked and early improvement occurs in exploration and discovery success and . . . investment in oil producing activities in the United States, there appears little chance that domestic production can keep up with the strong upward trend in demand."

He further predicted that by 1985 we will be forced to rely upon the Middle East for at least 45 percent of our supply of crude oil.

A more pessimistic view of our growing reliance on Middle East oil was presented by Mr. M. A. Wright, Chairman of the Board of Humble Oil and Refining Company on May 17. He told the Florida Governor's Conference on the Big Swamp that—

"After the next year or so, essentially all of the growth in U.S. Petroleum demand will have to be met with imports from the Eastern Hemisphere. Unless we make a substantial effort to increase domestic supplies of all forms of energy, by 1985 foreign imports will supply over half our demand for petroleum and most of this will come from the Middle East."

He attached a chart to his statement which showed that by 1985 imports of liquid petroleum products could be 62 percent of our consumption.

I find these projections by the Interior Secretary and an eminent industrial leader most alarming. Unfortunately, these two projections cannot be considered to be either unique or without foundation.

Increasing reliance on Middle East sources is a totally unacceptable solution to our crude oil supply problems.

We must not allow ourselves to rely on any foreign sources to meet our needs for one of the foundations of our national security. And because of its history of turmoil and unrest, the Middle East is the least desirable of free world sources.

Our national security objectives regarding supplies of crude oil were officially established in 1959 by Presidential Proclamation no. 3279. These criteria were reaffirmed by the Presidents Task Force on the "Oil Import Question" in February 1970, and more recently by the "Report on Crude Oil and Gasoline Price Increases of November 1970" issued by the Office of Emergency Preparedness in April 1971.

The criteria are as follows:

First. The need to guarantee supplies sufficient to meet the needs of U.S. military forces and defense industries.

Second. The need for a sufficient supply of crude oil and its derivatives to meet essential civilian demands, and sustain economic growth.

Third. The need to foster exploration and development so as to insure a depletion of reserves to an extent which would not jeopardize the capability of the petroleum industry to meet future demands, without undue reliance on foreign sources of questionable reliability.

The Cabinet Task Force Report of 1970 also recommended that imports from Eastern Hemisphere sources not exceed 10 percent of our domestic consumption.

In summary, then, these objectives explicitly recognize that we must encourage continued exploration in order to insure sufficient producing petroleum reserves to meet both our military and essential civilian needs; that we should maintain a producing capacity sufficient to guarantee future economic growth; and that we should not become overly dependent upon foreign sources of questionable reliability.

These objectives were hammered out over an extended period of time. They have been honored by several administrations. They recognize that petroleum is a vital ingredient to our national defense and to our continued economic health.

I cannot stress strongly enough the importance I place upon the maintenance of these objectives. If the projections of the experts come true, we will have knowingly violated these national security and economic goals. Unless we act now to reverse the current trend, our military capability and our national economic health will be seriously jeopardized, perhaps irrevocably.

Of course, the percentage of our total energy requirements which will be satisfied by oil will probably decrease in the future as other sources of energy develop. Nevertheless, our need for oil will continue to be tremendous. Secretary Morton, in his June 15 testimony, projected that by year 2000, oil will still provide 35 percent of our energy needs, down from the present 44 percent. This translates into a volumetric increase in crude oil requirements from 15 million to 33 million barrels per day, since our energy needs will rise substantially.

Secretary Morton's projected decrease in the percentage of our enegry requirements which will be met by crude oil may be overly optimistic, for his projections are based on assumptions which could be erroneous. The projections assume that we will have developed the necessary technology and machinery by the year 2000 to utilize various exotic means for energy production such as the breeder reactor, solar and thermal cells, oil shale, and coal gassification and liquifaction to name a few of the possibilities. Past estimates of the speed of development of this type of technology and equipment have been notoriously inaccurate, and we have no basis for assuming the new estimates to be more accurate. Development of this type technology and equipment often requires more time than at first anticipated.

I can appreciate the difficulty in making such estimates. Many of the problems are unknown and unforeseen at the time of the estimates. But we should be aware that these estimates may be too optimistic. If so, we may be forced to depend upon crude oil for longer periods of time and in greater quantities than presently estimated.

The essential point is that we are heading into an intolerable situation in which we are becoming increasingly dependent upon Middle East sources to supply our essential petroleum needs and that political realities in the Middle East make this source insecure.

The Middle East has a long history of turmoil and unreliability. I could compile a lengthy list of uprisings which have resulted in the disruption of the flow of oil from this area.

In addition, there have been recent events in the Middle East which could make these sources even less secure than in the past.

For example, the Soviet Union has increased its capability to disrupt oil shipments through the Mediterranean Sea. *Time* magazine reported in its June 28 issue that the Soviet Union had dramatically increased the size of its fleet there. At the present time, the fleet of the Soviet Union very nearly equals our own, it was reported. This means that our strength in the Mediterranean is being challenged. The Mediterranean sealanes are of vital strategic importance in the shipment of crude oil.

Another recent event which increases doubts about the reliability of Middle East oil was the signing of the 15-year treaty between the Soviet Union and the United Arab Republic. Dr. Fayez A. Sayegh, a permanent observer of the League of Arab States and a leading spokesman for the Arab world, recently warned that the signing of this treaty represented an indication of further deterioration of Arab-American relations. He stressed that the significant feature of this treaty was that the UAR had abandoned its policy of nonalinement, and he implied that other Arab countries may be tempted to do the same.

Perhaps the single most important development which high-lighted the insecurity of Eastern Hemisphere oil was the dramatic display of bargaining strength and unity by the members of the Organization of Petroleum Exporting Countries in their recent negotiations with the oil company concessionaries. This organization is often referred to as OPEC, and is composed of the following countries: Abu Dhabi, Qatar, Kuwait, Saudia Arabia, Iraq, Iran, Algeria, Libya, Venezuela, Indonesia and Nigeria.

This list includes practically all the major producers of crude oil in the free world besides the United States. The importance of this organization is exhibited by the fact that we presently draw 55 percent of our total imports, equivalent to about 11 percent of our total oil consumption, from these OPEC members.

The tough and unified bargaining stance taken by the OPEC countries represented a reversal of several of our traditional concepts concerning Middle East oil.

First, this was essentially the first time that these countries united to bargain for their common good. In the past, these countries had bargained on an individual basis, often exhibiting a lack of trust in each other. Their overall stance had made it relatively easy for the oil companies to bargain effectively with one at a time.

Second, the demands made by the OPEC countries and finally obtained by them were extremely tough. They extracted large percentage increases in their participation in the profits derived from the production and transportation of oil within their own countries.

Third, their main bargaining weapon was the threat of an embargo on all oil shipments from these countries. This was a most powerful and effective weapon. Until 1970, few believed that any Middle East country would voluntarily reduce or terminate its oil production. Most believed that none of these countries would deprive itself of the substantial revenues derived from this production. But in 1970, Libya stopped producing a sizable percentage of its oil, and the myth was shattered.

In order to appreciate the relative bargaining strength of the OPEC, it is necessary to examine the increased reliance of Western Europe, Japan, and the United States on Middle East oil. In 1950, the primary source of energy for Western Europe and Japan was coal. Now over one-half of the total energy supplies of these large industrial nations is supplied by Middle East oil. As to the magnitude of this source, the 10 OPEC countries control over 80 percent of the known oil reserves in the world.

We presently import only three percent of our needs from Middle East sources. This figure, though small, is deceptive. Middle East oil constitutes 93 percent of the fuel oil consumed on the east coast of the United States. And I have already stressed the trend of increasing reliance upon imports from the Middle East to meet future oil deficits. Some areas of the United States are already over-reliant on Middle East oil, and it is now predicted that we shall become over-reliant as an entire nation.

The result of the OPEC bargaining was that the balance of power tipped in favor of the oil exporting countries. Under the terms of the resulting contract, oil revenues to these countries will be increased by approximately $8 billion over the next five years. Large portions of this increase in cost to the oil companies will probably be passed on to the consumers.

The critical aspect of these negotiations was the use of the threat of embargo on oil shipments from these countries. This threat can, and probably will be used again. Most of the oil consuming countries will be powerless to do anything but to capitulate to the demands of the exporting countries.

The United States does not have to cower before threats of embargo. We have enough indigenous oil reserves to satisfy our needs for several decades to come at projected rates of consumption. It has been reliably estimated that there remains to be discovered more oil in the United States than we have yet discovered throughout our history. The U.S. Geologic Survey has estimated that approximately 430 billion barrels of recoverable oil await discovery in the United States. It has been estimated that we will consume an average of 21 million barrels of oil per day over the next 15 years. If this estimate is accurate, we will consume approximately 105 billion barrels of oil the next 15 years. So, we have adequate undiscovered reserves of oil to meet all our needs.

But, the mere possession of undiscovered oil reserves does not give us a viable alternative to increasing reliance upon Middle East oil. Our undiscovered reserves must be converted into producing oil fields.

Converting undiscovered reserves into producing reserves can be accomplished only through massive investments in exploration. Estimates of the required investments range into the tens of billions of dollars.

Yet, at the present time, our exploration investment is minimal and the level of our domestic exploration activity is at a 28-year low.

The reason for the depressed level of exploration activity can be attributed to the overall negative attitude of the public and government toward the domestic petroleum industry. This negative attitude has been manifested by a combination of government policies which appear to have been especially designed to inhibit and discourage domestic activity rather than encourage it.

For example, the Tax Reform Act of 1969 reduced the depletion allowance from 27½ to 23 percent. It has been estimated that this placed an additional cost on the industry of approximately $700 million per year. Thus, at the very time when the oil industry desperately needed help, this tremendous tax burden was added. This dampened domestic exploration.

At this very time, our producing reserves are declining more rapidly than they are being supplemented. Our surplus producing capacity is now less than our imports. Therefore, our own producing reserves are no longer sufficient to sustain normal consumption should our imports be disrupted. Our energy supply situation is bad and is worsening.

In providing policies designed to bring forth adequate supplies of this essential commodity, we must not be overly cautious. If the remedies we employ are later found to be overly effective in bringing forth supplies of crude oil, we can adjust them. I am proposing today a tax incentive program to encourage the domestic production of oil.

Tax incentives encourage exploration. Our history has shown that this form of incentive works. We must devise new and imaginative tax incentives designed to stimulate exploration for new reserves of oil and natural gas.

In this connection, the measure I am proposing today would establish a seven percent domestic exploration investment tax credit. This tax credit would reduce a year's income taxes by seven percent of any money spent that year in exploring for or developing new domestic reserves of oil and natural gas. The tax credit would be a temporary one and would expire automatically ten years from enactment of the bill.

This measure is similar to a bill that I had introduced on July 14 of this year, S. 2273, which is currently pending before this Committee. The only difference between the two is that my original measure called for a 12½ percent credit and did not include the secondary recovery provisions of the current amendment. I have changed the 12½ percent figure to the general seven percent figure already approved by the House and upon reflection have become convinced that secondary recovery must be included to have a well-rounded approach to our energy crisis.

The intent of this legislation is to stimulate investments for exploration of new domestic reserves of oil and natural gas. It is intended to help reverse the present dangerous trends which would result in our growing reliance upon insecure Middle East sources of crude oil and to guarantee the consumer the energy supplies he requires.

I urge prompt consideration of this proposal. We must act now to reverse the depressed level of domestic exploration activities so this nation will not be dependent upon insecure Middle East sources for the bulk of our crude oil supplies which are so vital to our national security and our economic health.

The CHAIRMAN. Due to the fact that he is unable to appear this afternoon, Mr. Clarence M. Tarr, vice president, National Association of Retired Federal Employees, has decided to submit his statement for the record.

(Mr. Tarr's prepared statement follows:)

PREPARED STATEMENT OF CLARENCE M. TARR, VICE PRESIDENT, NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES

Mr. Chairman and members of the committee, for the record, I am Thomas G. Walters, President of the National Association of Retired Federal Employees (NARFE). I am accompanied this morning by Mr. Clarence E. Tarr, Vice President of our organization, and Miss Judith E. Park, Administrative Assistant. NARFE is now in its 50th year and is a nonprofit, incorporated association with a membership of more than 150,000, composed exclusively of retirees of the Federal Government and their survivors residing throughout the 50 States, Puerto Rico, the Canal Zone, and the Philippines.

I appear before this Senate Committee on Finance today on behalf of our membership to suggest some amendments and liberalizations to H.R. 10947, especially as it applies to annuitants and survivors and to senior citizens who are forced to live on low insufficient incomes.

Generally speaking, we support President Nixon's legislative proposals included in his economic program released on August 15, 1971, and H.R. 10947 which was approved by the House of Representatives on Wednesday, October 7, 1971, but we do believe that the personal exemption should be further liberalized and made effective as of January 1, 1971.

RETIREES SUFFER

Mr. Chairman, I do not feel that any member of this committee needs to be persuaded of the fact that the retired persons of this country have been the ones most fiercely hit by the inflationary economy of the past several years. The average retiree on a fixed, limited income has had to bear the brunt of ever-increasing rents, consumer prices and services without the benefit of any substantial pension increase. The cost-of-living increases provided by law since December 1, 1965, have been helpful, but a 4 percent or 5 percent increase on a base annuity of $100 or $200 a month, does not bring about enough increase to realistically aid in meeting such cost-of-living increases as a $25 rent increase, or soaring food prices.

The pension that at one time might have allowed him to maintain a decent standard of living has been eaten away to the point that he now finds himself in dire financial need, unable to afford even the basic necessities of life, such as rent, food, clothing, and medical services. Wage increases that have aided active employees in coping with the inflation have not been reflected in the pensions and annuities of the majority of retirees, and resulting price increases have simply pushed the elderly closer to or further below a poverty level existence.

We are hopeful that the present wage-price freeze and the proposed second stage of this economic policy will provide an effective means toward checking inflation, particularly as the freeze applies to rents and to prices on consumer products and services so essential for simple existence.

The latest statistics available to us show that of the more than 900,000 Civil Service retirees and survivors, some 273,000 receive less than $100 per month; more than 511,000 receive less than $200 per month; and 698,000 more than two thirds, receive less than $300 per month. These figures show gross annuities, and do not take into account deductions for health benefits, Medicare, etc.

In quoting these statistics, in the past we have often been confronted with the argument that the majority of these low annuity retirees were "short term" employees, who only spent a few years of their working careers in the Federal service, and therefore, it would be only natural that their annuities would fall into a low-income bracket. We have never agreed that this theory was fully correct but were not able to determine from official records just how many of them were "short term" employees. Therefore, about five months ago we began encouraging our members with more than fifteen (15) years of service and monthly annuities of less than $350 to contact us as to their years of service and resulting annuities, with the understanding that we would not publicize their names.

Since requesting this information from our membership we have received more than 15,000 letters on the subject, and I assure you that all of these letters are authentic and signed by Civil Service annuitants. The entire file is available in my office and could be made available to this Committee at any time.

The letters have been broken down into categories of years of service and resulting annuities. Included in this exhibit we have 13 members with 14 to 19 years' service receiving less than $100 per month, ranging from $19 for 14 years through $52 for 19 years, and $99.20 for a fifteen-year annuitant. In the 20-25 year category, we show 15 members receiving less than $100, with one 23-year retiree receiving $45.00 per month. Even in the 25-30 year group we find four members reporting annuities of less than $100 per month: one such member receiving $75.00 for 27 years' service. We also have a letter from a 37-year annuitant who receives $78 per month.

Mr. Chairman, I don't believe anyone will contest that 40 years' Federal service is not "short term," and in this category we have numerous members receiving less than $300 per month. One retiree reports a $209 annuity based on 45 years of service, and one with 54 years' service receives a mere $292 monthly annuity. One couple with more than 50 years of service between them receive less than $250 per month. Among the survivor annuitants we have heard from, we have exhibits of $92 based on 39 years' service; $74 on 38 years; $52 on 25 years; and $27.50 on 15 years of service.

NARFE strongly supports the general idea that is contained in H.R. 10947 to advance the personal exemptions and percentage standard deductions scheduled in the 1969 Tax Reform Act. We strongly believe, however, that today's social structure and present economic situation warrants a further increase in the personal exemption and percentage standard deductions, and we urge this Committee to go beyond the President's proposal and H.R. 10947's provisions and grant a personal exemption of $1000 and a 20 percent standard deduction with a $2000 ceiling effective January 1, 1971. Such a provision would be of great benefit to millions of American taxpayers and would be especially helpful to the elderly and low income people as those retirees 65 years of age and over receive a double exemption. We strongly believe that any senior citizen who is forced to live on an income at or below the so-called poverty level should be exempt from all Federal, State, and municipal taxes, but if we had on the statute books a $1000 personal exemption and a 20 percent standard deduction with a $2000 ceiling, the majority of these needy elderly people would be removed from Federal income tax rolls.

Mr. Chairman and Members of the Committee, I know that each of you are anxious to pass legislation that will give tax relief to our senior citizens 65 years of age and older. This is the group I am most concerned about, and I am sure that you share that view. It is my deepest hope that we can find some way to exclude from Federal income tax all of these retirees and survivors who are being forced to live below the poverty level through no fault of their own.

I am sure you realize that because of age thousands of annuitants and survivors who are living today will not be here next year. Our membership of more than 150,000 is made up of men and women who range in age from 50 years to 100 plus years, and from this number we average 300 to 500 deaths per month, so whatever we do to assist these annuitants and survivors should be done today—tomorrow may be too late.

Though I speak today with special emphasis on the plight of the elderly and low-income people in today's "high-priced" society, I sincerely believe that the proposals I have mentioned will be beneficial to millions of Americans, regardless of their age, for certainly every citizen has felt the bite of inflation. I trust that in the near future this Committee and the Congress will pass and send to the President for approval, legislation to ease the financial burden of those who need it so badly, and which will work for the common good of this country.

In conclusion, Mr. Chairman, may I again urge that as this Committee works upon this important legislation, it keep uppermost in mind the necessity for bringing under control the terrifying inflation that rapidly ruins those retired on a fixed income. I have heard inflation spoken of as debilitating, I have heard it spoken of as an economic illness. Some seem to feel it should be treated as a chronic disease of an industrial society. But may I direct the attention of this Committee to the fact that for a retiree on a fixed income, inflation is a terminal economic illness slowly repressing his freedom, his quality of life, and his dignity as a human being. It is beyond his control. There is nothing he can do to alleviate it or ease the pain. It is an economic leukemia that wastes his resources and finally destroys his economic well being. He has no cure. Mr. Chairman, as you proceed with your deliberations, we look to you and this Committee to help cure this illness of inflation. Above all, this is our need.

On behalf of our entire NARFE membership I express to you, Mr. Chairman, and to the Members of this Committee our sincere thanks for this opportunity to present our story on the need for correcting legislation for retirees and the elderly. We also extend our deep appreciation to your most efficient staff for the work and cooperation we have received from them.

We shall be delighted to answer any questions you may have.

The CHAIRMAN. We will now stand in recess until 2:30 due to the fact some of us have commitments during the noon hour.

(Whereupon, at 12:30 p.m., the committee was recessed until 2:30 p.m. of the same day.)

AFTERNOON SESSION

Present: Chairman Long and Senator Miller.

The CHAIRMAN. The next witness will be Mr. John R. Greenlee, chairman, tax policy committee, the Tax Council.

STATEMENT OF JOHN R. GREENLEE, CHAIRMAN, TAX POLICY COMMITTEE, THE TAX COUNCIL

Mr. GREENLEE. Thank you, Mr. Chairman.

The CHAIRMAN. We are pleased to have you.

Mr. GREENLEE. My name is John R. Greenlee. I am director of taxes for the Hanna Mining Co., Cleveland, Ohio. I appear here for the Tax Council, of which I am a director and chairman of the tax policy committee.

We welcome the opportunity to appear in these hearings. We support and urge your approval of the provisions of H.R. 10947, the Revenue Act of 1971, which would:

(*a*) Establish a 7-percent job development investment credit;

(*b*) Create a new depreciation system retaining, except for the first year convention, the major features of the asset depreciation range (ADR) system adopted by the Treasury Department in June;

(*c*) Repeal the 7-percent excise tax on automobiles, and the 10-percent excise tax on small trucks; and

(d) Reduce individual income taxes.

We also strongly support enactment of the DISC—Domestic International Sales Corp.—program, but urge that you substitute deferral of tax on all DISC income for the "incremental" approach of the House bill as recommended by the Secretary of the Treasury in his testimony before you on October 7. Further, we hope you will give favorable consideration to the administration's proposal that the rate of the job development credit be set at 10 instead of 7 percent for the first year, because we believe this would mean more new jobs opening up at the earliest possible date.

(*a*) The charge that the investment credit and new depreciation rules represent a "trickle down" policy is not just short on objectivity, it is countereducational because the benefits of capital formation are no trickle; they are the most substantial economic benefits known to man.

(*b*) The corporation is the principal means in non-Communist countries for maximizing for people the benefits of capital formation.

(*c*) More capital formation first puts people to work producing new productive facilities, and then puts additional people to work using those facilities—or keeps people at work who otherwise would lose their jobs to foreign competitors.

(*d*) As contrasted with consumption spending, capital formation makes a continuing contribution to employment, economic product and revenues. Over 10 years, a $1,000 marginal investment is estimated to bring a total addition to national product of $3,346—of which Government would take $1,305 (table 1).

PLANT UTILIZATION AND CAPITAL FORMATION

A third reason which currently might be used to rationalize, but certainly would not justify, the notion that capital formation is a "trickle down" process is the plant utilization rate of 73 percent.

It first should be noted that the utilization figures apply only to manufacturing and manufacturing accounts for only about 40 percent of business expenditures for new plant and equipment. Public utilities account for 16.5 percent, communications 12.8 percent, mining 2.4 percent, railroads 2.3 percent, air transportation 3.4 percent, other transportation 1.6 percent, and commercial and other the remaining 21 percent. With utilization crowding capacity in public utilities, communications major mining areas, commercial and transportation except for air, complacency about the need for new facilities is hardly warranted.

A second point about utilization is that a great deal of manufacturing capacity is obsolete, perhaps as much as 10 percent, and then another percentage is marginal. Of course, the situation will vary industry by industry.

A third point about utilization involves economic balance. We have no experience which indicates we could have a fully operating, balanced economy without business capital spending holding up its end. We know that when capital formation flourishes, so does the economy, and when the economy flourishes it needs all the capital formation it can get in order to improve productivity and counterinflationary forces. A step-up in capital formation is the best way both to increase plant utilization and to assure a balanced and less inflationary economy when we get back to high-level production and employment.

CAPITAL AND INTERNATIONAL COMPETITION

A valid question is why America with its high stock of capital per worker finds itself at a competitive disadvantage with nations whose stocks of accumulated capital are substantially lower. We believe open and frank discussion of this subject would be a healthy educational exercise. Without pretending to delimit the subject, our thinking turns up five major points affecting our ability to compete which we believe deserve consideration:

First, the push of wage and salary levels for so many groups in the United States beyond the increases in real incomes made possible by capital formation and increased productivity.

Second, a serious lag in productivity in recent years.

Third, concentration of other nations in capital formation and high technology in export areas.

Fourth, a much faster rate of growth of capital formation in other countries than here, so that a larger proportion of their capital stock is of the most modern technology.

Fifth, more restrictive tax provisions for capital recovery in the United States than among our major competitors.

Some of the figures and facts which bear on these points are most illuminating. In the 5 years after 1965, average hourly earnings in the United States increased three times as fast as productivity, with the difference approximating the inflation rate; when productivity over the 5 years was increasing 10 percent here, it increased 70 percent in Japan and then ranged downward from 40 to 18 percent in Europe; in 1970, West Germany passed the United States in the production of machine tools and Russia and Japan were not far behind; and, in 1968, capital formation as percent of GNP was only 13 percent in America but ranged upward to 18 percent in France and Germany on to 27 percent in Japan.

For a vivid illustration of the adverse effects of Federal tax policy on business capital spending in the United States, as compared with other nations, table I of Secretary Connally's testimony on October 7 could not be improved upon.

I would now refer you to table 2 of our statement.

(*g*) Over the past 18 years, there has been a substantial decline in unemployment when profits increased by more than 10 percent—5 years—and a substantial increase in unemployment when profits declined by more than 10 percent—2 years. (Table 2.)

(*h*) There was a profit gap of $25 billion in 1970, and a cumulative gap of $64 billion, using profits in relation to GNP in 1965 as the base. (Table 3.) The January 1966 annual report of the Council of Economic Advisers attested to the fact that 1965 was a year of good balance in the economy.

(*i*) From the same base, there was a cash flow gap of $21 billion in 1970, and a cumulative gap of $56 billion. (Table 4.)

(*j*) Compared with the profit and cash flow gaps, estimated corporate tax savings from the new investment credit and depreciation rules are quite modest.

A GUIDE FOR POLICY

The facts and figures recited provide a clear guide for policy. They indicate it would be a major mistake of economic policy for this committee or the Senate to fail to go along completely with the new credit and depreciation rules as passed by the House. Instead of cutting back on these measures, after a year or two of experience we think it may well be found that further easing of the tax restraints on capital formation is very much in order to serve the public interest.

(*m*) Although the economic situation is more serious now than in the early 1960's, the tax actions preceding the fine balance in the economy of 1965 included lower corporate tax rates as well as the investment credit and liberalized depreciation.

(*n*) Because (i) the problem today is lack of income of people who are unemployed and not shortage of income of people who are employed; (ii) Federal stimulus of demand is out of hand with a full employment deficit of $5 billion up; (iii) of the profit and cash flow gaps; and (iv) the need for revival of business capital spending if we are to move forward to a period of economic balance, there is no economic case whatsoever for modifying the business tax cuts in order to make further tax cuts for individuals.

The great concern which I express to you is that the need of the unemployed for new job opportunities not be subordinated in any degree to putting more money directly into the hands of the employed.

(*o*) More specifically, we emphatically urge upon you the view that none of the potential for jobmaking of the new investment credit and depreciation rules combined be traded for any kind or amount of further personal tax cuts to aid those now employed.

(*p*) If the United States is to reverse the trend which jeopardizes its world economic leadership, the release of tax restraints on capital formation provided in H.R. 10947 would be a very modest beginning.

Thank you.

The CHAIRMAN. I would like to ask you one question about this. This is an impressive table over here that could really prove what you seem to think it does.

Now, would you mind explaining to me how that table demonstrates your point. I would like to see if it supports it to the point that you apparently think it does.

Mr. GREENLEE. Well, we have used the figure of 25 percent of increased or GNP generated by capital investments. As I recall, 20 years ago the economists, as a general rule, were accepting that as a foregone conclusion. We have just picked up that same 25 percent figure.

The CHAIRMAN. Give me that again. You say you are relying upon an assumption?

Mr. GREENLEE. That is right.

The CHAIRMAN. What is that assumption now? Would you restate that?

Mr. GREENLEE. The assumption is one, at least I have heard economists, and I just use the term broadly, have used for the last 20 years, that the resulting flow and the effect on gross national product from capital investment as opposed to a substantial investment is in the range of 25 percent. That is an assumption on which this table is based. The other assumption is that some 14 percent of our gross national product, in turn, goes into capital investment.

Now, the point we are making is that funds released, with funds released that becomes a part of gross national product on the consumption area and will be subject only to the 14 percent which will go as on the average into the area of capital investment, whereas the effect of the additional job creation by capital formation has a factor such as 25 percent added to it in addition to the 14 percent that will flow from all expenditures that affect GNP. That is the basis for the table and it is based on those assumptions.

The CHAIRMAN. I want to study this and explore that assumption, because it might be correct and, if it is, I would like to put it in the computer and leave it there.

Mr. GREENLEE. Sure.

The CHAIRMAN. I discovered all during the periods that we were prosperous, that for the gross national product to increase by $1, the total public and private debt, that is, the debt structure of public plus private, had to increase by $2, and it did.

Mr. GREENLEE. All right.

The CHAIRMAN. That was our experience. Of course, you understand that gross national product is a recurring thing, it is an every year thing, while the public and private debt structure is a cumulative thing.

Mr. GREENLEE. Yes, sir.

The CHAIRMAN. So one is just a 1-year shot and the other is what happens after it is all over. It doesn't mean that you are poorer because you have a bigger public and private debt structure, because after all, we as a nation owe it to one another. But it would appear in order for the economy to produce and consume one more automobile, let's say, than it had the year before—in other words, assuming last year it produced a million automobiles and you want to produce a million and one this year, if that were a $3,000 automobile, you are going to have to increase your debt structure by $6,000. That would mean, in effect, in order to merchandise that one additional automobile beyond what you merchandised the year before, that a man would have to borrow the money from a bank to buy the automobile, or from GMC, and that they in turn would borrow that from an insurance company. So that the debt structure had been increased by $2 to make that $1 increase in the gross national product.

Now, please understand we are no poorer, what we owe is all owed to one another. So the total economy is no poorer, but the debt structure has increased in order to accommodate that additional auto. It might be that we can keep the country prosperous without expanding the debt structure, although I know I have made some independent study of every year that we were prosperous and every year that we were prosperous we expanded the debt structure by $2 for every $1 we increased the gross national product.

Have you looked at those figures?

Mr. GREENLEE. No, I have not. They are interesting. I will make a point to do so.

The CHAIRMAN. Please take a look at the figures that we put in the record every time we raise the debt limit. We have a whole group of comparative figures, some are in constant dollars, some are in current dollars, and if you just get those figures together and look at your gross national product and then look at your public plus private debt—and I am talking about the total, not any one segment.

Mr. GREENLEE. Yes, sir.

The CHAIRMAN. So that when I see all of that and hear someone screaming about the fact that the Government owes more money, I find myself saying, "While that may be bad, and taken alone it is, if you want to be prosperous somebody is going to owe somebody some more money because if the country is to grow the debt structure has to grow."

Mr. GREENLEE. I agree with that, Mr. Chairman, and that is particularly true as long as we can keep our country on the dynamic path. I agree with you completely.

The CHAIRMAN. I don't want to go into any more debt myself, unless I can afford it. I don't enjoy being in debt. But as a practical proposition there is only so much gold around and so much currency and when a bank reflects that one man has money in his account, it is usually because somebody owes money at some point. Ane man's debt is another man's asset.

Mr. GREENLEE. Yes, sir.

The CHAIRMAN. Well, thank you very much. I appreciate your statement and I assure you I will study it further. I particularly want to do justice to the theory that you point out here on page 4.

Senator MILLER. Before the witness leaves, as long as we are talking economic theory, I would like to have him probe this point a little further.

If, for example, you bought a $3,000 automobile but you went down to the bank to borrow the $3,000, and that was the only transaction as of the end of the year, I doubt if you would be talking about an increase in your gross national product, or an increase in your real economic growth because the one offsets the other.

Mr. GREENLEE. That is perfectly right.

Senator MILLER. And in looking at it from a countrywide standpoint, I suggest that you would look at the same thing.

Now, of course, there is a lot of disagreement over what is true economic growth, but it would seem to me as a basic principle if the true economic growth is offset in whole by the addition to the national debt, then we are just kidding ourselves if we think we have had real economic growth.

Mr. GREENLEE. Senator, I would suggest, if you will, and I think the point we are trying to make is that it is not just the car itself but the extra people that are put to work making that car, all the way from the expanding machine tool industry to the job of suppliers all the way up the line.

I quite agree with you on the one transaction. I have no quarrel at all with your statement.

Senator MILLER. We could make it as many transactions as you want. If you have had so much economic, true economic, growth for the Nation.

Mr. GREENLEE. Yes, sir.

Senator MILLER. And you have had an equal amount added to the national debt or to the total borrowed debt, consumer credit, national debt, the State and local increase in debt, then I suggest to you you haven't had any real economic growth, you have just stood still.

Mr. GREENLEE. Yes, sir.

Senator, I would suggest, however, this is one of the points we were trying to make to the extent that we can generate profits, and I am talking about corporate profits, with which to acquire new capital necessary for expansion and maintaining additional technology. This does add to real wealth and real income. To that extent, we are not talking about a debt acquired in order to accomplish this goal.

Senator MILLER. I am all for that and I am all for borrowing money in order to put more people to work and make more profit. I just want to warn, however, that if we for a period of time have found an serious increase in economic growth and at the same time an equal amount of increase in total debt, that we are just kidding ourselves if we think we have made any progress.

You see, you would have to allocate it across the board. How much additional growth is there from every man, woman and child in this country? And then how much of the total debt for every man, woman. and child in the country, and you get down to the individual case that I mentioned to you.

So it seems to me that we shouldn't confuse that situation with the desirability of adding to debt if that will help us increase, I mean make a genuine increase in our economic growth.

So that I think what Senator Long is talking about is this addition to the national debt in relationship to the gross national product actually may be smaller this year than it was 10 years ago.

Mr. GREENLEE. That is correct.

Senator MILLER. But that doesn't tell the whole story and I think the whole story is you have to look into the true economic growth; perhaps you have to shrink the inflation out of it to get the real dollar picture, not only on both sides of the ledger, on the plus side and on the debt side, and see what the picture is then.

Mr. GREENLEE. Surely, I quite agree.

Senator MILLER. Thank you.

(Mr. Greenlee's prepared statement follows. Hearing continued on p. 511.)

PREPARED STATEMENT OF JOHN R. GREENLEE IN BEHALF OF THE TAX COUNCIL

1. POLICY RECOMMENDATIONS

(*a*) Enactment of provisions of H.R. 10947 which would—

(i) establish a 7-percent job development credit

(ii) create a new depreciation system retaining (except for the first year convention) the major features of the Asset Depreciation Range (ADR) System adopted by the Treasury Department in June

(iii) repeal the 7-percent excise tax on automobiles, and the 10-percent excise tax on small trucks and

(iv) reduce individual income taxes

(*b*) Enactment of the DISC (Domestic International Sales Corporation) program, substituting deferral of tax on all DISC income for the "incremental" approach of the House bill as recommended by the Secretary of the Treasury in his testimony on October 7th.

(*c*) Favorable consideration of the Administration's proposal that the rate of job development credit be set at 10 instead of 7 percent for the first year.

2. SUPPORTING POINTS

(*a*) The charge that the investment credit and new depreciation rules represent a "trickle down" policy is not just short on objectivity, it is counter-educational because the benefits of capital formation are no trickle; they are the most substantial economic benefits known to man.

(*b*) The Corporation is the principal means in non-Communist countries for maximizing for people the benefits of capital formation.

(*c*) More capital formation first puts people to work producing new productive facilities, and then puts additional people to work using those facilities (or keeps people at work who otherwise would lose their jobs to foreign competitors).

(*d*) As contrasted with consumption spending, capital formation makes a continuing contribution to employment, economic product and revenues. Over ten years, a $1,000 marginal investment is estimated to bring a total addition to national product of $3,346—of which government would take $1,305 (Table 1).

(*e*) The plant utilization rate of 73 percent is not a reason to hold off on capital formation because: 1) The percentage relates only to manufacturing which accounts for only 40 percent of new exepnditures on plant and equipment, and utilization crowds capacity in most of the other areas; 2) a great deal of manufacturing capacity is obsolete, and another percentage is marginal; and 3) when capital formation flourishes, so does the economy, and when the economy flourishes it needs all the capital formation it can get in order to improve productivity and counter inflationary forces.

(*f*) Despite its high stock of accumulated capital, the U.S. ability to compete with other nations is adversely affected by i) the push of wage and salary levels for so many groups here beyond the increases in real incomes made possible by capital formation and increased productivity; ii) a serious lag in productivity in recent years; iii) concentration of other nations in capital formation and high technology in export areas; iv) a much faster contemporary rate of growth of capital formation in other countries than here; and v) more restrictive tax provisions for capital recovery here than among our major competitors. Supporting figures include: in the five years after 1965, average hourly earnings in the United States increased three times as fast as productivity, with the difference approximating the inflation rate; when productivity over the five years was increasing 10 percent here, it increased 70 percent in Japan and then ranged downward from 40 to 18 percent in Europe; in 1970, West Germany passed the United States in the production of machine tools and Russia and Japan were not far behind; and, in 1968, capital formation as percent of GNP was only 13 percent in America but ranged upward to 18 percent in France and Germany on to 27 percent in Japan. Also see Table 1 of Secretary Connally's testimony on October 7th.

(*g*) Over the past 18 years, there has been a substantial decline in unemployment when profits increased by more than 10 percent (five years) and a substantial increase in unemployment when profits declined by more than 10 percent (2 years). (Table 2.)

(*h*) There was a profit gap of $25 billion in 1970, and a cumulative gap of $64 billion, using profits in relation to GNP in 1965 as the base. (Table 3). The January 1966 annual report of the Council of Economic Advisers attested to the fact that 1966 was a year of good balance in the economy.

(*i*) From the same base, there was a cash flow gap of $21 billion in 1970, and a cumulative gap of $56 billion. (Table 4).

(*j*) Compared with the profit and cash flow gaps, estimated corporate tax savings from the new investment credit and depreciation rules—$2 billion in 1971, $4.6 billion in 1972 and $5.4 billion in 1973—are quite modest.

(*k*) Considering all the facts and figures cited, it would be a major mistake of economic policy for the Committee or the Senate to fail to go along completely with the new investment credit and depreciation rules as passed by the House.

(*l*) Instead of cutting back on the credit and depreciation rules, it may well be found in a year or two that a further easing of the tax restraints on capital formation is very much in order.

(*m*) Although the economic situation is more serious now than in the early 1960s, the tax actions preceding the fine balance in the economy of 1965 included lower corporate tax rates as well as the investment credit and liberalized depreciation.

(*n*) Because i) the problem today is lack of income of people who are unemployed and not shortage of income of people who are employed, ii) federal stimulus of demand is out of hand with a full employment deficit of $5 billion up (compared with surpluses in 1962–1965), iii) of the profit and cash flow gaps, and iv) the need for revival of business capital spending if we are to move forward to a period of economic balance, there is no economic case whatsoever for modifying the business tax cuts in order to make further tax cuts for individuals.

(*o*) More specifically, none of the potential for job-making of the new investment credit and depreciation rules combined should be traded for any kind or amount of further personal tax cuts to aid those now employed.

(*p*) If the United States is to reverse the trend which jeopardizes its World economic leadership, the release of tax restraints on capital formation provided in H.R. 10947 would be a very modest beginning.

"THE BENEFITS OF CAPITAL FORMATION ARE NO TRICKLE"

The Council is a non-profit, policy organization supported by business. Its membership includes large, medium-size and small companies. The Board of Directors is a working board drawn largely from membership but including some distinguished people in the field of taxation without a membership connection.

We welcome the opportunity to appear in these hearings. We support and urge your approval of the provisions of H.R. 10947, The Revenue Act of 1971, which would: a) establish a 7-percent job development investment credit; b) create a new depreciation system retaining (except for the first year convention) the major features of the Asset Depreciation Range (ADR) System adopted by the Treasury Department in June; c) repeal the 7-percent excise tax on automobiles, and the 10-percent excise tax on small trucks; and d) reduce individual income taxes.

We also strongly support enactment of the DISC (Domestic International Sales Corporation) program, but urge that the substitute deferral of tax on all DISC income for the "incremental" approach of the House bill as recommended by the Secretary of the Treasury in his testimony before you on October 7th. Further, we hope you will give favorable consideration to the Administration's proposal that the rate of the job development credit be set at 10 instead of 7 percent for the first year, because we believe this would mean more new jobs opening up at the earliest possible date.

Mr. Chairman, the national problems of unemployment, inflation and low productivity have not been thrust upon our nation by external forces, they are of our own creation. When we look for the sources of our problems, we must start with government but the challenge is not to decide who is responsible but to work together to resolve them. All of us have got to display more understanding and a more cooperative attitude if we are to be successful. We must bring a high level of objectivity into our discussions if we are serious about a common effort to get our nation back on the track of its great destiny. We must avoid language which frustrates constructive dialogue.

"TRICKLE DOWN"

In the doom and gloom of the great depression the phrase "trickle down" was coined as an epithet against concepts attributing necessary function to profits, savings and capital, but its use was abandoned as the economic dialogue became more sophisticated in the late 1950s and early 1960s. It was revived early this year as the leading edge of the attack on the Asset Depreciation Range (ADR) system initiated by the Administration. More recently, it has been used to attack the job development credit, the combination of the credit and the new depreciation rules or in general the concern for direct tax action to re-energize the capital formation process as reflected in the Administration's new economic program and now in H.R. 10947. The phrase has been used by union leaders, some Presidential hopefuls and other members of Congress, editorial writers, columnists and college economists including the head of the Council of Economic Advisers at the time the original investment credit, the 1962 depreciation guidelines and the 1964 corporate tax reduction were initiated.

Counter-educational

The charge of "trickle down" is not just short on objectivity. It is counter-educational. The benefits of capital formation are no trickle. They are the most substantial economic benefits known to man. The high real wages and salaries including those of government employees, and the high standard of living of the American people as a whole, all derive from high capital formation. When we compare real incomes here with those in other countries, we find ours are way ahead for the basic reason that our stock of capital (accumulated total of savings and investment) per worker or per citizen is far higher than elsewhere. The level of unemployment benefits here is far above the level of income for work in major industrial nations. Even welfare payments here are larger than wages in many countries. It all stems from more capital.

If union power, or government dispensation, could uplift the real wage and living standards of a nation, the rest of the world would be as well off as Americans. Unions and well-meaning governments are not peculiar to the American shore. The well-being of a nation's people advances on the disciplines of saving, investment and work, not on the largess of government nor the boasts and claims of union leaders.

When we look for reasons why capital formation would be downgraded by use of the phrase "trickle down", we find three which seem the most likely.

Corporations and people

The first is really only a ploy to attract the support of people who do not understand their stake in the profitable operation of corporations. The ploy is to make antagonists out of corporations and of people. The truth of course is that the corporation is the principal means in non-Communist countries for maximizing for people the benefits of capital formation.

The benefits of capital formation

The second major reason for the "trickle down" attribution would appear to be the tendency to appraise the results of tax reduction in an extremely short-term and narrow context. It's obvious that people who spend most of their income immediately will do the same with most of any tax reduction they get. But it is equally obvious that once spent the economic effect of such tax reduction tapers off except as there is a flow through to profits and capital formation. It also is obvious there may be some delay in the first effects of tax reduction to further capital formation, but what's overlooked in the "trickle down" frame of reference is the double impact of more capital formation in creating more jobs and in its continuing contribution to employment, economic product and revenues.

As regards *double impact*, capital formation first puts people to work producing new productive facilities, and then puts additional people to work using those facilities (or keeps people at work who otherwise would lose their jobs to foreign competitors).

As regards the *continuing impact* of capital formation, a reasonable estimate of the economic yield from marginal capital investment is 25 percent. That is, for every additional dollar of capital investment, there is an annual addition to national product of 25 cents. On this basis marginal capital investment will, compounded, yield its value in current consumption in less than four years, with the annual yield thereafter being all bonus for having saved and invested the original income instead of using it for immediate consumption. Over a 10-year period, a $1,000 marginal capital investment brings a total addition to national product of $3,346—of which government would take $1,305. Table 1 shows how the figures increase year-by-year.

Plant utilization and capital formation

A third reason which currently might be used to rationalize, but certainly would not justify, the notion that capital formation is a "trickle down" process is the plant utilization rate of 73 percent.

It first should be noted that the utilization figures apply only to manufacturing and manufacturing accounts for only about 40 percent of business expenditures for new plant and equipment. Public utilities account for 16.5 percent, communications 12.8 percent, mining 2.4 percent, railroads 2.3 percent, air transportation 3.4 percent, other transportation 1.6 percent, and commercial and other the remaining 21 percent. With utilization crowding capacity in public utilities, communications, major mining areas, commercial and transportation except for air, complacency about the need for new facilities is hardly warranted.

A second point about utilization is that a great deal of manufacturing capacity is obsolete, perhaps as much as ten percent, and then another percentage is marginal. Of course, the situation will vary industry by industry.

A third point about utilization involves economic balance. We have no experience which indicates we could have a fully operating, balanced economy without business capital spending holding up its end. We know that when capital formation flourishes, so does the economy, and when the economy flourishes it needs all the capital formation it can get in order to improve productivity and counter inflationary forces. A step-up in capital formation is the best way both to increase plant utilization and to assure a balanced and less inflationary economy when we get back to high level production and employment.

TABLE 1.—10-YEAR YIELD IN ADDITIONAL PRODUCT (INCOME) AND REVENUE FROM MARGINAL CAPITAL INVESTMENT OF $1,000

	Marginal capital investment, cumulative (1)	National product (income) generated (25 percent of col. 1) (2)	New capital investment from (14 percent of col. 2) (3)	Total addition to national product (cols. 2+3) (4)	Revenue yield (30 percent of col. 4) (5)
1971	$1,000	$250	$35	$285	[1] $386.50
1972	1,035	259	36	295	88.50
1973	1,071	268	38	306	91.80
1974	1,109	277	39	316	94.80
1975	1,148	287	40	327	98.10
1976	1,188	297	42	339	101.70
1977	1,230	308	43	351	105.30
1978	1,273	318	45	363	108.90
1979	1,318	329	46	375	112.50
1980	1,364	341	48	389	116.70
Total		2,934	412	3,346	1,304.80

[1] Includes 30 percent of the $1,000 capital investment.

CAPITAL AND INTERNATIONAL COMPETITION

A valid question is why America with its high stock of capital per worker finds itself at a competitive disadvantage with nations whose stocks of accumulated capital are substantially lower. We believe open and frank discussion of this subject would be a healthy educational exercise. Without pretending to delimit the subject, our thinking turns up five major points affecting our ability to compete which we believe deserve consideration:

First, the push of wage and salary levels for so many groups in the United States beyond the increases in real incomes made possible by capital formation and increased productivity.

Second, a serious lag in productivity in recent years.

Third, concentration of other nations in capital formation and high technology in export areas.

Fourth, a much faster rate of growth of capital formation in other countries than here, so that a larger proportion of their capital stock is of the most modern technology.

Fifth, more restrictive tax provisions for capital recovery in the United States than among our major competitors.

Some of the figures and facts which bear on these points are most illuminating.

In the five years after 1965, average hourly earnings in non-agricultural, private employment in the United States increased by over 31 percent. In the same period, productivity increased only about 10 percent. The difference of 21 percentage points approximates the inflation rate (consumer price increase) of 23 percent.

In the five years in which productivity was increasing only about 10 percent in the United States, the increases were over 70 percent in Japan, a little more than 40 percent in the Netherlands and a little less in Sweden, 33 percent in France and 27 percent in West Germany. Even in the United Kingdom the increase was 18 percent, nearly double the U.S. rate.

In 1970, West Germany passed the United States in the production of machine tools and Russia and Japan were not far behind.

In 1968, capital outlays in the United States were 13 percent of gross national product while among our competitors the percentages ranged upward from 14 percent in the United Kingdom to 16 percent in Belgium, 18 percent in France and also in Germany, 21 percent in the Netherlands and 27 percent in Japan.

For a vivid illustration of the adverse effects of federal tax policy on business capital spending in the United States, as compared with other nations, Table I of Secretary Connally's testimony on October 7th could not be improved upon.

More capital formation may seem unimportant to some here at home, but for most of the years since World War II the rest of the world considered the United States a model of how to advance human well-being through this process. The figures suggest, however, that the model may be getting a little worn around the edges. On the opening day of these hearings, Senator Bennett quoted from an Evans and Novak column in the *Washington Post* transmitted from Japan which I repeat here: "It is a chilling experience to hear a top government economist say, with a broad smile: 'I am sorry to tell you this, but I think the United States is beginning its economic decline just as Great Britain began theirs 20 years ago. The decline is irreversible'." We stand with the Senator in his opinion that the decline can be reversed, but if we are to pull the trick we must seek better public understanding of the critical role of capital formation and avoid such counter-educational inputs as "trickle down".

TOWARDS A BALANCED AND STRONGER ECONOMY

To reverse the decline in our competitiveness with other major nations, we must achieve a better balance in our economy than obtains today. The first matter of balance which we must face is under-utilization of our labor force. This is not just a matter of economics and national pride, it is a matter of conscience. It may be difficult to agree on a precise level of unemployment which is tolerable, or whether and at what level there is a trade-off between unemployment and inflation, but there's no room for disagreement that the six percent zone of unemployment is much too high. When we look at the economics of the matter, it is not hard to find cause and effect. Increasing the pay of the employed more than justified by the productivity performance of the economy does not just put inflationary pressure on prices, it puts a deflationary squeeze on profits. The victims are those who lose their jobs or who can't find jobs in an economy in which profits are out of balance with other factors.

Union leaders may rail at profits when they are seeking wage increases unrelated to productivity in the economy, but to do so is as counter-educational as the "trickle down" phrase. Profits are the mainspring of job-making. Loss of profits means loss of jobs and more profits means more jobs. Aside from the incentive to produce which profits provide, they are the major source of new business capital. If we are to avoid the fate of the Japanese economist sees for us, the profit level has got to be adequate to the task.

The connection between profit trends and jobs may be verified statistically from experience. Substantial variation from one year to another in the volume of profits usually is accompanied by an opposite movement in the rate of unemployment. In the five of the past 18 years, for example, when net profits increased by more than 10 percent over the preceding year, there was a substantial decline in the rate of unemployment. In the two years in which profits declined by more than 10 percent, the rate of unemployment increased substantially. The figures are shown in Table 2.

By the fourth quarter of 1970, net profits were down to an annual rate of $39 billion, and the unemployment rate was up to 6.2 percent—an increase of 2.6 percentage points or 70 percent over the fourth quarter of 1969.

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TABLE 2.—VARIATIONS IN NET PROFITS AND RATE OF UNEMPLOYMENT

Year	Net profits after taxes (billions)	Unemployment (percent of labor force)	Profit variation of more than 10 percent (billions)	Percentage-point variation in rate of unemployment
1953	$20.4	2.9		
1954	20.6	5.5		
1955	27.0	4.4	+$6.4	−1.1
1956	27.2	4.1		
1957	26.0	4.3		
1958	22.3	6.8	−3.7	+2.5
1959	28.5	5.5	+6.2	−1.3
1960	26.7	5.5		
1961	27.2	6.7		
1962	31.2	5.5	+4.0	−1.2
1963	33.1	5.7		
1964	38.4	5.2	+5.3	−.5
1965	46.5	4.5	+8.1	−.7
1966	49.9	3.8		
1967	46.6	3.8		
1968	47.8	3.6		
1969	44.5	3.5		
1970	41.2	4.9	−3.3	+1.4

The profit gap

It would be a mistake, however, to assume from these figures that all that is needed to put the unemployed to work and regain some economic muscle in international competition is a modest annual increase in profits over the next few years. The facts are that we have developed a serious imbalance in the relation between wages and profits since 1965 and the result is a rather frightening profit gap, or lag or deficiency in profits, both on an annual and a cumulative basis.

In 1965, wages, salaries and other labor income were 55.2 percent of gross national product. By 1970, this had increased to 58.6 percent. A large chunk of the increase was in the government sector, where the total moved up from 10.1 percent to 11.7 percent of GNP.

In 1965, net profits were 6.8 percent of GNP, but by 1970 had dropped to only 4.2 percent—a drop roughly comparable to the percentage increase in compensation. As we noted earlier, the victims of this process are those who are unemployed. The lag or deficiency in profits over the five years on an annual and cumulative basis is shown in Table 3.

TABLE 3.—THE LAG IN PROFITS

[Dollars in billions]

Year	Gross National product	The profit record: Profits after tax	Percent GNP	Reduction from 1965: Percent GNP	Current year	Cumulative
1965	$685	$46.5	6.8			
1966	750	49.9	6.6	0.2	$1.5	$1.5
1967	794	46.6	5.9	.9	7.2	8.7
1968	864	47.8	5.5	1.3	11.2	19.9
1969	929	44.5	4.8	2.0	18.6	38.5
1970	974	41.2	4.2	2.6	25.3	63.8

This table tells us that the profit gap in 1970 was $25.3 billion, and that the cumulative gap over five years was $63.8 billion.

If we were this year to return to the profitability of 1965, net profits would be in the order of $71 billion; next year, the figure would be some $78 billion. If these figures seem startling compared with present profit levels, it should be recalled that 1965 was one of fine balance in the economy.

The 1965 economic performance was eulogized by the Council of Economic Advisers in its annual report to Congress of January 1966. A major section was entitled "The Balance of the Economy" and this was the theme which flowed throughout the report. After a number of years of economic lag and too much unemployment, the economy was filled out and the unemployment rate was down to the 4 percent zone at the end of the year.

The cash flow gap

While profits are the essential incentive to produce, the most important factor in business capital spending is cash flow which is profits after tax plus capital consumption allowances. The investment credit adds to profits, whereas both the credit and larger depreciation allowances add to cash flow. Even with the lingering effects of the 1962 depreciation guidelines, the cash flow gap is nearly as great as the profit gap. The figures are shown in Table 4.

As the table shows, there was a steady decline in the ratio of cash flow to GNP from 12.1 percent in 1965 to 10 percent in 1970. The annual deficiency in cash flow in 1970 was $20.5 billion. The cumulative deficiency was $55.5 billion.

The job development investment credit and the new depreciation rules, as provided in H.R. 10947, would mean a tax reduction for corporations of roughly $2 billion in this calendar year, $4.6 billion in 1972 and $5.4 billion in 1973.

TABLE 4.—THE LAG IN CASH FLOW

		The cash flow record				
				Reduction from 1965		
	Gross national product	Cash flow		Current year		
Year	(billions)	Billions	GNP (percent)	GNP (percent)	Billions	Cumulative, billions
1965	$685	$82.9	12.1			
1966	750	89.5	11.9	0.2	$1.5	$1.5
1967	794	89.6	11.3	.8	6.4	7.9
1968	864	94.6	10.9	1.2	10.4	18.3
1969	929	95.8	10.3	1.8	16.7	35.0
1970	974	97.4	10.0	2.1	20.5	55.5

As compared with the annual and accumulated deficiencies in profits and cash flow, these totals are quite modest.

A guide for policy

The facts and figures recited provide a clear guide for policy. They indicate it would be a major mistake of economic policy for this Committee or the Senate to fail to go along completely with the new credit and depreciation rules as passed by the House. Instead of cutting back on these measures, after a year of two of experience we think it may well be found that further easing of the tax restraints on capital formation is very much in order to serve the public interest.

The record surveyed here re-enforces the findings of The Tax Council bulletin of March 25, 1971, entitled "Investment Credit Needed Now", in which we stated "The economy of 1971 is confronted with a mix of problems with much more serious implications for economic health than was the situation in 1962 (when the investment credit was enacted initially). Reinstatement of the credit would not be a cure-all, but there certainly is much greater need for such a credit now than in 1962." Instead of restating the various points made in that bulletin, copy is appended to this statement.

When we compare the present situation with that in the earlier period, we should not forget that enactment of the investment credit and promulgation of the depreciation guidelines (which reduced property lives in some categories as much as 35 to 40 percent as compared with the 20 percent overall reduction in the new rules) was followed by a substantial reduction in the top rates of corporate tax. In a discussion of the "Key role of business fixed investment" in the January 1966 Economic Report, the tax measures were rated a major determinant of "investment demand" over the preceding two years in these words: "the anticipated future returns from investment have been enhanced by the prospect of continuing economic expansion and by the investment tax credit, the liberalized depreciation rules, and the lowered corporate tax rates".

We do not understand how it can be argued that less is needed now.

THE DISC PROGRAM

By deferring tax on profits of Domestic International Sales Corporations (DISCs) when such profits are used in export-related activities, the Administration's original DISC proposal would have increased the profitability of producing goods for export, thus not only creating new job opportunities in domestic industries, but protecting old ones. In modifying the proposal to largely limit deferral to increased or incremental export sales, H.R. 10947 essentially eliminates the role of protecting existing export-related jobs. In view of the momentum which foreign producers have achieved in increasing productivity, which makes it ever more difficult for American producers to compete in their markets, we think it would be a mistake to limit the objectives of the DISC program to creating new jobs. We urge this Committee to accept the Administration's suggestions for revision of the bill before you to carry out the objectives of the orignal proposal.

REPEAL OF THE AUTOMOBILE EXCISE TAX

Repeal of the 7-percent excise tax on new automobiles would bring to an end a selective and discriminatory levy which, in our view, should have been off the books a long time ago. We also concur in the House action which would repeal the 10-percent excise tax on small trucks. These actions will add to the stream of production, employment and consumption, and have a favorable effect on the automobile component of the cost of living index. A fringe benefit from this move would be improvement of the environment by more rapid replacement of old, pollution-prone cars with new cars which already reflect a great deal of progress in pollution control.

INDIVIDUAL INCOME TAX CUTS

Adding the personal tax reductions which will take place under existing law and those provided by the House bill, individuals will receive an annual tax cut of $8.6 billion effective in 1972. While we would not ask nor expect the Senate to reduce this total, we do urge forbearance as regards going further for three reasons:

First, the problem today is lack of income of people who are unemployed, not shortage of income of people who are employed. There is still an inflationary potential from the excessive (in relation to productivity) wage and salary increases of the past few years, but this potential is held in check by the unusually low rate of current spending out of current income (less than 92 percent of disposable personal income, whereas 94 plus is considered a normal range). An increase of 1½ percent in the rate of spending would add some $12 billion to the consumption stream, reducing the flow of current savings by a comparable amount. These shifts could come abruptly enough over the months ahead to cause quite a problem of digestion by the economy without any further stimulus on the demand side of the equation.

Second, using the full employment budget as the measure, federal stimulus of demand already is out of hand as compared with the experience preceding the balanced year of 1965. A full employment deficit of $5 billion up is now estimated for the current fiscal year, as compared with full employment surpluses of $1 billion in 1965, $1.8 billion in 1964, $9.0 billion in 1963 and $4.4 billion in 1962. In appraising the importance of investment demand in achieving the balanced economy of 1965, the 1966 economic report observed that the experience of the preceding two years had refuted the "pessimistic assessments of the strength of private demand" and continued "With stronger consumer markets and higher after-tax profits, business fixed investment has broken out of its earlier lethargy. Balance was restored in 1965 between private investment and private high-employment saving, demonstrating that high employment was in fact achievable without substantial, permanent Government deficits".

Third, with the tremendous profit and cash flow gaps, and the importance of a revival of business capital spending to moving forward to a period of economic balance and steady, less inflationary growth, there is no economic case whatsoever for modifying any part of the business tax cuts provided in the pending bill in order to make further tax cuts for individuals.

The great concern which I express to you is that the need of the unemployed for new job opportunities not be subordinated in any degree to putting more money directly into the hands of the employed. More specifically, we emphatically urge upon you the view that none of the potential for job-making of the new investment credit and depreciation rules combined be traded for any kind or amount of further personal tax cuts to aid those now employed.

A CONCLUDING COMMENT

Mr. Chairman, the Japanese economist cited by Messrs. Evans and Novak may well have found the courage of his convictions in a piece by Andrew Stein which appeared a week earlier, October 1st, in the New York Times, entitled "On to the Poorhouse". Mr. Stein is a Democratic State Assemblyman from Manhattan. The piece is not appended to my statement because the Times has not responded for our request for permission to reproduce, but I have an original here if the Committee wishes it placed in the record.

Mr. Stein recounts the figures which show that New York State's population is "increasingly dominated by the helplessly poor, by civil servants and retirees" while a "dwindling number of middle-income taxpayers struggles to cope with rising government costs" and the State's economic climate deteriorates more rapidly than the climate of the nation as a whole, and concludes "Unless the current movement is reversed, the next ten years will push this state to economic collapse".

The thought I would like to leave with you, Mr. Chairman, is that the kind of pressures to beef up government at the expense of the private economy which exist in New York also exist in Washington. The basic criticism of the new depreciation rules and a new investment credit is that they preempt money which otherwise could be used in various spending programs. Table 1 of this statement demonstrates the shortsightedness of this view as regards to the nation's economic strength and the tax base. If the United States is to reverse the trend which jeopardizes its World economic leadership, the release of tax restraints on capital formation provided in H.R. 10947 would be a very modest beginning.

THE TAX COUNCIL

March 25, 1971.

INVESTMENT CREDIT NEEDED NOW

1. *Revival of the investment credit would be good for the economy*

The credit would make an important contribution towards a faster growing economy. This was the conclusion of a Council sponsored tax legislative conference on revival of the credit on the morning of March 24th. In the afternoon, the Council's Tax Liability Policy Committee decided to ask the government's tax policy leaders to give top priority to seeking early re-enactment of the credit.

2. *The economy of 1971 needs the investment more than did the economy of 1962*

In the summer of 1962, the Treasury Department revised depreciation rules to reduce permissible property lives by an average of about 15 percent. Shortly thereafter the Congress enacted the investment credit as the second step of a two-part program to re-energize capital spending to induce faster economic growth and create more jobs in the private economy.

A new revision of the depreciation rules, providing a reduction of 20 percent in property lives through the ADR system, is nearing final promulgation. While the new allowances fall short of those provided by some of our major competitors abroad, they will be tremendously helpful in quickening the pace of business capital spending and making more growth possible over the years ahead. The need, however, is for a substantially greater release of the tax restraints on capital formation. The economy of 1971 is confronted with a mix of problems with much more serious implications for economic health than was the situation in 1962. Reinstatement of the credit would not be a cure-all, but there certainly is much greater need for such a credit now than in 1962. Some of the reasons are:

(*a*) *The labor force is increasing much more rapidly now than in 1962.*—In the five years ending with 1962, the annual increase in the civilian labor force averaged only a little over 700,000; but in the five years ending with 1970, the average was over 1,600,000. Faster growth in the labor force makes it more difficult to return to full employment, and to maintain full employment once achieved. Strong growth in capital formation is indispensable to getting back to and staying on the full employment track. Faster growth in the labor force, moreover, requires faster growth in the stock of capital in order to maintain growth in productivity.

(*b*) The rising aspirations of the American people result in much greater emphasis now than a decade ago not just on jobs but on better and more remunerative jobs. Unless underwritten by more and more capital, these aspirations end up in the frustration of higher prices chasing higher wages.

(*c*) *The current unemployment of scientific and professional people had no counterpart in the early 1960's.*—There can be little doubt that adequate career opportunities for these people, and for the highly-trained college people just entering the labor force, are dependent on re-establishing and maintaining a higher rate of capital formation in the private economy.

(*d*) *The over-all need for capital is much greater in this period than it was a decade ago.*—Another way of saying this is that any list of national priority areas is simply a list of areas where more capital is needed—housing, pollution abatement and control, sources of energy, community facilities of all kinds, and improved productivity, in addition to the over-all one of underwriting faster growth and more new and better jobs.

While the contemporary easing in capital markets may make the problem seem a little less urgent, most authorities seem to agree the United States will not escape in the 1970's the world wide problem of scarce capital.

(*e*) *Financially, American business is in much tighter straits than in 1962.*—For example, net working capital of American corporations averaged only 22 percent of gross national product in 1970 as compared with 28 percent in 1962; and retained earnings of corporations in 1970 came to about two percent of GNP as compared with three percent in 1962.

(*f*) *Despite the easing in capital markets, long-term money rates for corporations are approximately double those of 1962.*

(*g*) *The wage-push inflation of 1971 had no conterpart in 1962.*—While nothing except abatement of excessive wage increases will resolve the problem of wage-push inflation, the measure of excess is the extent to which the increases exceed average productivity gains in the private economy. Because more capital is the primary force for greater productivity, release of capital from taxation is counter-inflationary.

(*h*) *Foreign competition is more intense today than in 1962.*—The U.S. trade surplus was 0.8 percent of GNP in 1962, declining to 0.3 percent in 1970. It's a hard race, and it's fought primarily with capital expenditures for modernizing plant and equipment. Our competitors have tremendous advantage in lower wages, as well as more favorable tax rules.

(*i*) *Forbearance in consumer spending in 1971 as compared with 1962 reflects lack of confidence in economic direction and not lack of enough income among the employed.*—This point is especially significant in weighing reinstatement of the investment credit against tax relief designed to increase consumer incomes. Consumers are now spending something less than 93 percent of their current income as compared with over 94 percent in 1962. It seems evident that more unemployed would be put to work by using a given amount of tax reduction dollars to influence and finance an uptrend in capital formation than to increase the income of the employed.

3. *Capital formation has a double effect in putting people to work*

The first effect of more capital formation is more jobs in the capital equipment industries, and the second effect is new and better jobs using the new equipment.

4. *Time consuming controversies should be avoided in seeking reinstatement of the credit*

Other things being equal, a credit at a higher rate than the original seven percent credit would have a more beneficial effect on the economy, and any limit on life of the credit would be undesirable. However, the most important thing at this time would be to move as rapidly as possible towards re-enactment even if this meant staying with the seven percent rate or even putting a time limit on the life of the new credit.

5. *Thorough study is needed of the burden of corporate taxation on capital formation and economic progress*

Instead of a statutory time limit on a new credit at this time, a most constructive development would be a commitment or understanding by or among the tax writing authorities that there would be undertaken a thorough review, no later than 1973, of the burden of the corporate tax on capital formation and economic progress. The objective of the review would be to provide a base for legislative decisions on the continued place in the federal tax system of the investment credit, on a further reduction in property lives under the ADR system and on goals for reducing the rate of tax on corporate profits.

J. R. Greenlee, *Chairman,*
Tax Policy Committee, The Tax Council.

NOTE.—The substance of this bulletin has been transmitted by letter to Secretary of the Treasury John B. Connally; Office of Management and Budget Director George P. Shultz; House Ways and Means Committee Chairman Wilbur D. Mills; House Ways and Means Committee Minority Leader John W. Byrnes; Senate Finance Committee Chairman Russell B. Long and Senate Finance Committee Minority Leader Wallace F. Bennett.

The CHAIRMAN. The next witness will be Mr. Reed Larson, executive vice president, National Right To Work Committee.

We are pleased to have you.

STATEMENT OF REED LARSON, EXECUTIVE VICE PRESIDENT, NATIONAL RIGHT TO WORK COMMITTEE

Mr. LARSON. Mr. Chairman, Senator Miller, I am Reed Larson, executive vice president of the National Right To Work Committee. Ours is a citizens' organization devoted exclusively to opposing the abuses resulting when individuals are compelled to pay money to a labor organization as a condition of employment.

I want to thank you for the opportunity to be here today, and commend this committee on its careful consideration of this important problem at hand. We particularly appreciate the opportunity to give our testimony because we acknowledge that the solution that we recommend is not within the jurisdiction of this committee. However, your is the only committee that is holding hearings at this time and giving consideration to the present economic crisis in our country. We believe that, in addition to hammering out the details of the tax package to treat the immediate symptoms, it is very important that solutions be considered to get at the root causes that have brought us to the point of economic crisis.

So this is why we felt it was appropriate for this committee to hear testimony on our view as to one of the fundamental causes that has created this economic crisis which we are trying to solve in the interests of all members of the public.

We believe that there is general agreement today on the part of most economists and certainly on the part of the general public that a key factor that has brought our Nation to the present point of economic crisis is the excessive power concentrated in and wielded by a few top union officials. One of the economists who has summarized this problem in this last few weeks, which I think is fairly representative of the opinion of many who have studied this question, is John Davenport, a well-known journalist and formerly an editor of Fortune magazine. He wrote, and I would like to quote about three paragraphs of his recent paper.

Mr. Davenport said:

For while organized labor constitutes something less than 25 percent of the U.S. working force, its grip on our basic industries is wholly critical. It is this monopoly power which forces producers to raise prices if they can, and if they can't cut back production with resulting unemployment. And it is this monopoly power * * * which has thus far defeated all attempts to achieve stabilization and high employment levels by traditional fiscal and monetary means.

The wage price freeze in itself does nothing to get at the tap roots of union power and, indeed, controls if perpetuated may in the long run enhance that power.

Mr. Davenport concludes:

The effective and courageous way to deal with union monopoly power is large-scale revision of our present permissive labor laws and their administration.

This is the missing ingredient from the President's program and had it been undertaken in good time we might never have arrived at the present impasse.

Mr. Chairman, this summarizes the relationship that we see between the need for a national ban on compulsory unionism, a root cause, in our opinion, of the present economic problems and the current financial crisis. This crisis certainly has to be dealt with by short-range measures, but, we hope, combine with long-range measures as well. We believe this is the time to seriously raise the prospect of a national ban on compulsory unionism which exists in this country because of the sanction of Federal law.

The Federal law, the National Labor Relations Act and the National Railway Labor Act, gives the authority of the Federal Government to the practice of compelling workers to join and pay dues to a union in order to work. An amendment is needed to remove from the Federal law those specific sanctions of compulsory unionism. Such an amendment, we believe, would contribute immeasurably to the elimination of the root cause that today has brought us to an economic crisis which is working to the disadvantage of the wage earner, business and all aspects of our society.

I might comment further that all surveys and public opinion indicate that the public is in accord with this concept and that the average voter, the average citizen, including a large proportion of the members of union families, would support a ban on all forms of compulsory unionism.

I will not go into any more detail. If you have any questions, I would appreciate an opportunity to answer them. Again I thank you for giving us a hearing in this forum which I acknowledge is dedicated primarily to hammering out very sticky economic details of a proposal to solve a problem we have gotten ourselves into in this country. I hope we will do something fundamental about solving it, as well as something to treat the symptoms.

The CHAIRMAN. Well, thank you, sir.

I am afraid that on this Committee on Taxation, if we can solve the part that falls into our lap, we will be doing more than anybody has a right to expect from us, and I am afraid it is not within our capability to solve the problem that you bring to us, which, as you know, falls within the jurisdiction of another committee.

We are pleased to have your statement and we will make it available to the Senate.

Mr. LARSON. Thank you, and I appreciate the opportunity to get it on the record. I think it needs to be.

(Mr. Larson's prepared statement and attachments follows:)

PREPARED STATEMENT OF FRED LARSON, EXECUTIVE VICE PRESIDENT, NATIONAL RIGHT TO WORK COMMITTEE

Mr. Chairman, members of the committee; the National Right to Work Committee is a single-purpose citizens organization, comprised of both employers and employees, devoted to the concept that no individual should be compelled to pay money to any private organization as a condition of employment. On behalf of our members, I wish to thank you for the opportunity to submit this statement.

Like most Americans, we are deeply disturbed by the economic woes confronting our Country today. Therefore, Mr. Chairman we compliment you for your prompt action in holding hearings on the various legislative proposals outlined by President Nixon on August 15 and those contained in HR 10947.

These proposed measures are certainly commendable; however, they appear to offer only short-range solutions. When looking at our economic ills in their total context, the proposals in HR 10947, in the judgment of many economists, tend to treat only the symptons, not the disease.

There is widespread agreement by the public and by most respected economists that excessive union power is the key factor in bringing our Nation to the brink of economic disaster. Thus the root cause of this unhealthy concentration of power—compulsory union membership—must be eliminated. Only this course of action holds out hope for the long term; the remaining alternative appears to be a totally regulated economy.

To bring about such a solution will be difficult. Shrewd union bargainers know that most big concessions to compulsory unionism in the past have been wrung from government and industry as bribes to union officials to obtain their support and cooperation with national policy in times of great emergency. History shows that:

1. The federal government first sanctioned compulsory unionism in most of industry with the passage of the Wagner Act during the economic upheavals of the 1930's.

2. Compulsory unionism first fastened its stranglehold on much of major industry during World War II when government wage-price administrators recommended forced unionism clauses as the price of keeping union bosses from fomenting production-interrupting strikes. Labor Department reports show that of all employees covered by union contracts, only 20% were bound by compulsory membership clauses before World War II, whereas 77% were under such clauses in 1946.

3. The only major federal legislative gain for compulsory unionism since 1935 came with the repeal of the Right to Work provision of the Railway Labor Act in 1951, sneaked through Congress by union lobbyists under cover of the Korean War emergency.

Expecting history to repeat itself, CWA president Joe Beirne—just four days after President Nixon's announcement of the wage-price freeze—called on Congress to repeal Section 14(b) of the National Labor Relations Act.

Mr. Chairman, we must reverse this trend. Today our Nation is at the crossroads. It can face up to the problem of union monopoly power by eliminating compulsory unionism, thus setting a course toward freedom of choice economy; or, it can purchase the cooperation of union officials through concessions of even greater union privilege, thereby insuring the necessity of permanent government controls of every detail of our economic system.

We believe the time has never been more appropriate than now to ask seriously of every Member of Congress and the President to remove the federal sanction of compulsory unionism, first enacted in 1935. An outpouring of public demand for such a National Right to Work law will point the Nation in the direction of *real* labor reform and away from the typical patchwork solutions which have resulted in today's economic crisis.

It is important to note that others share our view.

On December 5, 1970, Mr. Jenkin Lloyd Jones in a nationally syndicated column entitled "Union Demands Could Signal End to Free Market," discussed the enormous power wielded by union officials and noted that "an imbalance of the law . . . makes the abuse of union power inevitable. . . .

In concluding his article, Mr. Jones states that the cure "won't be simple but the right of unions to cut off the water was not handed down among the Ten Commandments, and the compelling of a worker to join and obey a union in order to hold a job is probably going to have to go."

More recently, Mr. John Davenport, a former editor of Fortune magazine focussed on our present economic difficulties in a cover article in the September 11, 1971 issue of Human Events titled, "Congress Must Curb Labor Union Monopoly." Mr. Davenport states: "What ails the economy is not the free price and profit system as such but the fact that it is afflicted in a single sector by a powerful and pervasive monopoly element. I refer, of course, to the power of labor unions. . . ."

Mr. Davenport goes on to say, "The effective and courageous way to deal with union monopoly power is large-scale revision of our present permissive labor laws and their administration. . . . Unions should be what they set out to be; namely purely *voluntary* organizations, purged of their present coercive and often violent practices."

A copy of each article is enclosed so that they may be included in the record.

The results of a recent Opinion Research Corp. survey show that an overwhelming majority of the American people share Mr. Davenport's view concerning voluntary unionism. These results indicate that 62% of the American public favor labor legislation which would permit a man to hold a job whether or not he belongs to a union. It is significant that 53% of the members of union families also favor such a law.

In conclussion, Mr. Chairman, I would like to reiterate that our committee is a single purpose organizaion concerned with the concept that all Americans should have the right to join or to refrain from joining a labor organization. It is not our role to express an opinion on the relative merits of an economic system based on voluntary exchange of goods and services as compared to a system based on totalitarian regimentation of the market place. We do, however, feel a deep obligation to point out that the decisions that will be made by this committee, the Congress and the President in the next few weeks will profoundly affect the economy and the American people—probably for generations to come. We also feel a responsibility to bring to your attention the prospect that failure to deal with the fundamental problem of unrestrained union power will, in the opinion of many authorities, leave no alternative to long-term totalitarian government regimentation of the economy—an alternative we believe would be totally unacceptable to the majority of the American people.

We believe the proper course of action is to eliminate compulsory unionism and we call upon the members of this committee to assume the initiative in seeking congressional approval of a legislative measure which would repeal the existing provisions in federal law that sanction compulsary union membership.

This concludes my statement. I will be happy to respond to any questtions.

'ULSA TRIBUNE WASHINGTON STAR PHILADELPHIA ENQUIRER
From a Column Syndicated Nationally by General Features Corp., December 5, 1970

Union Demands Could Signal End to Free Market

By JENKIN LLOYD JONES

IS LABOR union power in America leading us all into an economic strait-jacket? Could be. And if it could be, the fault lies not with union labor or even the most ambitious labor leaders, but with an imbalance of the law that makes the abuse of union power inevitable, and the suppression of that abuse by government inevitable, as well.

Jones

The greatest unresolved problem in human economy is how to make the laborer worthy of his hire and the hire worthy of his labor.

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WHEN THE 19th-century factory system destroyed cottage industry, it succeeded also in breaking rural serfdom by offering employment opportunities other than scratching and harvesting the land. But as the cities burgeoned and increasing thousands depended for their daily bread upon the opening of the factory gates, the power of the factory-owner grew enormously. As his machines improved and production increased, he was reluctant to pass on a fair share of the benefits to his hired hands.

Instead, the threat of the lock-out became ever more devastating and the lightly taxed profits to the few plus the spread of wage-slavery to the many led Karl Marx to assume the coming collapse of the whole system.

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THREE THINGS made Marx a bad prophet. First were the anti-trust laws, most stringently enforced in America, which made it unlawful for industrialists to band together in order to diminish competition, rig prices and depress wages. Second was the income tax, putting the largest burden of taxation upon those with the highest ability to pay. Third was the rise of union labor.

The union turned the feeble power of the individual worker into the collective clout of the work-force. The power of the boss met its match in collective bargaining.

The mistake was made, however, in not foreseeing that union power, if subjected to no regulation, could develop the same evils that had been demonstrated by unregulated industrial power.

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WHEREAS, once combinations of employers could say to workers, "Take what we offer you or you will not eat," now union power can say to employers, "Give what we demand or you will not produce," and to the general public, "Unless we win, what you need you will not have!"

It is unfair to curse union leadership for unrealistic wage demands. Indeed, the most moderate wage demands are likely to come from Mafia-controlled unions where a corrupt leadership is willing to write "sweetheart" contracts for a price. Honest union leaders are under pressure from the rank-and-file to equal the highest percentage raise obtained by any other union. The result, quite naturally, is mad escalation.

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AND THIS feeds inflation. Unions understand this and in the recent General Motors settlement an unlimited "cost-of-living" wage increase was achieved. It will be impossible for the self-employed, the farmers, the retirees or most of the people in the service industries to obtain for themselves similar protection from rises in the cost of living.

Thus the UAW becomes the beneficiary of special privilege—exemption from a condition which its own action will help produce.

The auto worker whose wage increases outrun his productivity can be paid only by lower profits or increased prices. The UAW settlement will be a tax upon all auto users. It may kill the much-hoped-for American minicar in its cradle.

The $18,000-a-year plumber imposes a tax on all home buyers. The $17,000-a-year bricklayer shows up in supermarket prices. One railway union, having made wage demands that even it concedes the railroads cannot pay, is now suggesting federal subsidies, which means its intention to charge part of its wages to the taxpayers, who are everybody.

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WHERE ARE we going? It's pretty plain. Unions, having priced more and more American goods out of the international trade and having made foreign imports even more alluring, are beginning to demand high protective tariffs which could trigger international retaliation and perhaps a worldwide depression. Outraged consumers are beginning to demand wage-price controls which would mean the end of the free market and free wage negotiations.

The cure?

It won't be simple. But the right of unions to cut off the water was not handed down among the Ten Commandments, and the compelling of a worker to join and obey a union in order to hold a job is probably going to have to go.

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Human Events
YOUR WEEKLY WASHINGTON REPORT

Wage-Price Controls Unneeded

Congress Must Curb Labor Union Monopoly

By JOHN A. DAVENPORT

Despite widespread acclaim in many quarters, and an initial favorable reaction from the stock market, President Nixon's so-called new economic program is neither entirely new nor internally consistent.

In its international aspects the program deserves praise and support, since it has been clear for some time that the dollar is over-valued in terms of other currencies and that a readjustment of exchange rates is a prime necessity. But in coupling dollar devaluation abroad with a general price and wage freeze at home the President has embarked on a dangerous expedient where possible short-term gains must be measured against long-term losses both for the economy and for the principles of the free market which the President says he is seeking to uphold.

With respect to short-term gains the wage-price freeze may temporarily dampen inflationary expectations which usually follow monetary devaluation and in this case cutting loose from the fiction of $35 gold, and one must charitably suppose that this was the determining factor in the President's decision.

Mr Davenport is author of U S Economy, *a former editor of* Barron's *and former member of the board of* Fortune.

Moreover, if the freeze momentarily slows the upward pressure on wages and costs, which is the chief cause of our difficulties, it may allow production, productivity and employment to expand and the economy may well work its way onto higher ground. But when these possibilities are conceded, the fact stands the President has not come to grips with the fundamental causes of inflation and unemployment, and with every day that passes the program will face new administrative difficulties.

As to that, Mr. Nixon now finds himself playing the role of King Canute bidding the tides of inflation to recede and even the little waves to be quiet. In their hearts both he and his advisers know that this cannot really be effected by government ukase and the frenetic activity of the pitifully unprepared Office of Emergency Preparedness and the new Cost of Living Council.

Already the price freeze has left the steel industry in the curious position of having raised prices on structural steel but now being denied contemplated raises in the price of tin-plate products and other items. Similar distortions are appearing in textiles and other industries and applications for exceptions are bound to multiply both as regards prices and wages.

If these exceptions are granted, then price stabilization becomes just another name for unbridled governmental discretion by officials who cannot possibly know what a fair price or fair wage for any particular class of workers really is. If exceptions are not granted, then we may confidently expect the emergence of grey and black markets.

Large producers in the public eye may officially adhere to ceiling prices, or as in the case of automobiles, patriotically announce a roll-back. But especially among smaller firms this semblance of stabilization will be accompanied by covert but perfectly legal readjustments in trade discounts and extras that nullify official orders and guidelines.

The truth is that an enterprise economy can no more function without continuous price and profit adjustments than a gasoline engine can perform without its vital timing and distributor mechanism.

But the difficulties of enforcing controls, and the harm done if they are enforced, is not the crucial point. The crucial point is that the freeze is at best an indirect and one might almost say surreptitious way of dealing with what ails the economy.

What ails the economy is not the free price and profit system as such but the fact that it is afflicted in a single sector by a powerful and pervasive monopoly element. I refer

Reprinted by special permission from the September 11, 1971 issue of HUMAN EVENTS.

of course to the power of labor unions to force up wages and costs year after year without regard to general productivity advance.

For while organized labor constitutes something less than 25 per cent of the U.S. working force, its grip on our basic industries is wholly critical. It is this monopoly power which forces producers to raise prices if they can, and if they can't to cut back production with resulting employment. And it is this monopoly power (aided by unwise minimum wage laws) which has thus far defeated all attempts to achieve stabilization and high employment levels by traditional fiscal and monetary means.

The wage-price freeze in itself does nothing to get at the tap roots of union power and, indeed, controls if perpetuated may in the longer run enhance that power. It should not be forgotten that it was during a regime of controls in World War II and during the Korean War that organized labor gained some of its most costly victories—notably the spread of union shop contracts which force workers to pay union dues as the price of holding their jobs and which automatically swell union treasuries with funds that can then be used for political purposes. The explanation of this is not far to seek.

Faced by a government control board, unions will accompany exhorbitant wage demands with "sweeteners" such as demand for the union shop, or the closed shop, or changes in work rules. In an effort to chip off a few cents from the wage package, the government agency will swiftly capitulate in other matters, the more so because such boards are always politically motivated. Union muscle will thus be increased rather than diminished for the years ahead by throwing wage settlements into the arena of politics.

The effective and courageous way to deal with union monopoly power is large-scale revision of our present permissive labor laws and their administration. This is the missing ingredient from the President's program and had it been undertaken in good time we might never have arrived at the present impasse.

The objective of sound labor reform is not to smash all unions, but to bring them back under the sweep of the law as it applies to other private associations and to individuals. Unions should be what they set out to be; namely purely *voluntary* organizations, purged of their present coercive and often violent practices. The scope of collective bargaining needs sharp limitation to the end of preventing unions from closing down whole industries, not to mention vital state and municipal services.

The legal means for effecting these reforms are various, but in general we need to apply to unions the spirit, if not the letter of our anti-monopoly laws to the end of freeing up the labor market, protecting the rights of working men themselves, and meeting the needs of the long-suffering public which is the chief loser under present arrangements.

Combined with prudent fiscal and credit policies, such legislative reform would give the American people what they want and deserve; namely, price stability and expanding job opportunities for all able and willing to work. Good for the economy at home, such a program would also yield high dividends abroad.

In seeking a realignment of world exchange rates and in temporarily cutting the dollar loose from $35 gold, the President has made a first step in reconstructing a more rational international order. But it is only that., If the effort is to succeed, whether under a "floating" or fixed exchange rate system, it is essential that the U.S. permanently conquer both inflation and unemployment; and on the evidence the wage-price freeze and controls will not turn the trick.

Foreign nations like Canada that have tried controls and so-called "incomes policy" have had to abandon these palliatives as wholly ineffective. Indeed, "incomes policy" is really only another name for evading the tough realities that now confront us.

Beyond all this, controls pose a symbolic issue for the American people. The U.S. has grown great by combining a philosophy of limited government with a free market economy which allocates goods and services through free choice and tends to disperse power and decision. Such a system requires that government lay down the rules of the road and provide among other things an adequate monetary framework. It is directly threatened, however, by bureaucratic controls which in the end must lead to the socialization of the economy and the endangering of our higher liberties. Free men need free markets.

The President instinctively knows this. It is time he translated principles into practice by redeeming his pledge to lift the wage-price freeze promptly at the end of 90 days, by resisting pressure to set up permanent stabilization machinery and by setting in motion now the reform of labor legislation which would make controls wholly superfluous. The result could be the strengthening both of the U.S. economy and the world economy. It could be the beginning of a truly *new* economic policy—a policy worthy of our traditions and legitimate expectations.

ORC CARAVAN SURVEYS INC.

THE U.S. PUBLIC'S

ATTITUDE TOWARD

RIGHT-TO-WORK

Research Findings
Prepared for

NATIONAL RIGHT TO WORK COMMITTEE

RESEARCH PARK, PRINCETON, N.J. 08540

FOREWORD

This report presents the findings of a personal interview research survey conducted among 2,061 men and women 18 years of age or over living in private households in the continental United States.

Interviewing for this Caravan survey was completed during the period January 27 through February 20, 1971, by members of the Opinion Research Corporation national interviewing staff. All interviews were conducted in the homes of respondents.

The most advanced probability sampling techniques were used in the design and execution of the sample plan and the results, therefore, may be projected to the total U. S. population of men and women 18 years of age or over.

Only one interview was taken per household, regardless of the number of people 18 years of age or over in the household. Weights were introduced into the tabulations to ensure proper representation in the sample.

As required by the Code of Ethics of the American Association for Public Opinion Research, we will maintain the anonymity of our respondents. No information can be released that in any way will reveal the identity of a respondent. Also, our authorization is required for any publication of the research findings or their implications.

Caravan Surveys, a division of Opinion Research Corporation, is a syndicated, share cost data collection vehicle. Caravan reports, such as this one, are presented in tabular form. Interpretive analysis is provided by Caravan, only if specifically contracted for by the client.

Which one of these arrangements do you favor for workers in industry?

1. **A man can hold a job whether or not he belongs to a union**
2. **A man can get a job if he doesn't already belong, but has to join after he is hired**
3. **A man can get a job only if he already belongs to a union**
4. **No opinion**

	NUMBER OF INTERVIEWS UNWTD	WTD	1.	2.	3.	4.
TOTAL U.S. PUBLIC	2061	8012	62	27	4	7
MEN	1031	3854	61	31	3	5
WOMEN	1030	4158	64	23	4	9
18 - 29 YEARS OF AGE	528	1971	65	29	1	5
30 - 39	359	1282	65	25	5	5
40 - 49	348	1471	60	30	5	5
50 - 59	323	1313	59	31	3	7
60 YEARS OR OVER	498	1958	62	21	4	13
LESS THAN HIGH SCHOOL COMPLETE	747	3371	58	28	4	10
HIGH SCHOOL COMPLETE	679	2743	61	31	4	4
SOME COLLEGE	623	1848	72	21	2	5
PROFESSIONAL	290	946	76	18	2	4
MANAGERIAL	232	855	72	21	1	6
CLERICAL, SALES	261	1079	64	25	2	9
CRAFTSMAN, FOREMAN	394	1515	59	33	5	3
OTHER MANUAL, SERVICE	421	1798	53	38	4	5
FARMER, FARM LABORER	66	252	82	5	0	13
NON-METRO -- RURAL	263	958	75	15	1	9
URBAN	391	1655	63	25	4	8
METRO - 50,000 - 999,999	583	2223	63	28	3	6
1,000,000 OR OVER	824	3177	57	32	4	7
NORTHEAST	464	2038	59	29	4	8
NORTH CENTRAL	611	2205	59	33	3	5
SOUTH	599	2447	68	20	2	10
WEST	387	1322	62	27	6	5
UNDER $5,000 INCOME	485	2427	64	20	5	11
$5,000 - $6,999	309	991	56	34	4	6
$7,000 - $9,999	421	1510	62	32	2	4
$10,000 - $14,999	492	1760	60	33	3	4
$15,000 OR OVER	311	1158	68	23	3	6
WHITE	1828	6968	63	26	4	7
NONWHITE	198	943	55	36	2	7
NO CHILDREN IN HOUSEHOLD	1032	4213	62	25	3	10
WITH CHILDREN UNDER 18	1026	3794	63	29	4	4
WITH TEENAGERS 12 - 17	463	1895	60	30	6	4
OWN HOME	1383	5185	63	27	4	6
RENT HOME	667	2790	61	27	3	9
UNION MEMBERS	319	1200	40	50	6	4
UNION FAMILIES	297	1170	53	39	4	4
NON-UNION FAMILIES	1423	5534	69	20	3	8
POLITICAL AFFILIATION						
DEMOCRAT	910	3654	56	32	4	8
REPUBLICAN	467	1632	75	17	3	5
INDEPENDENT	515	1960	62	29	4	5

EDITORIAL PAGE

The Richmond News Leader
Friday, September 17, 1971

National Right to Work?

The National Right to Work Committee, recognizing that union bosses may demand many concessions in exchange for their co-operation with the current wage-price freeze, has organized a drive for a national right-to-work law.

If such a law had existed in the past, the state of the economy might not have demanded emergency action in the nature of a wage-price freeze. For years, especially in the States without right-to-work laws, organized labor has grown powerful through compulsory unionism. Today a handful of labor leaders can shut down entire industries, at great inconvenience to the public, to gain exorbitant wage increases. And that same handful of labor leaders can declare war on the United States government and defy presidential action aimed at rectifying economic situations largely caused by the unions themselves.

Public opinion finally may be rallying against the unions. Even while union leaders were denouncing the freeze, public opinion polls were showing that 71 per cent of union members support the freeze. A similar public opinion poll also shows that 62 per cent of the public and 53 per cent of families with union members favor a national right-to-work law.

No doubt the Right-to-Work Committee is right in expecting union bosses to demand trade-offs in return for their co-operation, even though a vast majority of union members favors the freeze. Joseph Bierne, head of the Communication Workers of America, already has called for repeal of Section 14 (b) of the Taft-Hartley Act that permits States to enact State right-to-work laws. George Meany may be bargaining for the compulsory unionism of all farm workers.

Such trade-offs have occurred before. At the beginning of World War II, only 20 per cent of union members were covered by compulsory membership provisions. During the war, when wage-price freezes were in effect, union leaders won a number of compulsory unionism concessions from the Roosevelt-Truman Administrations in return for their agreement not to strike. At the end of the war, 77 per cent of union members were covered by compulsory membership provisions. And during the Korean War wage-price freeze, railroad workers learned to their dismay that they had lost their right to work through congressional repeal of a clause in the Railway Labor Act.

No doubt union leaders hope that the current freeze will give them fresh opportunities to demand more compulsory unionism as the price for their co-operation. But the Nixon Administration, however much it may be tempted to smooth over its differences with recalcitrant union leaders, should resist strongly any such compromise. Far better, now that union leaders have defied the national interest with unparalleled arrogance, that President Nixon should announce instead that he intends to support a national right-to-work law. Judging by the polls, he would have the public behind him all the way.

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The CHAIRMAN. That concludes the hearing until tomorrow morning at 10 a.m.

(Whereupon, at 3 p.m., the committee adjourned, to reconvene at 10 a.m., on Friday, October 15, 1971.)

THE REVENUE ACT OF 1971

FRIDAY, OCTOBER 15, 1971

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to recess, at 10:05 o'clock a.m., in room 2221, New Senate Office Building, Senator Clinton P. Anderson, presiding.

Present: Senators Long, Anderson (presiding), Talmadge, Bennett, Curtis, Jordan of Idaho, and Fannin.

Senator ANDERSON. The committee will come to order.

Congressman Link, we will start now.

STATEMENT OF HON. ARTHUR A. LINK, A REPRESENTATIVE IN CONGRESS FROM THE SECOND CONGRESSIONAL DISTRICT OF THE STATE OF NORTH DAKOTA

Mr. LINK. Thank you, Mr. Chairman, and members of the Senate Finance Committee. I want to thank you for the opportunity to appear here today.

I wish to discuss the investment tax credit provisions of H.R. 10947, the Revenue Act of 1971, and to suggest two changes that are needed to provide greater equity for farm operators and small businessmen.

As a Representative of North Dakota, the most agricultural State in the Union, I am keenly aware of the need for legislation beneficial to farm operators and small business enterprises that serve agriculture. I can also justify this position as a U.S. Congressman on the ground that tax relief should be given where it is most needed and that it would help solve the interconnected problems of rural renewal and urban renewal, so vital to achieving a more rational population balance in the Nation. The weak agricultural economy continues to cause an exodus of people from rural America to our already congested cities. This rural economic weakness infects the entire national economy.

The vast majority of farm operators and small businessmen in my State of North Dakota pay their taxes on a calendar year basis. It is unjust to change the tax rules for those people in the middle of the tax year. Therefore, I recommend that your committee make the investment tax credit retroactive to January 1, rather than April 1, as is provided by the House bill.

If your committee should decide the revenue loss would be too great by lengthening the retroactive period, I would suggest that it be applied on a limited basis only for the January to April period. This could be accomplished by providing the full credit on just the first $15,000 of capital investment. Such a provision would hold the revenue loss down to approximately $175 million while giving meaningful relief to those who most need it, such as the farm operators and small businessmen I represent.

I wish to point out still another problem of considerable consequence to farm operators and farm equipment dealers: The provision in the House bill excluding all imported capital goods from the investment tax credit.

As a general proposition, I believe this provision, together with the 10 percent surcharge or imports imposed by the President under existing authority, invites retaliation from other countries, thus encouraging an international trade war.

In particular, I wish to explain how the provision affects farm operators and farm equipment dealers in my constituency.

Several leading farm equipment manufacturers now have factories in Canada. In many cases a large proportion of the parts are made in the United States. Many farm equipment dealers have continued their long association with their companies despite the fact that they have plants across the border. Under the House bill these dealers would be placed at a serious competitive disadvantage through no fault of their own, because farmers who wish to continue buying a certain brand of equipment that may be manufactured in Canada will not be able to take advantage of the investment tax credit.

I speak with full knowledge of the effects in rural America. Similar inequities in other segments of the economy can also be cited.

I urge your committee to write a provision into the Revenue Act that would remedy this problem, as well as to extend the retroactive feature of the investment tax credit to January 1, 1971.

I want to thank you for this opportunity to present this formal statement and, Mr. Chairman, with the permission of you and the other members of the committee, I would like to indicate the results of a poll that we took just this last week, a representative poll of a substantial number of farm equipment dealers in the State. They indicated to us that on a statewide average about 15 to 20 percent of their sales are made in the first quarter of the year.

Under the provisions of the present bill, these purchasers, these farmers who bought in the first quarter of the present tax year would be denied the investment tax credit that will be forthcoming to those who purchase after April 1.

All of these dealers expressed support of my suggestion that the bill be amended to provide for the retroactive feature to January 1.

I would like to share just short excerpts from letters received. They came yesterday. From S & S Motors at Watford City, N. Dak.: "We and our customers are waiting for passage of an investment credit bill which we feel would be beneficial to the economics of our region and of the country. In anticipation of such a bill, we have put two unemployed men to work.

"Approximately 15 percent of our machine business is done during the January 1–March 31 period. We would like to see an investment credit bill passed that would be retroactive to January 1, 1971."

From another dealer: He indicates that their average sales for the first quarter of the year are 14 percent and he concludes his letter with this statement:

"I hope these figures will help you convince the Senate Finance Committee that investment credit should be backed up to the farmers' fiscal year of 1 January 1971."

Mr. Chairman, I again thank you and the members of your committee for giving me this opportunity to present my requests and solicit your favorable consideration.

Senator ANDERSON. Thank you very much.

Senator Long, the Chairman, is now presiding.

The CHAIRMAN (now presiding). Is Mr. Mark Freeman here, and Mr. Frank Costello? We will call them later.

Is Mr. John C. Williamson here?

Mr. WILLIAMSON. Yes, sir.

The CHAIRMAN. It is nice to have you, Mr. Williamson.

STATEMENT OF JOHN C. WILLIAMSON, DIRECTOR, GOVERNMENTAL RELATIONS, NATIONAL ASSOCIATION OF REAL ESTATE BOARDS, ACCOMPANIED BY EDWIN KAHN, SPECIAL TAX COUNSEL, NAREB

Mr. WILLIAMSON. Mr. Chairman and members of the committee, my name is John C. Williamson and I am speaking here on behalf of the National Association of Real Estate Boards. With me is our Special Tax Counsel, Edwin Kahn.

I am going to ask permission to file our full statement in the record and I will take a few minutes to discuss one section of the House-passed bill and upon the conclusion of my remarks I would like to have Mr. Kahn supplement my remarks and fill in some of the blanks which I am sure I will leave.

I would like to address my oral statement to Section 304 (a) of the bill which appears on page 48 and 49.

By way of background, the Tax Reform Act of 1969 provided for the disallowance of the deductibility of the excess of investment interest over investment income, that is, a substantial portion of this excess would not be deductible under certain circumstances, and as I understand it the rationale for this is that in many instances investment interest is a charge for income which reflects a lack of business activity on the part of the taxpayer, that it is passive income.

The 1969 act provided that net leases would invoke this disallowance under the theory that net leases would reflect a lack of business activity on the part of the lessor.

Then the act provides that a net lease would be considered to exist if the section 162 expenses, that is ordinary business expenses are less than 15 percent of the rental income.

Now, in the regulations which the IRS proposed they went further and said that reimbursable expenses, that is expenses which are paid by the lessor and reimbursed by the lessee, would not be considered as expenses in determining the 15 percent.

Now, we protested this regulation as going beyond the stature and apparently the theory behind the regulation is that if expenses are reimbursed that reflects a lack of business activity on the part of the lessor; and we challenge that because the expenses that are paid by the lessor, many of them do, in fact, reflect a business activity. For example, a lessor could be supervising a security service for which and the expenses would be reimbursed. Just because the expenses are reimbursed does not mean that there was no business activity with respect to that expenditure.

So we think that the Internal Revenue Service was wrong and we protested it and said that it went beyond the statute. But now section 304(a), in the House bill, would provide for that—what the IRS wants in the regulation would be provided in the law, that reimbursed expenses would not be considered in determining the 15-percent test. We strongly urge the committee to delete this provision from the bill.

Mr. Kahn may have some remarks.

Senator CURTIS. May I ask a question right there?

What do you mean by net lease? Is that where a business place is rented on the basis of the percentage of the profits?

Mr. WILLIAMSON. That could be. A basic rent and a percentage——

Senator CURTIS. To what do you refer when you talk about the net leases?

Mr. WILLIAMSON. Just a total, a net return to the lessor.

Mr. KAHN. May I add to that, Senator Curtis? A net lease is usually a lease in which some of the expenses of the lessor, but perhaps not all, are to be charged back to the tenant.

A very good example would be real estate taxes which change from year to year. The ordinary commercial lease extends beyond 1 year and, therefore, when a commercial lease of several years is written it is customary to provide that if the taxes in effect at the time the lease goes into effect are increased, the rent will be increased by a similar amount.

That does not indicate that there is a lack of activity on the part of the landlord in maintaining the property, particularly where you have multitenant properties such as an office building or shopping center.

May I add to Mr. Williamson's statement, Mr. Chairman.

The CHAIRMAN. Yes, sir.

Mr. KAHN. If I could just add briefly, we have several problems with this provision: (1) As pointed out in Mr. Williamson's filed statement, it is not germane to the emergency situation to which the rest of the bill is directed; and in this area there are a large number of technical problems of which this is only one.

This association as well as others joined in a joint technical brief to the Internal Revenue Service on the regulations in which around 18 different aspects of the regulations were protested as either without statutory authority or producing very peculiar and discriminatory results. This particular provision is one of the worst in the sense that by statute there is a definition of net lease that is arbitrary and does not conform to whether there is business activity or not and, therefore, under the statute and the proposed regulation two businessmen running a shopping center or office building may find themselves in two entirely different situations because of what is an arbitrary rule not directed to the amount of business activity.

The service and taxpayers have experienced in four other tax areas as to when a landlord is deemed to be in a business and when he is not, and we are suggesting in the filed statement that that experience is sufficient and this arbitrary rule of the statute is not desirable.

If the committee has time to get into the problems to which section 304 is directed, we suggest the committee should consider the entire problem and not this little aspect. If it does not have time, we suggest that the best approach is merely to delete this provision that is unrelated to the much more important aspects of the bill.

The CHAIRMAN. I might say, Mr. Williamson, this is very seldom I make this statement, but I think I have one bone to pick with you that might come as a surprise. You are not asking for enough and you are one of the very few witnesses to whom I would say that. It seems to me that if we are going to have a program to stimulate the economy, we ought to be doing more to help people to own their own homes and we ought to be taking another look at some of those things that we did with that so-called tax reform act 2 years ago when we removed a great deal of the incentive for people to build homes and people to own them.

If I can, I am going to try to do something about those interest rates. Aren't you concerned about that?

Mr. WILLIAMSON. Oh, yes, but not—we didn't think this was the forum to discuss the availability of mortgage money.

With respect to other provisions and the results of the Tax Reform Act of 1969, the industry is still reeling under the Tax Reform Act; and in our statement we do address ourselves to some of the language in the House report which would—could result in very serious consequences. We do have—we know we were going to be limited in our time—and we do have some other witnesses who will follow in the real estate field who will probably discuss some aspects which we would have discussed had time permitted.

The CHAIRMAN. I know we don't have—ordinarily it would be the Banking and Currency Committee rather than this one that would have some jurisdiction with regard to the Federal Reserve Board and that is one area where you expect to have some help. But it has been my experience if you want the administration to help you get something done that you think is necessary that the time to talk to them about it is when they are asking you to do something. And this bill right here is the one they want to move the economy and I want to help them. But in connection with this bill we ought to talk to them about these interest rates because, frankly, would you not agree with me that a lower level of interest rates would do a great deal more than some of the other things in this bill to help move the economy ahead?

Mr. WILLIAMSON. Well, Senator, we are encouraged by reports we are receiving from all over the country that interest rates are easing; and we think that they will continue to ease, and that is the position of our Association at this time, which is that if you try to impose any rigid interest rate ceiling that you might cut off sources of money for real estate. We think——

The CHAIRMAN. The Federal Reserve Board has the power to create as much money as it wants to create. We gave them that power. Now, it seems to me that one way to make the economy move, and I mean really move ahead to whatever degree you want it to move ahead, is to first put controls on so that by widening the money supply, broadening it and increasing it, that you are not going to have run-way inflation or inflation to any degree that would be the cause of concern.

And then having gotten your controls on to where you can hold a lid on those areas of the economy—I mean both business and labor—where certain people are in a position to write their own ticket and get it, then proceed to ease up on the money supply, make a lot more money available and at lower interest rates so it would be attractive for people to build homes as well as build plants and machinery.

Why shouldn't we at least try to bring about the same kind of incentive to build a home that this bill provides to build a new plant or machine?

Mr. WILLIAMSON. Senator, that has not been the experience of controls. When we have had rent controls to try to keep rents down, you discourage investment and you have less housing. And we have had experience with rigid interest rate ceilings even in the FHA and VA programs. We would much rather take our chances on what will happen to the economy if the rest of the President's program is approved.

There are signs that the interest rates are easing and we are hopeful that they will continue to ease.

The CHAIRMAN. I will just refer you to some of the speeches I made back at a time when I was advocating that we repeal or suspend the investment tax credit. I put charts in the record at that point to illustrate that what was being done here was the use of tight money and high interest rates to try to control inflation on the one hand, and a tax incentive to build new plants on the other, with the result that the major corporations of the country were just muscling the potential homeowners away from the market by hogging up all the available capital. That led to high interest rates.

There was no parallel tax advantage for a homeowner; and the high interest rates squeezed him out of the home market so that those who wanted to build homes found it almost impossible to obtain credit on reasonable terms while those who had the tax advantage to build new plants, had the economic muscle with their own people sitting right there on those bank boards to guarantee them they could get the credit to build these new plants.

Now, I want to see a balanced, forward movement of this economy. I don't want to see the homeowner left out of it and as it stands right now he is going to be left out of it.

I am surprised you are not in here advocating that we do more than what you are asking here. I thought, speaking for the real estate board that you would be in here saying by all means let's put the little prospective homeowner in on the act, let him have a piece of the action.

Mr. WILLIAMSON. Senator, we are building 2.2 million housing units this year. I don't think that we have reached that level in the post-World War II period. Rather than approach it from that angle, I think it might be better to encourage more investment in real estate which, in turn, would create jobs if we could back up a little on some of the provisions in the Tax Reform Act of 1969, because it is the construction of real estate that produces jobs. If the Treasury would take a more realistic view toward the useful lives on real estate you could neutralize some of the adverse aspects of the 1969 act.

Mr. Kahn and I could talk for a long time about some of the provisions of the Tax Reform Act of 1969 which do inhibit investment in real estate.

The CHAIRMAN. Let me ask you this: Do you think that a representative for the Association of Home Builders will testify the same as you are testifying, that they are not concerned about the level of interest rates and not asking us to do anything about it?

Mr. WILLIAMSON. Well, Senator, we are concerned about the level of interest rates. We want the interest rates to go down because every time the interest rates go down it broadens the market for homeownership. We contend that there are signs that the interest rates are going down. We are afraid at this time that the imposition of some interest rate control would divert money away from home ownership and to other sources of investment. This has been the history. And at this point now—our convention is meeting in November—we are having people from all over the country and we are going to review the subjects of interest rate controls because it will be a matter of hearings before the House Banking and Currency Committee next week; but at this point the information that we have received from brokers all over is that the interest rate, the structure situation is easing sufficiently to avoid at this time any type of control.

The CHAIRMAN. Well, now, tight money brings high interest rates in a free economy. We agree on that, don't we?

Mr. WIILIAMSON. That's right.

The CHAIRMAN. In other words, in a free economy if you tighten up on the money supply you raise the interest rates; isn't that right?

Mr. WILLIAMSON. That's right.

The CHAIRMAN. If the law of supply and demand operates anywhere that is how it has to work. You tighten up on the supply, that raises the price of the product.

All right, now, that can be defended as an anti-inflationary device—it tends to slow the economy down; isn't that correct?

Mr. WILLIAMSON. That is correct.

The CHAIRMAN. All right. Now, you don't need that device of tight money and high interest rates if you are going to put controls on prices. At that point you can afford to keep your prices where you want them with your controls and you can afford to ease up on the money supply, and the Federal Reserve Board without even imposing any controls on interest rates can push them down by just making money much more freely available; is that correct or not?

Mr. WILLIAMSON. Well, they could, yes; whether this would defeat our antiinflationary objectives I don't know.

The CHAIRMAN. But the point Mr. Williamson, is that you can have low interest rates when you have controls on prices, and there are only a few segments of the economy that are in position to write their own ticket and get it.

Some of our friends in organized labor can do that. They can go out on strike and just deny you the product unless you pay them what they demand. A fellow who has a patent on a commodity can just refuse to sell it unless you pay him the price he wants under his Government protected patent. But most segments of the economy have to sell for a competitive price.

Now, when you put price controls on what people can sell for, why can't you also expand the money supply enough to bring interest rates down to whatever point you want it to be?

I mean, some reasonable point. I am not talking about making them loan the money out for nothing or 1 percent; but suppose you are talking about a reasonable level of interest rates. Why can't you push them back down?

Mr. WILLIAMSON. Well, if it could be done without aggravating inflation, fine. But what we have discovered—we have discovered that lenders are putting an inflationary premium on their rates because of the anticipation of inflation.

Now we think that this is going to stop. We have hopes of it.

I went to a Minnesota convention recently and talked to a realtor from Red Falls, Minn., and I asked him what the rates were for FHA and he said banks were beginning to make 7 percent loans without discounts. This is probably the most heartening thing I have heard, because the lenders are starting to refrain from exacting this inflationary premium and I think that is going to bring the interest rates down; we hope it will.

The CHAIRMAN. Well, thank you. I think I have your view.

Any further questions?

Thank you very much, Mr. Williamson

(Mr. Williamson's prepared statement follows:)

STATEMENT OF JOHN C. WILLIAMSON, DIRECTOR, DEPARTMENT OF GOVERNMENTAL RELATIONS, NATIONAL ASSOCIATION OF REAL ESTATE BOARDS

Mr. Chairman and members of he Committee:

I welcome this opportunity to testify on behalf of the National Association of Real Estate Boards at this hearing on H.R. 10947, the Revenue Act of 1971.

BACKGROUND

The National Association of Real Estate Boards consists of approximately 1,600 local Boards of Realtors located in every state of the Union, the District of Columbia and Puerto Rico. The combined membership of these 1,600 boards is approximately 500,000 persons actively engaged in the business of brokering, managing, and appraising residential, commercial, industrial and farm real estate.

COMMENTS ON H.R. 10947

Our remarks here today are limited to two aspects of H.R. 10947:

1. The alteration of the statutory definition of "property subject to a net lease"—Section 304(a) of the bill; and

2. The House Ways and Means Committee Report reference to useful lives of real property—House Report 92-533, p. 35.

(1) "Property subject to a net lease"

Section 57(c)(1) (relating to items of tax preference subject to the minimum tax) and Section 163(d)(4)(A)(i) (relating to the limitation on the deduction of interest on investment indebtedness) are similar provisions. One imposes a minimum tax on excess investment interest for the years 1970 and 1971, and the other provides for a disallowance of a portion of such interest for years after 1971.

The problem at which these provisions is directed is not germane to the President's Emergency Program, which is the subject of this bill. It appears to us to be inappropriate to include this type of technical legislation in a bill directed at an emergency situation. Careful study is necessary for technical provisions of this nature, and there may not be time for such study in connection with this bill.

The problem at which both of these provisions are directed is the problem of the current deduction of interest on indebtedness used to carry investments. These provisions are not supposed to be directed against business indebtedness.

Unfortunately, both statutory provisions contain an arbitrary rule that if real property is subject to a net lease, and if under the net lease certain deductions are less than 15 percent of the rental income, the property will thereby be deemed to be investment property whether or not the operation of he property is in fact a business. This statutory rule is particularly burdensome on owners of large real property projects, such as shopping centers and office buildings, where most of the property is subject to leases to tenants, and where the owner of the property must perform substantial services in the operation of the property.

There are at least four regulations which have directed themselves to the question of when income from real property operations is rental income, that is, passive or investment income, and when such income is in fact business income. These regulations have been issued with respect to the imposition of the self-employment tax, which is imposed only on business income and not on rental income (Regs. § 1.1402(a)-(4)(c)(2)), the impostion of the tax on unrelated business income of exempt organizations, which is imposed on business income but not on rental income (Regs. § 1.512(b)-1(c)(2)), the determination of personal holding company income, which will subject the corporation to a personal holding company tax on its rental income (proposed Regs. § 1.543-12(d)(2)(ii)), and the regulations with respect to Subchaper S corporations, which cannot qualify as such if pasive income such as rental income amounts to more than 20 percent of gross recepits (Regs. § 1.1372-4(b)(5)(vi)). In each one of these regulations no specific statutory test is provided. Instead, a factual determination is made as to the amount of service activity required of the landlord. Taxpayers and the Internal Revenue Service have developed considerable experience under these regulations, and many rulings have been issued by the Internal Revenue Service on this question.

On the other hand, neither taxpayers nor the IRS has any experience with the specific rules relating to the 15 percent test imposed in the determination of excess investment interest under the 1969 Revenue Act provisions. In issuing the regulations under Section 57, the Treasury obviously had severe problems. Proposed regulations were issued, and these were the subject of vigorous protests by this Association as well as others on the ground that many of the rules in these regulations did not have a statutory authority, as well as on the grounds that many of these rules would produce distorted results and present very burdensome problems in record keeping and other compliance aspects.

Apparently, the point that some of the provisions in the regulations were without statutory authority was well taken, since we find in H.R. 10947 retroactive provisions designed to support the provisions of the regulations. Specifically, these provisions would treat rent paid by the operator of a shopping center or an office building (that is, ground rent) as not includable for purposes of the 15 percent test. In addition, the proposed legislation would adopt the provision of the regulations that expenses of the landlord which are reimbursed by the tenant also may not be counted in determining whether the 15 percent test is met. This last provision is particularly inappropriate since it has no connection with the amount of activity required of the landlord. Obviously, any businessman is going to be reimbursed and, hopefully, make some profit on his activities. The fact that he covers his costs by his income does not go to the question of the extent of his activity, and it is the extent of his activities which is crucial in determining whether the operation is a mere passive investment or is an active business.

It is our position that the net lease provisions of the 1969 Act with respect to excess investment interest are so poorly adapted to the problem involved that these provisions should be stricken from the law if any legislative action is to be taken at this time. Removing these provisions from existing law will leave the matter as a factual question, so that the experience developed in the four other areas of the tax law described above can be applied in this situation, and sensible and appropriate results can be achieved.

On the other hand, if the Committee feels that the emergency nature of the legislation included in H.R. 10947 will not permit a non-germane technical amendment of this type, then we further submit that section 304(a) is also non-germane and should be stricken from the bill; in addition, it reaches improper results and requires more study and analysis than is possible in a bill of this importance directed at other urgent matters.

(2) *Reference to useful lives of depreciable property in the House Ways and Means Committee report*

To the best of our knowledge, the Treasury Department has not made a thorough study of what would constitute the proper guidelines for depreciable real property since the 1942 edition of Bulletin F. The Treasury has an abundance of experience with this subject, and this Association endorses the views of the Ways and Means Committee that the Treasury Department should undertake a review of guidelines for the useful life of depreciable real property. These guidelines should provide lives which are much shorter than those which were originally placed in effect in 1942 and in substance continued in the 1962 guidelines. The considerable technological changes in the construction and use of real property since 1942, as well as the economic changes that have occurred in the interim, make the longer guidelines of 1942 unrealistic today.

On the other hand, we strongly oppose the suggestion in the Ways and Means Committee Report that further consideration be given to the question of whether the depreciation recapture rules presently applicable in the case of real property should be made more like those applicable to personal property. These recapture rules as to real property have been the subject of intensive study by both the Treasury and Congress in connection with the Revenue Acts of 1962, 1964, and 1969. As the result of these studies, not only have recapture rules for real property been adopted, but real property has been subjected to a much narrower allowance for accelerated depreciation than that allowable for personal property.

To a large extent, the recapture rules are a function of accelerated depreciation rather than of the actual useful life of the property. As noted above, the Congress has already deprived real property of much of its right to accelerated depreciation.

Furthermore, the re-enactment of the investment credit, which will be applicable primarily to personal property and not to real property, will place real property at a further disadvantage as a capital investment when compared with personal property. In view of this, we strongly oppose reopening consideration of the recapture rules for depreciation on real property.

Mr. Chairman, on behalf of the National Association of Real Estate Boards, I appreciate this oportunity to present our views on these aspects of H.R. 10947 and respectfully hope that our comments will be of help to the Committee in your deliberations.

The CHAIRMAN. Next we will call Mr. Fred Peel, American Mining Congress.

STATEMENT OF FRED W. PEEL, CHAIRMAN, TAX COMMITTEE, AMERICAN MINING CONGRESS

Mr. PEEL. Mr. Chairman and members of the committee, I am Fred W. Peel, chairman of the Tax Committee of the American Mining Congress, and I am appearing today to present the tax committee's views on the House-passed bill.

We urge the enactment of the job development credit. We think it will be most effective if the credit is established at the 7-percent rate on a permanent basis.

We were opposed to the temporary suspension of the credit several years ago we were opposed to its elimination in 1969, and we feel that to be most effective it should be on a permanent basis at a fixed rate rather than on a temporary basis.

When we appeared before the Committee on Ways and Means we pointed out that the 5 percent-10 percent proposal of the administration would not accomplish much during the initial 10-percent rate period, as far as the mining inudstry is concerned, because of the very long leadtime that is involved in making plans for new capital investment and getting that new capital investment either acquired or constructed and in place. We suggested that, unless the period for the 10-

percent rate was enlarged, a flat 7-percent rate would be preferable.

We suggest that the incentive effect not be diluted by any offsetting adjustments in the tax system. In particular, we point out that if the credit should be applied against the basis of assets, then the credit's effectiveness would be cut unless there is a compensating increase in the 7-percent rate.

We suggest that regular income tax should be subtracted from tax preference items to arrive at the base to which the 10-percent minimum tax is applied, before the regular tax is reduced by the investment credit. Otherwise a taxpayer who has tax preference items in substantial amount—and the mining industry generally does have tax preference items—will, in essence, have its investment credit discounted by 10 percent.

If we take the example of a taxpayer who has $2,030,000 of tax preference items, and an income tax liability for regular income tax of $1 million, and suppose that taxpayer earns a $100,000 investment credit under the 7-percent investment credit as passed by the House, the effect of that $100,000 investment credit is to reduce his regular income tax from $1 million to $900,000. So then when he computes his minimum tax he subtracts the $30,000 exemption, and instead of $1 million he subtracts $900,000 of regular income tax from the $2,030,000 of tax preference items, and as a result he has an additional $100,000 subject to the 10-percent minimum tax. So, in effect, he has had his investment credit discounted by 10 percent; so that he gets a 6.3-percent investment credit instead of a 7-percent investment credit. And aside from any question of fairness on that, it just simply means that so far the mining industry and some other industries are concerned, the investment credit won't be doing the job that Congress anticipated that it would do.

So we suggest that in computing minimum tax liability the credit not be taken off until after that computation has been made.

We also suggest the credit will be more effective if it is available, to be applied against any minimum liability the taxpayer may have as well as being applicable against his regular income tax liability.

We suggest the credit not be denied on pollution abatement facilities because the taxpayer elects to deduct the cost of these facilities over a 60-month amortization period. The House-passed bill requires the taxpayer to make a choice. He can either have the tax credit or the 60-month amortization, but he is not permitted to have both and the effect of the investment credit is such that, as a practical matter it is just about a standoff, and the taxpayer will get no greater benefit from the 60-month amortization.

We recommend that the asset depreciation range system be retained. The statutory authorization for the ADR system as contained in the House bill is desirable. We suggest that the study of the useful lives of industrial buildings, which was requested by the Committee on Ways and Means in its report, should be broadened to include consideration of making industrial buildings eligible for the accelerated depreciation methods such as the double declining balance and the sum-of-the-years digits depreciation.

Finally, we recommend that the Domestic International Sales Corporation provision be adopted. This will stimulate exports of a number of minerals produced in this country.

We suggest that the deferral be permitted on all of a DISC corporation's income rather than being limited to the excess of the income generated by exports over 75 percent of a base period.

If the deferral is limited, however, to the excess over 75 percent of base period exports, we suggest that this 75-percent limitation be applied separately with respect to each mineral exported, because the theory of having any sort of a base period is to allow the deferral where the taxpayer has increased his export of that particular item.

There is no logical reason to believe that a taxpayer will deliberately cut down exports of one product in order to increase exports of another. He would want to increase them all as much as possible.

But if circumstances are such that for some other reason exports of one product decline, there is no reason why that should interfere with the taxpayer's eligibility to defer through a DISC the income generated by exports of another product. In the case of minerals it would be relatively simple to distinguish the minerals, one from another.

That completes the summary of our position.

The CHAIRMAN. Thank you very much, sir.

I have no doubt that under the pressure that this committee was subjected to rush that 1969 act through, that we undoubtedly did a lot of things in the bill—I don't want to take all the credit for it in this committee; the House was even worse in that respect than we were—but there were undoubtedly a lot of things in that so-called tax reform bill which have served to stagnate this economy. And we ought to be taking another look at some of those things.

The investment tax credit repeal undoubtedly played its part, but the sort of thing that you make reference to here should also be considered in connection with that.

If you want to put people back to work and provide somebody with a profit incentive to employ people and engage in new enterprises, we ought to be taking a second look at some of those things we did with that bill; and that is part of what you are suggesting here.

Mr. PEEL. We would hope the committee will do that particularly with reference to the minimum tax. I was describing its effect in relation to this investment credit but it is really a built-in drag on any attempt to stimulate the economy.

The CHAIRMAN. I hate to say it, and I am afraid nobody in that conference when we put this minimum tax together could have told you just exactly how it would have applied to your industry; and unless somebody has analyzed it with regard to each individual industry and each segment of the taxpayers, it is not fair to say that it has been thoroughly considered.

Thank you very much.

Mr. PEEL. Thank you.

The CHAIRMAN. Now, the next statement will be from Mr. Clifford Brown, executive vice president of the Federated Investors, Inc. He will be accompanied by Mr. Edward L. Merrigan and Mr. Charles H. Morin.

STATEMENT OF CLIFFORD BROWN, EXECUTIVE VICE PRESIDENT, FEDERATED INVESTORS, INC., ACCOMPANIED BY EDWARD L. MERRIGAN AND CHARLES H. MORIN

Mr. Brown. Mr. Chairman and gentlemen, I appreciate the opportunity to appear before you this morning. I have already submitted a written statement and in the interest of saving your time——

The Chairman. We will print the statement.

Mr. Brown. I would ask it be incorporated in the record.*

The Chairman. May I say for the benefit of all witnesses we do print your full statements and we expect you to summarize it.

Mr. Brown. I would like to introduce Mr. Charles Morin.

Mr. Morin. Mr. Chairman, in an effort to again conserve the time of the committee, I should like to offer into the record a letter from counsel to the Joint Committee on Internal Revenue Taxation which goes into a great deal of detail on the matters that Mr. Brown will now summarize, and I think it would be a great saving of time for us to introduce this letter and also a fact sheet entitled "Federal Tax Generation by Tax-Free Exchange Investment Companies." if I may offer those for the record.

The Chairman. Fine.*

Mr. Brown. Mr. Chairman, our firm is an investment adviser to 15 investment companies registered with the Securities and Exchange Commission with assets of approximately $300 million, which are invested mostly in the securities of American corporations, and we represent 40,000 shareholders almost all of whom are individual taxpayers. Our interest, of course, is in the security market, but more importantly in the health of the economy and for that reason we support the provisions of the Revenue Act of 1971 because we believe it will strengthen the economy. And we are especially interested in the investment tax credit provision because it will provide, in our opinion, additional revenues for business, additional jobs, additional confidence in the economy.

However, these provisions are expected to reduce Federal revenues. We address ourselves today to a proposed amendment to title II to H.R. 10947 which if enacted would permit individuals in certain extraordinary circumstances to diversify their security holdings without incurring a premature capital gains tax and, at the same time, such an amendment to section 351 would, in our opinion, produce additional Federal tax revenues of approximately $25 million in fiscal 1972, and $100 million in fiscal 1973.

The amendment is a simple one since it would restore section 1 of the Internal Revenue Code to its status in 1966 and really to what it was through the 40 years prior to that time.

Prior to the 1966 amendment to section 351, individuals in this country, individual taxpayers, were permitted to band together and exchange securities with an investment company, form a new investment company of which they would be the sole owners and in that way to diversify their securities, their investment position without an immediate realization of capital gain and capital gain taxes.

This was done in the period 1960–67 by 18,000 individuals in the United States, in some 36 investment vehicles. However, in 1966 the

*See pp. 538 ff.

Treasury department took the position that they no longer felt that individuals should be entitled to do that. So an amendment was proposed in this committee in 1966 to make the point very specific in section 351 that it would apply to the formation of investment companies. That amendment was passed on the floor of the Senate, but in joint conference committee, at the insistence of the Treasury, a compromise was adopted so that this type of diversification for individuals was permitted only for a limited time, namely, through June 30 of 1967; and the objection was based on the contention that the Joint Committee for Internal Revenue Taxation had not had sufficient time to examine the entire problem.

Since that time we have submitted voluminous statistics on this matter and met with members of the staff of the Joint Committee on Internal Revenue Taxation.

We would like you to consider restoring Section 351 to its 1966 status for two important reasons: First of all, it will increase tax revenues. One of the theories for excluding individuals from forming investment companies under this section was that the individuals will sell their securities and pay their taxes right now and, therefore, there will be more revenue generated by the individuals selling those securities; but the experience of the entire investment community is that individuals with a low tax cost basis in fact will not sell.

There are 32 million individuals in this country who own securities, equities that the market value is some $700 billion. In our opinion, over half these securities are in safe deposit vaults and they will never be sold because the individuals have too high a tax liability.

The studies by the New York Stock Exchange have indicated that the average tax cost basis of securities held by all individuals in the United States is only 40 percent, 40 percent of market. Our own experience with the formation of some 36 investment companies was that the individuals, 18,000 individuals who participated in these formations had an average cost, tax cost basis in their hands of only 10 percent.

Now, these 18,000 people, and the 32 million people, do not represent the wealthy people of the country; they represent the general cross section, the general middle class of the country. There are not only presidents of corporations who wish to exchange their securities for shares in investment companies but also we had in our own funds rather modestly employed employees of Sears Roebuck who had accumulated shares over a period of years in an employees' trust. We have had steelworkers; we had all types of individuals.

But the pressure on the individual not to sell is just too great. With Federal taxes and State taxes, the individual with a nondiversified investment, with a low tax cost basis, stands to lose some 35 percent of his capital when he sells.

I don't think many advisers in this country, investment advisers, would ask a client to incur an immediate 35-percent capital loss for the idea of protecting himself against some possible future loss in the individual stock.

Our experience is that the individuals who come into these investment companies have held their stocks for quite a long time; 63 percent of them had held their securities over 5 years.

The increased capital gains tax rates for 1972 will inhibit further the securities sales. We believe that by amending section 351 many individuals would band together to form investment companies; the investment companies would then manage the portfolios and sell the securities and create capital gains taxes; we would create substantial additional revenues in the first 18 months.

The other point is the point of public policy. The U.S. securities market is the envy of the rest of the world and it is the envy because it is a very liquid market; and that is so because we have great quantities of stock; it is widely held and shareholders are willing to sell.

However, while 85 percent of the securities in the United States are owned by individuals and institutions only own 15 percent; almost 40 to 50 percent of the trading is now done by institutions. Institutions are becoming more dominant in the securities market and the individual is becoming less of a factor because they will not sell their securities and reduce their capital through the tax.

So the lessening participation by individuals is not good for liquidity; it is not good for a sound market mechanism and it is not good for the brokers, the individual people who constitute the investment institution in this country, and make it possible to have a liquid securities market.

Allowing individuals again to participate in exchanges would free up rather enormous quantities of securities. The potential tax liability in the securities held by individuals, the half that we believe they would refuse to sell, the potential tax liability is $45 billion, an enormous possibility.

One last point; in the formation of these new funds it would be a help to the brokerage community which is very hard pressed these days—they need new products. Investors want to participate in this sort of diversification program.

And we have to remember that as we saw in the stock market decline of 1970, the people who are affected are the 32 million people in this country, not just a few people in Wall Street; it is estimated that one out of three households in United States has a stockholder in the house. So things that happen to the securities market happen to a large number of people in the country, and diversification is sound and is important for all of them; but they are prevented from doing that now.

We recognize the reluctance of this committee to consider amendments to the present bill, but we hope that we can ask you to consider this one because while it will apply to individuals it will not result in less revenue but will result in more revenue and provide a great benefit to the individual securityholders in this country.

Thank you very much. We appreciate it.

Mr. MORIN. Before the witness leaves, may I please introduce, sir, for the record, a proposed amendment so that it will appear in the record?

The CHAIRMAN. Yes; it will appear in the record at this point.

(The proposed amendment follows:)

PROPOSED AMENDMENT TO SECTION 351 OF THE INTERNAL REVENUE CODE OF 1954

Section 351(a) of the Internal Revenue Code of 1954 (relating to transfers to corporations controlled by the transferors) is amended to read as follows:

"SEC. 351. TRANSFER TO CORPORATION CONTROLLED BY TRANSFEROR

"(a) GENERAL RULE.—No gain or loss shall be recognized if property is transferred to a corporation (including a regulated investment company as defined in Section 851) by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange such person or persons are in control (as defined in Section 368(c) of the corporation. For the purposes of this section stock or securities issued for services shall not be considered as issued in return for property."

Section 351(d) is repealed in its entirety.

Section 351(e) is redesignated Section 351(d).

Senator ANDERSON. What percent of stock is held by individuals?

Mr. BROWN. Stock in this country is—85 percent of the stock in this country is held by individuals and 15 percent by institutions, but institutions do more of the trading.

Senator ANDERSON. What is the source of that information?

Mr. BROWN. Well, the New York Stock Exchange, sir, their annual fact book. The recent releases indicate that the individuals own $700 billion worth of stock; those are SEC figures put out in the Department of Commerce monthly survey and the total of all stocks in the country is estimated at somewhere around $900 billion.

Senator ANDERSON. It is estimated; aren't there some facts? Doesn't some information actually show what it is?

Mr. BROWN. Well, in the New York—the American exchanges—it is possible to calculate that. The over-the-counter market is not quite as definable as that. I think the SEC characterizes their calculations as estimates. You can tell how much stock there is but the problem is who owns it. They can sort of tell the changes that are made each year, but for people who have held stock 20 or 30 years—it is pretty hard to do it on a national basis. I think the SEC is probably the best figure on that and the New York Stock Exchange.

Senator ANDERSON. But you do have some authority for your statement earlier?

Mr. BROWN. Yes, sir.

Senator ANDERSON. Will you submit that for the record, please?

Mr. BROWN. Yes, sir.

The CHAIRMAN. Thank you very much, gentlemen. We will take a look at this problem.

Mr. BROWN. Thank you.

(Mr. Brown's prepared statement, letter, and fact sheet follow. Hearing continues on p. 550.)

PREPARED STATEMENT OF CLIFFORD BROWN, EXECUTIVE VICE PRESIDENT, FEDERATED INVESTORS, INC.

My name is Clifford E. Brown, and I am Executive Vice President of Federated Investors, Inc., whose address is 701 William Penn Place, Pittsburgh, Pennsylvania.

Federated Investors is in the business of managing people's money through the medium of some 13 investment companies, all of which are registered with the Securities and Exchange Commission. We have presently under management some $360 million, most of it invested in equity securities issued by hundreds of the Nation's publicly-held corporations.

As money managers, we are, of course, vitally interested in the performance of the stock markets of the Nation. More importantly, however, we are concerned with the health of the economy within which these corporations exist, since it is the strength of the country's economy which is eventually reflected in the performance of the stock markets.

I appear, therefore in support of the Administration's 1971 Tax Program, which we believe will have the ultimate effect of greatly strengthening the economy as a whole by providing necessary tax relief to many now struggling segments of the business community.

More particularly, we as money managers firmly support the Administration's proposal to restore and implement the Investment Tax Credit, which we believe will not only provide needed revenues for many business corporations, but which has also proven to be an effective method of providing new jobs on a broad and permanent basis.

Obviously, the Administration's income tax proposals will result in some reduction in internal revenue, and I should like briefly to discuss our proposal that this Committee now consider an amendment to Section 351 of the Internal Revenue Code which we believe will provide at least an additional $25 million of new revenue in fiscal 1972 to offset at lease some of these losses, and should be expected to produce at least $100 million of new tax revenue in fiscal 1973. That amendment would provide again for the organization of investment companies by virtue of the exchange of investment company shares for shares of stock in publicly-held corporations without the realization of taxable gain at the time of the exchange. At the present time, Section 351 contains a provision which was enacted very hastily and as a compromise measure in the closing days of the 87th Congress in October 1966. We invite at this time an examination of the legislative history of the present provision.

THE RELEVANT LEGISLATIVE AND ADMINISTRATIVE HISTORY

Attached to this statement is a letter of some 15 pages addressed to the Joint Committee on Internal Revenue Taxation which discussed in detail all of the relevant aspects of our proposal to amend Section 351. This letter was written by our counsel as the result of several conferences with members of the staff of the Joint Committee on Internal Revenue Taxation. It served to summarize for that staff and for the Joint Committee the voluminous evidence and statistical material which had been submitted by us over a period of more than a year.

Section 351 of the Code had its origin in the early Revenue Act and had remained substantially unchanged since the Revenue Act of 1924 until it was amended in 1966. Between 1960 and 1966 twenty-two incorporated investment companies were organized pursuant to Section 351, having assets of well over $1 billion. Until 1966 there had never been any question that Section 351 clearly permitted the organization of these companies without the realization of taxable gain at the date of incorporation.

On July 14, 1966, the Treasury Department effectively amended the Internal Revenue Code by the simple act of publishing a Technical Information Release informing the public that the Treasury Department no longer would treat the exchange of property which consisted of securities for stock in a corporation which otherwise complied with the provisions of Section 341 as a tax-free exchange fund.

Because this Technical Information Release was made very late in the Second Session of the 87th Congress, it was impossible for legislation to be introduced and for Congressional hearings to be held in the normal fashion before the introduction of clarifying legislation. The Senate Finance Committee, which was then considering the Foreign Investors Tax Act, was deeply concerned over the unorthodox method of tax administration employed by the Treasury Department, and eventually adopted an amendment which was passed by the Senate, the effect of which was to make it clear that the Congress intended not to discriminate against investment companies in the enactment of Section 351.

The Treasury Department, contending that the House Ways and Means Committee had not had the opportunity to consider the amendment and that no hearings had been held thereon, vigorously opposed the Senate amendment in the Conference Committee deliberations. This opposition lead to a last minute compromise which continued the coverage of Section 351 to investment companies until June 30, 1967, with what we believe was a clear understanding that eventually the problem would receive full consideration by the appropriate committees of Congress.

It is for this reason that I appear before you today. For reasons which I shall state, we believe that the proposed amendment of Section 351 will not only provide for the addition of substantial revenues to the Treasury, but also that it is overwhelmingly in the public interest for reasons other than those related to income taxation.

EXCHANGE FUNDS GENERATE IMPORTANT INCOME TAX REVENUES

The argument against the tax-free organization of investment companies—which have come to be known as "Exchange Funds" in the industry—assumes that they are a tax-avoidance device. *Nothing could be further from the truth.*

This argument assumes that those individuals exchanging shares of stock for investment company shares in a tax-free exchange would have sold this stock and paid a tax on the resultant gain. As businessmen who have exhaustively researched the market, we *know* that this assumption is false. We *know* that the persons who have become our shareholders deposit securities with us which otherwise never would have been sold in the open market—and for a very good reason: at the capital gains rates then applicable with the very low cost basis characteristic of these investors, the sale on the open market would have resulted in a loss of up to one-third of the individual's investment.

The average cost basis of our shareholders and of those of other Exchange Funds' was approximately 11% of the market value at the date of exchange. What is even more significant is the fact that only 17% had held their securities for less than 2 years, while *13% had held them for over 20 years. 36.7% had held their securities over 10 years. 62.7% had held them over 5 years.*

Let us repeat that we *know for a certainty* that our investors and the investors to whom we will appeal if our amendment is adopted and the investors who will make the decision to participate in the organization of an Exchange Fund will deliver to us stock which they now have no intention of selling, and which it cannot be predicted with any confidence that they will ever sell. In many states of the country at today's Federal capital gains tax rates an investor whose securities have increased many times over in value may lose as much as 45% of his investment by selling his securities. There is absolutely no question that this fact is a permanently inhibiting deterrent to the sale of these securities.

This revenue situation is drastically changed upon the organization of an Exchange Fund. For example, ase of March 31, 1969 (the last date as of which statistics have been compiled by the industry), the Nation's Exchange Funds had generated since 1961 federal income taxes totalling $153,578,401. Industry statistics tell us that the total *potential* capital gains tax liability on all of the securities deposited in these Funds as of the date of deposit was only $282,107,347. In other words, over half of this potential tax actually was paid in a period of only 7 years. It is unthinkable to suppose that any significant portion of this tax would have been paid had the Exchange Funds not been organized.

Why is this so? The very nature of the Exchange Fund guarantees the generation of income tax liability:

1. Immediately after its organization, an Exchange Fund must sell something over 3% of its portfolio securities—all of which have an extremely low cost basis, which has, of course, been passed on to the Fund—for the purpose of paying the expenses of organization and commissions on the sale of its shares.

2. The managers of the Fund have an obligation to manage its portfolio in accordance with its stated investment policy, regardless of income tax implications. The portfolio activity of Exchange Funds does not differ substantially from that of the ordinary investment company in the industry.

3. Any capital gains tax liability incurred by the Fund is shared by all of the Fund's shareholders and not by any one shareholder. Thus, the impact of the tax is no longer a matter of paramount importance either to the person making the decision to sell or not to sell or to the person who delivered the securities to the Fund originally.

Again may I respectfully refer to the letter of our counsel to the Joint Committee for a more detailed discussion of this issue. In addition, we have attached a memorandum entitled "Federal Tax Generation by Tax-Free Exchange Investment Companies" which clearly describes the method used by the industry in compiling the figure of $153,578,401 of income taxes generated by Exchange Funds through March 31, 1969.

PUBLIC POLICY CONSIDERATIONS FAVORING EXCHANGE FUNDS

Both the New York Stock Exchange and the Securities and Exchange Commission have in the past enthusiastically approved the organization and operation of Exchange Funds. These regulatory agencies look upon these Funds as a highly desirable mechanism for the controlled and regulated release of "locked-in securities" which are now held by individual investors who are effectively prevented by the capital gains tax from trading in the open market. The financial community has known for years and is deeply concerned about the fact that *less than 20% of all stock listed on the New York Stock and held by investors is free for active trading in the market place, and the liquidity and depth of the stock market are in continuous jeopardy as a result.*

Obviously, in any period of active trading this condition tends to create a volatile market, since the supply of available stock tends to be insufficient to satisfy demand. On the other hand, public interest demands a broadly based central market place with as much liquidity as possible. Today the "locked-in" reservoir of listed stocks is estimated to be over $300 billion. The Exchange Fund industry is confident from its past experience that some substantial percentage of these frozen securities would be released for trading if the pre-1967 application of Section 351 were reinstated. There is no question whatsoever that this would be beneficial to our national financial policy. We must observe at this point that until 1967 Exchange Funds served a very important public function in providing a means for immediate investment diversification to a very broad spectrum of individual investors, *both large and small*, who were "locked-in" in a low cost basis stockholding in one corporation obtained over a period of years as the result of employee stock options, employee stock award plans, corporate mergers and acquisitions and the like. These individual investors simply could not and cannot afford to lose 35%—40% of their lifetime investments as taxes in exchange for mere diversification of their one investment. Thus, Exchange Funds provided thousands of individuals in these categories to provide their families with sound financial plans with no loss of revenue to the Government.

SUMMARY AND CONCLUSION

For many years prior to 1967 the organization of Exchange Funds was permitted under Section 351. The Treasury tried to change this rule in 1966 by administrative fiat, but the Senate overruled the Treasury. A conference Committee thereafter adopted a stopgap compromise which served to terminate tax-free organization of Exchange Funds after June 30, 1967.

The issues involved have never received full and fair consideration by the Ways and Means Committee.

The record proves that Exchange Funds generated more than $150 million in new tax revenues in the 1960's alone. They should generate far more than this in the 1970's.

There are compelling public policy considerations favoring restoration of the Exchange Fund industry in the interests of market liquidity and prudent family planning.

SMATHERS AND MERRIGAN
ATTORNEYS AND COUNSELLORS AT LAW,
Washington, D.C., June 8, 1971.

HON. LAURENCE N. WOODWORTH,
Chief of Staff, Joint Committee on Internal Revenue Taxation, 1015 Longworth House Office Building, Washington, D.C.

DEAR DR. WOODWORTH: At the meeting held on April 28 with you and your associates on the staff of the Joint Committee and Mr. Charles Morin of Gadsby & Hannah, it was suggested that we summarize our position in favor of permitting "exchange funds" to continue to operate substantially as they did prior to the 1966 amendment to Section 351 of the Internal Revenue Code by writing this additional letter which might then be utilized by the Staff in preparation of a report on this subject.

Accordingly, we have prepared the following presentation for your review, and in line with your further suggestion, this letter will deal not only with revenue and tax considerations but with important public policy factors which favor the proposal to which we have been addressing ourselves.

THE RELEVANT LEGISLATIVE AND ADMINISTRATIVE HISTORY

As you undoubtedly recall, Section 351 of the Internal Revenue Code had its origin in the early history of Federal income tax law, primarily in the Revenue Acts of 1918, 1921 and 1924. As modified in the Revenue Act of 1924, the tax free exchange provisions of that section continued substantially unchanged into the 1954 Internal Revenue Code.

Thus, for approximately 42 years prior to 1966, Section 351 and its predecessor sections had continuously provided that no taxable gain shall be recognized if property is transferred to a corporation solely in exchange for stock or securities in such corporation and if, immediately after the exchange, the person or persons who transferred the property are in control of the corporation. No distinction was made between an incorporated investment company and any other kind of corporation.

Accordingly, during the period from 1960 to early 1962, nine exchange funds were organized, and in each case the Commissioner of Internal Revenue issued a written ruling which stated that the exchanges of stock in other corporations for stock in an Exchange Fund were tax-free under Section 351.

In 1961, after he became Commissioner of Internal Revenue, Commissioner Mortimer Caplin issued two additional rulings, bringing the number of Funds organized pursuant to Section 351 rulings to eleven. Commissioner Caplin thereupon announced, however, that no further rulings would be issued by the Internal Revenue Service. The Commissioner simultaneously made it clear that he did *not* intend to imply that Exchange Fund transactions were not tax-free; rather , the Service has simply decided to discontinue the rulings for each proposed Fund.

The creation of additional Exchange Funds thus continued until July, 1966. According to published reports, as of December 31, 1965, seventeen Exchange Funds with assets of $800.7 million were in existence. The companies then in operation ranged in size from $4.5 million to $154.7 million in value of net assets, and in number of shareholders from 97 to 1,151. The number of different issues held in the portfolio of each Exchange Fund ranged from 40 to 337.

In any event, on July 14, 1966, after the formation of some twenty-two Exchange Funds with assets of well over $1 billion and many thousands of shareholders, a decision was reached in the Treasury Department that, as a matter of federal tax policy, the normal stock for stock exchange transactions of Exchange Funds should no longer be deemed tax-free under Section 351. That decision was reached and announced while top officials of the Treasury Department privately conceded to industry representatives that same would probably result in a substantial reduction of federal capital gains revenue.

In any event, no effort was made by the Department to gain an amendment to Section 351 itself. On the contrary, the Department simply published a Technical Information Release (TIR-832) which proposed to amend the existing regulations under Section 351. The TIR explained that the proposed amendment to the regulations would provide that:

". . . Section 351 does not apply to the transfer by taxpayers of stock or securities to a corporation which is an investment company, in exchange for stock or securities . . . in such corporation, if the transfer was solicited or arranged by a broker or similar intermediary and if filing of a prospectus with the Securities and Exchange Commission . . . was required in connection with the transaction."

This precipitous reversal in policy on July 14, 1966 caught several mutual funds and private investors in the very midst of organization pursuant to prospectuses which had become effective with the Securities and Exchange Commission prior to July 17. In addition, there were several other funds in registration before the Commission. In deference to two or three of these registrants, two later TIR's were published, each of which extended the period during which a tax-free exchange could be made without application of the suddenly-announced, new reversal of tax policy.

Because the Treasury Department announcement was made so late in the session of Congress in 1966, it was impossible for legislation to be introduced and Congressional hearings to be held in normal fashion regarding the Treasury Department proposals. Congress was deeply concerned about the matter, however, so the Senate Finance Committee, which was then considering the Foreign Investors Tax Act, adopted an amendment to that bill which rejected the Treasury Department proposal and confirmed that Exchange Fund transactions were to continue to be non-taxable under Section 351. The Senate passed the Foreign Investors Tax Act in late 1966 with the said amendment intact, but the Treasury Department, contending that the House Ways and Means Committee had not had the opportunity to consider the amendment; that Congressional hearings had not been held; that the amendment was not germane; and that complete Congressional consideration of the problem covered by the amendment was exceedingly important so that the Department's position could be fully considered, vigorously opposed the amendment in conference. And, of course, as you will recall, that opposition finally led to a compromise which extended the tax-free coverage of Section 351 to all Exchange Funds organized up to June 30, 1967, with the understanding on the part of some of the Conferees at least that Congress would ultimately study the problem in full detail.

EXCHANGE FUNDS GENERATED SUBSTANTIAL TAX REVENUES NOW LOST TO THE TREASURY

Over the months since this matter was originally referred to you by Chairman Mills, we have filed all of the statistical data which is readily available to the mutual fund industry to prove that Exchange Fund operations under Section 351 have indeed generated very substantial federal tax revenues.

Those statistics show that during the period from 1961 through March 31, 1969, the Exchange Funds organized prior to the 1967 cut-off date generated federal taxes on sales commissions and capital gains totalling $153,578,401. The available industry statistics also demonstrate that these same Funds had an initial federal capital gains tax potential based on their net asset values of only $282,107,347, and thus the taxes actually paid by the Funds, their brokers and their shareholders had already reached by March 31, 1969 a very high percentage (more than 50%) of the total capital gains tax potential of the assets actually transferred to the various Funds. Thus, when the 1967 cut-off date became effective, the Treasury patently was deprived of a *definite, expanding* source of federal tax revenues.

We have also demonstrated that these tax revenues, otherwise lost to the Treasury, were necessarily generated by inherent characteristics of the Funds themselves, to wit, (i) the necessity for each Fund to sell immediately after the initial exchange of securities approximately 3% of its portfolio for the purposes of paying expenses of organization and sale of shares; (ii) the fiduciary obligation of the Fund managers to manage the portfolio in accordance with the stated investment policy of the Fund, regardless of tax implications; and (iii) the fact that any capital gains taxes incurred by the Fund are shared by all of the Fund's shareholders and not be one shareholder standing alone, and thus the impact of such taxes is no longer a matter of paramount importance to the person or persons who transferred the taxed shares to the Fund.

The argument has been made, of course, that absent the availability of tax free treatment under Section 351, those persons who exchanged their holdings for Exchange Fund shares may have felt constrained to go ahead and sell their holdings and the Treasury would have thereupon collected the full capital gains tax potential involved. During our discussions with you and your staff, however, your staff necessarily conceded that certainly that would *not* have been the case in many instances, and that probably *most* of the persons involved would *not* have opted to sell their "*locked in—low cost basis*" holdings, because by so doing they would have necessarily lost 25%—30% of their investments in capital gains tax. Moreover, we have submitted for your review a copy of the 1965 study made by Louis Harris and Associates, Inc. for the New York Stock Exchange. That study shows that increasingly investors in the last mentioned category are reluctant to pay the gains tax as a price for selling such holdings. The study states:

"The new data shows that investors regard themselves as being more tightly locked in with their holdings in 1965 than in 1960. . . .

"Some noteworthy investor attitudes toward the present capital gains tax rate were disclosed during the course of the survey interviews.

"Most of the respondents felt strongly about being locked in with their present stockholdings. *They frequently regarded the capital gains tax as a key factor*—along with the price level and outlook for a particular stock—in making the decision to sell. . . ."

The magnitude of investor reluctance to sell their "locked-in" holdings was demonstrated in greater detail by the New York Stock Exchange—Harris study which showed:

(1) That the *cost basis* of the NYSE stocks held by individuals had *decreased* from 60% in 1960 to 46% in 1965; and

(2) That accordingly, with *no relief* from the 25% capital gains tax rate, only 6% of the locked-in holdings would be sold by investors in 1960; *and that, with the lower cost basis in 1965, only 2½% of the said holdings would be offered for sale in the late sixties.*[1]

Further tangible evidence of the fact that the overwhelming majority of investors who traded their shares for shares in Exchange Funds were not in the least interested in selling their traded shares at the cost of paying the gains tax, are the following statistics obtained from the managers of the Empire Fund, Inc.; Sixth Empire Fund, Inc.; and Presidential Exchange Fund, Inc.—Exchange Funds organized in 1962, 1967 and 1965 respectively. The records of these Funds *demonstrate that the "average holding period" for shares traded for Fund shares was 9 years 9 months.* More specifically, the *average "per-trade date" holding periods* for shares traded for shares in each of the said Funds were as follows:

Empire Fund.— 11 years 7 months.
Sixth Empire Fund.—7 years 9 months.
Presidential Exchange Fund.—10 years 1 month.

The same Fund records show that 12.8% of the investors involved held their traded shares for more than 20 years before delivering them to one of the said Funds; that 9.3% had holding periods ranging from 15 to 20 years; that 14.6% had holding periods of 10 to 15 years; that 26% had holding periods ranging from 5 to 10 years; that 19.6% had holding periods of 2 to 5 years; and that only 17% had held traded shares for less than 2 years.

In the final analysis, therefore, the aforementioned argument against tax free treatment for Exchange Funds under Section 351, is *at best* dubious and unprovable. Indeed, the available authoritative studies and the actual experience of the mutual fund industry itself show that said argument is basically inaccurate and misleading. The correct premise, we submit, is that, as the cost basis of long term stock holdings decreases in proportion to market value, the investor is more and more "locked in" and dissuaded from selling by the prospect of losing a large precentage of his holding to the capital gains tax.

From the standpoint of positive tax generation, therefore, it follows that an early return to the pre-1967 application of Section 351 is highly desirable, not only for the thousands of investors involved, but for the Treasury as well.

PUBLIC POLICY CONSIDERATIONS WHICH FAVOR THE REACTIVATION OF EXCHANGE FUNDS

Both the New York Stock Exchange and the Securities and Exchange Commission have in the past put their enthusiastic stamps of approval on the organization and operation of Exchange Funds, and for very good reasons. The Exchange Fund is looked upon by these regulatory agencies as an appropriate mechanism for the liberation and release of "locked-in" securities, now held by individual investors who are effectively prevented by the capital gains tax from trading on the open market. The New York Stock Exchange, the S.E.C. and the mutual fund industry know that *less than 20% of all stock listed on the New York Stock Exchange and held by investors is free for active trading in the market place, and thus the liquidity and depth of the stock market suffer as a result.*

Obviously, in any period of active trading, this condition tends to create a volatile market, since the supply of available stock would tend to be insufficient

[1] In our letter of January 15, 1971 we demonstrated that Treasury Department statistics for the five years ending December 31, 1964 proved that the cost basis of all securities sold by individuals was 85% of market value. *Ergo,* those who sell obviously have an extremely high cost basis while those who refuse to sell have an extremely low cost basis.

to satisfy demand. The same condition affects the other side of the market—that is, where the supply of stock is "thin", there tends to be a shortage of buyers in a "down market".

The public interest thus demands a broadly-based central market place with as much liquidity as possible. Whatever can be done to encourage that liquidity is extremely beneficial to the national interests necessarily involved in the welfare of the stock market. Today, the "locked-in" reservoir of listed common stocks is estimated at about $300 billion. The Exchange Fund industry feels confident from its past experience that a substantial percentage of those frozen securities would be released for trading if the pre-1967 application of Section 351 were reinstated. This, we earnestly believe, would be beneficial to our national financial policy.

In our letter to you dated January 15, 1971, we also alluded to another beneficial effect of Exchange Funds, and that is that they tend to provide an appropriate "escape valve" for the orderly sale of large blocks of stock. In many instances, the attempted public sale of a large block of stock by an Estate, for example, results in a sharp drop in the market price of the stock involved. However, when such blocks are deposited in an Exchange Fund, same are released for sale in orderly fashion because the Fund, having issued its shares to the depositor, can afford to dispose of the shares over a period of time. This tends to eliminate any adverse impact on the market and thus it is beneficial to the public at large.

We have also constantly referred to the fact that, prior to 1967, Exchange Funds served a very important public function to the extent they provided a means for immediate *investment diversification* to a very broad spectrum of *individual investors*, large and small alike, who were "locked in" with low cost basis stock holdings in one corporation obtained over a period of years as a result of employee stock options, corporate mergers, reorganizations, and the like. By and large, such individual investors simply could not afford to lose 25%–30% of their lifetime investments to taxes as the price for mere diversification of their one investment. Exchange Funds, prior to 1967, provided the answer and thus afforded a means for sounder, diversified investment to thousands of persons in the several categories mentioned above. Considering the overwhelming importance of that function to so many thousands of individual investors, we urge you to support the proposition that reinstatement of the pre-1967 tax treatment of Exchange Funds under Section 351 is clearly in the public interest.

RESPONSE TO YOUR LETTER OF MARCH 24, 1971

A. Ratio Between Redemptions By Estates And Total Exchange Fund Redemptions

In your letter to me dated March 24, 1971, you state:

"I am glad to hear that you are now attempting to determine the ratio between redemptions by estates and redemptions by individuals in the case of swap funds. A comparison of this ratio with the corresponding ratio for other mutual funds should prove interesting."

The information you requested has now been obtained from three of the Exchange Funds organized prior to the 1967 cut-off date. Those Funds are the Empire Fund, Inc., Sixth Empire Fund, Inc. and Presidential Exchange Fund, Inc. These Funds describe their experience as follows:

"The total for the three Funds reflects 1,266 redemption transactions representing $28,284,790, of which 81 of the transactions, *or 6.4%*, were identified as death-related redemptions worth $4,843,752, or 17.1%."

A breakdown of the aforesaid redemptions is annexed hereto for your information. It demonstrates that the Empire Fund, organized in 1962, has experienced 858 redemption transactions, only 56 *or 6.5%* of which were "death-related"; that the Sixth Empire Fund, organized in 1967, has had 212 redemptions, only 13 of which or 6.1% were "death-related"; and that the Presidential Fund has had 196 redemptions only 12 or 6.1% of which were "death-related".[2]

[2] The data used for Empire Fund, Inc. covered the period from January 1, 1965 through April 15, 1971. The data for the Sixth Empire Fund covered the period from date of original exchange on June 28, 1967 to April 15, 1971, while the data for the Presidential Fund covered the period from date of original exchange (August 16, 1965) to April 15, 1971.

I trust you will agree that these figures establish quite clearly that Exchange Fund redemptions *for reasons other than death of a shareholder account for approximately 95% of all such redemptions, and that accordingly, Exchange Funds constantly find it necessary to engage in redemption transactions which have no relationship whatsoever to death of a Fund shareholder.*

In conclusion on this point, please permit me to direct your attention once again to the following facts referred to in my letter to you of January 15, 1971:

(i) Every Exchange Fund of which we have inquired has reported that its redemption rate is as high as the redemption rate in the ordinary mutual fund.

(ii) While there are no reliable statistics on the average age of investors in Exchange Funds, *the sales approach of the organizers of these Funds has never been aimed at investors of advanced age, and the stepped-up basis at death has never been a material selling point.*

B. There Are Valid Distinctions To Justify Reinstatement Of The Pre-1967 Application Of Section 351 To Stock For Stock Exchanges By Exchange Funds And Such Reinstatement Should Not Be Related To The Taxability Of Other Types Of Investment

As you know, we wholeheartedly disagree with your interpretation of those portions of my letter of January 15, 1971 which set forth the "clear distinction between Exchange Funds organized under Section 351 and exchanges of 'investment stock' generally".

Briefly summarized, the main distinctions are as follows:

1. In an Exchange Fund, when an investor exchanges his stock for stock in the Fund, he relinquishes all further investment choices with regard to his deposited stock.

2. In an Exchange Fund, when an investor exchanges his stock for stock in the Fund, he relinquishes all power to determine whether or when to trigger a tax liability with reference to his deposited stock. The exact opposite is true in the case of the other investment rollovers to which your letters have referred.

3. In an Exchange Fund, when an investor exchanges his stock for stock in the Fund, any possibility of a stepped-up basis for the deposited stock is forever lost.

In the light of these distinctions and bearing in mind that for several years the Treasury Department itself ruled that Exchange Fund stock-for-stock transactions were significantly different from the other type of investment rollover transactions to which you refer to qualify the former for coverage under Section 351 of the Code, we respectfully submit that some of the observations contained in your letter of March 24 are not really relevant to the issue presently under consideration.[3] *Section 351 is applicable to Exchange Fund transactions because, in the case of those Funds, investors' stock "is transferred to a corporation [the Fund] . . . in exchange for stock . . . in such corporation and immediately after the exchange such person or persons [the investors] are in control . . . of the corporation".*

The issue, therefore, really is, why should the pre-1967 rationale of Section 351 be permanently terminated in the case of Exchange Funds solely because the *incorporated Funds* are investment companies [i.e. a particular type of "corporation"] and because the "property" transferred to the Funds for their stock is intangible property rather than tangible?

If you conclude, as we feel you must, that there are no sound public policy consideration which require permanent termination of Exchange Fund activities,[4] and if you believe, as we hope you will, that the established *positive generation* of expanding tax revenues flowing from Fund operations and totalling hundreds of millions of dollars outweighs the nebulous, baseless argument that termination of Fund operations "might force" Fund investors to trigger substantial capital gains tax revenues,[5] then we submit you sohuld recommend that

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[3] I refer here to the first full paragraph on page 2 of your letter where you state: ". . . it would seem that . . . there is no more justification for granting the tax-free treatment to investors in exchange funds than for allowing tax-free treatment for gains which are rolled over and invested in ordinary mutual funds."

[4] As stated above, we contend the opposite is true. All relevant public policy considerations favor reactivation of the Funds under Section 351.

[5] An argument which cannot be supported with facts or figures and which flies in the face of the evidence hereinabove discussed.

Exchange Funds be permitted to reactivate under Section 351 and to operate as they did prior to the 1966 compromise amendment. Other types of Mutual Fund investments and other types of rollovers which *did not* qualify for such treatment under Section 351 prior to the 1967 amendment patently should not be permitted to qualify now solely because the Exchange Funds are authorized to revert to their pre-1967 tax status, and thus arguments related to those other types of investment are clearly not pertinent to the issue here to be decided.

C. There Is No Substantial Basis For The Contention That Exchange Fund Investors As A Whole Eliminate Capital Gains Tax on Appreciated Stock By Receiving A Stepped Up Basis at Death

As we stated at the conference on April 28, we do not agree with the staff's contention that Exchange Fund investors eliminate capital gains tax on appreciated stock by receiving a stepped up basis at death. Please permit me to reiterate our rea sons for this disagreement.

In the regular course of events, it is very possible that prior to death and the acquisition of any stepped-up basis by reason of death, *all of the appreciation in value of the deceased investor's investment will have been realized and that he will have paid income tax on all of it. It is certain in almost all cases that he will have paid income tax on some of it, depending on how long he has lived.* And, of course, the amount of his stepped up basis is going to depend upon what option the Exchange Fund has exercised in filing its own income tax returns. That is, in a given year, the Fund might have elected to retain capital gains and pay the taxes itself, in which event the investor is entitled to an increase in his basis. Or, the Fund may have elected ot distribute capital gains, in which event the investor himself will have paid the tax and received no increase in basis. It is, for example, almost inevitable that for over a period of say 20 years, the Exchange Fund will have realized capital gains at least equal to the total unrealized appreciation in its portfolio on the original exchange date. *Depending on the elections the Fund managers have made over the years, an individual investor therefore will either have realized all of his own unrealized appreciation and kept his same old basis, or the Fund will have realized all of his unrealized appreciation, and his basis will have been increased to fair market value.* But, even in the former instance, it is clearly inaccurate to asert that the investor in the Exchange Fund may succeed in avoiding the payment of taxes on appreciated stock and still receive a steped up basis at death.

CONCLUSION

As stated above, the issue is clear and simple. For a period of years prior to 1966, stock for stock transactions of Exchange Funds were admittedly tax free under Section 351. The Treasury proposed that rule in 1966 by administrative fiat only, but the Senate overruled the Treasury. A Conference Committee thereafter adopted a stopgap compromise which served to terminate the tax free treatment of Exchange Funds in 1967, but the issues involved have never received full and fair consideration by the Congress.

The record shows that Exchange Funds generated more than $150,000,000 in tax revenues in the sixties alone, and there are compelling public policy considerations which favor reactivation of the Funds under Section 351. There is no evidence that termination of the Funds under Section 351 in 1967 has resulted in any substantial amount of new capital gains tax revenues, and the available record tends to establish the opposite.

Therefore, the question presented is simply whether the staff of the Joint Committee should, in light of the available facts, recommend that early consideration be given by the Congress to reinstatement of the old rule (or some similar rule) under Section 351 so that Exchange Funds may resume their operations which were terminated by the 1966 stopgap amendment. On the basis of the evidence presented and the factors discussed with you and the Staff, we urge you to make that recommendation at your earliest convenience.

With appreciation for your excellent cooperation and consideration and with highest regards to you and your associates, I am,

Sincerely,

EDWARD L. MERRIGAN.

	Transactions	Percent	Dollar	Percent
Empire Fund:				
Redemption transactions	858		$16,880,308	
Death-related transactions	56	6.5	3,284,476	19.5
6th Empire Fund:				
Redemption transactions	212		$7,488,817	
Death-related transactions	13	6.1	1,127,850	15.1
Presidential exchange fund:				
Redemption transactions	196		$3,915,665	
Death-related transactions	12	6.1	431,426	11

FEDERAL TAX GENERATION BY TAX-FREE EXCHANGE INVESTMENT COMPANIES—AUGUST 15, 1960, THROUGH MARCH 31, 1969

HISTORY

From August 15, 1960, when the first underwriting of an exchange of securities for shares of a mutual fund was completed by Centennial Fund of Denver, through June 30, 1967, when the last such fund was formed, thirty-six funds were founded. To form these funds approximately 16,900 investors exchanged securities valued at $1,566,994,926 on the respective exchange dates and these investors became shareholders of the respective mutual funds.

Because of the difficulties in obtaining complete data, this memorandum will focus on the developments of 25 of the 36 funds, representing approximately 82% of the value of all securities exchanged or $1,284,715,546. These 25 funds were sponsored and managed by eight different well-known fund management groups. The largest fund had an exchange value of $152,147,865 and the smallest a value of $10,321,265. Two sponsor groups developed 17 of the 25 funds: Vance, Sanders & Co. of Boston formed six funds with an exchange value of $514 million and Federated Research Corp. of Pittsburgh formed eleven funds with an exchange value of $249 million.

HOW TAXES ARE GENERATED BY EXCHANGE FUNDS

INITIAL TAX COST BASES AND TAX POTENTIAL

At the instant of formation of each exchange fund, the depositing shareholders exchanged securities which, on average, had low tax cost bases. When the fund accepted these securities it took on the same cost bases as had obtained in the hands of the depositors. The depositors, receiving fund shares, were required to attribute to their fund shares the same cost basis which had obtained in their securities now exchanged. The mean average initial tax basis of the assets of the 25 funds (unweighted for dollar size) was 10.1%. Among the various funds the initial tax cost bases of portfolios ranged from 5.1% (Federal Street) to 18.5% (Fourth Empire). Assuming a tax rate of 25% on unrealized gains, the initial tax potential of the 25 funds at the time of exchange amounted to $282,107,347.

SALES COMMISSIONS AT THE EXCHANGE

These exchanges were arranged through the members of the National Association of Securities Dealers for a commission. The commission was paid by the depositor, but not in cash. Instead, the fund assumed ownership of the securities at full market value and also assumed the liability to pay the gross commissions. The funds generated cash for these payments by the sale of securities soon after the exchanges. As a consequence of these arrangements the initial net assets of the 25 funds totaled $1,245,349,250, after reflecting their payments of $39,366,296 of sales commissions.

These commissions were paid to brokerage firms and represented an income generation which would not have existed without exchange funds. If the funds had not come into being, the depositors would have incurred normal brokerage (approximately 1%) on their sales but this brokerage is more than equaled by the brokerage incurred by the funds.

By way of illustration, the seven funds in this study which originated in 1961 and 1962 had an initial exchange value of $522,127,848 and an initial unweighted mean average cost basis of 8.5%. From their exchanges through their latest fiscal periods ending by March 31, 1969 these seven funds realized net gains of $145,805,712. Although funds of this type tend to sell high-cost securities first, we may for the argument assume that the funds sold at the low initial average tax cost basis. On this assumption portfolio sales were at least $159,350,505 and were probably a great deal more, perhaps double. Actual redemptions from these funds, as a test of sales intent by the depositors, were $211,410,563.

The sales commissions paid by the 25 funds totaled $39,366,296. Based upon the exchange value of $1,284,715,546, the commission represented a 3.06% rate. These non-recurring commissions were received by incorporated firms, partnerships and security salesmen. The average sale of $100,000 per transaction indicates that these sales mere handled by experienced and successful individuals. Coming on top of their normal income it seems fair to attribute a 50% Federal income tax rate generation to these commissions. For the 25 funds these commissions therefore resulted in an unlooked-for tax generation of $19,683,148.

FUND PORTFOLIO SALES AND GAINS

Investment companies pay Federal Corporate Capital Gains taxes on net realized capital gains not distributed to their shareholders. Their shareholders pay the capital gains tax on distributed gains. The 25 funds during this period paid capital gains taxes of $63,361,043. Certain funds distributed portions of their capital gains, the total distributions amounting to $26,985,064. Assuming a 25% tax rate for the shareholders, an additional $6,746,266 was paid in Federal taxes. Combining the two payments, the 25 funds were responsible through portfolio sales for the generation of $70,107,309 in Federal capital gains taxes.

SHAREHOLDER REDEMPTIONS

Tax-free exchange funds are unique in that redemptions of fund shares are generally not paid in cash but are paid by the delivery of a strip of portfolio securities valued at market. This practice is followed because such disposition does not realize capital gains for the fund. For this reason the funds attempt to deliver low-cost basis securities when investment factors permit. The shareholder. on the other hand, experiences a taxable transaction at redemption whether he receives cash or securities. The shareholder's taxable gain or loss is measured by the difference between the redemption proceeds at market value and his adjusted tax cost basis. His basis consists of his original basis in the securities exchanged by him, actual purchase price of any shares later acquired, distributions received in shares at net asset value on record dates and adjustments due to the fund's payment of capital gain taxes on undistributed gains. Under the Code shareholders of an investment company are entitled to increase at the end of each fiscal year their tax cost bases by the difference between net gains realized and taxes paid on their behalf by the fund. Until the advent of the surtax this increase amounted to three times the taxes paid.

In the present study of 25 funds each fund was analyzed to update the cost bases of its shareholders year-by-year in order to approximate the amount of gain realized by its shareholders each year by reason of redemptions. This was done by starting with the dollar value of the tax cost basis in the fund at origination, which bases was that of its shareholders as a group. Redemptions during the first year were considered to have a percentage cost basis equal to the initial percentage of cost basis found in the fund. For each subsequent year the cost basis was increased by three times the amount of taxes paid in the previous year and a new sharholder percentage tax cost basis was derived by dividing the adjusted cost basis by the fund net assets at market at the beginning of each year. This new percentage was then applied to the redemptions for that particular year to derive the amount of gain.

Certain redemptions are made by the estates of deceased shareholders in whose hands the tax cost basis is at or near 100% of net asset value; little or no taxable gain would result in redemptions of this kind. Although precise data are not available on the scope of this factor, the experience of funds under the management of Federated Research Corp. is estimated to be under 10% of all redemptions. Of the seven funds in the study (initial assets of $507 million) which began operation prior to 1963, the dollar amount of redemptions as a percentage of average net assets was 50%. a figure much too high to suggest a high content of death redemptions. These same actual redemptions, annualized for each fund, show an average annual redemption rate of 6.8%, almost exactly the same rate as that experienced by the entire mutual fund industry during the period 1962–1968.

One of the main purposes of this study is to compare tax generation arising out of the exchange fund phenomenon with the tax generation that would have occurred had there been no exchange funds. Since stepped up cost bases due to death would have occurred under either assumption, in this study no diminution by reason of the effects of death redemptions was calculated into the estimate of taxes generated by redemptions.

The 25 funds experienced during this period redemptions of $348,952,763. This study estimates that the gains realized by shareholders on these redemptions amounted to $255,151,776, indicating an average cost basis at redemption of 27%. Assuming a capital gains tax rate of 25%, these redemptions generated tax revenue of $63,787,944.

TOTAL TAX GENERATION

Total Federal taxes generated by the 25 exchange funds from their respective exchange dates through fiscal years ended by March 31, 1969 are as follows:

	Amount	Percent
Tax on sales commissions (paid by dealers)	$19,683,148	12.8
Tax on undistributed capital gains (paid by funds)	63,361,043	41.3
Tax on distributed gains (paid by shareholders)	6,746,266	4.4
Tax on redemptions (paid by shareholders)	63,787,944	41.5
Total tax generation	153,578,401	100.0

The tax generation capability of exchange funds is better judged by grouping the older funds, since 16 of the 25 funds have been in existence only since 1965. The seven funds in operation prior to 1963 show the following pattern:

	Amount	Percent
Tax on sales commissions	$7,581,299	8.7
Tax on undistributed capital gains	33,671,332	38.6
Tax on gains distributed	2,780,096	3.2
Tax on redemptions	43,265,717	49.5
Total tax generation	87,298,444	100.0

The CHAIRMAN. The next witness will be—Senator Pearson was to be here accompanying Mr. Mark H. Freeman. Is Mr. Freeman in the room now?

Mr. FREEMAN. Yes, sir.

The CHAIRMAN. We will hear your statement now, Mr. Chairman.

Senator CURTIS. Mr. Chairman, I am particularly glad to welcome Mr. Freeman here for his testimony. I have not read his testimony so I can't speak as to that, but as a member of the Committee on Agriculture, Subcommittee on Rural Development, I am very much interested in all groups who are directing their attention to rural America.

It happens that Mr. Freeman is the executive director of the Coalition for Rural America. This organization is backed by many prominent Americans. Two of the originators were former Governors, one from each of the major political parties—Governor Breathitt of Kentucky, and Gov. Norbert Tiemann of Nebraska. Both have a great interest in this, so I want the record to show my interest in the same subject matter.

STATEMENT OF MARK H. FREEMAN, EXECUTIVE DIRECTOR, COALITION FOR RURAL AMERICA, ACCOMPANIED BY FRANK COSTELLO, COUNSEL

Mr. FREEMAN. Thank you very much, Senator.

Mr. Chairman, my name is Mark Freeman. I am the executive director of the Coalition for Rural America and I am accompanied by Mr. Frank Costello, our attorney.

Mr. Chairman and members of the committee, as executive director of the Coalition for Rural America, it is my pleasure to appear this morning in support of Senator Pearson's amendment to double the development tax credit for job-creating investments in rural areas. Because of illness, Senator Pearson was unable to appear today and it is my understanding that he was to introduce his amendment on the floor today.

I also understand that this amendment had been submitted to members of the Finance Committee, and that Senator Peason intended to formally submit the amendment on the floor on Monday.

We feel this amendment is an important step toward truly balanced grow of this country; and I speak on behalf of and bring you greetings from our chairman, Governor Breathitt; Governor Tiemann, our president; and Gov. Winthrop Rockefeller, our executive vice president. Other members on the coalition of interest to the committee are from Senator Anderson's State of New Mexico: former Gov. Jack Campbell; Governor Bartlett of Oklahoma; Governor McNair of South Carolina; Governor Sanford of North Carolina; former Secretary Orville Freeman and four corporate representatives: Robert O. Anderson of Atlantic Richfield; Orin E. Atkins of Ashland Oil; Donald Cook of American Electric Power; and Mr. Robert Pamplin of Georgia Pacific. There are many other members but that is a fair cross section of the type of people who are concerned with the problems of rural America.

The coalition is newly formed and has come into existence to deal with a problem of long standing in our country. As Governor Breathitt put it:

> Through a complete lack of any governmental policy, we have permitted rural America to deteriorate like a rusting hand plow languishing in a fallen-down barn, while the social and economic problems once scattered across the thousands of square miles of our great land have become compacted into urban ghettoes where they have become both more evident and more volatile.
>
> Since the depression we have heard talk about rural development, but something seems wrong. Somehow there has been only talk and not much action.
>
> In the past ten years we have heard a lot of talk about balanced national growth, a balance between rural and urban America. Again, we have just heard talk. There are about 200 federal assistence programs designed in whole or in part to help rural America, and somehow they are not having an economic impact that would promote balanced growth.

Balanced growth for the United States is hardly a controversial objective. It is accepted on both sides of the aisle as something that is desirable and which should be encouraged. But what does it really mean and how can it be accomplished? These are questions that have never really been adequately answered, by either Government or the private sector, and the search for these answers is one of the principal reasons the coalition has been formed.

There is, then, an imbalance in our development: concentrated urbanization, not only at the expense of rural life but also at the expense of our metropolitan areas. This is an important point—the problems of rural America are really the problems of the entire country. The coalition does not think of itself or Senator Pearson's intended amendment as representing a special interest. The days when city and country fold battled each other for their share of the Federal pie are over. Our problems are totally interrelated and equally complex, and they cannot be resolved in isolation. As the President said in his 1970 state of the Union message:

> What rural America needs most is a new kind of assistance. It needs to be dealt with not as a separate nation but as part of an overall growth policy for America.

With this in mind, the Coalition has developed certain legislative objectives described by Governor Tiemann as:

> * * * the direct infusion of dollars into the rural economic system, the investment or job tax credit, nonagricultural credit, and the regional approach toward public works assistance.
>
> Our reasoning is simple enough.

Governor Tiemann continued:

> Our organization is composed of a number of former governors. Through sometimes brutal experience they have learned what works to stimulate economic development.
>
> The indications are that the older approaches may be the best ones.

It is heartening that there are a number of bills now pending including Senator Pearson's amendment which go right to the heart of the problem, and the concepts embodied in these bills are endorsed by the Coalition. One such bill is S. 2223 which would provide for nonfarm rural credit, and which has 50 cosponsors in the Senate.

An investment tax credit of the type proposed by Senator Pearson is a powerful economic tool. It can be used quickly and is relatively simple to administer. Since it relies on the initiative of the private sector it has the potential to be more effective than direct Federal spending. The leverage gained from such an incentive can be tremendous. For example, under Senator Pearson's amendment, if new rural investment is stimulated and takes advantage of the investment tax credit, every dollar lost to or in effect spent by the Federal Treasury will be matched by $7 invested by the private sector in rural America. It also has the advantage of encouraging rural industrial development without destroying the tax base of rural communities—when tax incentives are left to the State or local communities alone, those who can least afford the loss of revenues are often those who have to make the biggest concessions to attract industry.

The advantages of the investment tax credit proposed by this amendment, however, are contingent solely upon the extent to which this credit is focused, by this committee and the Internal Revenue Service, on the real problem. Like any other tax break, it can be abused by use inconsistent with its underlying purpose. To insure that this does not happen, the amendment would have to be administered pursuant to criteria which clearly delineate the types of industries the credit would be available to and the types of nonmetropolitan areas where investment would qualify.

One important criterion is already contained in the amendment, which requires that "the new employment opportunities in the rural area which will be assisted by such property will not result in a decrease in employment in any other area." As I noted earlier, we are not involved in a battle between urban and rural areas for industrial investments; it is rather an attempt to reorder the development of the Nation for the benefit of all areas.

Therefore, a criterion which prevents the credit from being used to relocate industries from our beleaguered inner cities to rural areas is absolutely essential. But even if relocation is effectively prohibited, it would also seem essential to limit the credit to those industries which will fit the pattern of economic restructuring most suited for that particular area.

The Public Works and Economic Development Act of 1865 contains such a criterion in its "excess capacity" provision, section 702, which prohibits assistance to those industries where the demand is not sufficient to employ the efficient capacity of existing enterprises—a difficult criterion to administer, certainly, but at the least it is a recognition of the directions which the implementation of the public policy should take.

We ask only they be made explicit in the committee's report and hopefully in the IRS regulations implementing the new law should it be passed.

We think these criteria are implicit in the amendment and its underlying purpose.

In conclusion, I want to reemphasize that the amendment proposed by Senator Pearson, if adopted and administered as described above, will eventually have a substantial impact on rural America. We recognize, however, that a tax incentive alone is not enough, but it will serve as a precedent for the adoption of other vitally needed legislation and indicate congressional approval for a new and long overdue change in direction for U.S. economic development policies.

Senator ANDERSON. Senator Curtis, any questions?

Senator CURTIS. No questions.

Senator ANDERSON. Thank you very much for your appearance here today.

(Mr. Freeman's prepared statement follows:)

PREPARED STATEMENT OF MARK H. FREEMAN, EXECUTIVE DIRECTOR, COALITION FOR RURAL AMERICA

Mr. Chairman, members of the Committee, as Executive Director of the Coalition for Rural America it is my pleasure to appear this morning in support of Senator Pearson's amendment which, by providing increased incentives for rural investment, will be an important step toward truly balanced growth for this country. I speak on behalf of, and bring you greetings from, our Chairman, Governor Breathitt, Governor Tiemann, our President and Governor Winthrop Rockefeller, our Executive Vice President.

The Coalition is newly formed and has come into existence to deal with a problem of long standing in our country. As Governor Breathitt put it:

"Through a complete lack of any governmental policy we have permitted rural America to deteriorate like a rusting hand plow languishing in a fallen down barn, while the social and economic problems once scattered across the thousands of square miles of our great land have become compacted into urban ghettoes where they have become both more evident and more volatile.

"As former Secretary of Agriculture Freeman says, this process couldn't have occurred in a more insidiously efficient way if we had planned it in our national policy councils.

"Governor Tiemann and I have been chosen to lead the Coalition for Rural America. In directing the activities of the coalition, we will be guided by these principles:

"—We are strongly in support of a structure of agriculture that includes prosperous family farms and an economically viable marketing and processing system based in rural areas.

"—In building rural America, our aim is to see that development is consistent with the preservation and enhancement of a quality environment.

"—We are concerned, not just with the aggregate development of the rural economy, but with eliminating the causes and ameliorating the effects of rural poverty, through such measures as welfare reform and public service employment.

"—We are committed to the principle of equal concern for, and equal involvement of, all the people of rural America, without discrimination on any basis.

"Admittedly these are broad purposes that take in a lot of territory. But the need clearly exists. The people who live in rural America need a voice, and we hope to give it to them. Certainly there are a number of fine farm orzanizations now existing, and we support their basic aims. We will work closely with them. But the fact is that the vast majority of the people now living in Countryside U.S.A. are not farmers, and they have no one to speak for them.

"Since the depression we have heard talk about rural development, but something seems wrong. Somehow there has been only talk and not much action.

"In the past ten years we have heard a lot of talk about balanced national growth—a balance between rural and urban America. Again, we have just heard talk. There are about 200 federal assistance programs designed in whole or in part to help rural America, and somehow they are not having an economic impact that would promote balanced growth."

Balanced growth for the United States is hardly a controversial objective. It is accepted on both sides of the aisle as something that is desirable and which should be encouraged. But what does it really mean and how can it be accomplished? These are questions that have never really been adequately answered, by either government or the private sector, and the search for these answers is one of the principal reasons the Coalition has been formed.

Certain facts are obvious and have been so for a number of years. Seventy-five percent of our population is urbanized, living on only 2% of our land, and each year 600,000 more rural Americans migrate to the cities. Experts predict that by the turn of the century at least one-half of our population of 300 million will live in *three* giant urban strips. But these are merely statistics—given the fact that massive urbanization is occurring at an accelerated rate, what is the net effect on the quality of our lives?

To those directly involved with the problems of our cities, it has become increasingly apparent that one of the root problems is the tide of rural migration. The inner city of today is a monument to the collapse of our rural society, and the massive social problems we now face in our cities will never be solved until the tide is stemmed. Our deteriorating environment can also be traced, in part, to the decline of rural America. With increasing urbanization, our nation has lost sight of those basic natural resources upon which it was built

For rural America, the impact of urbanization has been equally severe. It is important at this point to state what the Coalition means by "rural America"—this is the part of the population that lives outside the major metropolitan areas, the people living in the towns, villages and small cities of this country, as well as on the farms and ranches. Interestingly, less than one-fifth of the rural population now resides on farms, and only 800,000 farmers account for 90% of our agricultural production

The Coalition is alarmed at the shocking statistics of rural America where the economic base of rural America, for both farmers and non-farmers, is being destroyed by the present patterns of urbanization: one-half of our citizens living in poverty, 14 million people live in rural areas, and 60% of the nation's inadequate housing is found outside the major metropolitan areas; thirty thousand rural communities lack adequate water systems and more than 45,000 have no sewer systems at all: the infant mortality rate in rural areas exceeds the national average by 20%, and for non-white rural infants it is almost twice as high.

This, then, is the imbalance in our development: concentrated urbanization, not only at the expense of rural life but also at the expense of our metropolitan areas. This is an important point—the problems of rural America are really the problems of the entire country. The Coalition does not think of itself, or Senator Pearson's amendment, as representing a special interest. The days when city and country folk battled each other for their share of the federal pie are over. Our problems are totally inter-related and equally complex, and they cannot be resolved in isolation. As the President said in his 1970 State of the Union message:

"What rural America needs most is a new kind of assistance. It needs to be dealt with not as a separate nation but as part of an overall growth policy for America."

With this in mind, the Coalition has developed certain legislative objectives described by Governor Tiemann as:

". . . the direct infusion of dollars into the rural economic system—the investment or job tax credit, non-agricultural credit, and the regional approach toward public works assistance.

"Our reasoning is simple enough. Our organization is composed of a number of former governors. Through sometimes brutal experience, they have learned what works to stimulate economic development

"The indications are that the older approaches may be the best ones."

It would appear that many of the 200 Federal Assistance programs established all, or in part for rural people were established on the basis of guesstimates that this or that program might be a good idea, with no planning beforehand to determine whether they would accomplish anything worthwhile. The basis for this criticism comes from a report done for the Economic Development Administration by the Center for Political Research This two-volume report has not had much circulation, and that is a shame, because it is the first attempt that I know of to determine which Federal programs truly influence rural economic development, and which ones do not. The report states that even with substantial modifications of priorities, funding levels and administrative processes, the capabilities of most federal assistance programs to alter—and particularly reverse—geographic pattern of economic development is extremely limited.

The report concludes that broad economic forces in the private sector are the major determinants of economic trends and decisions, and that many programs are not designed, administered or funded to achieve a significant impact on economic development.

It is heartening that there are a number of Bills now pending, including Senator Pearson's amendment, which go right to the heart of the problem, and the concepts embodied in these Bills are endorsed by the Coalition. One such Bill is S. 2223 which would provide for nonfarm rural credit.

An investment tax credit of the type proposed by Senator Pearson is a powerful economic tool. It can be used quickly and is relatively simple to administer. Since it relies on the initiative of the private sector, it has the potential to be more effective than direct Federal spending. The leverage gained from such an incentive can be tremendous. For example, under Senator Pearson's Amendment, if new rural investment is stimulated and takes advantage of the investment tax credit, every dollar lost to, or in effect spent by, the Federal Treasury will be matched by seven dollars invested by the private sector in rural America. It also has the advantage of encouraging rural industrial development without destroying the tax base of rural communities—when tax incentives are left to the state or local communities alone, those who can least afford the loss of revenues are often those who have to make the biggest concessions to attract industry.

The advantages of the investment tax credit proposed by this amendment, however, are contingent solely upon the extent to which this credit is focused, by this Committee and the Internal Revenue Service, on the real problem. Like any other tax break, it can be abused by use inconsistent with its underlying purpose. To insure that this does not happen, the amendment would have to be administered pursuant to criteria which clearly delineates the types of industries the credit would be available to and the types of nonmetropolitan areas where investment would qualify.

One important criterion is already contained in the amendment, which requires that "the new employment opportunities in the rural area which will be assisted by such property will not result in a decrease in employment in any other area."

As I noted earlier, we are not involved in a battle between urban and rural areas for industrial investments; it is rather an attempt to reorder the development of the nation for the benefit of all areas. Therefore, a criterion which prevents the credit from being used to relocate industries from our beleagured inner cities to rural areas is absolutely essential. But even if relocation is effectively prohibited, it would also seem essential to limit the credit to those industries which will fit the pattern of economic restructuring most suited for that particular area. The Public Works and Economic Development Act of 1865 contains such a criterion in its "excess capacity" provision, Section 702, which prohibits assistance to those industries where the demand is not sufficient to employ the efficient capacity of existing enterprises. A difficult criterion to administer, certainly, but at the least it is a recognition of the directions which the implementation of the public policy should take.

The Public Works and Economic Development Act of 1965 also contains the criteria as to the types of areas that should qualify for assistance, and we think that they should be equally applicable to the Pearson amendment:

(1) The rate of unemployment or underemployment is substantially above the national rate;

(2) The median level of family incomes is significantly below the national median;

(3) The level of housing, health, and educational facilities is substantially below the national level;

(4) The economy of the area has traditionally been dominated by only one or two industries, which are in a state of long-term decline;

(5) The rate of outmigration of labor or capital or both is substantial;

(6) The area is adversely affected by changing industrial technology;

(7) The area is adversely affected by changes in national defense facilities or production; and

(8) Indices of regional production indicate a growth rate substantially below the national average.

We think these criteria are implicit in the amendment and its underlying purpose. We ask only that they be made explicit in the Committee's Report and, hopefully, in the IRS regulations implementing the new law should it be passed.

In conclusion, I want to reemphasize that the amendment proposed by Senator Pearson, if adopted and administered as described above, will evenutally have a substantial impact on rural America. We recognize, however, that a tax incentive alone is not enough, but it will serve as a precedent for the adoption of other vitally needed legislation and indicate Congressional approval for a new and long overdue change in direction for U.S. economic development policies.

Senator ANDERSON. The next witness is Mr. Hahn. Will you introduce the group here with you.

STATEMENT OF ERNEST W. HAHN, PRESIDENT, INTERNATIONAL COUNCIL OF SHOPPING CENTERS; ACCOMPANIED BY ALBERT SUSSMAN, EXECUTIVE VICE PRESIDENT; AND PAUL E. TREUSCH, TAX COUNSEL

Mr. HAHN. Yes. Mr. Chairman and members of the committee, my name is Ernest W. Hahn, and I am president of the International Council of Shopping Centers, and I have with me Mr. Al Sussman, on my left, the executive vice president of our association; and Mr. Paul Treusch, on my right, tax counsel.

I speak today as the officially elected representative of close to 4,000 companies and individuals who are engaged in the business of developing and operating shopping centers, including construction, leasing, financing, and retailing. We are active businessmen in an active and thriving industry.

During a timespan of less than 25 years, shopping center construction and operation has become a giant industry. There are about 14,000 shopping centers in the United States today, distributing more than $118 billion a year in goods and services to the American people. These centers provide jobs for more than 5,800,000 people and represent an investment of over $60 billion. They are vital to the consumers of this country and essential to this country's continued growth.

We are here to express strong support for the objectives spelled out by the President and the Congress to control inflation, create jobs and stimulate business; and we are here to ask for a part in helping to restore the economy to full strength.

We are not here to plead for special treatment. We are not here to avoid the payment of our share of business and individual taxes. We are here because as businessmen we not only want to remain in business but we also want to expand and prosper. We want to do our part toward reviving the national economy and we believe we are in a position to make a significant contribution.

We estimate that in the next 10 to 15 years there will be a need in this country for at least 10,000 new shopping centers. They can provide employment for more than 4 million people. They will require a capital investment of $4 to $6 billion a year. It will take a massive effort on the part of our industry to develop and construct these centers. We are prepared to make that effort if we have the support of the Federal Government. At the moment, I am sorry to say, we do not have that support. In fact, we lack the Government's understanding of our business and we lack its encouragement.

Please look carefully at the revenue bill of 1971. It offers all sorts of tax incentives for industries and businesses of all kinds. They are being encouraged to invest in new plants and equipment and to expand their operations. By contrast, there is nothing in the bill to stimulate real estate development in general and shopping-center expansion specifically. Whatever we do, it seems, will have to be done in spite of serious obstacles put in our way by the 1969 Tax Reform Act. Some of these obstacles are now being reinforced by Section 304 of the 1971 Revenue Bill.

In the 1969 Tax Reform Act, Congress sought to close many of the loopholes by which passive investors in real estate were able to avoid the payment of income taxes. At the same time the statute sought to make a clear distinction between those who are actually engaged in the trade or business of leasing real estate and those who are passive investors when determining whether they should be limited in the amount of interest deductions they may take on their tax returns.

To separate the two, the statute sets up two tests. One is the test of guaranteed income. The second is the 15-percent test. Insofar as shopping center businessmen are concerned, the 15-percent test is arbitrary, unrealistic and unsound. Let me explain why this is so.

In the bill before you, Section 304 removes ground rents as an item of expense when applying the 15-percent test. Can you conceive of a passive investor entering into a ground lease which may run anywhere from 33 to 99 years at a rental cost of $200,000 a year, and can you see him accepting all the risks that such a lease entails? Only a businessman running an active income-producing business could even consider such risk.

One of our members owns a shopping center on which the ground rent payment is $278,000 a year. On another they pay $106,000 in ground rent every year. Both leases have 40 years to run. A passive investor would not accept the financial risk that such longterm leases and such large amounts would expose him to.

Section 304 also specifies that reimbursable expenses may not be included as items of expense for the purpose of the 15-percent test. This apparently is based on the assumption that the owner provides no services of his own but pays for the services of others and then seeks reimbursement from his tenants.

In a shopping center these services constitute an important business activity of the lessor. They generally include such items as cleaning and sweeping of common areas, snow removal, parking-lot repairs, painting, striping and other services provided by the center owner for the common benefit of all tenants.

The shopping center owner normally charges the tenant for these services and these charges are, in effect, added rent. The very fact that the owner of a shopping center provides these services for tenants is clear evidence that he is conducting an active business and is not merely a passive investor.

The combined impact of how interest is treated under the 1969 Tax Reform Act and section 304 of the 1971 revenue bill on the active shopping center owner is frustrating and punitive.

Senator ANDERSON. Where are you reading from?

Mr. HAHN. Pardon me, sir. I am reading an oral manuscript, sir. We have filed a detailed technical document with the committee, sir, and there is an oral presentation.

Senator ANDERSON. Do you have a copy?

Mr. HAHN. I would be very happy to furnish you with one, sir. Mr. Sussman will give you one.

The combined impact of how interest is treated under the 1969 Tax Reform Act and section 304 of the 1971 revenue bill on the active shopping center owner is frustrating and punitive. The 15-percent test ensnares the active shopping center developer and owner who is engaged in a complicated and demanding business, with its normal share of business risk, in a trap that was set to catch the passive investor.

The test reaches the heights of absurdity when a taxpayer tries to apply the proposed Treasury regulations enforcing the interest provision in the 1969 Tax Reform Act. Section 304 by itself will cause most of our members who own and operate shopping centers to fail the 15-percent test.

Under the Treasury regulations, no shopping center may be treated as a single entity for purposes of the 15-percent test. Each and every lease must be submitted to the test individually. And, in addition, all income and all expenses are to be allocated separately to each lease. I shudder to think how we would even begin to make these calculations on several centers in which I am a principal owner. These centers each have more than 100 tenants. It is almost impossible to make the allocations tenant by tenant; and it is totally horrifying from an administrative point of view to see how we can keep accurate and adequate records.

Now, let's examine what happens when this test is applied to each lease individually.

In one shopping center you may find that a given number of leases pass the 15 percent test while others fail it. If this happens, you are now confronted with the fact that you have two types of income or loss to report on the same center. One is income or loss from investment property. The other is income or loss from business property.

On the investment property you are subject to a limitation of interest deductions. On the business property there is no such limit.

At one and the same time you are classified for tax purposes as both a passive investor and as an ordinary businessman, even though all your income or losses derive from the same business enterprise.

How do you, as a businessman, divide your identity to satisfy the tax collector. How do you logically and sanely accept the concept that on the very same mortgage you can deduct interest payments for some tenants while on neighboring tenants you may not? How do you deal with the fact that from year to year, depending on whether business is good or bad, any given lease or group of leases can shift from passing to failing the 15 percent test by virtue of the fact that each year everything is subject to recomputation?

How do you cope with the fact that if you have a center that fails the 15 percent test and loses money, you cannot offset the interest expenses of this center against the income from another center that produces only business income?

The 15 percent test discriminates against the active businessman. It is an accountant's nightmare. It is an administrative calamity. It frustrates the businessman who wants to actively and aggressively expand his business and develop more shopping centers.

We respectfully request that it be eliminated from the net lease definition. Anything so cumbersome, so illogical, so inequitable and so difficult for businessmen to comply with should not remain in the statute.

Some question has been raised in the proposed Treasury regulations about the intent of Congress with regard to the deductibility of construction interest. We appeal to you to make it clear by amendment to H.R. 10947 that interest paid or accrued on loans incurred during the construction of real estate developments constitutes business interest. This will continue to serve as a strong incentive for developers to build and expand shopping centers. At a time when Congress is offering substantial incentives to other businesses and industries to expand, there should be no question about permitting real estate developers to continue deducting business expenses that will permit them to expand their operations.

I am grateful for the opportunity to present these observations to you.

In summation, I want to emphasize that the International Council of Shopping Centers and its members fully support the national effort to revitalize the economy. Our members have built a giant industry without any Government subsidies or grants of any kind. We have faith in the future of America and in our ability to contribute to that future. We ask only that we be given the same benefit and consideration being given other segments of industry—no more and no less—and we ask for it in relation to the essential and vital role we play in the total economy.

Thank you, gentlemen.

The CHAIRMAN. Thank you very much, Mr. Hahn. I want to assure you I am going to study your statement. I had to step out of the room while you were testifying but I am going to carefully study it because I know we created somewhat of a problem for your people when we passed the Tax Reform Act.

I think that had something to do with the slowdown of the economy the way it is now and if we can we ought to try to undo some of that in this bill.

Mr. HAHN. Thank you, Senator Long.

I was greatly encouraged by the tenor of your remarks to Mr. Williamson, and I certainly hope you will pursue that line of thinking.

Thank you very much.

(Mr. Hahn's prepared statement follows:)

PREPARED STATEMENT OF ERNEST W. HAHN, PRESIDENT OF THE INTERNATIONAL COUNCIL OF SHOPPING CENTERS

Mr. Chairman and members of the Committee, my name is Ernest W. Hahn. I am President of the International Council of Shopping Centers, a trade association of almost 4,000 members, engaged in the development and operation of shopping centers including construction, design, financing, leasing and retailing. Over 90 percent of our members are taxpayers who actively conduct business activities in this country.

According to the most current figures available, more than 13,000 shopping centers containing more than 200,000 retail stores are now operating in the United States. As an industry, shopping centers represent a total investment in our economy of more than $60 billion and provide livelihoods for more than 5,800,000 employees.

There is a continuing need in this country for new shopping centers to provide vital goods and services to millions of American families. We have estimated that the development and construction of all the new centers that will be required in this country for the next 10 to 15 years will require an investment in the range of $4 to $6 billion a year. It will take a massive effort on the part of our industry to construct these centers. We are prepared to make that effort and will make it if we can have the support of the government. I regret to report, however, that at this moment we are lacking the support of the government; we lack its understanding and we lack its encouragement.

American industry in general is being offered incentives to invest in new plant and equipment and to expand their operations so that there will be more jobs and greater economic activity. In the case of real estate in general and shopping centers specifically, the 1969 Tax Reform Act contained a proliferation of ill-conceived provisions which hamper and complicate the normal business activities of shopping center developers and owners. The effect of these provisions is to discourage shopping center expansion. Now the 1971 Revenue Bill seeks to extend one of the most onerous and inequitable provisions of the 1969 Tax Act. Section 304 of H.R. 10947 attempts to broaden the definition of a "net lease" and the result is that the shopping center developer and owner who is actively engaged in a complicated and demanding business, filled with its normal share of risk, is ensnared by a test that has been set to trap the passive investor.

Section 304 of H.R. 10947 has eliminated reimbursed expenses as Code Section 162 expenses for purposes of the 15 percent test under the statutory definition of a "net lease". The House Ways and Means Committee report accompanying H.R. 10947 states that the 15 percent test ". . . looks to the degree of the lessor's business activity with respect to the leased property." (H. Rep. 92–533, 92d Cong., 1st Sess., p. 47). If this is the purpose of the 15 percent test, we do not understand why reimbursed expenses should not be allowed in applying the 15 percent yardstick. Expenses incurred by the lessor and reimbursed to him by the lessee, by their very nature, impose a burden and obligation upon the lessor to perform services which otherwise would fall to the lessee. In short, the lessor, rather than the lessee, is carrying out the business activity with respect to the property. The fact that the lessor is reimbursed for such expenses demonstrates that the reimbursed amount represents additional income for specific services.

In addition to this, Section 304 of H.R. 10947 is strangely silent as to whether the amount of expenses reimbursed by the lessee to the lessor constitutes income to the lessor for purposes of the 15 percent test. Even the proposed Treasury regulations which dealt with this matter eliminated reimbursed expenses as both Code Section 162 deductions and as rental income. H.R. 10947 is even more punitive.

Section 304 also seeks to eliminate ground rents as a Code Section 162 expense for the purpose of the 15 percent test. My company owns one shopping center on which we pay $278,000 a year in ground rent. We own another on which we pay ground rent of $106,000 a year. These are typical of the ground rents paid by many regional shopping center owners. It is clearly not in the nature of passive investors to commit themselves to large amounts of rents for extended periods of time, ranging anywhere from 33 to 100 years, with all the inherent risks involved. This is the type of risk that only a businessman would consider and commit himself to. A passive investor would not consider it.

Simply stated, we believe Section 304 of H.R. 10947 will cause most of our members who own and operate shopping centers to fail the net-lease test. This will produce chaotic administrative burdens on shopping center owners along with intolerable and absurd accounting procedures for tax purposes.

Under the proposed Treasury regulations, no shopping center is to be considered as a single unit for the purposes of the 15 percent test. Instead each and every lease is to be submitted to the test individually. All income and all expenses are to be allocated separately to each lease—a virtually impossible and horrendous task.

The absurdity of these requirements is evident when it is recognized that in a typical shopping center, it is quite possible to have some leases that pass the 15 percent test while others do not. The center owner will then have investment income (or losses) to report on the one hand and business income (or losses) on the other from the very same shopping center.

In the one instance, he is deemed to be a passive investor and in the other he is treated as an ordinary businessman. Such a division of identities, even for tax purposes, is indefensible. It runs counter to good business practice and frustrates the honest businessman who wants not only to remain in business but also to expand and prosper. How can he logically and sanely cope with the concept that on one lease he may not be allowed to deduct interest but on a neighboring lease interest is fully deductible, and in the next year the lease that formerly produced business income is now producing investment income because the entire formula is subject to year-to-year recomputation.

The 15 percent test is patently and indefensibly self-defeating. Any device so ill-conceived and so discriminatory should be dropped from the statutes. It is an accountant's nightmare. It discriminates against the active businessman. It compels him to assume the identity of a passive investor. It frustrates the businessman who would otherwise actively and aggressively expand his business and develop new shopping centers.

Congress, at the request of the President, is seeking to control inflation, stimulate the economy and create jobs.

There will be 152,000,000 square feet of new shopping center space built next year, according to present projections. This new construction will alone require the employment of close to 275,000 construction workers, in addition to capital expenditures of $4 to $6 billion.

Other industries are being granted business incentives for expansion consistent with the President's outlined program for the development of a sound, stable economy.

The shopping center industry is not seeking singular or special consideration, but rather requesting an extension of the same basic philosophy that the government is granting to other key industries; namely the encouragement of future growth and prosperity.

In conclusion, we are deeply concerned that the probable failure of the 15 percent test by most shopping centers may limit the deductibility of construction interest and thereby seriously affect the ability of developers to produce more centers. We believe that in the 1969 Act, Congress intended to provide that construction interest paid or incurred by shopping center developers would be treated as business interest and accordingly would be fully deductible. Unfortunately, the proposed Treasury regulations dealing with construction interest have cast doubt as to whether construction interest will be treated as business interest. The deductibility of construction interest is essential if there is to be more development of shopping centers and the accompanying benefits that such development will generate for the economy.

The Revenue Bill of 1971 provides a multitude of tax incentives for almost every segment of the economy. There is none for real estate development and operation. We respectfully request that the 1971 Revenue Bill clarify what was Congress' intent when it passed the 1969 Act—namely, that interest paid or accrued on indebtedness incurred or continued in the construction of property is to be treated as business interest expense and not as investment interest expense.

In addition, because of the basic confusion and inequities caused under the 15 percent test as originally adopted in 1969 which are broadened and compounded under H.R. 10947, we further urge the Committee to recommend the complete elimination of the 15 percent test from the net lease definition as stated in Code Sections 57(c) and 163(d)(4). By such action, active businessmen would not be penalized and Congress' concern over passive investors would still, in our opinion, be satisfied under the present "guarantee test" adopted in 1969.

Lastly, we request that Congress re-examine all of Code Section 163(d) and delay the effective date of this provision, now scheduled for January 1, 1972, until such point as its full implications on active businessmen, which in our opinion are unduly punitive, are fully explored and understood.

I appreciate this opportunity to present our viewpoint to you and I respectfully hope that our observations will help you in your deliberations.

The CHAIRMAN. The next witness will be Mr. Alan J. B. Aronsohn, counsel for the National Realty Committee, Inc.

STATEMENT OF ALAN J. B. ARONSOHN, ESQ., COUNSEL, NATIONAL REALTY COMMITTEE, INC.

Mr. ARONSOHN. Mr. Chairman and members of the committee, my name is Alan Aronsohn. I am appearing on behalf of the National Realty Committee which is an organization that represents major owners and developers of investment real estate throughout the country.

I don't think that we are guilty of Chairman Long's suggestion earlier that we are not asking for enough. Our written statement which has been submitted to you is a very lengthy one and the time allotted to us for an oral presentation is so brief that I will simply touch on some of the points that we make in the written statement. I respectfully urge as much consideration for the written statement as you feel you can give it.

The CHAIRMAN. If I might say, Mr. Aronsohn, the approach for witnesses would be to have your full statement prepared and we will print every word of it in this record as though you had read every word of it. Then when you appear before the committee, as the law indicates you summarize the statement but try to see to it that in summarizing it you alert those of us on the committee to the principal points you want us to look at so that somebody who agrees with you can fortify himself with everything in it to fight your case when they go behind closed doors in executive meeting.

Mr. ARONSOHN. Mr. Chairman, that is what I hope to do.

To start, actually from the end of our statement, I want to just touch upon on section 304(a) of the House bill to which previous speakers this morning have alluded. We do support the statements made earlier today by the National Association of Real Estate Boards, and the International Council of Shopping Centers with respect to the adverse effect of the investment interest limitations on real estate investment.

This provision, as you will recall, was one of the many reform provisions included in the 1969 Tax Reform Act. The Treasury was somewhat unhappy with it at the time. It was originally in the House bill;

it was deleted by the Senate; it was reintroduced in conference and the applicability of these provisions to real estate is particularly troublesome from an administrative and economic point of view, and, in our judgment, produces very little in the way of actual final economic or revenue result primarily because income-producing real estate is not comparable to the non-dividend paying growth stock which, I think, Chairman Mills was primarily concerned with when the provision was introduced.

As we understand the primary goal of the provision, it was to prevent the deduction of interest incurred in carrying a nonincome producing investment. Typically, such income-producing real estate does produce income and it is subject to the recapture rules of section 1250 on sale and, therefore, we think the situation is substantially different.

If this committee does not see fit to delete rental real estate from the investment interest provisions, we have two positions that we urge upon the committee: (1) that the reimbursed expense provision of section 304(a) of the House bill, which was previously discussed this morning, be deleted; and (2) that the Senate amend the investment interest provision to make it clear that construction interest is in all cases deductible by a taxpayer irrespective of the purpose for which the property will be put subsequent to the completion of construction.

We are raising this point because the Treasury, in its proposed regulations, takes the view that if property subsequent to completion of construction is utilized in a certain manner, that can affect the deductibility of the interest incurred by the taxpayer during the construction of the property. We feel that there is no mandate for this in the legislative history of the original provision and, frankly, no sense to it. We feel that it is difficult to point out a business activity more fraught with hazards, risk and a great deal of active work than the construction business, and to compare that to a passive investment during the construction period, no matter what happens to the property thereafter seems to us to make no sensible tax policy whatsoever.

To move on, we urge this committee to extend the President's job development tax credit to the construction of new buildings. This credit is labeled as a job development investment credit. It seems to us that the obvious purpose is to create the greatest incentive to employment opportunities in the economy that is possible.

The House expanded the President's original proposal to include livestock. It seems to us that there are considerably greater opportunities for improving the economy by creating tax incentives for the construction of new buildings rather than to increase livestock herds.

We also feel that the House bill's provision with respect to creating a new class life system of depreciation is a good provision, a salutary one, but we would request that this committee instruct the Treasury to include buildings within the new class life system, something the Treasury did not do with respect to the ADR system which was the precursor of the provision in the House bill.

In summary, we feel that the real estate industry was badly hurt by the provisions of the 1969 Tax Reform Act. We do not have available to us the statistical machinery that the Government has; but we doubt very much whether the estimated revenue gains from real estate set forth in the record concerning the 1969 Tax Reform Act probably actually eventuated. We feel that the provisions of the 1971 Revenue

Act, to the extent that they provide incentives to certain sectors of the economy, through the investment credit or through depreciation revision, should be extended to real estate. Otherwise we are going to find that this important area of the economy falls further and further behind the rest of the country.

I thank you very much.

The CHAIRMAN. Thank you very much, Mr. Aronsohn.

What we did with regard to interest in that Tax Reform Act proceeded on the theory that the person paying interest on an investment was going to make money, and, assuming that it was going to be a profitable deal, that he would receive a favored tax situation.

If you look at the way it works out, in some cases, why, the fellow gets the worst of it. He does not make a good investment; he makes one where he is going to lose money. Not all investments make money; some of them are going to lose. So if you are going to have to take a loss on it and he is trying to hold on and do the best he can to work himself out of an unfortunate situation, to deny him the deduction of his interest expense while he is holding on trying to make the best of a bad deal is a very unfair tax situation.

Mr. ARONSOHN. We feel that way and we feel, in particular, that the way the investment interest provisions operate with respect to rental real estate, this is precisely what happens. It is the rental real estate project which is in trouble, which is the one that really gets hit by this. The rental real estate project which is not in trouble after you go through all the calculations is an administrative horror; you find out it does not have much, if any, application. It is the job that is producing an economic loss that then suffers this double penalty of having a detrimental tax in addition.

The CHAIRMAN. Thank you very much.

(Mr. Aronsohn's prepared statement follows. Hearing continues on p. 573.)

PREPARED STATEMENT OF ALAN J. B. ARONSOHN, ESQ., COUNSEL, NATIONAL REALTY COMMITTEE, INC.

Mr. Chairman, my name is Alan J. B. Aronsohn, and I am appearing on behalf of the National Realty Committee Inc., an organization representing many of the most active real estate developers and investor-builders throughout the country. We are grateful for the opportunity to present our views to you.

We are appearing before this Committee for the purpose of commenting on the proposals for a Job Development Investment Credit and Depreciation Revision contained in Title I of H.R. 10947 and the amendments to the investment interest provisions contained in Section 304 of H.R. 10947.

DEPRECIATION REVISION

Section 110 of the House bill substitutes a new class life depreciation system for the ADR system and the guideline life system. While Section 110 does not specifically exclude real property, the creation of classes for the class life system is delegated to the Secretary of the Treasury, and the prior position of the Treasury, as reflected in the ADR system, militates against any expectation that the Treasury will, at this time, include buildings within the new class life system, if enacted.

In connection with the Treasury's adoption of the ADR system, which excluded buildings, the Treasury issued a report, prepared at the request of Senator Sam J. Ervin, Jr., Chairman of the Subcommittee on Separation of Powers, Senate Judiciary Committee, which set forth the Treasury's reasons for adoption of the ADR system and the legal authority of the Treasury Department in adopting those changes by administrative action. This report, dated June 22, 1971, was published on pages 193, et seq., of a document issued by the Department of the Treasury, dated June 1971, entitled "Asset Depreciation Range (ADR) System". The only reference to buildings is contained in footnote 65 to the report, which states, in part, as follows:

"Buildings, generally, and assets which are predominantly used outside the United States are not eligible for the ADR system. Reg. § 1.167(a)-11(b)(2). The authority under §§ 167 and 7805 of the Internal Revenue Code is sufficiently general to permit the Treasury to exclude such assets from the ADR system. Moreover § 167(d) of the Code specifically authorizes the Internal Revenue Service to enter into agreements with particular taxpayers with respect to depreciation of particular assets. See Reg. § 1.167(a)-(11)(g)(1).

"Buildings are generally sold by taxpayers upon retirement. The rules for recapture of depreciation under section 1245 of the Code provide in general that gain on sales of personal property are taxed as ordinary income to the extent of all the depreciation taken on the property. Although opportunities for avoiding taxes as a result of accelerated depreciation for real estate were substantially reduced by the Tax Reform Act of 1969, the rules for recapture of depreciation as ordinary income upon the sale of buildings under section 1250 of the Code still permit a significant number of taxpayers who dispose of buildings prior to the expiration of their useful lives to depreciate below the anticipated sale value of the buildings and, upon sale, to treat a substantial portion of the excess of disposition proceeds over adjusted basis as capital gains. The added flexibility provided by the ADR system which permits taxpayers to select useful lives from within a range from 20 percent below to 20 percent above the guideline life would, in the case of buildings, increase opportunities for converting deductions from ordinary income into capital gains. In addition, such flexibility would increase the opportunity for generating 'tax losses' in the early years of buildings' lives. See generally H. Rept. No. 91-143, 91st Cong., 1st Sess. Pt. 1, 165-67 (1969); S. Rept. No. 91-552, 91st Cong., 1st Sess. 211-15 (1969).

"Since buildings are generally sold upon retirement by the taxpayer information made available through the ADR system as to retirements of assets to enable the Treasury to refine and update the estimations of useful lives will not be meaningful with respect to buildings. In addition, the administrative difficulties to be resolved by the ADR system are not present to the same extent in the case of buildings as with other business assets such as machinery and equipment.

"Although Treasury has concluded that these factors require the exclusion of buildings and property primarily used outside the United States from the ADR system, the reasons for rejecting the reserve ratio test as the sole method of determining useful lives apply with equal force to these assets. The reserve ratio test is a mechanical, backward looking mechanism which cannot take economic obsolescence into account. In addition, the reserve ratio test was designed primarily for multiple asset accounts composed of a wide variety of assets to measure the replacement practices of taxpayers; as a technical matter, its application to buildings often produces results which are not meaningful. See the discussion of the reserve ratio test at pp. 27-47, supra."

The foregoing statement indicates that the Treasury's opposition to the inclusion of buildings within the ADR system was based solely upon two points:

1. "The administrative difficulties to be resolved by the ADR system are not present to the same extent in the case of buildings as with other business assets such as machinery and equipment."

2. Despite the limitations imposed upon real estate under the 1969 Tax Reform Act, the Code still permits "a signifiant number of taxpayers who dispose of buildings prior to the expiration of their useful lives to depreciate *below the anticipated sale value* of the buildings and, upon sale, to treat a substantial portion of the excess of disposition proceeds over adjusted basis as capital gains." [Emphasis added.]

With respect to the Treasury's contention respecting administrative difficulties, it would seem obvious to us that the administrative difficulties of determining, with any degree of certainty, reasonable economic useful lives for long-lived assets, such as buildings, must be inherently far more difficult than similar determinations with respect to assets having shorter economic useful lives. The Treasury's argument with respect to abolition of the reserve ratio test, that such test is a "mechanical, backward looking mechanism which cannot take economic obsolscence into account", has obviously even greater validity when attempts are made to determine obsolescence factors involving buildings having an inherently long physical life but potentially subject to a substantial number of factors, such as technological change, changes in life style, changes in neighbohood, and the like, which may affect income producing real estate over a period of many years.

We are, therefore, of the opinion that the establishment of reasonable capital cost recovery periods for investment real estate, based upon factors which the average investor takes into account in making an investment decision, is an even more pressing necessity for a smoothly functioning revenue system minimizing administrative difficulties than the problem of making similar determinations with respect to short lived assets. As a practical matter, it may be feasible for the newly-created Treasury Office of Industrial Economics to collect and analyze data on obsolescence and repair and maintenance practices with respect to relatively short lived machinery, but it is doubtful whether any such analysis can realistically be made concerning buildings before the information collected becomes stale and of no real relevance to future investment policy. The accelerating rate of change in our society makes it virtually impossible to predict with any degree of certainty whether, for example, a newly constructed shopping center will constitute an economically viable unit two generations from now when changes in living and highway patterns, merchandising styles, and consumer preferences will, in all likelihood, substantially differ from those prevalent today. Many so-called "Triple A" retail urban locations of twenty years ago are today in areas requiring demolition and replacement under urban renewal programs.

We, therefore, submit that buildings held for the production of rental income are uniquely qualified to be subjects of a class life system based neither upon any mechanical, backward looking mechanism nor upon any illusion of certainty with respect to forward looking predictions of economic useful life. Instead, we suggest the establishment of class lives for rental real property based upon standards generally accepted in the financial markets as reasonable periods for recovery of investment capital from wasting assets. In this connection, in a speech before the Tax Foundation, Dr. Richard Slitor, Acting Director of the Office of Tax Analysis, U. S. Treasury Department, made the following statement as an expression of his personal view, not that of the Treasury:

"How many advocates of a brutal long-service life policy have stopped to examine the implications of time discounting? Standard actuarial tables tell us that the present value of a depreciation deduction 50 years hence is about 5 cents of the dollar even with a 6 percent discount rate. At a 10 or 15 percent discount rate more appropriate for business risks in today's economy, its value is negligible. The truth is that the long-deferred part of tax depreciation on a depreciable asset is worth little or nothing. Stretching out of lives is tantamount to taking away a part of capital recovery as far as the effective horizon of the sophisticated investment decision is concerned. An allowance 50 years, 30 years, or even 25 years hence—even in a normally high-risk industry—has little significance in the weighing of an investment decision. This argues for a rational view of realiste lives and a skeptical view of very long lives in light of the fact that a long stretchout is virtually denial of the remote portion of the allowance."

With respect to the Treasury's second argument that the ADR system (or the class life system) should not be applicable to buildings because buildings may be depreciated "below the anticipated sale value of the buildings" resulting in a portion of any gain realized upon the disposition of such buildings being treated as capital gain, the obvious answer is, why not treat such gains as capital gains?

Disposition of a building at a "sale value" in excess of the adjusted basis of the building generally has no bearing whatsoever on the question of whether or not the depreciation previously taken with respect to such building accurately measured the physical wear and tear on the building or fairly represented a reasonable capital cost recovery period for the amounts invested in the physical structure of the building.

The Treasury report previously referred to states, under the heading "What Depreciation Is" (p. 194), that "The depreciation deduction is allowed in order that taxpayers may treat as an expense in determining taxable income an allocable part of the cost of business assets which have a limited life." Depreciation is permitted for the recovery only of "cost". Value is irrelevant to the determination of depreciation, except to the extent that it constitutes a factor in measuring economically useful life.

Since the value of a building held for the production of rental income depends upon a multitude of factors, of which the value of the physical components constitutes only a part and in many cases less than the predominant part, the sale value of a building most often reflects more than the value of simply the physical assets, the useful life of which alone, however, constitutes the measuring period for depreciation.

The sale value of a building held for rental income is virtually always a reflection of the value of the estimated income stream to be generated by the building and the land upon which it is situated. The value of this estimated income stream is affected not simply by the physical age of the improvements and their condition, but, more importantly, by the rents estimated to be derived from the property and the relationship of such rents to expenses.

Rental values are subject to innumerable factors, including, for example, inflationary trends, changes in neighborhood in which the property is located, local laws and regulations, general economic conditions in the area and the relative success of tenants' operations where leases containing provisions for percentage rentals are involved.

Expenses of operating rental property are, similarly, subject to a myriad of uncontrollable factors. such as changes in local taxes, technological changes (such as the installation of self-service elevators and improved heating and air conditioning equipment), changes in utility costs, and, most importantly, changes in interest rates, which affect to a substantial degree the cash flow income which can be anticipated by any investor in rental real estate.

As a consequence, the fact that a taxpayer may be able to sell a 10-year old building for a price equal to the original cost of construction does *not* mean that the building has not "depreciated" during the 10-year period. The physical structure of the building and all of its components are. indeed, ten years older, ten years closer to the need for replacement, and ten years behind in terms of competition with new structures then being constructed and, perhaps, containing amenities not usual or available ten years earlier.

The fact that a 10-year old building may be sold for a price equal to its original cost may reflect inflationary increases in the cost of construction, an increase in the value of the underlying land, an increased cash flow income from reductions in mortgage interest rates, or increased rental receipts derived from tenants under percentage leases. *Gains realized as a consequence of any one of the foregoing causes are traditionally treated as capital gains*, and it should be noted that the operation of the recapture rules, as presently contained in Section 1250 of the Internal Revenue Code, more often result in the treatment of a portion of such gains as ordinary income than the absence of stricter recapture rules may produce the conversion of an ordinary deduction into future capital gain as the Treasury apparently fears.

A simplified example may be useful in illustrating this point. Assume a retail store building constructed on land leased for a period of twenty years. The building is subleased to a chain store under a 20-year lease providing for percentage rentals. The owner's cost in constructing the building is recoverable for income tax purposes over the 20-year term of the ground lease since, at the expiration of the 20-year term, the owner has no residual interest in the property. If the building cost $100,000 to construct, the owner would be permitted to deduct $5,000 per year. At the end of ten years, the owner's adjusted basis would have been reduced to $50,000. Assume further that because of a successful sales history by the store tenant, percentage rentals have doubled the rent between the first and the tenth year of the lease so that at the expiration of the tenth year the owner can sell the building, subject to the outstanding lease to the retail store, for $100,000. The owner, therefore, has realized a $50,000 taxable gain, representing the difference between the $100,000 realized on the sale and the $50,000 representing the adjusted basis of the owner for the property. The $50,000 gain realized should be taxable at capital gains rates and should not be subject to ordinary income tax treatment by the application of any recapture rule.

In this regard, we note that the report of the House Ways and Means Committee on H.R. 10947 (H.R. Report No. 92-533, 92nd Cong., 1st Sess.) contains the following statement:

"Useful lives for real property.—During your committee's consideration of depreciation and useful lives, its attention was called to the useful lives prescribed for real estate under the 1962 guideline program. Your committee believes that in connection with its review of the useful lives of tangible personal property, it is also desirable to make a study of the lives accorded various types of real property, and therefore it is requesting the Treasury Department to undertake such a review. In this connection your committee believes that it is also desirable to consider whether, if lives are shortened, the recapture rules presently applicable in the case of real property should be made more like those applicable to personal property."

We believe that such a review of useful lives for real property should be undertaken and we request this Committee to join the House Ways and Means Committee in its request to the Treasury Department to undersake such a review.

However, with respect to any review of the recapture rules presently applicable in the case of real property, we submit that Congress has recognized since the introduction of recapture rules in the 1962 Revenue Act that the purpose and effect of recapture rules respecting personal property and real property are vastly different.

Recapture rules respecting depreciation taken with respect to machinery used in productive processes have little practical effect upon the taxpayers utilizing such machinery. However, applying stringent recapture rules to investment assets has an important influence on investment decision. Such provisions do not produce revenue; they simply inhibit sale. Taxpayers owning substantial investment assets such as rental real estate cannot afford to sell such assets if the tax consequences from such a sale are prohibitive. Stringent recapture rules when applied to such assets, therefore, merely produce an increasing "lock-in" effect on that segment of the investment market to which applied and ultimately result in a decline in investment in that sector of the economy, particularly where the assets possess long useful lives and the expectation of the investor is not necessarily to retain ownership of the investment to the expiration of its economic life.

Decisions to invest in machinery for productive use are not usually made based upon any expectation of gain on resale. Investments made in rental real estate are made in the expectation of such gain, and without some reasonable expectation of such gain, there is no incentive for the private sector to invest. Profits are the cornerstone of investment decisions. It is, therefore, sensible to recognize that it is appropriate to treat gains derived from probably incidental profitable sales of productive machinery differently from gains derived from profitable sales of rental real estate, particularly when, as illustrated above, gains realized on the sale of rental real estate are rarely the result of any miscalculation of depreciation, but rather result from numerous factors, not usually present in connection with productive machinery, which are of a basic nature entitled to capital gain treatment.

Real estate would simply cease to be a viable vehicle for individual investment if recapture rules more stringent than those already imposed by the 1969 Tax Reform Act were enacted. By its nature real estate generally represents a relatively illiquid investment in comparison with marketable securities. Recapture rules, by increasing investment illiquidity, make real estate investment progressively less attractive than competitive inestments in personal property. In fact, the effects of the substantial tightening up of allowable methods of depreciation and the recapture rules applicable to commercial real estate imposed by the 1969 Tax Reform Act have already had a substantially adverse effect upon new investment in this sector of the economy.

JOB DEVELOPMENT INVESTMENT CREDIT

Section 101 of H.R. 10947, providing for restoration of the investment credit, amends the definition of property which will be entitled to the new Job Development Investment Credit by extending such credit to livestock and to certain property used in furnishing communication services and by excluding certain property entitled to rapid amortization. The House bill does not include any Job Development Tax Credit for construction of new buildings.

The exclusion of new buildings from the ambit of investment entitled to the tax credit reflects a continuation of the pattern established by the investment credit provisions of the 1962 Revenue Act. We submit to the Committee that present economic conditions and the differences in the Federal income tax treatment of real estate which have occurred subsequent to the 1962 Revenue Act require reconsideration in the Revenue Act of 1971 of provisions to stimulate additional investment in real estate, as well as other fields. Since the enactment of the original investment credit proposals in 1962, the tax treatment of investments in real estate, as opposed to investments in tangible personal property, has steadliy deteriorated.

In examining the merits of the proposed Job Development Investment Credit, we submit that he Congress should not lose sight of the favorable compound effect on the economy as a whole that will result from increased construction activity. The construction of new buildings creates not only a demand for increased employment in the actual erection of the structures, but also has a multiplier effect on the economy in creating a further demand for construction equipment and for the materials used in construction, from structural steel, lumber, glass and cement to wiring, plumbing, appliances, furniture and the many other products utilized in the building industry. No comparable activity can create more jobs throughout the United States and a greater increase in the Gross National Product.

In 1962, when the investment credit was initially proposed, buildings were excluded because, in the words of the report of the House Ways and Means Committee, "the greater emphasis is placed on equipment and machinery because it is believed the need for such investment is the major requirement of the economy." (H.R. Rep. No. 1447, 87th Congress, Second Session, as reported in the 1962–63 Cum. Bull. (413).)

At that time, the primary purpose of the enactment of the investment credit was to improve the competitive position of American industry by creating incentives to the modernization of industrial plant. (Sen. Rep. No. 1881, 87th Congress, Second Session, as reported in 1962–63 Cum. Bull. 716–717).

The purpose of the President's Job Development Tax Credit proposal, while undoubtedly including among its goals the improvement of America's competitive position in the world economy, was primarily directed at enhancing the immediate prospects for the creation of jobs in the domestic economy.

We submit that the exclusion of real estate from the scope of any proposed Job Development Investment Credit substantially diminishes the effectiveness of any such credit to achieve its stated objective and, in fact, will be counterproductive to the achievement of such results.

It has been suggested, for example, that a Job Development Investment Credit relating primarily to machinery and equipment, at a time when substantial excess plan capacity exists in the United States, may not produce any immediate substantial increase in jobs, but on the contrary may in part simply result in the introduction by industry of additional labor saving machinery. (Statement by the AFL–CIO Executive Council, August 9, 1971.)

Certainly, the expansion of the coverage of the Job Development Investment Credit by the House to cover livestock can hardly be viewed as enhancing the prospects for any substantial increase in employment. The reason set forth in the report of the House Ways and Means Committee for the inclusion of livestock is that "in 1969, livestock was placed in the position as other types of business property in that it was made subject to the depreciation recapture rules. As a result, your Committee concluded that consistent treatment under the credit required that livestock be made eligible for the credit." (H.R. Report No. 92–533, 92nd Congress, 1st Session.)

We find it difficult to discern any necessary relationship between depreciation and the Job Development Investment Credit, and less relationship between depreciation recapture rules and the existence of a tax credit. If the purpose of the credit is to create jobs, then it would seem that the credit should be offered first to those sectors of the economy most likely to increase employment if the credit were granted. In any event, real estate is subject to recapture rules which, if not identical to those applicable to personality, still adequately protect the public fisc against any excessive depreciation benefits.

If Congress feels that the total tax treatment being accorded to any particular industry, including the existence of any tax credits, represents an excessive incentive to capital investment in such industry, Congress is, of course, free to, and should, reduce such excessive incentives. It can hardly be contended at this juncture, however, after the passage of the 1969 Tax Reform Act, that incentives to capital investment in rental real estate are excessive or even at a level comparable to those accorded to investments in personal property or minimally necessary to sustain the oft-stated Government goals for the production of housing and related commercial structures during the 1970's. (See statement of Dr. Leon H. Keyserling before this Committee, October 13, 1971.)

Investment in rental real estate is essentially discretionary, and the industry is characterized by a very large number of small producers. Tax incentives have a substantial effect on discretionary investments of this kind. No incentive could create a greater expansion of job opportunities throughout the economy as a whole, while at the same time substantially contributing to the Nation's goals for adequate housing and urban redevelopment than the extension of the proposed Job Development Investment Credit to the construction of new buildings.

INVESTMENT INTEREST EXPENSE

Section 304(a) of the House Bill would amend the definition of 'net lease', set forth in the investment interest provisions enacted as part of the Tax Reform Act of 1969. For the reasons discussed below, we submit that in lieu of Bill Section 304(a), the statute should be amended to limit application of the investment interest provisions in respect of real estate to *non-income producing investment real estate.* In the alternative we submit that Bill Section 304(a) should be revised by deleting the phrase ". . . and reimbursed amounts . . ." and by further providing for the deletion in I.R.C. Section 57(b)(2)(D) and I.R.C Section 163(d)(4)(D) of all references to interest incurred during the period that property is under construction, as more fully discussed below.

PURPOSE OF THE INVESTMENT INTEREST PROVISION

It is our understanding that when the Treasury first considered provisions relating to investment interest, the objective was to limit the tax advantage of borrowing funds to carry non-income producing growth investments, the profit from which would be taxed at preferential capital gains rates while the interest expense would be deducted against ordinary income. For example interest on a margin account maintained to carry a non-dividend paying growth stock would provide an ordinary deduction while profit on sale of the stock would be taxed at capital gain. However the ambit of sections 57(b) and 163(d) as proposed in the House Ways and Means Committee draft of HR 13270 was materially broader than the provision suggested by Treasury. This Committee followed the Treasury's recommendation and deleted the investment interest provisions from the Senate draft of The 1969 Act. Nevertheless, an investment interest provision was agreed to in Conference with an amendment relating to construction interest.

Our review of the investment interest provisions as applied to actual real estate transactions indicates that rather than minimizing or reducing a tax advantage, these provisions have the unintended potential of increasing a real economic loss from a bad investment as discussed below.

As the House has seen fit to propose a substantive amendment relating to the investment interest provisions, we believe it appropriate at this time for the Congress to consider another important amendment to the investment interest provisions, as hereafter described, as applied to rental real estate.

OPERATIONS OF THE NET LEASE PROVISION IN THE CASE OF RENTAL REAL ESTATE

In the normal parlance of the real estate industry, the concept of a Net Lease generally requires a rent which includes a fixed amount representing a return on the lessor's cash investment plus an amount sufficient to cover (1) his payments of mortgage interest and principal (2) all real estate taxes and assessments (3) all expenses of repair and operation of the property and (4) all costs of capital improvements following occupancy by the lessee. The definition of "net lease" in sections 57(b) and 163(d) incorporate this type of lease under the "guaranteed return" test set forth in § 57(c)(2) and § 163(d)(4)(A)(ii). The statutory definition, however, also includes a novel definition of "net lease" based on the relative activity or passivity of the landlord (net lessor) in respect to the lease. This test (the "business activity" test) set forth in § 57(c)(1) and § 163(d)(4)(A)(i) provides that if the lessor incurs section 162 expenses in an amount less than 15% of the rents produced by the property, the lease will be deemed a "net lease".

Under both sections 57(b) and 163(d), the first test to determine the existence of investment interest which may be a tax preference item (pre 1972) or which may be disallowed (post 1971) is whether such interest exceeds the "gross rents" from the property minus real estate taxes, straight line depreciation and operating expenses. Since the "guaranteed return" type of net lease invariably provides for a gross rent which includes an amount equal to real estate taxes and all operating expenses, plus mortage payments and a return on the cash investment, the required computation produces rental income in excess of expenses, depreciation and mortgage interest unless the portion of the rent representing the investor's return on his cash investment plus the payments of mortgage principal do not equal or exceed straight line depreciation. Few "guaranteed return" type net leases will not produce investment income in excess of investment interest expense under this computation.

However, in the case of a lease characterized as a net lease *solely* by virtue of the so-called business activity test, the investment interest provisions will usually apply if the property is in fact producing an unintended economic loss to the landlord.

Unlike the "guaranteed return" type net lease, discussed above, which virtually always produces a net cash flow income to the lessor so long as the lessee is financially sound, the net lease which is such *solely* by virtue of the "business activity" test may not provide protection against increases in real estate taxes nor reimbursement for necessary capital expenditures. If the property meets the lessor's projections upon which he negotiated the lease, then, as in the case of the "guaranteed return" type net lease, there will generally be no excess investment interest because the property will generally produce investment income in excess of investment interest expense. However, if the anticipated investment return is not achieved, for example because of unanticipated increases in real estate taxes, which the lessee is not obligated to pay, the lessor may be burdened with both an economic loss from the property, as well as a minimum tax, and, post 1971, a partial disallowance of interest which might otherwise be applied against the income from profitable real estate. It appears unlikely that Congress intended this unrealistic result.

Apart from the actual application of the investment interest provisions, if, as we believe, Congress intended merely to penalize the deduction of interest to carry investments which produce profits subject only to capital gain taxation, then, Sections 57(b) and 163(d) have the unintended effect of including within their definition property which *is* potentially subject to ordinary income tax rates. Rental income from real estate is subject to ordinary tax either at the time earned, or if the property is sold at a gain, any excess of accelerated depreciation over straight line depreciation used in prior years to defer the tax on the rental income is subject to the recapture rules of § 1250. We submit therefore, that the Committee should adopt the following amendment:

Renumber proposed Section 304(c) as 304(e) and insert as Section 304(c).

"Section 57(b)(3) is amended by striking the phrase 'property which is subject to a net lease' and Section 163(d)(4)(A) is amended by striking the phrase 'property which is subject to a lease' and inserting in lieu thereof 'personal property which is subject to a net lease . . ."

REIMBURSED EXPENSES

As stated above, there are two statutory tests for characterizing property as 'net leased' for purposes of the investment interest provisions. The "guaranteed return" test and the "business activity" test. Under the "business activity" test, a lease will be characterized as a 'net lease' if the lessor's ordinary and necessary business expense deductions under section 162 are less than 15% of the rental income produced by the property. The House bill would require the elimination of so-called "reimbursed expenses" from the lessor's computation of his section 162 expenses to be used in the computation.

The House Report describing this provision (H. Rpt 92-533 92nd Cong. 1st Sess. p. 4647) recognizes that the 15% test looks solely "to the degree of the lessor's business activity with respect to the leased property." However the Report then appears to confuse the "activity" test and the "guaranteed return" test. The stated reason for the proposed amendment as to reimbursed expense is that "the lessor is not at risk with respect to the reimbursed expenses, and therefore has the equivalent of a net lease". We submit that it is the "guaranteed return" test of sections 57(c)(2) and 163(d)(4)(A) (ii) that encompasses the "no risk" criteria for a net lease. If the terms of the lease are such that there is "no risk" then it will be a 'net lease' under the "guaranteed return" test. Obviously an obligation of a tenant to provide a complete reimbursement of all expenses and all capital expenditures could result in net lease characterization under the "guaranteed" test. However the "business activity" test, which section 304(a) is intended to amend, relates to activity, not to risk of loss.

We submit that the underlying economics of a provision for reimbursed expenses, and the activity of the lessor in performing the function to which such expenses relate, require the conclusion that in the case of real estate rental property such expenses do reflect activity by the owner of the premises.

The reimbursed expense concept in real estate transactions was originally based on the same theory as setting a low base price for a car and providing separate additional prices for optional equipment so as to increase the overall price and profit. Similarly, by requiring a shopping center tenant to reimburse the landlord for common area expenses, such as security service and snow removal, a real estate owner increases his overall effective rent. This reimbursement is for services actively performed and for expenses of a type which require actual time and attention by the landlord. While such reimbursements (in some cases over a base amount) also provide for inflationary increases in the landlord's expenses under long term leases, another approach to providing against such increases is a cost of living index adjustment in the rent. However in all of such cases the landlord still incurs the expenses and performs the service, reflecting his activity in connection with the leased premises.

We therefore urge this Committee to delete the § 304(a) amendment insofar as it relates to reimbursed expenses.

If, in spite of the foregoing comments, this Committee determines to amend the activity test in respect of reimbursed expenses, we urge that such an amendment provide that reimbursed expenses should be eliminated from section 162 expenses only to the extent of the actual reimbursement by the tenant. For example, if the tenant is to reimburse the landlord for snow removal expenses in excess of $1500, and the expense amounts to $2000, only $500 should be eliminated from the section 162 expenses included under the 15% test.

CONSTRUCTION INTEREST

The Treasury's proposed investment interest regulations provide (Prop. Reg. Section 1.57-2(b)(1)(iv) that interest incurred during the construction of property constitutes investment interest if the property is subject to an agreement to enter into a net lease in the future.

The only satutory reference to construction interest is in Sections 57(b)(2)(D) and 163(d)(4)(D). These sections state that interest which is incurred or continued in the construction of property to be used in a trade or business shall not be treated as investment interest. This affirmative statement is the only reference in the statute to construction interest.

However, the currently proposed Treasury regulations appear to be premised on the concept that this simple sentence in the statute carries a negative implication that in all cases where, subsequent to construction, the property is net leased, construction interest must be investment interest. Such a negative view is inconsistent with the purpose, the history and the plain words of the statute.

The legislative history indicates that the Treasury had originally proposed to Congress that all construction interest be treated as a separate tax preference item. In fact, neither the House nor the Senate versions of the 1969 Act even mention "construction interest". However, during the Senate Finance Committee hearings on that Act, the tax Section of the American Bar Association suggested that the Bill be clarified with respect to "construction interest." The Bar Association suggested that it should be made clear that a trade or business exists during the period of the construction of a building which, when completed, will be operated as a trade or business, so that the interest expense prior to the receipt of rental income will be deductible.

This suggestion appears to have been adopted in Conference. It was, obviously, intended to be ameliorative. It was based on the assumption that, in certain cases, it might not be clear that the owner's activity during construction constituted a trade or business.

Based on an assumed negative implication of Section 58(b)2(D), the Treasury's proposed regulations disregard the taxpayer's actual activity during construction and provide, in summary, that construction interest will be treated as investment interestt (a) if, during construction an agreement to enter into a future net lease exists, or (b) the facts and circumstances, including a pattern test, indicate an intent to net lease the property following construction.

We submit that the proposed regulations relating to construction interest disregard the statute, and that the regulations are not required, in their present form, by the mandate of Congress concerning investment interest. The purpose of the investment interest provisions, as initially proposed by the Treasury and as enacted by Congress, was to discourage the use of borrowed funds to carry a passive investment.

In contrast, during the actual construction of property, and prior to the actual existence of a net lease, as opposed to merely *an agreement to lease*, there is nothing passive about construction activity. The owner's activity and risk are extremely substantial during the construction period. Even if a tenant has agreed to enter into a net lease after construction is completed, the tenant's obligation to enter into such a lease, which may in the future create a passive investment, is normally subject to the prior satisfaction of at least two substantial conditions. In the first place, the building has to be satisfactorily completed in accordance with the tenant's requirements.

Second, the construction has to be completed within a certain period of time. The time element is particularly susceptible to construction hazards such as unforeseen excavation conditions, labor shortages, strikes, and delays in the shipment of materials to the job site. Such factors can seriously affect the ability of the landlord to produce the building as required under the lease agreement and thereby to actually secure a net lessee for the property.

During the entire construction period, the owner must supervise construction to insure satisfactory completion. There is nothing passive about this activity and there is certainly no guarantee of anything from the prospective lessee until the building has been in fact satisfactorily completed.

The Treasury's proposed regulation is premised on the assumption that the Conference Committee, in 1969 without any explanation in its Committee Report, intended a major adverse change in the statute by its addition of a reference to construction interest i.e. it intended to broaden the ambit of the investment interest provision to include construction interest rather than merely to exclude the owner-user situation, previously described. Parenthetically if the Conference Committee had made no reference to construction interest, there could be no basis for characterizing the property during construction as investment property unless it was such under the general definitional income tax rules developed by the courts.

The Treasury's position on construction interest is untenable in view of the fact that the Treasury proposals for The 1969 Act specifically included construction interest as a tax preference item and neither the House nor Senate versions of the Bill made any reference whatsoever to construction interest. While only the members of the Conference Committee subjectively know the intent of the reference to construction interest, we submit that the wording of the provision, the legislative history concerning construction interest as part of The 1969 Act and the realities concerning the financial risk during construction support the conclusion that Congress did not intend to penalize construction interest as investment interest. We therefore submit that the statute be clarified by the following amendment.

PROPERTY UNDER CONSTRUCTION

Section 57(b)(2)(D) is amended by striking the last sentence thereof, Section 163(d)(4)(D) is deleted in its entirely and Sections 57(b)(2)(D) and 163(d)(3)(D) are amended by adding the following sentence:

"Interest incurred during the construction of property shall not constitute investment interest expense."

The CHAIRMAN. The next witness will be Dr. Pierre Rinfret, secretary, Citizens for a New Prosperity.

Is he here? If he is not here yet, we will call on Mr. Harvey J. Taufen, vice president of Hercules, Inc.

We are pleased to have you, sir.

STATEMENT OF HARVEY J. TAUFEN, VICE PRESIDENT, HERCULES, INC.

Mr. TAUFEN. My name is Harvey J. Taufen and I appreciate this opportunity to testify. I am a vice president of Hercules, Inc., and I was general manager of its international department from 1963 through 1969.

Hercules manufactures and sells a very broad range of chemical products. Our sales last year were $799 million. Of these, our exports were $95 million and our net contribution to the balance of payments was $88 million.

Our corporation has been active in export since the 1920's making us a pioneer exporter in the chemical industry.

Our export position was originally based largely on products from the southern pine forests and from purified cotton linters, whose supply position is more or less unique to the United States. Hence, upgraded chemicals based on these raw materials found a ready market overseas. The tariff problems posed by the formation of the Common Market threatened this export business and, beginning in 1960, we began investing abroad to protect our established markets.

We are now involved in manufacturing in 38 plants in 18 countries. Nine of these are in the EEC. We continued to push our export business but we expected that this would automatically decline as a result of our overseas manufacture. To our surprise, we found that our overseas production actually stimulated our exports from this country. We learned that by manufacturing a portion of our product line abroad, the whole product line became much more salable; as a consequence our exports actually grew at a faster rate than before we began overseas manufacture.

By the middle of the 1960's our position of manufacturing and exporting worldwide made us very much aware of the benefits foreign competitors have in competing in world markets against firms based in the United States. We felt this particularly in our newer petrochemical and agricultural chemical lines where the United States does not have a unique raw material position.

In our industry, differing labor costs have been a relatively insignificant factor. On the other hand, foreign export subsidies including tax policies, export financing, shipping costs, and other tariff and nontariff barriers gave our foreign competitors a substantial competitive advantage. As a result we found that a very real ceiling was still placed on our rate of export growth.

In an effort to solve this problem, we began studying the advantages of an Export Trade Corporation which was provided for under the 1962 U.S. Tax Law. After initially rejecting the use of such a corporation because of the operating complications involved in meeting the requirements of the 1962 statute, we decided in 1969 that we could not remain competitive unless we utilized the benefits of ETC. Although there were many problems that had to be overcome to operate within the requirements of the 1962 law, and even though it was necessary to restructure our overseas trading patterns in order to conform with the ETC rules, we found that we were able to improve our export trading position even in the first year of the operation of our ETC.

This was part of the reason that Hercules' contribution to the balance of payments increased from $55 million in 1969 to $88 million in 1970, for a total of $143 million. In my view, the benefits of the ETC are the minimum required to permit us to compete effectively in the export market, and as far as we are concerned we are willing to accept the operating complications in order to be effective in foreign export markets.

The bill presently before this committee, H.R. 10947, makes it mandatory to terminate ETC on December 31, 1975. American companies who have been able to establish an export business or increase their export business through the use of export trade corporations and who, as a result have been able to improve the U.S. balance of trade, should not be forced to terminate these organizations. This is particularly important because the form of DISC in the bill presently before this committee does not offer as great an opportunity for increasing or maintaining exports as does the ETC; as a matter of fact, mandatory substitution of DISC for our ETC would damage our export position.

Let me illustrate this point with some examples:

We have been able to offer competitive contract credit terms to customers in the Far East and Middle East for petrochemicals from our plants in North Carolina and New Jersey through our ETC. These export sales contracts would not be attractive if we utilized the DISC form rather than the ETC.

Second, through the use of the ETC, we have been able to export naval stores products from Georgia and Mississippi to Europe, prepare emulsions of these products in Europe, and sell these emulsions abroad at competitive prices. This arrangement has permitted us to retain business that we were on the point of losing to competition in Europe. The procedures that make this possible are present under the ETC provisions, but would not be available to us under the DISC proposals.

I would like to deviate from my text here to state specifically what I mean, we export naval stores products from these plants in the South and they are sold in their final form as emulsions which contain large amounts of water.

It is impractical to ship these amounts of water across the ocean and remain competitive. Under the ETC we are allowed to have manufacturing done on these products as long as it does not exceed more than 20 percent of the value of the U.S. product. So we can export these products, have the emulsions made in Europe and then warehouse them and sell them to a customer under the ETC. DISC does not have this 20-percent feature in it.

Third, up to now our exports of polyolefins from our Louisiana petrochemicals plant have been small. The existence of our ETC makes it practical for the first time for us to consider a serious attack on the worldwide market. Under the pr sed DISC it would not be realistic to mount this program.

I should make it clear that in my view the DISC in its present form does offer an inducement to domestic firms to begin an export program. However, established exporting companies, and these are the ones who contribute most to the balance of payments and have the greatest potential for its quick improvement, will not benefit greatly from DISC in its present form. And forcing companies like Hercules to terminate their export trade corporations and adopt the proposed DISC will set back the momentum of our export expansion.

Therefore, I strongly urge the elimination of the provision requiring that Export Trade Corporations be terminated by December 31, 1975. My recommendation is that regardless of the form of DISC, if any, which eventually approved by the Congress, the law should permit the continuation of existing Export Trade Corporations and should allow American firms to have the option of using whichever organization best encourages their particular export business.

This recommendation establishes no precedent. Foreign countries often provide multiple export incentive plans for their citizens so that they may have a flexible and competitive position in world trade.

I appreciate very much the opportunity the committee has given me to present this statement, and I would welcome any questions.

Thank you.

The CHAIRMAN. Well, thank you very much.

Senator BENNETT. Mr. Chairman, I would like to have two brief ones.

If the ETC has some advantages that DISC does not have and DISC has some that the ETC does not have, this committee is in position to try to get the best of both worlds by modifying the DISC proposal to preserve or protect the advantage you see in the ETC. In other words, you are not insisting that they be mutually exclusive. You are pointing out the fact that there is an advantage in the present form which would be lost in DISC. But it could be retained by amending the DISC?

Mr. TAUFEN. Senator, that is very true. The two proposals do not overlap, and they do not overlap in very important aspects. It could be possible to improve ETC's, and there are advantages to DISC that are not in ETC's. There are also advantages in ETC's that are not in DISC; and I am saying at least don't make us collapse what we have set up. If you can improve it, so much the better.

I would be happy to write you specifically on recommendations that I think could be made.

Senator BENNETT. I think that would be useful, Mr. Chairman. I ask that he be permitted to add that to his testimony.

The CHAIRMAN. That will be done, without objection.

Thank you very much.

Senator BENNETT. The other question: If you have any statistics or any basic information to bear out the reference in your statement that by going abroad you have increased your exports from your domestic business or if you can give us indications of other businesses that have had the same experience, I think that this would be useful, too.

Mr. TAUFEN. Senator, I can easily supply that from our corporation. I believe it to be true of the chemical industry in general; and I will try to get the other statistical information for you as well.

Senator BENNETT Thank you.

(The following letter with attachment was subsequently received for the record:)

HERCULES, INC.,
Wilmington, Del., October 20, 1971.

Hon. WALLACE F. BENNETT,
U.S. Senate,
Washington, D.C.

DEAR SENATOR BENNETT: At the close of my testimony before the Senate Finance Committee last Friday, you asked for some supplementary information which I am enclosing herewith.

Your first question was whether Hercules could provide specific data to document my statement that our manufacturing operations overseas actually stimulated our exports from the U.S.A. The data which support this statement are shown in the attached graph. The export figures exclude our exports to Canada. This basis is more logical because our investments in Canada in the 1960's have been minimal. Also, the internal figures were available in this form since our Canadian exports are not handled by our International Department.

In 1962 our exports had leveled off at a little over $30 million a year. In that year (the 50th year of our corporate existence), Hercules made an exhaustive examination of all its businesses and what the future was likely to hold. We had already begun our overseas investment program in 1960 to recapture through overseas manufacture export markets we were losing. In 1962, the International Department forecast a modest continuing growth in exports rising to $38 million in 1967. This forecast, which is shown as the lower straight line on the accompanying graph was regarded as *optimistic* by the corporate management in view of our overseas investment program. Our actual experience is shown by the upper line on the graph. Already in 1967 our cumulative increase in exports was over our expectations by $35 million. The year 1967 was up 39% over our expectations. This increase in exports was an unexpected side effect of our overseas manufacturing activity. We saw this "pull through" of our exports in many countries. Our examples also apply to chemicals for diverse industries including e.g. paper, paint, inks, adhesives and textiles.

As I testified, however, we more or less reached a new plateau in the late 1960's which we are now trying to raise to a higher level by the use of the Export Trade Corporation.

The extent of our involvement in manufacture overseas will help add perspective. Sales from our overseas manufacture in the 1960's grew from $11 million in 1960 to $125 million in 1970. Nevertheless, Hercules' investment in these overseas facilities did not harm United States balance of payments. We now have about $160 million invested in the total operating assets associated with our overseas manufacture. Most of this was financed with capital obtained overseas. In fact, the total outflow of capital from the United States in this period was only $37 million. It turns out that the inflow into the United States from these manufacturing operations in the form of dividends, royalities, know-how payments and interest on direct loans also amounted to $37 million, just matching the outflow.

To sum up, our overseas manufacturing operations have exported neither capital nor jobs, have maintained and expended our world business, and this expanded business has greatly stimulated our exports. It is my impression that the Hercules story is not unique but is typical of many corporations. I am attempting to develop solid statistics to support this view but this will require a little more time.

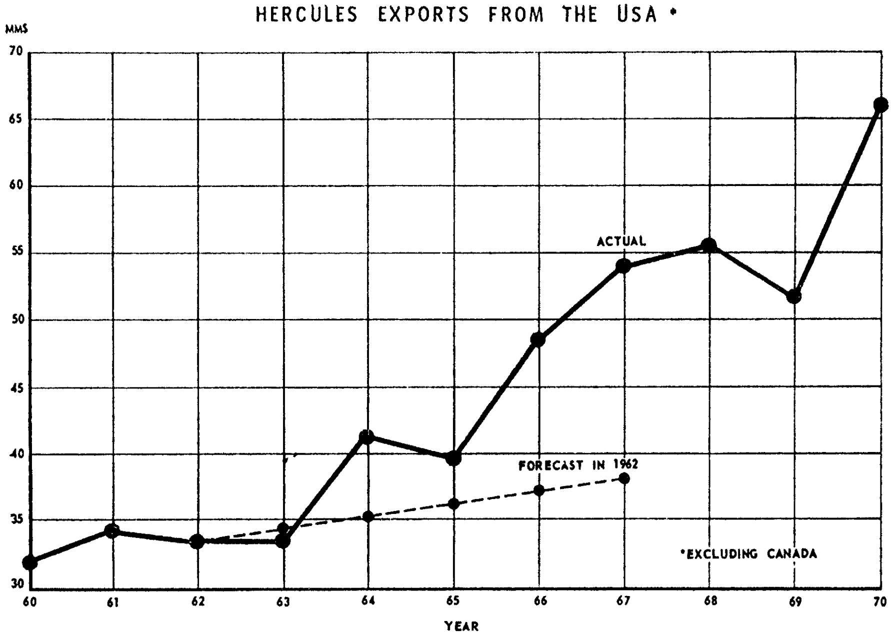
Your second question asked whether Hercules could make recommendations for some vehicle incorporating the best features of ETC and the beat features of DISC. This problem is not easy. The complicated rules of organizing and operating an ETC do have a certain internal consistency. DISC has its own internal consistency which is different. This makes it very difficult to try to dovetail and retain the advantages of both. The situation is further complicated when one thinks about the application of the law to different corporations with their differing internal structures and differing trading patterns.

I come back therefore to my original position that the best approach is to make the DISC as broadly applicable as possible so that the maximum increase in exports will be obtained thereby and, at the same time, leave the door open both for the continued operation of ETC's and for the eventual conversion of ETC's to DISC's, if and when experience shows that this conversion would further stimulate exports.

I want to take this opportunity to thank you very much for the courteous attention you have given to my testimony.

Very truly yours,

H. J. TAUFEN, *Vice President.*



The CHAIRMAN. Mr. Franklin M. Kreml, president of the Automobile Manufacturers Association.

STATEMENT OF FRANKLIN M. KREML, PRESIDENT, AUTOMOBILE MANUFACTURERS ASSOCIATION, INC., ACCOMPANIED BY PETER GRISKIVICH, DIRECTOR, GOVERNMENT RELATIONS AND INFORMATION, AMA

Mr. KREML. Mr. Chairman, and gentlemen, I am Franklin M. Kreml, president of the Automobile Manufacturers Association. This is my associate, Mr. Peter Griskivich, and I would like to have him join me here, if I may.

Sir, we have filed with the committee the full written statement. I shall, with your permission, make a relatively brief summary statement.

I am here to speak in support of the repeal of the excise tax on automobiles and light trucks in the amount respectively of 7 percent and 10 percent. I speak particularly of the light trucks since 70 percent of these of the gross vehicle weight of 10,000 pounds or less are used for personal transportation for recreation, and for agriculture. Increasingly, these light duty trucks are becoming a second car for an ever-growing segment of the American population and compete directly with the passenger car, particularly, of course, with the station wagon, ranch wagon, and such vehicles.

To speak descriptively of this vehicle, it is a four-wheel, single-tired vehicle. I have asked Mr. Griskivich to bring some pictures of this vehicle because I think that this will do more to acquaint the committee with the type of vehicle of which we are speaking than perhaps a substantial amount of rhetoric on my part, quoting figures or describing the vehicle. I shall be glad, sir, to hand those to you or members of your committee now or present them to the staff at the conclusion of the statement, whatever your pleasure is.

Senator BENNETT. I think every member of the committee has seen a 1-ton truck.

Mr. KREML. Sir, I was myself surprised when I looked at the 1-ton truck of today as compared to previous years' models.

The CHAIRMAN. Why don't you pass them up here and we will take a look at them.

Senator BENNETT. Off the record.

(Discussion off the record.)

Senator BENNETT. You are right in assuming that there are many families that are developing these as a second family vehicle.

Mr. KREML. Yes. Well, the recreational use is very high, and taking the recreational, personal and agricultural use in aggregate, this amounts to 70 percent of the use of this vehicle.

Now, I would like also to say a word or two about why we suggest excise tax repeal be broken at the 10,000 pound gross vehicle weight level.

In the first place, within the various agencies of Government, for example, in the Commerce Department, this is the point of breakage in the distinction between the passenger car type vehicle; namely, the light duty truck, and the heavy type vehicle. Thus the Department of Commerce in the transportation, the truck and vehicle censuses that are made, breaks at 10,000 pounds.

The Department of Transportation, through the National Highway Traffic Safety Administration, breaks at 10,000 pounds. Further, this is the natural breaking point in the manufacture of vehicles. Between those vehicles 10,000 pounds and under and vehicles above this, there is a substantial gap in the area of 10,000 to 14,000 pounds. For example, in the last year in which we have full figures—1970—less than 7,300 vehicles were manufactured in this country in the range of 10,001 to 14,000 pounds.

It is for these reasons that we emphasive, why the repeal of the excise tax should include the light duty truck.

Now, having made that statement, to speak generally as to the matter of repeal, I would like to say, first of all, that we filed with the House Ways and Means Committee, and are prepared to file with this committee if you wish, letters from each of the principals of the industry indicating clearly and unequivocally that the repeal, if granted, will result in the passing on by the manufacturer of the full amount of the tax reduction. Repeal is an immediate and noninflationary form of relief and would result, as you know, in an immediate price reduction on motor vehicles, particularly in light of the statement I have just made. The reduction would amount on the average to $200 per vehicle. This, in turn, would affect both new and used vehicles and would have an impact on the cost of living at once.

The cost of living reduction would result from the fact of the price reduction itself. But the real impact of this lies in the fact that the price reduction as a result of the elasticity of demand, would result in the sale of some 600,000 additional automobiles per annum, we estimate, and this, in turn, would result in some 150,000 new jobs.

These 150,000 new jobs, further, would develop in substantial part in those hardgoods cities which presently are feeling substantial unemployment and increased welfare costs.

Now, repeal of the excise tax will remove the dollar tax disadvantage that is now borne by American cars. While the percentage is the same, the cost differential of the foreign car versus the American car, means that the tax on the foreign car really amounts to $100, while, on the average, the tax on the American car amounts to $200. Thus, the American car would be advantaged, and we think that more of the American product would be sold. We think we see some evidences of this now in the marketplace.

The result of this, of course, is that there would be some contribution to an improvement in the balance of trade.

Now, we think that these several economic factors are very substantial: that they would have, as I have already indicated, an immediate and substantial effect upon the economy; that they would create jobs—the repeal of these two taxes would create jobs; that they would create those jobs in areas of the country where they are needed most; and that this would serve as a substantial boost to the economy and would help to reduce the balance-of-payments deficit.

But apart from these economic gains, we see certain social gains. Thus, the sale of 600,000 additional new vehicles, all of them equipped with current safety devices and emission control devices would mean the displacement of some 450,000 vehicles that are probably around 10 years old and which, in substantial part, have none of the safety or emission control devices which the industry has been increasingly putting on these vehicles since approximately 1962.

Now, the effect of this on safety, and the effect of it upon emissions would be very substantial indeed; and I am prepared, if you wish, to quote those figures in this oral statement although they are contained in my prepared statement.

I should like to anticipate here a question that was raised in the House, and that is whether 600,000 additional vehicles would present some further burden on our streets and highways and in our cities.

I would like to reemphasize that in the retirement of the 450,000 vehicles to which I have just addressed myself, that we then come out, of course, with a net increase of some 150,000 vehicles in the car population, not the 600,000 that would appear to be the case on first glance.

So that apart from the several economic gains, the several important and significant economic reasons why we urge your favorable consideration of this repeal. We have these significant social reasons in which we have a great interest, too.

This concludes my statement.

The CHAIRMAN. Let me ask this, Mr. Kreml: You are here speaking for the Automobile Manufacturers Association?

Mr. KREML. Yes, sir.

The CHAIRMAN. Are you speaking entirely for American manufacturers or are you speaking for foreign producers as well?

Mr. KREML. No, sir; I am speaking for American manufacturers. They are the only members of our association. We have no foreign members.

The CHAIRMAN. All right. I come from a State that does not produce any automobiles. About the best we can do is sell you a few batteries to put in some cars or some gas to put in the tank. I have been listening to this argument and I may wind up going with the suggestion that we take this tax off these automobiles.

Now, if we do and the argument there is to provide more jobs, I can't see how that benefits a State like mine that doesn t produce automobiles. All we can sell is gasoline, or some cotton to put in the cushion.

But I don't see where it is going to benefit this country to take the tax off those foreign automobiles.

Now, Arthur Summerfield testified here that we need more than that 10-percent surtax. As a matter of fact, applied to foreign automobiles it wasn't a 10-percent surtax anyway; it was only 6.5 percent because the President couldn't go beyond the authority that was already in the act which was a 10-percent tariff, so it wasn't a 10-percent surtax he put on automobiles, it was a 6.5 percent.

Some of us want to thin down some of the benefits in here that tend to benefit management and try to put some of that to where it can benefit some low-income taxpayers or consumers and it looks to us though as if there is one point here where we can save the Government some revenue and help Americans with some jobs at the same time by saving almost $400 million on those foreign produced automobiles.

Can you see where it benefits the American worker or the American automobile producer to take the tax off the foreign produced automobiles?

Mr. KREML. Sir, we have not—I am sorry to say to you—we have not taken a position on that matter; and I am not prepared to take a position on it here today. I have no wish to be evasive but this is simply the position in which I find myself and I must be completely forthright, and so indicate to you.

The CHAIRMAN. If I were you, I would be sort of afraid to rock the boat, too; but from where I am sitting I don't see that we are doing anything with that $400 million tax loss to help the fellow in Germany or Japan to take the job away from an American worker or from an American businessman.

I am not against those people but all things being equal if you can't put your plant in Louisiana, I am still happy to see you put your plant somewhere in America.

Mr. KREML. Yes, sir.

The CHAIRMAN. And off hand, I would think that you might be needing that differential to stay in business over a period of time. If we are going to save you, I think we had better save you now rather than postpone that to some point further down the road.

Mr. KREML. Yes.

The CHAIRMAN. Thank you very much.

Mr. KREML. You are welcome; thank you.

Senator BENNETT. Mr. Chairman, I think we should have those letters in our file to which the witness referred, those letters indicating the passing on.

Mr. KREML. We would be glad to do that.

(Responses received by the committee follow):

FORD MOTOR CO.,
Washington, D.C., October 19, 1971.

Hon. RUSSELL B. LONG,
Senate Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: During the appearance of Mr. Franklin M. Kreml, President of Automobile Manufacturers Association, Inc., on October 15, 1971, a request was made that each of the auto companies advise the Committee, in writing, as to the actions it would take in the event the auto excise tax were eliminated. In the absence from the country of Mr. Henry Ford II, our Board Chairman, and Mr. Lee A. Iacocca, our President, I am pleased to respond to this request.

If the present excise tax on automobiles and trucks, up to 10,000 lbs. GVW, is repealed, Ford Motor Company prices to our dealers will be reduced immediately by the full amount of the present tax. The suggested retail price shown on the price label will also be lowered by the same amount. You realize, of course, that the company has no authority to determine any dealer's subsequent action in this matter, but we have no doubt that competitive factors alone are sufficient to insure that our dealers will pass this reduction on to their customers.

We will be pleased to provide any additional information that might be helpful in your deliberations on the excise tax matter.

Sincerely,

R. W. MARKLEY, Jr.

GENERAL MOTORS CORP.,
New York, N.Y., October 21, 1971.

Hon. RUSSELL B. LONG,
Chairman, Senate Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: In connection with your Committee's consideration of the President's proposal to repeal the excise tax on motor vehicles, I want to state categorically—as I previously stated to the House Committee on Ways and Means—that General Motors, would pass on the full amount of the tax, if it were repealed, as a reduction in the prices charged to its dealers.

The suggested retail price shown on the vehicle price sticker would also be reduced if the excise tax were repealed. In addition, General Motors will refund the full amount of the excise tax reduction directly to purchasers who take delivery of a new General Motors car between August 15, 1971, and the date the tax is repealed. The record will show that we have followed this policy when excise tax changes were made in the past.

As you know, the price at which the new car is sold to the ultimate customer is one agreed to by the dealer and the customer. This is a transaction to which the manufacturer is not a party. However, while I cannot speak for General Motors dealers, I think there is every reason to expect that the savings which the manufacturer passes on to the dealer would be reflected in the transaction between the dealer and his customer.

Favorable Congressional action on the President's proposal to repeal the tax on motor vehicles will help to contain inflation, stimulate employment, improve the competitive position of American-made cars, and finally end the tax discrimination against car buyers. All segments of the population will benefit from such action as the effect of the reduction would be felt on both new and used cars. Finally, by encouraging the purchase of vehicles equipped with the most modern safety and environmental controls, an important contribution would be made toward reaching our national goals in these areas.

Sincerely,

J. M. ROCHE.

CHRYSLER CORP.,
Detroit, Mich., October 20, 1971.

Hon. RUSSELL B. LONG,
Chairman, Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: I wish to take this opportunity to urge favorable action on the President's proposal for repeal of the Federal excise tax on automotive products which your Committee has under consideration. In support of the President's proposal, we have already agreed to pass on to our dealers' customers with respect to cars already sold before such repeal the benefit of any retroactive refunds of the excise tax which Congress authorizes.

Moreover, we wish to assure you that with respect to cars sold after repeal our charge to the dealer will be reduced commensurate with such net reduction as Chrysler Corporation may realize in its cost as a result of the repeal. In addition. Chrysler Corporation will reflect this reduction in the manufacturer's suggested retail price label affixed to each car for the consumer's guidance as required by the Monroney Act.

Sincerely,

LYNN A. TOWNSEND.

AMERICAN MOTORS CORP.,
Detroit, Mich., October 19, 1971.

Hon. RUSSELL B. LONG,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: American Motors Corporation has publicly endorsed and supported the President's actions to stabilize the nation's economy.

Now, as the Senate considers the proposal to repeal the Federal excise tax on passenger cars and light duty trucks, we once again pledge that our prices will be reduced to reflect the full benefits of any excise tax repeal.

We also pledge that any floor stock and consumer refunds that may be provided by the legislation will be passed on to our dealers and consumers. In this regard, we wish to point out that as evidence of our cooperation with, and reliance on, the President's emergency program proposals, American Motors Corporation on August 18 began refunding to ultimate purchasers of its 1971 models the full amount of the excise tax.

We firmly believe the full repeal of this arbitrary and discriminatory tax at this time will prove to be a major stimulus in achieving the objectives stated in the President's program, and we sincerely request your cooperation and support toward repeal.

Sincerely,

AMERICAN MOTORS CORP.,
ROY D. CHAPIN, Jr.

INTERNATIONAL HARVESTER CO.,
Chicago, Ill., October 19, 1971.

Hon. RUSSELL B. LONG,
Senate Finance Committee,
Senate Office Building,
Washington, D.C.

DEAR SENATOR LONG: I wish to assure you that International Harvester Company will reduce prices by the net amount of the Federal excise tax that is repealed on motor vehicles. Such reduction will be reflected in the suggested retail selling prices of the vehicles included in the repeal. The prices of new vehicles to dealers will correspondingly be reduced.

These prices will be reduced as of the date the excise tax repeal is made effective. Refunds applicable to customers and to dealers for excise taxes paid in the interim period will be made promptly.

Sincerely,

R. H. BURNSIDE.

The CHAIRMAN. Yes; we are confident of your good faith in this matter and we believe you can see to it that the dealer plays his part; but we would like to be sure that the manufacturer does his part to put the pressure on the dealer because the larger the number of people you are doing business with the harder it is to assure compliance. The manufacturer can do some things that we here in the Congress can't see to it——

Mr. KREML. Yes, sir.

The CHAIRMAN (continuing). That the dealer plays his part. I know a lot of dealers who would probably like to hedge on that a little bit if they could.

Mr. KREML. Sir, in that area I must in honesty say that the manufacturer will do his very best to assure that, but he must in substantial part depend upon the operation of competitive forces at the community level.

The CHAIRMAN. Well, it would probably violate the antitrust laws for you to do everything that you would like to do to pass this savings along, but maybe we ought to take a careful look at that to be sure you do have the power to fulfill your commitment because we sure want you to do it.

Mr. KREML. Thank you.

The CHAIRMAN. Senator Anderson wants to ask you a question.

Mr. KREML. I beg your pardon, Senator Anderson.

Senator ANDERSON. You have a membership here of the Automobile Manufacturers Association. What firms are members of it, the Big Four?

Mr. KREML. The Ford Motor Co., the General Motors Corp., American Motors, Chrysler, International Harvester, the White Motor Co., Diamond Reo Truck, Inc., Duplex Division of Warner & Swasey Co., and the Checker Motors Co. This is our membership, sir.

Senator ANDERSON. Thank you.

The CHAIRMAN. Thank you very much.

(Mr. Kreml's prepared statement follows. A letter of Mr. C. B. Howard, chairman, taxation committee, Automobile Manufacturers Association, appears at page 901.)

PREPARED STATEMENT OF FRANKLIN M. KREML, PRESIDENT, AUTOMOBILE MANUFACTURERS ASSOCIATION, INC.

Mr. Chairman and members of the committee: I am Franklin M. Kreml, president of the Automobile Manufacturers Association. I am appearing to support repeal of the excise taxes on new passenger cars and other light-duty vehicles of 10,000 pounds gross vehicle weight or less, as provided in Title IV, Section 401, of H.R. 10947—the "Revenue Act of 1971."

We are in complete accord with the statement made before the Committee by John Connally, Secretary of the Treasury, concerning repeal of the automobile and light truck excise tax. He said:

"The House adopted the President's recommendation for repeal of the 7 percent automobile excise tax effective August 16, 1971, and also repeal of the 10 percent excise tax on small trucks, effective September 23, 1971. These trucks, primarily pick-up trucks, are extensively used for pleasure and recreational purposes or are used by farmers and small businessmen, and to a very large extent they are sold in direct competition with private automobiles. While the truck tax goes to the Highway Trust Fund, the truck tax on these small trucks generates more tax than is appropriate in light of their cost responsibility for the highway system. We endorse this additional action in the House bill."

Automotive excise tax repeal would have broad benefits—it would provide direct tax relief to a large segment of the buying public, and in so doing, help curb the inflationary spiral; it would assist in halting the spread of unemployment by putting people to work; it would aid in reducing our balance of payments deficit; and it would make a significant contribution toward meeting our nation's environmental and vehicle safety goals.

Let me briefly elaborate.

NON-INFLATIONARY TAX RELIEF

On September 16, I submitted to the House Ways and Means Committee the written assurances of the top officers of the principal domestic vehicle manufacturers that their prices would be reduced to fully reflect the repeal of the excise tax. Manufacturers have also pledged in their advertisements to refund the full amount of the tax paid by car buyers on sales made since August 15. Similar rebates can be expected on purchases of light trucks made since September 22—the effective repeal date proposed for that class of vehicles.

The buyer, therefore, will be the immediate beneficiary of excise tax repeal. The automobile and light truck, often used for the same purpose as a passenger car, have become a necessity to most American families. And for most, the purchase of a car or truck represents a major investment. The repeal of automotive excises would provide an *immediate* cost reduction to those millions of Americans who each year made this necessary investment.

I stress the word immediate. One of the prime factors to be considered in weighing the merits of various forms of tax relief is the relative speed with which their effects would be felt. The benefits of excise tax repeal would be immediate, not gradual. New vehicle prices will drop the instant the tax is removed—providing vehicle buyers with an immediate and direct cost reduction.

The price reductions would not be inconsequential. Purchasers of new vehicles can anticipate tax rebates ranging from $90–$125 for small cars, to over $300 for larger vehicles. On the average, new passenger car and light-duty truck prices would be reduced by about $200 per vehicle, thus also reducing the average buyer's financing costs.

By immediately lowering the price of motor vehicles, which are key elements in durable goods spending, removal of the excise tax will certainly have an almost immediate deflationary effect. For example, when new car prices were reduced in June of 1965, to reflect the 3 point reduction in the excise tax, there was both an immediate and a corresponding decrease in the new car price index and, within a few months, nearly a 3 point drop in the used car price index. (Appendix Exhibit I). With the elimination of the remaining 7 percent of the excise tax we can expect a proportionately greater effect on the cost of living than in 1965 and one which would be even more significant in view of today's inflationary pressures.

Used vehicle prices would also be reduced following the elimination of the excise tax. Used vehicles compete with new models in the market place and are directly price competitive within a major part of the price spectrum. New and used cars, for example, compete in substantial volume within the $2,000 to $3,500 price range. (Appendix Exhibit II). Even used cars selling in the $1,500 to $2,000 bracket feel the competitive price pressure of new cars.

This means that all income groups stand to benefit from the elimination of the excise tax through lower prices for both new and used cars. Over a fourth of all new cars produced are bought by families with incomes under $10,000. In the case of used automobiles, over half of the purchases are made by families with incomes under $10,000. (Appendix Exhibit III).

Secretary Connally made this point in his testimony before this Committee on October 7: "The distribution of automobile purchases is roughly a constant proportion of income, so this reduction amounts to a fairly uniform benefit among all income groups. While a higher proportion of used cars are purchased by lower income groups, the repeal of the tax on new automobiles will result in a reduction in the price of used cars, so the lower income groups will obtain proportional benefits."

Certainly ending the excise tax would be a counter inflationary move that would stimulate the economy. Mr. Leonard W. Woodcock, president of the United Auto Workers, remarked on this in July when he said: "There is no doubt that this tax has discriminated against the low and middle-income families, hurt the economy, served as a deterrent to new car sales and contributed to our rising unemployment."

MORE SALES AND MORE JOB OPPORTUNITIES

The price reduction that would result from repeal of the excise tax will increase sales and, in turn, generate more jobs.

Let me illustrate.

The demand responsiveness of buyers to price changes in new cars has been studied by several noted economists over the last 30 years or so.

Their findings showed that a decline of one percent in new car prices leads to an increase in demand ranging from 0.5 percent to 1.5 percent. A one to one ratio, therefore, would appear conservative—for each one percent decline in price, vehicle demand can be expected to increase by one percent.

The present excise tax on new cars and light trucks amounts to about $200 per vehicle. Since the average retail price of both types of vehicle is about $3,500, the $200 tax represents between 5 and 6 percent of the price paid by the average buyer.

Sales this year for passenger cars and light trucks are expected to total approximately 10½ million units. A 5 to 6 percent price reduction applied to a 10½ million unit market would result in an additional demand for 600,000 passenger cars and light trucks.

These added sales will certainly generate more jobs. Analysis of Department of Commerce input-output data indicates that direct and indirect employment in the automotive industry and related businesses now totals approximately 250 to 270 workers for each 1,000 vehicles produced, or 25,000 to 27,000 per every 100,000 vehicles.

Applying the lower figure of 25,000 workers per 100,000 vehicles, to the expected added sales volume of 600,000 units, results in an estimated total of 150,000 new jobs that would be created by repeal of the excise tax—not only in the motor vehicle industry, but in direct suppliers such as steel, glass and copper, and in the many allied businesses that depend on motor vehicle manufacturing.

A few figures indicate how far-reaching the new employment impact would be. For example, some 20 percent of the steel; 65 percent of the rubber; 33 percent of the zinc; and 10 percent of the aluminum consumed in this country is used for automotive products. Almost one-half of all radios produced annually are for automotive use, and nearly six million air conditioning units are manufactured for new automobiles and aftermarket installation. Obviously, added vehicle sales will stimulate new job opportunities in all of these businesses.

But as important as new jobs are in and of themselves, the key fact is that a large part of this expanded job market will probably occur in many of our large industrial cities now reporting unemployment rates substantially higher than the national average. And these are the areas where government programs have been designed to provide job training for minority and underprivileged groups. I emphasize that, unlike other tax actions, repeal of the new vehicle excise tax would focus sharply on these urban areas of critical economic and social need.

BALANCE OF PAYMENTS BENEFITS

While repeal of the excise tax would benefit both domestic and imported vehicles, the disproportionate dollar tax disadvantage borne by American built cars would be eliminated and their competitive position vis-a-vis imports would be improved. For example, on a typical American-made 2-door sedan in the medium price range the excise tax amounts to $200 and over $300 on larger cars. The excise tax on a typical small foreign import is about $100. The present tax burden imposed on an American car is roughly two to three times that on an imported car, as reflected in the price to the buyer, and therefore makes the American made vehicle less competitive. Steps, such as auto excise tax repeal, which relieve this competitive disadvantage will obviously help to reduce our balance of payments deficit.

ENVIRONMENT AND SAFETY BENEFITS

In addition to its favorable economic impact, excise tax repeal has vitally important environmet and safety benefits. Contrary to the concern that has been expressed by some, the added sales of 600,000 new vehicles expected to result from the repeal of the excise tax will not increase our nation's environmental problems.

For one thing, 600,000 vehicles will not be added to our highways. Historical evidence indicates that for every 100 new cars sold, 75 older cars are scrapped. Consequently, the net result of auto excise tax repeal would be the addition of only 150,000 vehicles on the nation's roadways.

Secondly, and perhaps most important, by lowering new and used vehicle prices, excise tax repeal would accelerate the substitution by car buyers of new vehicles for older vehicles lacking current safety and emission control equipment, and for other vehicles which have not been adequately maintained. The purchase of new vehicles with their advanced safety and emission equipment is impeded by the excise tax. Decisions to retire vehicles are, in a very large part, determined by economic considerations—by a weighing of the market value of the older vehicles against the cost of repeairs and the cost of another vehicle, new or used. A decline in the price as a consequence of this tax repeal would accelerate scrappage and result in the more rapid substitution of newer for older model vehicles. Thus, more rapid progress in meeting the nation's environmental quality and safety goals would result.

CONCLUSION

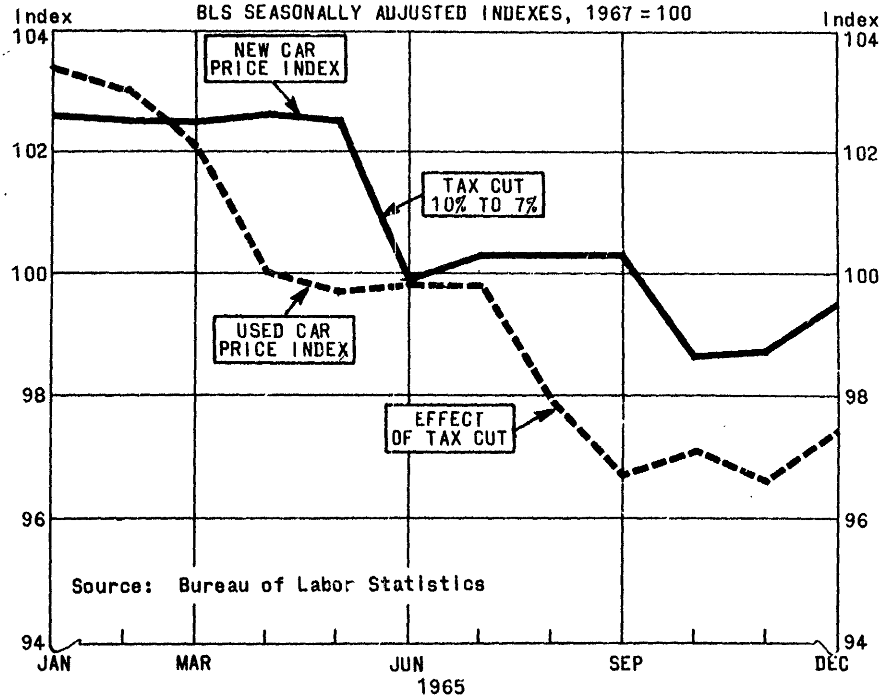
To spur employment, to contribute to the fight against inflation, to improve the price competitiveness of vehicles produced by U.S. labor, and to reduce the balance of payments deficit, repeal of the motor vehicle excise taxes—as provided in Title IV, Section 401 of the "Revenue Act of 1971"—can make a substantial and unique contribution to a growing and dynamic domestic economy. We urge this Committee to give thoughtful consideration to the benefits of this action at this time and urge its approval.

We stand ready, of course, to supply the Committee with any further information or evaluation it may wish and which we are in a position to provide.

APPENDIX EXHIBIT I

EFFECT OF 1965 AUTO EXCISE TAX REDUCTION ON NEW AND USED CAR PRICES

BLS SEASONALLY ADJUSTED INDEXES, 1967 = 100

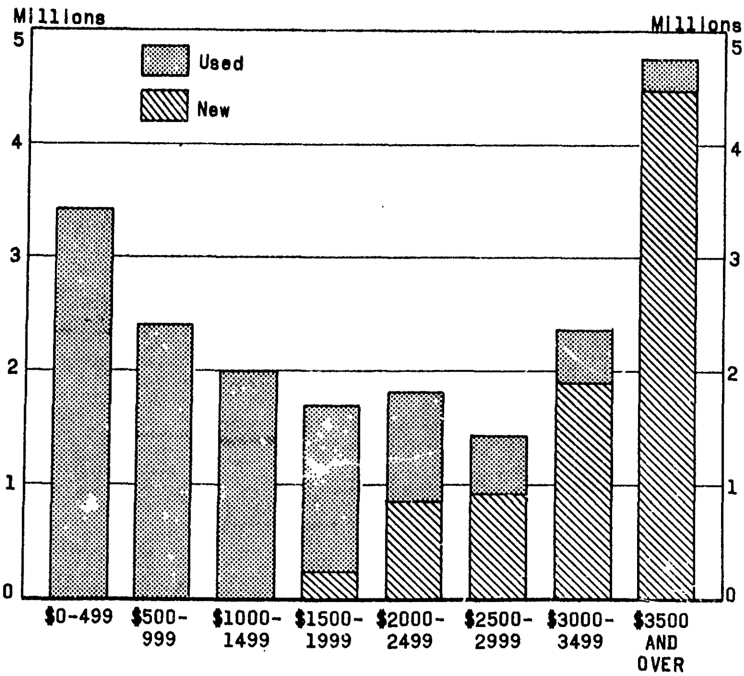


"Thus, the Full Amount of the Tax Cut Still Is Being Passed on by the Automobile Manufacturers as a Whole, and they Have Reduced Prices Fractionally, in Addition."

"Thus, New Car Dealers are Continuing to Pass on the Full Amount of the Federal Excise Tax Reduction and, in Addition, they are Giving their Customers the Benefit of a Fractional Price Reduction by Manufacturers."

Quote from Bureau of Labor Statistics, November 1965.

APPENDIX EXHIBIT II



Source: Based on Survey Research Center, University of Michigan Data.

APPENDIX EXHIBIT III—NEW AND USED CAR PURCHASES BY FAMILY INCOME GROUPS, 1969

Annual family income	New—percent of total	Used—percent of total	Total percent of new and used car purchases
Less than $3,000	2	9	6
$3,000 to $4,999	4	8	6
$5,000 to $7,499	8	16	13
$7,500 to $9,999	14	20	18
$10,000 to $14,999	38	26	31
$15,000 or more	34	21	26
Total	100	100	100

Source: Survey Research Center, University of Michigan.

The CHAIRMAN. Is Dr. Pierre Rinfret here?

Mr. WHITTIER. He is not here yet, Senator, but I believe we can appear; the rest of the panel is here.

The CHAIRMAN. Well, that is fine. In other words you have other witnesses who are with him and who can represent him?

Mr. WHITTIER. Yes, we do, sir.

The CHAIRMAN. I am very impressed by Dr. Rinfret's works because he seems to agree with some of the things I have been expressing. The biggest complaint I have in government is that I don't have more influence; and my second complaint is that the people who agree with me don't have more influence. [Laughter.]

I know Dr. Rinfret agreed with my analysis of these official foreign trade statistics which, I think, were deliberately published for the purpose of misleading the American public. That is a matter that has been of great concern to me and some members of this committee.

Suppose you go right ahead and make your presentation.

STATEMENT OF REV. W. SEAVEY JOYCE, S.J., MEMBER, CITIZENS FOR A NEW PROSPERITY; PRESIDENT, BOSTON COLLEGE

Reverend JOYCE. Mr. Chairman and Gentlemen, my name is Seavey Joyce and I am president of Boston College. I speak here today, however, on behalf of the Citizens for a New Prosperity. I am a member of the executive committee of that group.

The citizens organization was formed out of the belief that this Nation must control inflation, must create new jobs, must lower taxes, must contain high prices, must provide new incentives for expansion—for if it does not the other routes that the Nation may follow are a danger to continued democracy.

The members of the committee may disagree on detail, but are united in believing that no national economic program can work without the support of the citizens of this Nation. It provides a means for people of all political faiths, of all walks of life, to channel effectively their views, to demonstrate their backing of the economic blueprint presented by the President and endorsed by the overwhelming majority of the people of the country according to the polls.

Chairman of the group is Hobart Lewis, president of Reader's Digest. It includes three former secretaries of the Treasury—Robert Anderson, Douglas Dillon, and Henry Fowler. Mr. Fowler is Vice Chairman of the group. Among its members are businessmen, large and small, labor leaders, economists, consumers, veterans, educators, charitable workers—a cross-section of the life and activities of this Nation. I would like to submit for the record a list of its organizing members, a list which is growing far beyond the numbers shown here.

The committee is a nonpartisan private group. Committee members come from almost every State and their numbers grow daily. The panelists who testify here today reflect something of the cross-section of the American viewpoint that is the driving force of our Committee.

It is my pleasure to introduce the second member of our panel, Mrs. Katherine Pearce from Fort Worth, Tex. A teacher for most of her life, she is now head of the National Retired Teachers Association, a group 3 million strong.

STATEMENT OF MRS. KATHERINE PEARCE, PRESIDENT, NATIONAL RETIRED TEACHERS ASSOCIATION, AND MEMBER, CITIZENS FOR A NEW PROSPERITY, ACCOMPANIED BY CYRIL F. BRICKFIELD, LEGISLATIVE COUNSEL, NRTA, WASHINGTON, D.C.

Mrs. PEARC. Mr. Chairman, as president of the National Retired Teachers Association, I speak for hundreds of thousands of retired teachers throughout our Nation who support the goals of Citizens for a New Prosperity.

As a founding member of the Citizens for a New Prosperity, I can say that this organization was established because we believe that the far-reaching objectives of the President's new economic policies are in the interest of all Americans. These are to stop inflation, to create full employment, and to make American products and services competitive around the world.

The membership of the National Retired Teachers Association, together with that of our sister organization, the American Association of Retired Persons, have combined membership which is now in excess of 3.3 million. These individuals represent a lifetime of productive activity and have a vital stake in a strong economy.

As a representative of retired teachers whose earnings during their working years were not high and who are now confronted with living on low-fixed incomes, I can say that we have a deep and urgent concern in the objectives of H.R. 10947.

While much more needs to be done to attack the serious problems besetting our own age group, paramount among which are the problems arising from inflationary trends, we nonetheless feel that H.R. 10947 is needed now.

Therefore, we feel that enactment of this legislation, together with the tools available through the phase II program, will supply new strength to the economy while holding down spiraling costs, prices, and wages.

It is my privilege now to introduce Summer Whittier, who is the executive director of the Citizens for a New Prosperity.

STATEMENT OF SUMNER WHITTIER, EXECUTIVE DIRECTOR OF CITIZENS FOR A NEW PROSPERITY, ON BEHALF OF DR. PIERRE A. RINFRET, VICE PRESIDENT-SECRETARY

Mr. WHITTIER. Mr. Chairman, it is with deep regret that Dr. Rinfret is not here, but I think I can summarize the position of the committee I think he is on his way from the airport at the moment but I think this very distinguished and large committee does very much appreciate the opportunity to appear here.

The committee heartily endorses and advocates the President's new economic plan. I believe that the investment tax credit is desperately needed if we are to create jobs and if we are to meet foreign competition. The consumer is beset on all sides by tax increases and by inflation. There is substantial reason to believe that the consumer is not as well off as general information would indicate and that tax cuts are needed to stimulate consumption. We need, and I advocate, legislative changes which will stimulate investment and consumption simultaneously. If we do this, I believe that we will work ourselves into full employment and prosperity in 1972.

If we do not grant tax cuts to both the corporate and personal sectors, then I despair about our economic outlook.

Our tax cut record: It is well worth the effort to briefly examine our postwar economic history from the viewpoint of tax cuts.

In 1953 this country made its maximum dollar expenditure for the defense budget as a result of the war in Korea. In 1954 we spent $7.5 billion less for defense than we did in 1953. This was one of the primary contributing factors in the 1953–54 recession. In January 1954, Congress repealed the excess profits tax and lowered personal income taxes by increasing personal deductions. In 1955 this country chalked up economic records and made substantial economic progress

In 1961 this country began to recover from the 1960–61 recession. Seen in the perspective of history, large increases in Federal spending did little to expand the economy in 1961. In 1962 Congress passed the 7-percent investment tax credit. In 1964 Congress passed both personal and corporate income tax cuts. There was great learned debate at that time in which many tax cut opponents took the position that (1) the tax cuts would probably be saved and not be spent; (2) corporations would receive windfall profits and pass them on to stockholders; and (3) increases in capital investment would destroy jobs and create excessive unemployment.

In actual fact, the opposite happened. In terms of the national economy, the years 1961 to 1965 were good economic years. The gross national product increased 5.6 percent a year in constant prices compounded. Inflation, as measured by the Consumer Price Index, was contained to a rate of 1.3 percent a year compounded. Capital investment, as measured by producers' durable goods in constant prices, increased 11.9 percent a year. Employment in nonagricultural industries increased 1.545 million per year. The unemployment rate declined from 6.7 percent in 1961 to 4.5 percent in 1965. Real disposable income per capita increased 4 percent a year compounded. And, finally, to complete the record, corporate profits after taxes increased 14.3 percent a year compounded.

It is fair to say that our postwar history indicates clearly that tax cuts do stimulate economic activity and this activity, and the important factor, this activity creates jobs. When we combine tax cuts at both the corporate and the personal level, we get our greatest impact: everybody prospers, including the Federal Government. Not only are there corporate presidents and former Secretaries of the Treasury and other top officials members of this committee but I think when Mrs. Pearce spoke of the 3,300,000 retired people, it indicates that the people are concerned. As a former Administrator of Veterans' Affairs, and I appeared before the Senator and I know Senator Long's deep concern and interest in the veterans of America, if the veterans return from Vietnam you can set up all the committees of 100 looking for jobs for them; the VA can have all its fine programs, but if there are no jobs then we have not given to that veteran the promise of this country that he so richly deserves, so it is essential to stimulate the economy.

In the core cities across America, in the rural areas that have been deserted, it is virtually essential that we have a strong prosperity. The best answers to the conditions in the ghetto are jobs for those human beings there and in the rural areas. So these tax cuts and these incentives that you are considering in people terms, in human terms, are of tremendous significance and importance.

For this Nation does face a great challengee. This economy faces at this moment we believe on this committee one of its greatest challenges. The Nation has cut back on our spending on defense and is going through a conversion from war. We are faced with a labor force increase of about 1.5 to 2 million people a year for whom we simply must find jobs.

There is not a State, not a city, not an area that is not deeply concerned. We have about 400,000 war veterans per year returning home and looking for employment which the Senator and I have been concerned about in times past. We are operating at 73 percent of our total capacity in manufacturing industry. We have 6-percent unemployment.

We have a burgeoning Federal deficit. We have a serious balance-of-payments problem. We have unused gross national product capacity of about 6 percent. And of the 22 nations which comprise the OECD, we have the lowest ratio of investment in machinery and equipment to gross national product.

This country is in serious economic trouble, and we think that the legislation that you are considering will be helpful in solving that problem.

We believe this country urgently needs the stimulation that will most certainly arise from cutting corporate and personal taxes. This alone will not solve all of our numerous and complex economic problems, the difficult kind of problems with which this distinguished committee must constantly wrestle, but we have a far better chance to obtain economic prosperity if these suggestions become law than we do without them.

And if we achieve prosperity, and I think we will, many of our problems will resolve themselves. And many human beings will be tremendously helpful.

We are the major economic power in the world and prosperity at home will help create prosperity and confidence elsewhere.

I heard the President talk the other night and he said that if he went to Moscow and he can go to China and he could speak from a strong economy at home, he would be better able to represent this Nation than if he were in a weaker economy and he would be in a weaker position.

Our free enterprise system must lead the way by restoring incentives to individuals and industry and this committee and this Senate play a very great part in that.

For the committee I thank you for the opportunity to have appeared here, sir.

(Dr. Rinfret's prepared statement follows:)

PREPARED STATEMENT OF DR. PIERRE A. RINFRET, VICE-PRESIDENT/SECRETARY, CITIZENS FOR A NEW PROSPERITY, PRESIDENT, RINFRET-BOSTON ASSOCIATES, INC., NEW YORK

Introduction.—I am pleased to have been afforded the opportunity to testify before this distinguished Senate Committee on the legislative part of the President's New Economic Program. I appear before you as a representative of Citizens for A New Prosperity. The testimony which I am about to give has been written by me and may or may not be endorsed by all members of the Committee.

Conclusion.—The President's new economic plan. I believe that the investment tax credit is desperately needed if we are to create jobs and if we are to meet foreign competition. The consumer is beset on all sides by tax increases and by inflation. There is substantial reason to believe that the consumer is not as well off as general information would indicate and that tax cuts are needed to stimulate consumption. We need, and I advocate, legislative changes which will stimulate investment and consumption simultaneously. If we do this, I believe that we will work ourselves into full employment and prosperity in 1972. If we do not grant tax cuts to both the corporate and personal sectors, then I despair about our economic outlook.

Our Tax Cut Record.—It is well worth the effort to briefly examine our postwar economic history from the viewpoint of tax cuts.

In 1953 this country made its maximum dollar expenditure for the defense budget as a result of the war in Korea. In 1954 we spent $7.5 billion less for defense than we did in 1953. This was one of the primary contributing factors in the 1953–1954 recession. In January 1954, Congress repealed the excess profits tax and lowered personal income taxes by increasing personal deductions. In 1955 this country chalked up economic records and made substantial economic progress. In 1961 this country began to recover from the 1960–1961 recession. Seen in the perspective of history, large increases in Federal spending did little to expand the economy in 1961. In 1962 Congress passed the 7 percent investment tax credit. In 1964 Congress passed both personal and corporate income tax cuts. I remember great learned debates at that time in which many tax cut opponents took the position that (1) the tax cuts would probably be saved and not be spent; (2) corporations would receive windfall profits and pass them on to stockholders, and (3) increases in capital investment would destroy jobs and create excessive unemployment.

In actual fact, the opposite happened. *I think it is fair to say that in terms of our national economy, the years 1961 to 1965 were golden economic years. We did almost everything right.*

Look back at our economic performances. The Gross National Product increased 5.6 percent a year in constant prices compounded. Inflation, as measured by the Consumer Price Index, was contained to a rate of 1.3 percent a year compounded. Capital investment, as measured by Producers' Durable Goods in constant prices, increased 11.9 percent a year. Employment in nonagricultural industries increased 1.545 million per year. The unemployment rate declined from 6.7 percent in 1961 to 4.5 percent in 1965. Real disposable income per capita increased 4.0 percent a year compounded. And finally, to complete the record, corporate profits after taxes increased 14.3 percent a year compounded.

It is fair to say that our postwar history indicates clearly that tax cuts stimulate economic activity and this activity creates jobs. When we combine tax cuts at both the corporate and the personal level, we get our greatest impact: everybody prospers, including the Federal government.

The Challenges We Face: This economy of ours faces almost unbelievable challenges. We have cut back on our spending for defense and are going through a conversion from war. We are faced with a labor force increase of about 1.5 to 2 million people a year for whom we must find jobs. We have about 400 thousand war veterans per year returning home and looking for employment. We are operating at 73 percent of our total capacity in manufacturing industry. We have 6 percent unemployment. We have a burgeoning Federal deficit. We have a serious balance of payments problem. We have unused Gross National Product capacity of about 6 percent. And of the 22 nations which comprise the OECD, we have the lowest ratio of investment in machinery and equipment to Gross National Product. *This country is in serious economic trouble.*

Suggestions: As some of the distinguished Senators of this Committee know, I had the honor of testifying before the House Committee on Ways and Means concerning the President's legislative proposals. I repeat the suggestions which I made before that Committee. They are as follows:

A. Suggestions for the investment tax credit:

1. The effective date of any investment tax credit should be April 1, 1971.
2. The rate of the investment tax credit should be set at 10 percent for the period April 1, 1971 to December 31, 1972 and 7 percent thereafter.
3. Liberalized depreciation should not be allowed together with the use of the investment tax credit. Corporations should be given an either/or choice. If they opt for the investment credit, they cannot take liberalized depreciation, or vice versa.
4. Small business (defined as any economic entity which is not a subsidiary or an affiliate of a larger economic entity, and whose aggregate annual average employment of full and part-time workers is 500 people or less) should be entitled to a 25 percent investment tax credit.
5. Consider an investment tax credit for private research and development expenditures. I would set the rate at the same level as for investment in new equipment.

6. Consider the adoption of an American counterpart to the Swedish investment reserve systems. This would permit the U.S. Treasury or some other duly designated authority to regulate the use of investment tax credit funds so as to moderate the extremes of the investment cycle.

B. Suggestions for Personal Income Tax Reductions

1. Rescind the 7 percent auto excise tax.
2. Increase the minimum standard deduction for all taxpayers from the present level of $1,000 to $1,500. This would benefit low-income groups primarily and cost about the same amount as accelerating the personal exemption, i.e., about $2 billion.
3. Make the increase in standard deductions retroactive to July 1, 1971 in order to take into account the fact that Treasury withholding tables appear inadequate for most taxpayers in 1971.

Summary. I believe this country urgently needs the stimulation that will most certainly arise from cutting corporate and personal taxes. I know that this alone will not solve our numerous and complex economic problems. But this I believe: we have a far better chance to obtain economic prosperity if these suggestions become law than we do without them. And if we achieve prosperity, and I think we will, many of our problems will resolve themselves. Let's face up to one fact: we are the major economic power in the world and prosperity at home will help create prosperity and confidence elsewhere. Our free enterprise system must lead the way by restoring incentives to individuals and industry.

I thank you.

The CHAIRMAN. Thank you very much, sir.

I have a publication, I believe Dr. Rinfret mailed this to all those who were subscribers to Rinfret–Boston Associates. If there is no objection I would like to put in in the record. He says he agrees the official trade statistics are misleading to the effect of about $5.5 billion a year and have been that way for the last 10 years. It would lead us to believe we had a big surplus during all that time and, as a matter of fact, we have been having a tremendous deficit in foreign trade, losing money rather than making money.

They do that by leaving the freight off the cost of imports and by adding in the giveaways as though they were the same as commercial exports.

By adding these two items, you see, we had a big deficit in our balance of payments on the trade item alone for the past 5 years where for many years the Department of State has been successful in deceiving the American people by these quarterly good news announcements to the effect that we had a big surplus when as a practical matter we had a big loss.

Of course, it got so bad that this year, even with the books weighted $5 billion plus in a completely misleading fashion, we still had a deficit.

So, Dr. Rinfret has been one of those sufficiently knowledgeable and sophisticated to understand and point that matter out.

May I say that yesterday some of us went down to the International Monetary Fund to discuss this problem with Dr. Schweitzer and others there. I am pleased to say nobody down there is misled about this matter. It appears that this matter is only something to deceive the American people, that all of our trading partners abroad understand what the problem is just as a majority of us on this committee understand it.

I would like to ask that it be printed in the record.

(The material referred to follows:)

RINFRET BOSTON ASSOCIATES, INC., INTERNATIONAL ECONOMICS, NEW BOP STATISTICS, CONFIDENTIAL, JUNE 17, 1971

1. On page 2 of this Study you will find some new statistics on the balance of payments (BOP) position of the United States. *These are official statistics of the U.S. Department of Commerce.* They reveal a point that we have been making for several years, to wit: the U.S. has had a commercial trade deficit for some time.

The story behind these carefully concealed statistics is rather amazing. Here is that story as told by Senator Long. The transcript of his remarks is taken from the Congressional Record. What follows speaks for itself.

"Mr. President, several years ago, my late beloved colleague Everett McKinley Dirksen and I brought out the fact that our foreign trade statistics are fraudulent and misleading. In 1966, the Committee on Finance held a hearing on the subject, and the facts developed at this hearing substantiated our contention. Ever since the death of Senator Dirksen, I have been trying to get the Commerce Department to publish more accurate trade statistics to show our true international competitive position. At numerous hearings, I have brought this subject up to the Secretaries of Commerce and Treasury and to other officials.

"These top officials understood the problem and agreed that the present statistics are misleading. However, the entrenched, faceless bureaucrats in the Federal Government who maintain their status throughout every Administration, Republican or Democrat, have fought the presentation of accurate trade statistics in every way they could.

"Finally, after much agonizing and dilly-dallying the Commerce Department agreed to publish, on a quarterly basis, statistics which would break out those exports financed under our giveaway foreign aid programs from private commercial exports, and to add a factor to our imports showing the cost of insurance and freight. However, as time passed, it was clear that this quarterly publication was completely inadequate. In the meantime, the Government's monthly trade statistics were published proclaiming our foreign trade position to be in rosy surplus. The truth is that we have had actual deficits in our foreign trade position ever since 1968 as table I shown below indicates, which I ask unanimous consent to have printed in the Record."

The table was ordered to be printed in the Record as follows:

U.S. TRADE BALANCE 1960-70

[In billions of dollars]

	Total exports, f.o.b.	Total imports, f.o.b.	Trade balance	AID and Public Law 480, Government-financed exports	Total exports less AID and Public Law 480, financed exports	Total imports, c.i.f.[1]	Merchandise trade balance
	(A)	(B)	(C=A−B)	(D)	(E=A−D)	(F)	(G=E−F)
1970	42.7	40.0	+2.7	1.9	40.8	44.0	−3.2
1969	37.3	36.1	+1.2	2.0	35.3	39.7	−4.4
1968	34.1	33.2	+.9	2.2	31.8	36.5	−4.7
1967	31.0	26.9	+4.1	2.5	28.5	29.6	−1.1
1966	29.5	25.6	+3.9	2.5	27.0	28.2	−1.2
1965	26.8	21.4	+5.4	2.5	24.3	23.5	+.8
1964	25.8	18.7	+7.1	2.7	23.1	20.6	+2.5
1963	22.5	17.2	+5.3	2.6	19.9	18.9	+1.0
1962	21.0	16.5	+4.5	2.3	18.7	18.2	+.5
1961	20.2	14.8	+5.4	1.9	18.3	16.3	+2.0
1960	19.6	15.1	+4.5	1.7	17.9	16.6	+1.3

[1] CIF imports are assumed to be 10 percent higher in value than f.o.b. imports in accordance with Tariff Commission study.

Source: U.S. Department of Commerce.

What follows are excerpts from Senator Long's extended discussion of the statistical problem. We have excerpted only because of space limitations. The full text is available to you if you so desire.

"After many members of the Finance Committee and the Ways and Means Committee made it abundantly clear to the Secretary of Commerce that the two responsible committees of Congress were unsatisfied with the misleading trade statistics propagated on the American public by the Commerce Department, the Secretary of Commerce took the matter up with the President of the United States. This is stated in the Secretary's memorandum of December 17 . . .

"According to the Secretary's memorandum, the President directed the Secretary to implement the proposal. I repeat, the President of the United States directed the Secretary of Commerce to publish accurate import statistics. The memorandum states: 'I discussed this proposal with the President, and he directed me to implement it.'

"Mr. President, a most extraordinary thing has occurred. Those nameless and faceless bureaucrats in the Federal Government have told the President to go fly a kite; he is wrong.

"I shall ask to place in the Record a most extraordinary report from Mr. Shultz to Secretary Stans which states that 'A great majority of participants in the interagency Committee on Foreign Trade Statistics expressed the view that it would be inadvisable for both statistical and conceptual reasons to calculate and publish prominently such a series on a regular basis.'

"In other words, Mr. President, these bureaucrats are afraid of showing the American people the true facts with respect to our foreign trade position. It is incredible to me that the President of the United States cannot get foreign trade statistics published the way he and the Congress wants them published . . .

"It is time for American people to know the truth about our international balance-of-trade and balance-of-payments positions and the consequences that will occur if we do not solve them on our terms . ."

The CHAIRMAN. Thank you very much.

That concludes this morning's hearing and we will meet again at 10 o'clock on Monday.

(Whereupon, at 12:15 p.m., the hearing was adjourned, to reconvene at 10 a.m., Monday, October 18, 1971.)

THE REVENUE ACT OF 1971

MONDAY, OCTOBER 18, 1971

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to recess, at 10:05 a.m. in room 2221, New Senate Office Building, Senator Russell B. Long (the chairman) presiding.

Present: Senators Long, Anderson, Talmadge, Nelson, Bennett, Curtis, Jordan of Idaho, and Fannin.

The CHAIRMAN. This hearing will come to order. The first witness this morning will be Hon. Edward W. Brooke, U.S. Senator from Massachusetts. We are pleased to have you this morning, Senator Brooke.

STATEMENT OF HON. EDWARD W. BROOKE, A U.S. SENATOR FROM THE STATE OF MASSACHUSETTS, ACCOMPANIED BY PROF. B. F. ROBERTS, DIRECTOR, CALIFORNIA ECONOMIC FORECASTING PROJECT, UNIVERSITY OF CALIFORNIA, BERKELEY

Senator BROOKE. Thank you.

Mr. Chairman, I am pleased to testify before this distinguished committee today in support of S. 2632, the "Employment Incentive Act of 1971," which Senator Javits and I, and 10 other Senators introduced on October 1, 1971. I am joined by Prof. B. F. Roberts, director of the California economic forecasting project of the University of California, Berkeley, who will comment briefly on the technical aspects of this proposal and answer any questions which you might have.

Professor Roberts is uniquely qualified to be here today inasmuch as he and his colleagues at Berkeley have studied the potential of an "employment tax credit" as an instrument for increasing employment and dampening inflationary pressures, as well as President Nixon's tax proposals which are designed to achieve the same goal. His comments, therefore, are most relevant to this committee's deliberations.

The employment tax credit proposal contained in S. 2632 would amend the Internal Revenue Code of 1954 to provide a direct tax incentive to every business in America to expand its workforce. In doing so, it is designed to produce more jobs, in less time and at a lower cost to the American taxpayer than any of the proposals currently before you.

Under this bill, any employer who hires additional employees during the taxable years beginning in 1972 or 1973 would be eligible for a tax credit in the amount of approximately $1,000 for each new employee. For example, if an employer hired one additional worker during 1972 at $5,000 per year, he would be entitled to a tax credit ir an amount up to $1,000—or 20 percent of the worker's salary. However, the employer would not receive any credit for merely paying overtime to existing employees.

It is estimated that this new tax credit would result in approximately 500,000 new jobs in the first year of operation. Professor Roberts and his colleagues have concluded that if an employment tax credit similar to that contained in S. 2632 were used as a supplement to President Nixon's tax proposals, employment would increase by 1.9 million workers by the fourth quarter of 1972.

While we have already begun to see considerable progress in the fight against inflation, the fact remains that over 5 million American workers, or 6 percent of our civilian labor force, are presently unemployed. According to the Bureau of Labor Statistics, over 2 million additional jobs will have to be created during the coming year to reach 4 percent unemployment by the end of 1972.

Thus, unless the employment tax credit proposal before you—or some similar job producing measure—is adopted, we will fall short of the goal of providing a decent job for every American who is willing and able to work. It is difficult to explain to able-bodied defense and aerospace workers, to minority group workers and others—who are ready and willing to work—that jobs simply are not available. By enacting the employment tax credit, we would have made substantial progress in bringing unemployment within tolerable limits.

When President Nixon announced this "new economic policy" to the Nation on August 15, he stressed the need to create more and better jobs and outlined a number of proposals including the job development credit which are designed to achieve this result. The employment tax credit is designed to complement these proposals and provide a much-needed fiscal tool to deal more precisely with the problem of periodic unemployment. This proposal would create additional employment not only in capital intensive industries, but also in service industries which would not benefit from the President's job development credit.

In this respect, it is interesting to note that recent surveys of business leaders indicate that the job development credit—or the investment tax credit, as it is commonly known—is more likely to increase corporate profits than to create additional jobs for unemployed workers during the coming year. Most businesses stand to reap substantial profits if it is applied to equipment which has already been ordered or to machinery that would have been ordered even if the tax credit had not been announced.

Although the job development credit has been almost universally welcomed by business leaders, its impact on capital spending plans will be reduced substantially because of excess plant capacity and the long leadtimes involved with the purchase of capital goods. Most companies that participated in a recent New York Times survey indicated that they will replace machinery and equipment at about the same rate they had planned before the President's announcement last month. Consumers spending and the prevailing level of economic activity were generally considered to be more important in determining capital spending requirements than the job development credit.

With the exception of the railroad industry most companies surveyed indicated that their capital spending requirements were already in place and that there was little likelihood of disturbing them. Other industries clearly do not stand to benefit from the job development credit because they are not capital intensive industries.

Fiscal stimuli of this nature do not go to the heart of the problem—that is, creating more jobs at a time when the problem of unemployment is most acute—because of the "trickle down" effect. Specifically, the job development credit is primarily designed to provide an incentive to businessmen to modernize capital facilities; but it will provide jobs only indirectly and mostly in capital goods industries.

Owing to the fact that almost half of American business is represented by service-oriented—as opposed to manufacturing—industries, a large sector of our economy will not be directly influenced by this fiscal policy tool. This is not to say that employment will not be stimulated by a means of the job development credit in the long run; however, our immediate needs will not be met unless more is done.

Senate bill 2632, on the other hand, would provide a direct incentive for all employers—in capital intensive as well as service industries—to expand their work forces now. It would not depend on the acquisition of capital goods, and in doing so, would benefit all industries, including those service industries which do not acquire capital equipment. Thus a new fiscal policy tool would be created to complement, not replace, the job development credit proposed by President Nixon.

While there are further refinements to this concept which might be adopted to obtain maximum flexibility, I will refrain from discussing these suggestions because of the committee's heavy schedule today. I referred to these refinements in my remarks on the Senate floor when S. 2632 was introduced and they are described further in Professor Roberts' working paper which was inserted in the Congressional Record at that time.

In summary, I urge the distinguished members of this committee to carefully consider adopting the employment tax credit proposals before you for three reasons:

First, it produces more jobs at lower costs to the American taxpayer than the other proposals before you.

Second, it will have a direct and immediate impact on our economy.

Third, its impact is not dependent on the acquisition of capital goods and therefore it reaches service industries which are not affected by the job development credit.

The present high level of unemployment cannot be tolerated. Not only does it represent a waste of valuable resources—both in economic and human terms—but it also constitutes a drain on the American spirit which cannot be permitted at this or any other time.

Because excess plant and equipment capacity exists in many industries and because of the leadtime involved with capital expenditures, it is imperative that we consider proposals in addition to the job development credit which are more precisely designed to eliminate unemployment today rather than waiting until the problem takes care of itself.

The cost of failing to act can be seen, in the faces of unemployed workers throughout the country. We can and must act to address this problem.

With the committee's permission I would like to have Professor Roberts make some brief comments on the employment tax credit proposal and the findings which he and his colleagues at Berkeley have reached, using an econometric model.

Following his remarks, any questions of a technical nature can be addressed to Professor Roberts.

Thank you.

Professor Roberts.

Professor ROBERTS. Mr. Chairman, I am pleased to testify before this distinguished committee today in support of Senate bill 2632, "The Employment Incentive Act of 1971." I hope to bring to the attention of this committee the implications of this bill which make it uniquely appropriate as a supplement to the President's new economic program toward the goal of an acceptable reduction in unemployment.

In the current economic situation, the employment tax credit instrument contained in this bill could significantly stimulate employment and production, increase both labor income and profits, reduce the Federal deficit, and diminish underlying inflationary pressures. My preliminary estimates indicate that this bill, as a supplement to the President's new economic program, could, by the fourth quarter of 1972, increase employment by 520,000 workers, GNP by $22 billion, wages by $17 billion, and profits by $4.4 billion; and reduce the unemployment rate by 0.6 percent, and the Federal deficit by $4.7 billion more than can be expected from the President's program alone. In addition, the use of the employment tax credit to complement and reinforce other stabilization instruments can increase the possibilities for early removal of the wage/price controls.

To understand how the employment tax credit would accomplish all this, consider how the implications of the employment tax credit relate to and supplement those of the conventional stabilization instruments currently in use. Stabilization policy in the United States is almost exclusively associated with the regulation of aggregate demand. While the goals of stabilization often pertain to prices and employment, the conventional monetary and fiscal instruments operate through aggregate demand and only indirectly affect prices and employment.

Certainly, the regulation of aggregate demand is a crucial element for stabilization, but it is not sufficient for simultaneous maintenance of price stability and the full utilization of labor resources. Recent experience even suggests that attempts to affect prices and employment through demand manipulation can actually result in deterioration of the trade-off between price inflation and unemployment that can be achieved with the conventional monetary and fiscal instruments. Too much has been expected from these instruments. Other instruments which can selectively operate directly on prices or directly on employment must be applied to complement the conventional ones, if the dual goals of price stability and full employment are to be achieved. Realization of this point most likely provided some of the motivation for abandonment of the President's old economic game plan and adoption of the new economic program including the current wage/price freeze and phase II controls.

The President's new economic program, with its price control provisions, has the potential of directly and effectively restraining actual price increases. These controls coupled with the President's fiscal program could break the spiral of inflationary expectations and also avoid contributing to the underlying but masked inflationary pressures. However, the President's program does not promise adequate relief from unemployment. Of course, there are many unknowns about the program at this date, but on the basis of H.R. 10947 it is most unlikely that the employment rate will be below 5 percent by the end of 1972. To reach even this level would require a substantial reduction in the consumer savings rate and increases in consumption expenditures coupled with increased business investment. Business investment, however, will probably follow the lead of consumer expenditures and the savings rate. The savings rate is not likely to drop much below the 8 percent level while the uncertainties of a 6 percent unemployment situation persist and all this implies that the key to broad expansion may well be increased employment. A reasonable and often cited unemployment rate figure for the President's program is 5.2 percent by the end of 1972.

Attempts to increase the short-run employment potential of the President's program with the conventional demand stimulating devices will encounter the problem of increasing underlying inflationary pressures and will reduce the chances for an early removal of the direct price controls. On the other hand, direct employment stimulation with the employment tax credit of the Employment Incentive Act offers the possibility of immediately increasing employment without contributing to inflationary pressures. In addition, the indirect effects of the employment tax credit should enhance the overall potential of the President's program. In fact, I will conjecture that the employment tax credit during 1972 would stimulate more investment than the investment tax credit. Increased employment, capacity utilization, income and consumer spending would increase the profitability of new capital and thus induce investment.

The employment tax credit is a direct cost-reducing inducement for expanding employment and differs substantially from demand regulating instruments in its impact. Its basic concept is symmetric with that of the demand regulating investment tax credit but its impact is quite different. Since the employment tax credit is tied directly to labor, a primary factor of production, it is a supply regulating instrument. It directly induces the expansion of employment and correspondingly, the aggregate supply of goods and services. The direct supply stimulating character of the employment tax credit offers significant possibilities for the promotion of noninflationary economic expansion.

The basic concept of the employment tax credit can be operationally structured in numerous ways. Under the provisions of the Employment Incentive Act, the tax credit is tied to additional man-days at a flat rate for a fixed period of time. An automatic stabilizing version tied to wages has been suggested by Richard Thunen and me which might be considered for increasing the flexibility and refining the performance of the Employment Incentive Act version. Such modification, however, is a matter of detail and is of secondary importance to the basic concept. I respectfully urge, therefore, that the distinguished members of this committee give careful consideration to the adoption of the Employment Incentive Act.

I want to mention in concluding that our work at the University of California in estimating the impact of alternate versions of the employment tax credit is continuing, and we hope to offer additional analyses and estimates in the near future. We are currently modifying the model to more accurately build-in alternative tax structures, and I would be glad to develop estimates of any versions of interest to this committee.

The CHAIRMAN. Thank you very much, sir.

Senator FANNIN, Mr. Chairman.

The CHAIRMAN. May I say that we are all rather limiting ourselves and on interrogating witnesses because we have a long list we want to have here today.

Senator FANNIN. If you don't want us to——

The CHAIRMAN. That is all right.

Senator FANNIN. Dr. Roberts, what is the percentage of overtime paid in this country today?

You refer in the Senator's testimony, and you substantiate it, you are talking about whether or not an employee will be paid overtime by the existing employer but not receive any credit for overtime to the existing employees, is one of the statements made, and I am assuming some of this information has been obtained from you.

Are we talking about replacing overtime? After all we have to have more sales and demands if we are going to have more employees.

The question I have is how do you expect the companies to need more employees unless they have additional sales or additional work?

Dr. ROBERTS. In the first part of your question I don't have the figures with me as to what the percentage is of overtime but the point of this program is that by putting additional people to work productively they will increase production, they will be paid additional wages and salaries which in turn will stimulate demand.

Senator FANNIN. All right. I concede a circle. But that is a short circle. What we need now is to create the demand and need for employees and I think this would help solve the problems to a greater extent.

Thank you kindly.

The CHAIRMAN. Thank you very much.

(Dr. Roberts' prepared statement follows:)

PREPARED STATEMENT OF B. F. ROBERTS, PH. D., ASSISTANT PROFESSOR OF BUSINESS ADMINISTRATION AND DIRECTOR, CALIFORNIA ECONOMIC FORECASTING PROJECT, UNIVERSITY OF CALIFORNIA, BERKELEY

Mr. Chairman: I am pleased to testify before this distinguished committee today in support of Senate Bill 2632, "The Employment Incentive Act of 1971." I hope to bring to the attention of this Committee the implications of this bill which make it uniquely appropriate as a supplement to the President's new economic program toward the goal of an acceptable reduction in unemployment.

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To understand how the employment tax credit would accomplish all this, consider how the implications of the employment tax credit relate to and supplement those of the conventional stabilization instruments currently in use. Stabilization policy in the United States is almost exclusively associated with the regulation of aggregate demand. While the goals of stabilization often pertain to prices and employment, the conventional monetary and fiscal instruments operate through aggregate demand and only indirectly affect prices and employment.

Certainly, the regulation of aggregate demand is a crucial element for stabilization, but it is not sufficient for simultaneous maintenance of price stability and the full utilization of labor resources. Recent experience even suggests that attempts to affect prices and employment through demand manipulation can actually result in deterioration of the trade-off between price inflation and unemployment that can be achieved with the conventional monetary and fiscal instruments. Too much has been expected from these instruments. Other instruments which can selectively operate directly on price or directly on employment must be applied to complement the conventional ones, if the dual goals of price stability and full employment are to be achieved. Realization of this point most likely provided some of the motivation for abandonment of the President's old economic game plan and adoption of the new economic program including the current wage/price freeze and Phase II controls.

The President's new economic program, with its price control provisions, has the potential directly and effectively restraining actual price increases. These controls coupled with the President's fiscal program could break the spiral of inflationary expectations and also avoid contributing to the underlying but masked inflationary pressures. However, the President's program does not promise adequate relief from unemployment. Of course, there are many unknowns about the program at this date, but on the basis of H.R. 10947 it is most unlikely that the unemployment rate will be below five percent by the end of 1972. To reach even this level would require a substantial reduction in the consumer savings rate and increases in consumption expenditures coupled with increased business investment. Business investment, however, will probably follow the lead of consumer expenditures and the savings rate. The savings rate is not likely to drop much below the eight percent level while the uncertainties of a six percent unemployment situation persist and all this implies that the key to broad expansion may well be increased employment. A reasonable and often cited unemployment rate figure for the President's program is 5.2 percent by the end of 1972.

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I want to mention in concluding that our work at the University of California in estimating the impact of alternate versions of the Employment Tax Credit is continuing, and we hope to offer additional analyses and estimates in the near future. We are currently modifying the model to more accurately build-in alternative tax structures, and I would be glad to develop estimates of any versions of interests to this Committee.

The CHAIRMAN. The next witness will be Senator James B. Pearson, senior Senator from the State of Kansas.

STATEMENT OF HON. JAMES B. PEARSON, A U.S. SENATOR FROM THE STATE OF KANSAS

Senator PEARSON. Mr. Chairman, members of the committee, I understand this is the last day of your hearings and you have a very long list of witnesses. Therefore, I would ask that my statement be incorporated in the record and I would like to take only about two minutes to identify the thrust of the my amendment to H.R. 10947 that I have submitted for the consideration of this committee.

It might be considered another direction, a new dimension, to the Rural Job Development Act (S. 346) which is cosponsored by 51 Senators and I think, Mr. Chairman, about half of the members of this committee. And what it seeks to do is to double the investment credit for industry located in the rural areas of America.

Whether one speaks in terms of population balance or revitalizing rural America the evidence is now overwhelming that we suffer at both ends of the population scale. The migration from the rural areas and the countryside into the great metropolitan areas catches up in its flow really two classes of people.

The first is the unskilled, thinking as he moves into the city, that he is taking his first step up the ladder of economic opportunity, only to slide back into the ghettoes and on to the welfare roles.

And the second part of that great migration catches up the bright, young, skilled people who are virtually the lifeblood of the leadership of the rural communities.

And so once again, whether one talks in terms of population balance or rural development, this is a problem which affects both the rural areas and the great metropolitan areas. And this is why I think an amendment such as this, creating jobs rather than any sort of a new welfare program, giving the opportunity to those who seek to stay in the countryside an opportunity to do so has such great merit.

We have no estimate of its cost. One would say that perhaps it would be $200 to $300 million judged by the other information that is available to this committee.

I think it is another opportunity here, Mr. Chairman, to do something about solving both the problems of the countryside and problems of the great city.

The migration continues. It continues at a greater flow than anticipated. In my own State of Kansas there are 105 counties. Seventy-five lost population last year while our population level of the whole State remained rather constant.

So I offer this amendment for your consideration.

(Sen. Pearson's prepared statement, with a letter to the chairman attached, follows:)

Prepared Statement of James B. Pearson, a U.S. Senator From the State of Kansas

Amendment to Job Development Tax Credit to Provide Additional Incentives for Rural Areas

Mr. Chairman, I am pleased to have the opportunity to appear before this Committee this morning. I intend to limit my comments to the Job Development Tax Credit which is a part of the overall legislative package being considered by this Committee.

I believe that an investment tax credit along the lines proposed by the President and passed, with certain modifications by the House, is highly desirable, indeed essential, to the national interest at this time.

Past experience demonstrates that investment tax credits serve to stimulate the economy and create new jobs. Therefore, given the present state of our economy, the restoration of the investment credit is imperative.

However, I propose that we carry the concept of the Job Development Tax Credit one step further. I suggest that we aim not only to stimulate the overall national economic growth, but that, at the same time, we seek to achieve a more balanced pattern of national economic growth.

I propose that we do this by providing an additional tax credit to encourage the expansion of investments in job creating enterprises in rural areas.

Therefore, tomorrow I will introduce an amendment to H.R. 10947 providing for a doubling of the tax credit for new job creating industrial and commercial investments in rural areas. I believe that you have been provided with a copy of this amendment and I will discuss the details of it shortly. First, I want to talk about some of the general principles.

This amendment, if enacted, will not and should not lead to the relocation of existing job patterns. However, this amendment would, I believe, significantly influence the location of new jobs in the future. Moreover, this additional tax credit should serve to stimulate the creation of a greater total number of new jobs than would otherwise be the case.

Thus, this amendment reinforces the goal of overall national economic growth, while, at the same time, encouraging the development of more jobs in rural areas.

Mr. Chairman, the goal of rural development and balanced national growth is now widely recognized and fully accepted. I believe that all of you on this panel have addressed yourselves to this subject at one time or another in recent years and I will not take the time of this Committee with a long discussion of the necessity of rual community development. However, a few brief comments are in order.

President Nixon in his State of the Union message in 1970 said "we must create a new rural environment that will not only stem migration to urban centers but reverse it". And last year, the Congress, in Title IX of P.L. 91-524 committed itself to the objective of achieving a sound balance between rural and urban America.

The growing commitment to rural development and balanced national growth is a result of a recognition that the process of massive, unguided urbanization has gone awry—that the gathering in of people and industry has reached the point where the liabilities are beginning to outweigh the benefits.

On the one hand, we have overcrowded cities, many of which show disturbing signs of becoming economically inefficient, socially destructive, and politically unmanageable. And we now know that if we are to ever really solve the crisis of the cities, we must figure out how to keep more and more people from crowding into them.

On the other hand, we have underdeveloped rural communities which are losing their population wealth, and their economic resources. Many are declining and threatened with extinction. Others are barely holding their own. Too few are keeping pace with national growth standards.

Daily the evidence grows that the distribution of our people and industry is tilted too far toward the megalopolis and away from the small community. We suffer at both ends of the population scale.

Thus, we seek to expand economic and social opportunities in rural areas as a means of achieving a more sane and sensible distribution of future population and economic growth increments. But we, also, seek to expand economic and social opportunities in the rural areas in order to correct the socio-economic deficit which characterizes many of our smaller communities.

Mr. Chairman, the goal of rural development and balanced national growth will not be achieved overnight. We must proceed on many fronts. We urgently need more sophisticated and comprehensive multi-county and regional planning and development structures. We need an improved system for increasing the availability of credit in rural areas. We need better programs for rural housing, water and sewer systems, and for other public services.

But it is also clear that one of the key elements in rural development is the creation of new job opportunities. Unless we can do this, not much else that we can do will have any really lasting effects. We must have more and better jobs in rural areas if we are to stem the migration of the overcrowded and overburdened megalopolises.

One of the means to achieving this is to provide additional tax incentives aimed at encouraging job creating investments in rural areas as proposed by my amendment.

My amendment would double the Job Development Tax Credit for industrial and commercial enterprises which generate new employment opportunities in the rural areas in which they are located. This additional credit would not be made available across the board to all types of business enterprises in rural areas. It would be limited to those types of investments where it can be demonstrated that employment opportunities in the rural community will be improved because of the investment. Specifically investments in manufacture, processing, assembling, or the industrial or commercial distribution of personal property would be eligible for the additional credit.

This amendment does not seek to give rural business in general a special break and a particular advantage over urban business. It will not give rural retailers an advantage over urban retailers. Rather by providing this additionl tax credit, it seeks to equalize those conditions in rural and urban America which often affect the location of job generating industrial and commercial enterprises. Factors relating to such things as transportation, the availability of public services, accessibility to risk capital, distance for cultural and recreational facilities, and other conditions tend to place the rural community at a disadvantage in the competition for job creating enterprises. In many cases, the disadvantages cannot be overcome by a special tax incentive, but, I believe that this additional credit will make the difference in a large number of entrepreneural decisions as to where to locate new or expanded enterprises.

Rural areas are defined in the amendment as those communities outside the Standard Metropolitan Statistical Areas designated by the Office of Management and Budget. This definition is qualified to the extent that to be eligible for the additional tax credit the enterprise must be at least 25 miles distant from any Standard Metropolitan Statistical Area. The creation of a buffer zone of this type will assure that the new business and industrial activity generated by this additional tax credit will be dispersed across rural America, and not concentrated in close proximity to the megalopolises. We seek to avoid encouraging further metropolitan sprawl. And we want to preclude the possibility of encouraging the exodus of industry from the inner city to the outer fringes of the suburbs.

The amendment also provides that the additional tax credit will not be allowed if it should result in a decrease in employment in other areas. What we seek here is the establishment of new jobs in rural areas rather than the relocation of existing jobs from the large cities to the rural areas.

Mr. Chairman, when the nation's governors met in their annual conference in San Juan, Puerto Rico last month, they adopted a policy position calling upon Congress to "adopt a system of tax incentives to encourage industry to locate in non-metropolitan areas". The concept of special tax incentives for rural job development has, also, been endorsed by such varied groups as the National Federation of Independent Business and the National Rural Electric Cooperative Association. My Rural Job Development Act which provides a comprehensive set of tax incentives for rural areas has been cosponsored by 50 of my colleagues, including a number of the members of this Committee. And the Committee will recall the hearings in May of 1969 when a large number of witnesses from across the country testified to their support of tax credits to stimulate job opportunities in rural areas.

Mr. Chairman, given the fact that if we pass the Job Development Tax Credit we will be saying, "tax credits do create jobs," and given the fact that the goal of rural development and balanced national growth is now widely recognized, it seems to me, that this amendment is proper and propitious.

It represents no radical departure from the legislation at hand, but merely its logical extension. Given its limited nature, it will not result in an excessive drain on the treasury. It is a modest proposal but it is a proposal with great promise. A proposal with a potential for altering, at least to some extent, the future growth patterns of this country.

Mr. Chairman, in the past several years there has been a great deal of talk about the necessity of rural development. In considering the President's tax proposal, we now have the opportunity to take specific, concrete action to encourage rural development by providing additional tax credit for job creating investments in rural America.

U.S. SENATE,
COMMITTEE ON FOREIGN RELATIONS,
Washington, D.C., October 19, 1971.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR RUSSELL: Attached is a copy of my amendment to H.R. 10947, providing for a doubling of the tax credit for rural areas, which I have introduced today.

Since testifying before your Committee, I have modified that language of the amendment defining eligible rural areas and, therefore, I simply wanted to call this to your attention.

Very truly yours,

JAMES B. PEARSON,
U.S. Senator.

AMENDMENT

Intended to be proposed by Mr. Pearson to H.R. 10947, an Act to provide a job development investment credit, to reduce individual income taxes, to reduce certain excise taxes, and for other purposes, viz: On page 19, line 17, renumber section 110 as 111, and after line 16 insert the following new section:

SEC. 110. CERTAIN PROPERTY PLACED IN SERVICE IN RURAL AREAS.

(a) Allowance of Double Credit.—Section 46(c) (relating to qualified investment) is amended by adding at the end thereof the following new paragraph:

"(5) Rural job development property.—

"(A) In the case of section 38 property which is rural job development property, the qualified investment shall be twice the amount determined under paragraph (1).

"(B) For purposes of subparagraph (A), the term 'rural job development property' means property which is used predominantly in one or more rural areas and with respect to which the taxpayer establishes, under regulations prescribed by the Secretary or his delegate, that—

"(i) such property will assist in providing new employment opportunities in the rural area or areas in which it is used,

"(ii) such property will be used in the manufacture, processing, assembling, or distribution of personal property (other than in a business consisting primarily of selling or leasing property at retail), or in connection with, or a part of, a facility providing recreation to the public which is not inconsistent with State recreation plans, approved by the Bureau of Outdoor Recreation, and with local economic development plans, and "(iii) the new employment opportunities in the rural area or areas which will be assisted by such property will not result in a decrease in employment in any other area.

"(C) For purposes of this paragraph, a rural area is any geographical area which is within a county (i) no part of which is within a standard metropolitan statistical area designated by the Office of Management and Budget, and the population growth rate of which, according to the most recent decennial census for which statistics are available, does not exceed the national population growth rate, or (ii) no part of which is within 25 miles of a standard metropolitan statistical area which has a population of 250,000 or more. Such term also means any area comprising an Indian reservation."

(b) Effective Date.—The amendment made by this section shall apply to property described in section 50 of the Internal Revenue Code of 1954.

The CHAIRMAN. Thank you very much, Senator Pearson. We are very pleased to have you with us today. The next witness will be the Honorable John Seiberling, Member of Congress from Ohio.

STATEMENT OF HON. JOHN SEIBERLING, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Mr. SEIBERLING. Thank you, Mr. Chairman. I appreciate very much the opportunity to appear before this committee this morning. After 21 years as a corporate lawyer before I became a legislator, I have very strong awareness of the impact of taxes on business and the economy.

When the Revenue Act was before the House, I went on record against it. I am in favor of a tax program to encourage higher industrial productivity, expand the number of jobs, and relieve low-income and middle-income taxpayers. For example, I favor the investment tax credit and believe it should even be increased. But after much thought and careful study, I reluctantly concluded that on the whole H.R. 10947 was both inadequate and unfair.

However, my purpose in coming before this committee today is not to make a general statement on the tax bill, but to focus the committee's attention on one very specific aspect of it—the repeal of the automobile excise tax—and to suggest, as an alternative, repeal of the tire excise tax.

According to the best estimates I have seen, the repeal of the auto excise tax will result in a loss of revenues amounting to $26 billion over the next 10 years, and I think this is grossly disproportionate to the amount of economic stimulus such a repeal will generate.

Theoretically, the repeal of this tax will benefit those individuals who can afford to buy new cars and trucks, but I have strong doubts that many of them will ever realize an added saving equal to the tax. In any event, new car buyers are only a small minority of the Nation's consumers, and even those potential new car buyers will be more influenced by considerations of need than by the lure of a discount.

I have introduced legislation in the House, (H.R. 11040) to repeal the excise tax on tires, inner tubes, and tread rubber, and respectfully suggest that this committee give consideration to such a measure as a supplement and possibly an alternative to repealing the excise tax on automobiles.

Repeal of the tax on tires will be more likely to stimulate consumer demand than the repeal of the tax on autos. Owners of cars must have tires in order to operate, and the tires must be replaced periodically even if the owner continues to operate his old car.

In 1970 the excise tax on tires produced a total of $605 million. If the tire excise tax were repealed, as proposed in my bill, this total amount would be passed directly on to the consumer and would be available for the purchase of other goods, thereby stimulating the economy with an additional $600 million annually.

This would represent, I might add, a loss of approximately $6 billion of revenue over the next 10 years instead of the $26 billion loss that will result from repeal of the auto tax.

Senator NELSON. May I ask a question? I thought you said the excise tax brought in $105 million?

Mr. SEIBERLING. $605 million.

Senator NELSON. All right.

Mr. SEIBERLING. Repeal of the excise tax on tires would not diminish the administration's general operating budget by one penny, since all revenues from this tax go directly into the Highway Trust Fund.

While some may argue that a cutback in trust fund moneys will adversely affect the economy by slowing down highway construction, the facts are just the opposite.

For some time now, the Highway Trust Fund has been taking in money at a faster rate than it has been spending. This administration has followed a policy of restricting the spending of trust fund moneys already collected--to the point where there is now nearly $4.5 billion in revenues lying idle in the trust fund.

This is not only unjust, but it is bad economics.

How can we justify to the taxpayers in this time of inflation and high unemployment the continued collection of a tax when the Government does not even wish to spend the proceeds?

Senator NELSON. I am not particularly familiar with the Highway Trust Fund reserves. Is this money for which there is no planned program at this time over and above——

Mr. SEIBERLING. My understanding is that eventually this money would all be spent but——

Senator NELSON. We are sure of that. But I mean is it projected in current highway planning?

Mr. SEIBERLING. I believe part of it is and represents projects in the works that have been held up.

But I believe part of it is money that doesn't even represent any program that is presently in the works. What the breakdown is I don't know. It is very difficult to get that.

Moreover, receipts from the tire tax represented only 11 percent of total Highway Trust Fund receipts in fiscal year 1971. While repeal of the tire tax may result in eventual stretching out of the interstate highway program, it is not believed that it will have any immediate effect, for the reasons I have already mentioned.

At a time when all national priorities have been under close review, it seems appropriate to provide greater flexibility by reducing this special trust fund that was established more than 15 years ago to support a program that has been 75 percent completed.

In the event this committee and the Senate concur in the repeal of the automobile excise tax, there is an even stronger case to be made for also repealing the excise tax on tires. The economic arguments which I have already cited still pertain. And at a time when there is growing concern to improve our sagging trade balance and secure American industry against encroachments from imports, there is an additional argument for repeal of this tax.

Currently, American automobile manufacturers—who are major purchasers of new automobiles tires—are able to write off the tax they pay on tires purchased for new cars against the tax they must pay on those cars.

Foreign automobiles manufacturers on the other hand, do not pay the tire excise tax. They do pay the auto tax. If the excise tax on automobiles is repealed, domestic car manufacturers will no longer be able to write off the tire excise tax against it.

Unless the excise tax on tires is repealed as well, foreign car manufacturers, paying no tire excise tax, will realize an advantage of $10 to $15 a car over American automobile producers, who would find themselves absorbing for the first time, the full impact of the tire excise tax. If you multiply $10 to $15 a car by 8 million cars a year, obviously you are getting into a very sizable additional burden that the American auto industry will bear and foreign industry will not.

The Federal highway program has accelerated the dependency on automobile transportation, and as a result the burden of the tax falls most heavily on lower and middle income groups. In accordance with the aims of the President's economic proposals to stimulate spending, we should be moving away from such regressive taxes, and toward taxes based on ability to pay.

It would be possible to limit the tire tax repeal to automobile tires only. However, it might result in some problems of definition in borderline tire sizes and would also mean that the bus and trucking industries would continue to pay not only the tax on tires, tubes, and tread rubber, but also the excise tax on buses, trucks, and semitrailers, which it is not proposed to repeal, at least not in the Ways and Means Committee bill.

It seems only equitable that at least the tax on tires used by buses and truckers should be eliminated at the same time as the tax on auto tires. The same reasoning applies to the tax on tubes and tread rubber, since the trucking industry is the biggest consumer of innertubes and tread rubber.

Repeal of the tire tax would put $600 million per year directly into the hands of the consumers.

It will rid us of an outdated, highly regressive tax which has outlived its usefulness.

It will not reduce public spending at all, since the revenues from the tire tax are simply swelling the surplus in the highway trust fund.

I might add, for the record, that the auto tax revenues do not go into the highway trust fund, they come out of the general revenues.

Mr. Chairman, I thank you very much for this opportunity. I will be happy to answer any questions.

The CHAIRMAN. Thank you very much, sir. We appreciate your presentation here today.

(Congressman Seiberling's prepared statement follows:)

PREPARED STATEMENT OF JOHN F. SEIBERLING, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Mr. Chairman, I want to thank you for giving me the opportunity to appear before your committee this morning.

When the Revenue Act was before the House, I went on record against it. I am in favor of a tax program to encourage higher industrial productivity, expand the number of jobs and relieve low-income and middle-income taxpayers. But after much thought and careful study, I reluctantly concluded that on the whole HR 10947 was both inadequate and unfair.

However, my purpose in coming before this committee today is not to make a general statement on the tax bill, but to focus the committee's attention on one very specific aspect of it—the repeal of the automobile excise tax.

In my opinion, the repeal of this tax will result in a loss of revenues ($29 billion over the next ten years) grossly disproportionate to the amount of economic stimulus such a repeal would generate.

Theoretically, the repeal of this tax will benefit those individuals who can afford to buy new cars and trucks, but I have strong doubts that many of them will ever realize an added saving equal to the tax. In any event, new car buyers are only a small minority of the Nation's consumers, and even those potential new car buyers will be more influenced by considerations of need than by the lure of a discount.

I have introduced legislation in the House (HR 11040) to repeal the excise tax on tires, inner tubes, and tread rubber, and respectfully suggest that this committee give consideration to such a measure as a supplement and possibly an alternative to repealing the excise tax on automobiles.

Repeal of the tax on tires will be more likely to stimulate consumer demand than the repeal of the tax on autos. Owners of cars must have tires in order to operate, and the tires must be replaced periodically, even if the owner continues to operate his old car.

In 1970 the excise tax on tires produced a total of $605 million. If the tire excise tax were repealed, as proposed in my bill, this total amount would be passed directly on to the consumer, and would be available for the purchase of other goods, thereby stimulating the economy with an additional $600 million annually.

Repeal of the excise tax on tires would not diminish the Administration's general operating budget by one penny, since all revenues from this tax go directly into the Highway Trust Fund.

While some may argue that a cutback in Trust Fund monies will adversely affect the economy by slowing down highway construction, the facts are just the opposite.

For some time now, the Highway Trust Fund has been taking in money at a faster rate than it has been spending. This Administration has followed a policy of restricting the spending of Trust Fund monies already collected—to the point where there is now nearly $4.5 billion in revenues lying idle in the Trust Fund.

This is not only unjust, but it is bad economics. It is extremely difficult to justify to the taxpayers, in this time of inflation and high unemployment, the continued collection of tax when the government does not even wish to spend the proceeds.

Moreover, receipts from the tire tax represented only 11% of the total Highway Trust Fund receipts in FY 1971. While repeal of the tire tax may result in eventual stretching out of the interstate highway program, it is not believed that it will have any immediate effect. At a time when all national priorities are under close review, it seems appropriate to provide greater flexibility by reducing this special trust fund that was established more than 15 years ago to support a program that has been 75% completed.

In the event this Committee and the Senate concur in the repeal of the automobile excise tax, there is a case to be made for repealing the excise tax on tires. The economic arguments which I have already cited still pertain. And, at a time when there is growing concern to improve our sagging trade balance and secure American industry against encroachments from imports, there is an additional argument for repeal of this tax.

Currently, American automobile manufacturers—who are major purchasers of new automobile tires—are able to write off the tax they pay on tires purchased for new cars against the tax they must pay on those cars. Foreign automobile manufacturers on the other hand, do not pay the tire excise tax. If the excise tax on automobiles is repealed, domestic car manufacturers will no longer be able to write off the tire excise tax against it. Unless the excise tax on tires is repealed as well, foreign car manufacturers will realize an advantage of $10 to $15 a car over American automobile producers, who would find themselves absorbing, for the first time, the full impact of the tire excise tax. Certainly, retention of the tire excise tax, in the face of repeal of the automobile excise tax, would be unfair to the American automobile industry. And this tax is, in all events, unfair to American consumers. It is a regressive tax.

The Federal Highway program has accelerated the dependency on automobile transportation, and as a result the burden of the tax falls most heavily on lower and middle income groups. In accordance with the aims of the President's economic proposals to stimulate spending, we should be moving away from such regressive taxes, and toward taxes based on ability to pay.

It would be possible to limit the tire tax repeal to automobile tires only. However, it might result in some problems of definition in borderline tire sizes and would also mean that the bus and trucking industries would continue to pay not only the tax on tires, tubes and tread rubber, but also the excise tax on buses, trucks and semi-trailers.

In seems only equitable that at least the tax on tires used by buses and truckers should be eliminated at the same time as the tax on auto tires. The same reasoning applies to the tax on tubes and tread rubber, since the trucking industry is the biggest consumer of innertubes and tread rubber.

Repeal of the tire tax would put $600 million directly into the hands of consumers.

It will not reduce public spending at all.

And it will rid us of an outdated, highly regressive tax which has outlived its usefulness.

Thank you, Mr. Chairman.

The CHAIRMAN. The next witness will be Hon. Charles A. Vanik, from the State of Ohio. We are pleased to have you.

STATEMENT OF HON. CHARLES A. VANIK, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Mr. VANIK. Mr. Chairman and Members of the committee, I appreciate very much your giving me this opportunity to appear in connection with the tax bill.

My views on this legislation are fully expressed in the dissenting views which I prepared at the time the House Committee on Ways and Means reported this measure. In order to sav time, I will not restate my opposition to the thrust of this legislation. With your permission I would simply state these views for your consideration as a part of my statement.

From all of the testimony which was submitted before the Ways and Means Committee, it is quite apparent that the investment tax credit incentive will have a delayed effect in stimulating the economy.

It is for this reason that I urged the acceleration of all of the tax law changes relating to individuals so that they would be available to the individual taxpayer for full calendar year 1971.

This would result in a program of substantial refunds to most taxpayers which would go immediately into the marketplace by way of purchases and commitments to purchase.

It would provide an instant stimulus to the economy with a multiplier effect.

From previous consumer experience, we can readily expect that, in many cases, a refund of $200 is very likely to really generate a contract to purchase of up to $2,000—or 10 times the amount of the tax relief. This kind of impetus would stimulate consumer purchasing, productivity, and employment. Of all the stimulants embodied in the tax proposal, it would be the most effective.

But the individual tax relief provided by the House passed measure would be totally lost and wasted as a stimulant because of its insignificance.

The Treasury loss occasioned by increasing the degree of individual tax relief could be offset by making August 15th the effective date of the Investment Credit, a saving of $1.6 billion.

I consider moving the date of the investment tax credit back to April 1st, a windfall because those people who made purchases in the period between April 1st and August 15th had no law to rely on. They get a windfall benefit by being included in this credit at a period before the President's recommendation.

I think we could also give the business taxpayer the right in 1971 to use either the asset depreciation range system or the investment credit. I don't believe both could exist. I think the investment tax credit is a far greater stimulant. This suggestion was made before the House Ways and Means Committee by Dr. Pierre Rinfret; he also suggested the taxpayer should have the alternative of using one or the other but not both.

The cost-benefit ratio of the investment credit does not measure up to our expectancy in other Government programs. Almost 75 percent of the revenue loss goes for the replacement of items and for the purchase of items which could have been acquired as a matter of course, even without the investment credit. If the investment credit could be related to the increment of purchases over a base period, it could cost the Treasury less and do more as an incentive to stimulate the economy.

If the investment credit were based on an incremental factor, an even higher percentage credit might be allowed. It is my hope that your study will delve further into this aspect of the investment credit than was contained on our side.

I am considerably impressed by the suggestion of your distinguished chairman, of a tax on excessive interest, as a part of this tax package. While interest rates have been stabilized and moving slightly downward in recent weeks, there is no reason to feel this is a permanent and lasting pattern or that the pattern will even continue during this emergency.

Excessive interest is a proper subject of consideration in tax legislation, and excessive interest tax could prove to be an effective tool in our current efforts to control and hold down the inflationary spiral.

In my judgment, the inflationary spiral was ignited by the acceleration of interest rates, and a permanent policy of interest moderation assisted by tax law policy, is necessary as a safeguard against the repetition of the last several years.

The Nation will not accept a policy of stabilization which excludes the cost of borrowing. For many families in America, the cost of borrowing is almost 25 percent of the total cost of living. This component of the cost of living which, unfortunately, is not included directly in the Consumer Price Index, has contributed more to the intolerable cost of living than almost any other factor.

I certainly hope that this committee will act in this critical area and provide some safeguard against the pressure which are very likely to generate from higher interest in a capital short market—when our economy returns to normal. Capital shortages and high interest for enterprises and for individuals are an almost certain development and must be provided against now.

I think, Mr. Chairman, that in our decisions then we make on these tax programs that we owe it to our constituencies to give careful consideration of the problem of continuing and long range revenues losses which compound the Federal debt.

These revenue losses may develop into a situation which may require an increase in individual tax rates after 1972. If this is a possibility, it should be openly and frankly discussed at this time.

My concern about this tax program is that it is designed for what is termed an economic emergency. We are dealing with problems which have a great likelihood of being permanent. It would seem to me that it would be far better to take the time, now, to arrive at long term decisions which must be made in adjusting ourselves to a peacetime economy with a 2 million annual increase in our potential work force in the years ahead.

We cannot settle on a tax program which has, as its growth and development goal, only 500,000 new jobs—which may be nearly 2 million jobs less than our requirements.

It sems to me that we would be well advised to act out of deliberation rather than impatience, and work out long term solutions to our current problems which would take us much further than the short sighted goal of a single good year—1972.

There are several other issues which trouble me very much about the House bill and recent Treasury actions.

The House proposal, H.R. 10947, gives the President the right to extend the investment credit for foreign purchases—at such time as he intends to lift the import tax.

Although the President unquestionably had the power to impose the 10 percent import tax, I have grave doubts that he has the authority to terminate the tax, for this may be a necessary subject for congressional action.

I also question the advisability of giving the Executive the authority to extend the investment credit to foreign purchases at a date at which he may terminate the import tax. This gives the Executive the sole power to determine the effective date of a tax privilege. Further, I frankly don't know how we can create jobs in America by granting the investment credit for goods produced offshore. It would seem to me that it would be far more advisable to limit the credit to only that part of the item which is produced in the United States.

I also have grave doubts about the Treasury action announced on Tuesday, October 12, 1971, in which the Treasury indicated it would suspend the penalty tax on corporate profits which remain undistributed as a result of the administration freeze order.

Although this may be desirable in view of the Executive order, it seems to me that it should be the subject of legislation by the Congress. Otherwise, this action, following on Treasury's promulgation of the asset depreciation range system, may indicate that the Congress is losing its power over taxation—one of the few powers which have remained inviolate. If the Executive has the right to suspend this tax, he has the right to suspend all taxes. If these are the legal prerogatives of the Executive, there is very little need for a legislative body.

This last question has been a great source of concern to me. The constitutional effect of what is involved transcends even the grave economic emergency in which we find ourselves.

There is no need to destroy, by these precedents, the great principle of separation of powers—which has made our Nation so strong, so responsible, and so much admired around the world.

The CHAIRMAN. Thank you, Mr. Vanik. I wish we had some more of you populist type over here on the side to help me figure out how we can go about putting a tax on interest and making it work.

The thought occurs to me, and I have mentioned it before, that if these interest rates are structured to 5½ or 6 percent inflation, and they are, then if we are going to go and flatten out this inflation cycle and hold it down to 2, no more than 3 percent, that extra 3 percent in interest rates represents a windfall profit if I ever saw one.

Mr. VANIK. It certainly does.

The CHAIRMAN. It occurs to me if we just tax the difference on what they are making on Government bonds alone it would save $6 billion.

But as far as the savings for Treasury it wouldn't be quite that great if you allow for the fact a considerable amount of taxes may be paid on some of the interest collections.

Even so we ought to make $3 billion for the Federal Government and if we did I would like to use some of it to put tax relief where some fellow is going to get substantial advantage out of it.

The people I want to help, and I think the people you like to help, spend that money the day they get it. In the many instances they owe debts and one thing and another and they would put that money right into circulation.

I would like to do something along that line but I must say we must have some people show us how to do it because the Treasury is not going to help us. My impression is they don't like the idea and we are not going to get any more help from the Treasury than they are forced to give us on this.

If you have some ideas about how that can be done would you please favor us with some suggestions? I for one would like to vote to do something about it, about the windfall that would accrue to moneylenders if the program works.

I don't see any purpose in putting it into effect if it doesn't work. Wouldn't low interest rates do as much to stimulate the economy as the investment tax credit?

Mr. VANIK. It would have a greater effect. From my studies, many people spend 25 percent of what they earn for interest. They buy everything on time and their buying would be stimulated if these interest rates were held down.

The CHAIRMAN. Most people buying a home nowadays have to borrow the money to build it and at the level we have right now if they have to pay it off over a long period of time the interest cost exceeds the cost of the house.

Mr. VANIK. If there was a nominal tax on interest above 8 percent, a 20 percent tax even less, or some such thing, I think it would have a tremendous suppressive effect because it would, first of all, be a psychological barrier.

I think the amount of the tax is not quite so important as the fact that there would be a tax. I think it would give us an idea of the borrowing that is carried on at excessive rates of interest. When there are excessive rates of interest, they are certainly harmful to the home buyer and the purchaser of consumer goods. They are harmful to the businessman. If a businessman has to pay excessive interest it is the sure road to bankruptcy. I think it would stabilize the economy a great deal more if we had a stabilized limit on what the interst rate could be.

Senator BENNETT. No questions.

The CHAIRMAN. Thank you very much.

Senator NELSON. You suggest in your statement giving more purchasing power to low-income groups. If the scheduled social security tax increase is allowed to go into effect, that, as I recall, would mean an increased tax of about $3 billion. So even if we pass the increased tax exemption and low-income allowance as in the present bill, this is canceled out immediately by the social security tax increase. As a result, we are not really increasing purchasing power.

Mr. VANIK. Well, the social security tax is a gradual tax that would result in a few dollars more each a month while the refunds that would result by way of acceleration of the individual tax benefits to the year 1971 would flow immediately after January 1. It is true that at the same time there would be some cutback of the tax relief advantages, through increased social security taxes, but those would be gradualized.

I frankly believe in a strong social security fund. I wonder what the interest on the public debt would be today, if we did not have the great reservation and reservoir of resources that are in the public trust funds to invest in it.

I think that for most Americans their social security account is really their only investment in the public debt, and I frankly think that the presence of this trust fund is a very good and salutary thing. I have always tried to preserve it. As a matter of fact, I would prefer that the social security system were made independent so that its investment could be handled by its own board of trustees instead of out of the Treasury Secretary's pocket.

I feel that we are talking about two different things. Under the social security systems we are providing an insurance service and I think that while we do increase the tax, it is gradualized and the impact is felt over a period of 12 months. On the other hand, the increment to the taxpayer by some kind of tax refund would go into the marktplace and would be effective when he files his returns as early as January 1.

Senator NELSON. The point I was getting at is this: one of the objectives of the increased exemptions and increased low-income allowance is to increase purchasing power by about $3 billion. But when the social security tax increase goes into effect next year, that will cost $3 billion.

So you have not increased purchasing power. Is that correct?

Mr. VANIK. Well, I think, first of all, the figures have to be corrected. When they consider what is given to the individual, they toss in all of the excise tax benefits. The excise tax benefits only inure to those people who have $5,400 with which to purchase a new automobile and that is only going to be about 10 million people at the outside. If you take out the commercial buyers of vehicles you reduce that to about 7 million people.

The other 70 million taxpayers are left completely out of the picture. Their part of this bill is almost so insignificant that it will not be felt at all.

Senator NELSON. The point is that the $3 billion increase in exemptions is canceled out by the $3 billion social security tax increase. So you have not created any additional purchasing power.

Mr. VANIK. For all practical purposes none.

Senator NELSON. If we pass H.R. 1, we will have a social security tax increase, of $7 billion. So we will end up taking away a net of $4 billion in purchasing power.

Mr. VANIK. That is just about correct. I address myself to is the idea of accelerating all of the tax changes in the Reform Act of 1969, accelerated those to 1971, to provide the basis for some kind of a refund to the average taxpayer in January.

(Material referred to previously by Congressman Vanik follows:)

DISSENTING VIEWS OF CONGRESSMAN CHARLES A. VANIK ON H.R. 10947

This tax proposal, including the establishment of the 7% investment credit, the repeal of the automobile excise tax and the Administration's Asset Depreciation Range, provide a tax reduction of over $5 billion to the business sector of the American economy, while the average taxpayer earning $9,000 per year with three dependents will receive a tax savings this year of only $24, or 7¢ per day. This legislation constitutes an incredible backward step in the struggle for tax justice. It is a sluggish, uncertain approach to recovery, full employment and stable prices.

The 7% investment credit will cost the Treasury $2.4 billion in fiscal 1972, while the Asset Depreciation Range will cost about $1.5 billion. The fiscal 1972 cost of DISC will be about $100 million. Since a considerable portion of the motor vehicle and light truck excise tax is on vehicles used in business, the net Treasury loss and and business gain will exceed $5 billion in fiscal 1972. By fiscal 1977, this Treasury loss will reach an annual rate in excess of $12 to $15 billion.

For the next year the proposed tax credit appears more likely to increase corporate profits than to create jobs for unemployed workers. According to a New York *Times* survey, most companies will replace machinery and equipment at about the same rate they had planned before last month's windfall announcement. The survey indicated that few new jobs will be created quickly, either through plant expansion or in industries supplying new machinery.

If we calculate a $5 billion revenue loss in 1972 as the cost of creating 500,000 new jobs—a highly speculative figure—it would amount to over $10,000 in Treasury loss per job.

During Committee hearings, the testimony was overwhelming on the need for a tax break for every kind of business. There was an astonishing lack of expert testimony by objective, impartial economists—those who are motivated by principle—the love of nation over personal profit or reward.

The Committee considered the 7% investment credit as a permanent part of the tax law. There was no more evidence to support a 7% investment credit in 1971 than there was to support a 27½% depletion allowance in 1926. What is so holy and right about 7%? Why not 3%—or why not 14% on those purchases which are an increment over a base period? Why not a flat, five year depreciation on all machinery and equipment purchases? If we are writing a permanent law, why not establish some sustainable basis for our decision?

On April 22, 1969, the President, in urging repeal of the investment credit, said, "This subsidy to business investment no longer has priority over other pressing ntaional needs." If he was right in April of 1969 in urging repeal of the investment credit, is he well-advised now to urge its reinstatement as a permanent law in addition to the Asset Depreciation Range System.

The repeal of the excise tax on automobiles and light trucks will cost the Treasury \$2.6 billion in fiscal 1972 and \$3 billion per year thereafter. In addition to business purchasers, it only benefits the 7 million individual purchasers of automobiles who will now be expected to pay the straight sticker price for an overpriced automobile. The average automobile purchaser will soon catch on to this and return to his former practice of buying an automobile when he needs one, or when he gets a decent deal. In the meanwhile, the several states may impose excise taxes equivalent to or higher than 7%—and the Treasury loses \$3 billion per year forever. Quite a cost for a little "ping" in the marketplace.

When budgetary limitations are finalized as a part of this economic package, \$5 billion will have to come out of essential programs in health, job training, education, pollution control or welfare. In the alternative, the \$5 billion must be packed onto the federal debt and fuel the inflation which trims the value of the dollar at home and abroad.

This tax program is designed to produce a vibrant bloom of corporate profits next summer and a harvest of bitter fruit in the cold seasons that follow. The tax package is inequitable and cruel to the individual taxpayer who will have to pay for it in the years ahead.

I must oppose this bill.

CHARLES A. VANIK.

The CHAIRMAN. Thank you very much.

Mr. Frank Barnett, Chairman of the Board of the Union Pacific Railroad, on behalf of the American Association of Railroads. Good to have you, Mr. Barnett.

STATEMENT OF FRANK E. BARNETT, CHAIRMAN, BOARD OF DIRECTORS, UNION PACIFIC RAILROAD CO. AND UNION PACIFIC CORP., IN BEHALF OF THE ASSOCIATION OF AMERICAN RAILROADS, ACCOMPANIED BY ROBERT J. CASEY AND JOHN A. CRAIG, COUNSEL

Mr. BARNETT. Mr. Chairman, members of this distinguished committee: My name is Frank E. Barnett. I am Chairman of the Board of Directors of Union Pacific Railroad Co. & Union Pacific Corp., with offices at 345 Park Avenue, New York City.

I am accompanied by Mr. Robert J. Casey and Mr. John A. Craig, our tax counsel of the firm of Casey, Tyre, Wallace, and Bannerman.

I am appearing here today on behalf of the Association of American Railroads to present the views of the association with respect to H.R. 10947, particularly the portions thereof which provide for the 7-percent job development credit: a reasonable allowance for depreciation: a reasonable repair allowance; and for repeal of the manufacturers' excise tax on new passenger automobiles and light trucks.

With the permission of this committee, I request that my written testimony, which has already been submitted be made part of the record of this proceeding.

The CHAIRMAN. It has already been done, sir.

Mr. BARNETT. The members of the Association of American Railroads operate 99 percent of the class I railroad mileage in the United States, and employ 98 percent of the class I railroads total domestic work force.

In our judgment, the 7-percent job development credit constitutes the most expeditious means of stimulating our national economy—combating inflation—and dealing with the problem of unemployment.

The key to economic strength in the United States is capital investment. Thus inflation is best combated by a continuing increase in industrial capacity. To the railroads, the incentive to investment now before this committee will permit our industry to reactivate the programs of expansion and modernization which we were forced to curtail upon repeal of the 7-percent investment credit out of economic necessity.

These programs look to the expansion and modernization of our freight car fleets—the upgrading of the traction power of our locomotives—the construction of electronic marshaling yards—the installation of new track and related structures capable of sustaining high speed trains carrying ever-increasing freight cargoes—and the installation of modern communications equipment.

Ever since our appearance before this committee in 1962—as one of the first industries urging support of the 7-percent investment credit—we have consistently pointed to a basic need to generate the capital necessary to underwrite these programs.

Of necessity such capital must come from internal sources—due to ever-increasing interest rates on equipment financings and the nonexistence of equity capital.

Unquestionably, we have been materially aided by the speedup in cost recovery under the emergency amortization provisions and liberalized depreciation policies. However, these provisions alone are not sufficient to generate the dollars we desperately need if we are to overcome our equipment shortages and modernize our plant facilities.

We're thus heartened by what we know will be the dramatic stimulus to our investment immediately upon enactment of the proposed credit—a stimulus which we must have if we are to play our proper role in the President's economic program.

The immediate impact of such credit, is easy to understand: it provides instant dollars—available no later than the first estimated tax installment date following the taxable quarter when the acquired property is placed in service. The impact on cash flow is instant and as distinguished from the gradual impact of liberalized depreciation whose cash recoupment stretches over a number of years.

Congressman Vanik you heard a few minutes ago, mentioned a delayed impact of the 7-percent credit. It is curious. You gentlemen undoubtedly don't know that Congressman Vanik and I were law school classmates.

That was more years ago than I like to mention, but we have disagreed ever since. And this is another point of our disagreement.

In addition—investment credit dollars do not represent the return of prior capital expenditures. Rather, they are permanent tax savings which can immediately be committed to plant expansion and modernization programs.

Over and above the stimulus this credit will provide to our capital investment programs, it will have an anti-inflationary impact in the railroad industry.

We are all familiar with price increases occasioned by the closing of production facilities as the result of freight car shortages—shortages, I might add, resulting from the lack of capital funds to acquire badly needed equipment. Enactment of the Job Development Credit will—we predict give us the wherewithal to immediately and irrevocably reverse this trend.

In the railroad industry, my company represents roughly 5 to 6 percent in terms of revenue, and in terms of employment. Fortunately, we have not been so hard pressed to supply the beginning capital to acquire equipment over the past 10 years or so.

During those years during which we were 5 percent of the total of the industry, we were buying 10, 11, or 12 percent of the total equipment which was bought by the industry each year. We know what this investment credit does for us, and I think we all need only look at the record to become convinced of its efficacy.

In our judgment, enactment of the credit will make available the funds to overcome the equipment shortages--expand and modernize our track—install advanced computers and communications equipment—and thus respond more effectively to the demands of our shipper rather than forcing them to more expensive modes of transportation.

Moreover, the credit will also have an immediate and forceful impact on unemployment. Our car and locomotive builders and suppliers during the effective years of the 7-percent credit employed in excess of 500,000. We all remember what happened to them when that credit was suspended—the plants that were closed—and the drastic reductions in their work forces.

Enactment of the credit, we predict, will have the opposite effect on these industries once we again reach the high plateau of investment in plant and equipment we attained under the 7-percent investment credit.

In addition—the impact which our equipment orders will have within the steel industry must be considered.

Steel is basic to nearly all our equipment needs. Freight cars—locomotives—rails and rail fittings—CTC equipment—microwave towers—signals and multitude of other products depend on steel.

With the credit dollars in hand our orders for these products will begin to swell, bringing with them an ever increasing demand for steel.

Finally the jobs created within our own ranks must not be overlooked. In many instances we have been forced to set aside our expansion programs because our dollars were more desperately needed in the equipment area.

Now with the credit dollars once more available, we can again embark on those programs which call for the installation of heavier rail—the elimination of grades and curves—the daylighting of tunnels—the construction of electronic marshalling yards—in short, the development and sustaining of the most modern railroads on earth.

Turning to our investment in rolling stock, consideration should be given to the Department of Transportation's estimate that over the next 9 years we must invest in equipment alone—over $15.3 billion.

This estimate translates into an annual equipment investment over the period of $1.7 billion—and an annual freight car acquisition of at least 83,000 cars.

The actual cash outlay necessary to underwrite this program—only over the 9 years—is some $8.1 billion, that is explained and shown in Exhibit D of my written testimony.

We cannot hope to achieve this goal without the credit. Freight orders in 1970 were only 58,201—a non-credit year—far short of the 83,000 acquisition called for by DOT.

However, during 1966—a 7-percent credit year—our orders reached a peak of 112,898 cars.

Will the presently proposed credit be as dramatic? We sincerely believe it will. No other industry in this Nation was so materially aided as were the railroads by the 7-percent investment credit. Conversely, no other industry in this Nation was so affected by that credit's suspension and ultimate repeal.

While we are indeed heartened by the action of the House in respect to H.R. 10947, we are more than a little disturbed by that portion of the legislation which disqualifies for investment credit purposes property for which an election for 5-year amortization under section 184 of the code has been made.

If the railroad industry is to participate fully in the new prosperity in peacetime, both provisions—the credit and rapid amortization—should be available.

As noted in my written testimony, the railroads desperately need immediate cash to finance their road and equipment purchases. Looking to equipment alone, the Department of Transportation's estimate of a need for an aggregate expenditure of $15.3 billion over the next 9 years is, of course, representative of the purchase of $1.7 billion a year.

Because our equipment purchases are financed with a cash downpayment of 20 percent, the balance being financed over 15 years, we estimate that this $15.3 billion alone will require an aggregate cash flow of $8.1 billion over the 9-year period.

We have calculated what we believe will be the maximum cash available to us from rapid amortization provisions over the 9-year period. Before subtracting the 10-percent minimum tax on tax preference items—amortization provides cash of $5.3 billion—a deficiency in cash of $2.8 billion.

Subtracting the 10-percent minimum tax of some $0.4 billion leaves available cash of $4.9 billion, a deficiency in cash of $3.2 billion.

Thus, it is abundantly clear that the rapid amortization provisions alone cannot serve to satisfy our cash requirements if we are to meet the Department of Transportation's 9-year estimate of our needs.

Conversely, over the 9-year period, the credit alone would provide funds of $1.1 billion. Even if the two provisions are combined, as we earnestly believe they should be, the industry cash flow over the 9-year period would be augmented by some $6 billion—leaving a cash deficiency of some $2.1 billion.

We believe that the presently proposed credit will go far to make up this deficiency in cash flow. However, the credit dollars together with the dollars available under rapid amortization are absolutely essential if we are to meet the Department of Transportation's estimate of our needs.

Moreover, consideration must be given to the circumstances surrounding the enactment of the amortization provisions of section 184.

These provisions were emergency measures designed to overcome shortages in the railroad's national fleet of rolling stock—a shortage which continues to exist today.

By its terms, section 184 contains a self-destruct mechanism which is operative once the Secretary of the Treasury, on the advice of the Secretary of Transportation, determines that specific items of equipment are not in short supply.

Further, these provisions are applicable only with respect to property placed in service prior to January 1, 1975, thus giving the Congress an opportunity at that time to review the needs of the railroad industry, and to reenact section 184, or not.

Finally, it should be clearly understood that section 184, the amortization provisions, are emergency measures, drafted to deal with a specific situation—a national roalroad equipment shortage.

On the other hand, the proposed credit is designed to deal with another separate and distinct emergency, some method of stimulating the national economy. I need not point out that if we are to be denied the credit because of the availability of section 184, or, conversely, if we are to be denied amortization because of the credit—nothing will be accomplished in our industry. What would have been gained on the one hand would be taken away on the other.

In addition to the foregoing, we urge adoption of those portions of H.R. 10947 which provide for a reasonable depreciation and repair allowance. In our judgment these provisions represent the most realistic system of cost recovery in this Nation's history.

Finally, we urge immediate repeal of the manufacturers' excise tax on new automobiles. As the carrier of more than 76 percent of the new automobiles and automotive parts shipped in the United States, we recognize that the increased consumer demand for domestically produced vehicles will increase our freight revenues and thus add materially to our ability to take our proper place in the new prosperity without war.

I thank the committee very much for the courtesy extended today.

The CHAIRMAN. Thank you very much.

Senator ANDERSON. You had experience with the 7-percent investment?

Mr. BARNETT. Yes, sir.

It changed our capital programs very, very substantially.

Senator ANDERSON. Do you know how much it changed?

Mr. BARNETT. Yes, it changed our capital programs very, very substantially. How much it changed? I can answer that in the case of my own company very specifically. We went along prior to 1962 on the basis of acquiring equipment between $75 and $90 million a year. After 1962, with passage of the 7 percent investment credit, our equipment purchases went up to the area of $175 to $200 million a year, and over the last 6 years we have spent $750 million on equipment up to repeal of the investment credit.

Now, nationally, the effect of the credit orders of freight cars is shown in exhibits "A" and "B" of my written statement. In 1960 there were 36,000 freight cars ordered; in 1961, there were 33,000 freight cars ordered; in 1965, when the credit was in effect, there were 105,000 freight cars ordered; and now in 1966 there were 112,000—this being an increase from orders just prior to the credit of some 90-odd-thousand cars.

Senator ANDERSON. Thank you.

The CHAIRMAN. Both in the area of overloaded trucks and also in the area where trucks are permitted to carry heavy weights within the law, it is where the highways are sustaining most of their damage.

I know the trucks pay us a substantial amount of taxes and those are good people, I am sure, on the whole, but it would seem to me that we are just getting most of the damage to our highways, I would think probably 75 percent of them are coming from these heavyweight bearing trucks moving across the highways carrying things that could be just as well carried on the railroads.

Can you give us some suggestion as to how we might reduce the damage to our highways or just exactly how the economics on that tend to work out where we are loading the highways down?

I have driven behind some of these fellows and watched them crack slab after slab in my part of the country, especially when you have wet weather for several days running.

What kind of suggestion do you have along that line? Has your group studied the damage that has occurred to the highways because of the very heavy loads that are supposed to go by railroad ordinarily?

Mr. BARNETT. Yes; that question has been studied very, very extensively and it is clearly shown that the damage to a concrete highway is a function of both weight and speed of the truck creating an impact which would crackup most any highway we can build these days.

Perhaps the most effective measure which could be taken would be some reduction of the enormous speed. There is also a safety factor involved in the enormous speed at which these huge things run along the highway because they will create their own wind which is enough to blow a passenger car right off the road.

The most effective thing that could be done would be some national reduction in a speed limit that would also add very substantially to the safety factor.

The CHAIRMAN. Thank you very much, sir.

Senator FANNIN. Do you have any idea what percentage of the steel that is used by the railroads both in the tracks and equipment is imported?

Mr. BARNETT. Yes, sir; I have a very good idea about that, a very clear idea. Zero.

Senator FANNIN. In other words, as far as the steel rails and I know that some of the foreign countries now are making wheels and things of that nature. Aren't those being imported?

Mr. BARNETT. To a very, very minor degree there are some.

Senator FANNIN. Axles?

Mr. BARNETT. There are some axles of Japanese manufacturers that are being imported in this country. In the case of my own company our use of that amounts to zero. In the case of the national industry the use of imported steel in rail equipment is very minimal.

Senator FANNIN. I understand it was growing quite rapidly and I was wondering if this legislation would help turn it around.

Mr. BARNETT. It would indeed.

The CHAIRMAN. Thank you.
(Mr. Barnett's prepared statement follows:)

PREPARED STATEMENT OF FRANK E. BARNETT, CHAIRMAN OF THE BOARD OF DIRECTORS OF UNION PACIFIC RAILROAD CO., AND UNION PACIFIC CORP., ON BEHALF OF THE ASSOCIATION OF AMERICAN RAILROADS

Mr. Chairman and Members of the Committee, my name is Frank E. Barnett. I am Chairman of the Board of Directors of Union Pacific Railroad Company and Union Pacific Corporation, with offices at 345 Park Avenue, New York City.

I am appearing here today on behalf of the Association of American Railroads to present the views of the Association and its members with respect to the Revenue Act of 1971 (H.R. 10947); particularly those portions thereof which provide for the restoration of the 7 percent investment credit; a reasonable allowance for depreciation; a reasonable repair allowance; and for the repeal of the manufacturers excise tax on passenger automobiles and light trucks.

The members of the Association for whom I speak operate 99 percent of the Class I railroad mileage in the United States, and employ 98 percent of the Class I railroads' total domestic work force. On behalf of the Association and its members, I urge the swift enactment into law of the Revenue Act of 1971 as passed by the House of Representatives.

Job Development Credit

In our judgment there is no doubt that the 7 percent Job Development Credit constitutes the most expeditious method of stimulating our national economy, combating inflation, and reducing unemployment. Capital investment has long been recognized as the key to the economic strength of this nation, and thus we believe that an increase in industrial capacity is the most effective long-range weapon against inflation.

Similarly, there is no doubt that the astounding increase in industrial capacity, together with its almost total elimination of unemployment, experienced during the viable years of the 7 percent investment credit, is at present nonexistent. Analysis of new orders for machine tools during the 1962 to 1970 years, as set forth in the Report of the House Committee on Ways and Means, which accompanied H.R. 10947,[1] reflects not only the negative impact on capital spending which arose from suspension and ultimate repeal of the 7 percent investment credit, but also the positive influence of that credit.

Looking solely at the railroad industry, we believe that the incentives to capital investment presently pending before this Committee will, if enacted, permit our industry to reactivate its program of expansion and modernization which, out of economic necessity, we were forced to curtail upon repeal of the 7 percent investment credit in 1969.

This, I might add, is not a prediction based on idle speculation. The experience of the railroads with the 7 percent investment credit dates back to those days when many urged its defeat. Thus it was on April 6, 1962, that I appeared before this Committee on behalf of the Association and urged the immediate adoption of that portion of the Revenue Act of 1962 providing for the investment credit, and commended it as a means, "not only of stimulating an increase in employment opportunities and in the gross national product, but also as one way to initiate much needed plant modernization."

In October of 1966, Daniel P. Loomis appeared before this Committee on behalf of the Association to argue against suspension of the credit which he maintained would: add substantially to the existing national freight car shortage; add to rather than decrease the inflationary spiral then of such concern to the administration; and finally, would critically depress within a few months after its enactment, the freight car and locomotive building and supply industry which at that time employed in excess of 500,000 individuals.

Finally, in July of 1969, Mr. Thomas M. Goodfellow, on behalf of the Association, and I, on behalf of Union Pacific Railroad, argued strenuously against repeal of the investment credit, again pointing out what we believed would be the consequences attendant upon such repeal, not only to the railroad industry, but also with respect to our national economy.

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[1] H. Rept. No. 92-533, 92d Cong., 1st Sess., p. 6.

As has been said—what is past is prologue—and thus I would direct this Committee's attention to Exhibits "A," "B," and "C" attached hereto, which dramatically reflect both the positive impact of the investment credit in the railroad industry, as well as the negative impact of its suspension and ultimate repeal.

Exhibits "A" and "B" clearly underscore the stimulus to freight car acquisitions provided by the credit during the 1960–1970 period. Exhibit "A" reflects the orders actually placed for freight train cars during this period, while Exhibit "B" reflects those cars placed in service during this period. Taken together these Exhibits demonstrate how quickly and effectively the credit translated itself into ever-increasing equipment orders. Thus in 1962, the initial year of the credit's application, orders for freight train cars commenced their upward climb from the 1960 level of 36,800 units to 112,898 units ordered during the calendar year 1966. These statistics represent the positive influence of the credit within the railroad industry.

On the other hand, consideration of Exhibit "C" reveals how quickly lack of the investment credit dried up cash which would otherwise have been utilized in our modernization and expansion programs. Thus, orders placed during the 5-month period immediately preceding suspension of the credit, which averaged 8,466 units, dwindled to a 6,087 monthly average during the 5-month period commencing with the suspension. In addition, consideration should be given to the increase in orders placed in May of 1967, a point in time when retroactive restoration of the credit was a foregone conclusion, as well as the 11,449 orders placed in June of 1967, the month in which the credit was in fact restored retroactively.

In short, the dramatic stimulus to cpaital investment provided by the investment credit is nowhere more clearly demonstrated than in the railroad industry.

Job Development Credit Anti-Inflationary Impact

In addition to its contribution to programs of capital expansion, the proposed credit will have a decided anti-inflationary impact insofar as the railroad industry is concerned. This Commitee is well aware of instances of sharp increases in prices which have resulted from the shutting down of producing facilities due to freight car shortages. This Committee is further aware of situations where these freight car shortages have forced our shippers to turn to more expensive modes of transportation. In light of the fact that approximately 20 cents of the consumer's dollar is devoted to transportation costs, and the further fact that rail shipment of freight is the least expensive method of transportation, it is apparent that any shift by our shippers to non-rail modes of transportation has an inflationary impact.

Drawing directly on our experience with the 7 percent investment crdeit, we believe that the shortages of rail equipment which have given rise to these increased transportation costs can and will be reversed upon enactment of the proposed job development credit due to the availability to the members of our industry of the necessary funds to underwrite the acquisition of badly needed equipment. It is axiomatic that any incentive to the acquisition of rail and other components of the track structure, computers, advanced communication facilities, freight train cars, locomotives, and other qualifying and related assets must necessarily decrease the cost of transportation, and consequently is bound to be anti-inflationary.

Accordingly, enactment of the job development credit will provide our industry with the means to more effectively respond to the demands of shippers, rather than forcing them to alternative and more expensive modes of transportation.

Job Development Credit Will Combat Unemployment

As to the contribution which the job development credit will make to the national labor force, I would direct this Committee's attention to the situation which occurred within the car and locomotive building and supply industries upon the suspension of the 7 percent investment credit. As we predicted, these industries, within a short period of time after enactment of the suspension, were faced by the most critical period in their history. Car and locomotive building plants were forced to close, and the employment of thousands of highly skilled individuals was terminated. Work force reductions ranged from a low of 25 percent to a high of 75 percent.

In our judgment, enactment of the presently proposed job development credit will produce exactly the opposite results to those experienced during the suspension period within the car and locomotive building and supply industries. Once the necessary funds become available, the railroad industry will be in a position to climb back to the high plateau of plant and equipment investment attained during those years in which the 7 percent investment crdeit was available. It is only too obvious that this resurgence of investment will have a direct impact upon the car and locomotive builders and their suppliers.

Job Development Credit Essential to Railroad Modernization Programs

In addition to the foregoing, enactment of the job development credit will generate within the railroad industry imediate dollars which can be committed to expansion and modernization programs. Ever since our initial appearance before this Committee in support of the 7 percent investment credit, our industry has pointed consistently to a basic need to generate capital with which to underwrite the cost of its plant and facilities modernization programs. These programs look to the acquisition of newer and more sophisticated units of rolling stock, locomotives, electronic marshalling yards, track and related structures capable of sustaining high-speed trains, and modern communications equipment.

As we have indicated time and again, the cash with which to underwrite these programs has been traditionally derived from three sources: credit financing accomplished through equipment trust obligations, conditional sales, or bank financings; equity financings; and internal sources.

Credit financings account for some 80 percent of the total cost of our equipment acquisitions and are amortized over a 15-year period. A number of years ago these funds could be secured at an effective interest rate which ranged from 2 to 3½ percent. However, recent experience has seen a cost for these funds, even to our more prosperous members, which has ranged from 6.56 to 10.63 percent.

The balance of these acquisition costs, the 20 percent cash down payment, come from either equity financings or internal sources. When one considers the fact that the estimated rate of return on net investment for all Class I railroads in the United States for 1970 was only 1.47 percent, the lowest since the depression year of 1932, it is no surprise that the investment community looks elsewhere to purchase its equity securities.

Thus it is that the railroad industry must generate from within the funds to make the down payments on its equipment acquisition obligations, and to underwrite its other programs designed not only to maintain but also expand and modernize its existing facilities.

Unquestionably, the more rapid recovery of previously invested dollars through liberalized depreciation policies have and will continue to contribute to the generation of these funds. However, these provisions are not sufficient to enable us to meet our *immediate* need for capital with which to overcome our desperate equipment shortages and expand and modernize our facilities.

Accordingly, we are greatly encouraged by the presently proposed job development credit as contained in H.R. 10947. That it will have, upon enactment, an immediate impact within our industry is unquestioned, and easy to understand. The credit will generate immediate dollars to the purchasers of qualifying assets, dollars which will be available no later than the first estimated tax installment date occurring after the close of the taxable quarter within which such assets are placed in service. This instant dollar availability distinguishes the credit from depreciation liberalization which, while extremely vital to our acquisition programs, permits a dollar recoupment stretching over a number of years, thus providing a welcome but gradual impact on cash flow.

In addition, the credit dollars thus generated do not represent the return to the taxpayer of prior capital expenditures as do depreciation dollars. Rather, they represent permanent tax savings which immediately can be committed to plant maintenance, expansion and modernization programs by members of our industry.

Job development credit essential if railroads are to meet requirements estimated by the Department of Transportation

The pressing need for this resurgence of investment in our industry is made abundantly clear by the testimony of Charles D. Baker, Assistant Secretary for Policy of the Department of Transportation, before the Senate Subcommittee on Freight Car Shortages on June 29 of this year. In his testimony Mr. Baker referred to the Department of Transportation's estimate that the railroads, over the next 9 years, must place into service at least $15.3 billion in new and rebuilt freight cars and locomotives, an expenditure which he noted was exclusive of the industry's other needs such as new track and terminals.

Mr. Baker's estimates are certainly pertinent to the instant legislative proposals. His breakdown of our 9-year requirements revealed the following:

1. 617,000 cars each of the 80-ton capacity costing $8.8 billion, or an average of $14,200 per car to meet a projected rail demand of 1.03 trillion ton-miles in 1980;
2. 130,000 cars costing $2.3 billion to satisfy existing shortages; and
3. 11,169 road and switching locomotives costing $3.7 billion.

Looking solely to our freight car requirements, it is clear that we are currently unable to keep pace with the estimated annual need over the 9-year period for at least 83,000 cars. Orders placed during the calendar year 1970 aggregated only 58,201 cars, as contrasted to the 112,898 cars ordered in 1966 when the credit was in effect, and as contrasted with the first 4 months of 1969 (that period immediately prior to repeal of the 7 percent investment credit) when orders were placed for some 38,872 freight cars.

In the absence of the credit we must agree with Mr. Baker's conclusion that the railroad industry's present financial position "probably precludes their reaching a level of expenditures anywhere near $15.3 billion" over the 9-year period; a conclusion predicted on the fact that as an industry we are not now generating a cash flow sufficient to even renew existing car fleets, let alone add to them. As is evident from Exhibit "D," the acquisition of this equipment will require an aggregate cash outlay over the 9-year period on the order of $8.1 billion.

Thus it is that we urge the swift enactment of the job development credit—not only to stimulate a lagging economy and to combat inflation and unemployment, but also to permit our industry to reactivate those programs of expansion and modernization which we were forced to curtail upon repeal of the 7 percent investment credit in 1969.

Reasonable Allowance for Depreciation

Similarly, the railroad industry encourages enactment of those portions of H.R. 10947 which provide for a reasonable allowance for depreciation as well as a repair allowance. We have long been keenly aware of the necessity for, and have strenuously advocated, a system of depreciation predicated on the economic realities of today's marketplace. We believe the provisions contained in Section 110 of H.R. 10947 represent a highly significant and commendable step towards that goal.

In April of 1962, and again in November of 1963, we appeared before this Committee and pointed to a need for legislative action with respect to depreciation. We felt then as we do now that depreciation is an area in which absolutes are a necessity—absolutes which can only be insured by legislative action.

Our active interest in realistic depreciation policies has stemmed for the most part from our reliance on internal sources for funds with which to maintain, expand, and modernize our existing plant and facilities. As I noted earlier, depreciation has played a major role in the generation of these funds, returning to us over the depreciable period previously expended capital dollars which can once more be committed to our acquisition programs. As the net earnings of our industry have declined, our interest in realistic depreciation has become more and more acute.

The first major step in the direction of realistic depreciation was taken in 1962 with the promulgation of the Guidelines in Revenue Procedure 62-21. The primary function of the Guidelines was to stimulate investment in new properties and encourage the retirement of outmoded and obsolete assets. In addition, it was intended to, and did, eliminate a major component of the hidden cost most feared by business—an unexpected tax deficiency.

The second major step towards the goal of realistic depreciation was taken by the Treasury Department earlier this year in its promulgation of the ADR system of depreciation. At long last the taxpaying community could avail itself of a system of depreciation which gave full and complete recognition to not only the physical deterioration of a depreciable asset, but also to that asset's economic obsolescence.

The period of an asset's physical deterioration is readily ascertainable. Thus the service lives established under Bulletin "F" in pre-Guideline years were nothing more than the product of tombstone studies of varying business practices which revealed nothing more than the number of years an asset had been used in the past before it was retired from service, usually because it wore out.

However, in today's climate the mortality approach to depreciation is totally unrealistic. Today, assets are retired due to rapid technological changes in the arts, and not because of their physical deterioration. In the railroad industry we are constantly confronted with more sophisticated equipment which ranges from rolling stock to electronic classification yards. Accordingly, any realistic systems of cost recovery must give full recognition to this fact of accelerating economic obsolescence, and further must be responsive to the current purchasing power of the dollar.

We believe that the combination of the Guidelines and the ADR system of depreciation, as enacted by the House of Representatives, and as presently contained in Section 110 of the Bill before this Committee, represents the most practical and realistic system of cost recovery in this nation's history—and we therefore urge its immediate Congressional enactment.

Repeal of Manufacturers Excise Tax

Finally, we urge repeal of the manufacturers excise tax on passenger automobiles and certain other vehicles. As the carrier of more than 76 percent of the new automobiles and automotive parts shipped in the United States, the railroad industry has a vital interest in any measure which will stimulate consumer demand for domestically produced vehicles. The increased demand for these vehicles will not only provide additional job opportunities, but also will result in increased freight revenues which will add materially to our ability to contribute to an international prosperity without war.

In conclusion, I would like to thank this Committee for the courtesies which have been extended to me today.

EXHIBIT A

Freight train cars ordered during calendar years 1960–70

Calendar years:	
1960	36,800
1961	33,085
1962	40,401
1963	71,311
1964	85,120
1965	105,674
1966	112,898
1967	70,551
1968	71,663
1969	90,151
1970	58,201

NOTE.—Includes cars of all railroads and private car lines, as well as cars built new by carbuilders and in railroad shops, and cars rebuilt by carbuilders and in railroad shops.

Source: Reports American Railway Car Institute and The Association of American Railroads.

EXHIBIT B

Frieght train cars placed in service, calendar years 1960–70

Calendar year:	
1960	58,322
1961	34,241
1962	39,822
1963	48,255
1964	83,266
1965	89,653
1966	106,058
1967	100,181
1968	68,836
1969	76,014
1970	75,225

NOTE.—Includes cars of all railroads and private car lines, as well as cars built new by carbuilders and in railroad shops, and cars rebuilt by carbuilders and in railroad shops.

Source: Reports American Railway Car Institute and The Association of American Railroads.

EXHIBIT C

Freight train car monthly orders during 5-month period prior to suspension of credit and during the period commencing with suspension and termination with its retroactive restoration

Orders during 5-month period prior to suspension:

June 1966	7,538
July 1966	6,353
August 1966	8,678
September 1966	13,045
October 1966	6,720

Orders during period commencing with suspension and terminating with its retroactive restoration:

November 1966	6,258
December 1966	9,863
January 1967	4,364
February 1967	4,041
March 1967	5,909
April 1967	[1] 1,728
May 1967	7,677
June 1967	[2] 11,449

[1] Month restoration effective.
[2] Month restoration retroactively enacted.

NOTE.—Includes cars of all railroads and private car lines, as well as cars built new by carbuilders and in railroad shops, and cars rebuilt by carbuilders and in railroad shops.

Source: Monthly Reports American Railway Car Institute and The Association of American Railroads.

EXHIBIT D

ANNUAL CASH REQUIRED FOR ACQUISITION OF $15,300,000,000 OF EQUIPMENT OVER 9-YEAR PERIOD

Year	Downpayment [1]	Principal [2] amortization	Interest [3]	Total
1	$340,000,000	$52,070,646	$53,040,000	$445,110,646
2	340,000,000	108,046,590	104,049,245	552,095,835
3	340,000,000	168,220,730	152,875,428	661,096,158
4	340,000,000	232,907,931	199,354,819	772,262,750
5	340,000,000	302,446,672	243,311,410	885,758,082
6	340,000,000	377,200,818	284,555,990	1,001,756,808
7	340,000,000	457,561,525	322,885,158	1,120,446,683
8	340,000,000	543,949,285	358,080,259	1,242,029,544
9	340,000,000	636,816,127	389,906,237	1,366,722,364
Total	3,060,000,000	2,879,220,324	2,108,058,546	8,047,278,870

[1] At 20 percent of annual purchases of $1,700,000,000.
[2] 80 percent of annual purchases amortized over 15 year.
[3] Calculated at 7½ percent, less 48 percent effective Federal tax rate.

Senator ANDERSON (presiding). The next witness is Mrs. Thea Braiterman, assistant professor of economics, Baltimore College of Commerce.

STATEMENT OF MRS. THEA BRAITERMAN, ASSISTANT PROFESSOR OF ECONOMICS, BALTIMORE COLLEGE OF COMMERCE, BALTIMORE, MD.

Mrs. BRAITERMAN. My name is Thea Braiterman and I am assistant professor of economics at the Baltimore College of Commerce, and I am speaking before this committee on behalf of the Women's International League for Peace and Freedom.

The U.S. section of the league is composed of the 150 branches across the country and members at large, both men and women, and the league was founded in 1915 by Jane Adams.

I have submitted a written statement and I would appreicate it if the committee would make the statement a part of the record.

Senator ANDERSON. That will be done.

Mrs. BRAITERMAN. The Revenue Act of 1971 has been advertised to the public as a measure to reduce unemployment. If it could do that, it would be most welcome. Unemployment stands at over 6 percent, which means that we must find at least 5 million new jobs.

Yet the most optimistic prediction for President Nixon's new economic policies—that offered by Dr. McCracken, Chairman of the Council of Economic Advisors—promises only 500,000 new jobs.

If Dr. McCracken is correct, less than 10 percent of the unemployed would get back to work in the next year. Although the bill before this committee is an improvement over the President's original economic proposals, it still does not offer any serious hope of creating anything close to a full employment economy.

The reasons are very clear. The enormous benefits it provides for business in the form of the job development investment credit and the Asset Depreciation Range System (ADR) will cost the U.S. Treasury a permanent annual loss of between $6 and $9 billion in revenues, without any indication that this loss will be compensated for by a corresponding increase in jobs.

This represents an aggregate cut of 15 to 20 percent in corporate taxes at a time when profits are rising. The second quarter of 1971 was the highest quarter at aggregate profits in history. We know that the economy needs stimulation, and that profits are low in some businesses. But widespread improvement in prosperity is not likely to be found in measures directly benefitting profits across the board. Stimulation needs to be provided elsewhere.

At the present time, American industry is operating at only about 73 percent of capacity. As a result of insufficient demand, we have a deflationary gap of $70 billion—the difference between the present gross national product and what the gross national product would be at full employment.

In such a situation, most economists agree that investment incentives are not what is needed. Idle plant and machinery will begin to be put to use when this is warranted by growing demand, If it is tax measures that are proposed to stimulate that demand, not an investment credit but more direct job oriented and consumer-oriented measures are what is called for.

When people are buying business will expand without any help from the Government. The investment credit is not an employment measure, it is a windfall for business.

If there is any doubt about the windfall nature of this measure, one need only remember President Kennedy's original investment credit, introduced in 1962, which applied only to new investment above and beyond the routine replacement of existing plant, equipment, and machinery.

Somewhere along the line, this qualification has been dropped. Now business is offered a credit on all new plant and equipment. Thus it is quite possible for a business to reduce its investment, and yet be richer by the investment credit. The lucky businessman gets a credit on both gross and net investment; but it is only net new investment that brings about a rise in the gross national product.

So, therefore, we urge that the job development credit be rejected and that the asset range depreciation system be repealed.

I would like next to speak about DISC, the domestic international sales corporation provisions.

Gentlemen, this is a windfall being slipped past an unexpecting public. The average American citizen has no idea that there is a lucrative loophole for foreign subsidiaries of American corporations. As you all know, foreign subsidiaries don't have to pay taxes on profits unless and until those profits are paid to the parent corporation in the United States.

What this bill before your committee is proposing to do is offer the same loophole to American exporters at a cost to the Treasury of between $600 and $955 million each and every year. Tax-free foreign investment is costly to the Treasury, it generates problems in our balance of payments, it causes dislocation in our foreign relations with development countries such as Western Europe, Japan, and Canada, it causes problems of unfair competition for American exporters and American labor.

All of these inequities and dislocations do need repair but not by the DISC provisions which only make a bad situation worse. The way to equalize competition between American exporters and American business abroad is by removing the tax benefits that follow American investment around the world.

This could be done by taxing the profits of foreign subsidiaries of American corporations on a current basis by which we tax business generally—without deferring or postponing taxation until profits return home in the form of dividends.

The DISC provisions should be rejected by this committee. Third, I would like to speak on the matter of tax reduction.

In the tax reduction provisions of this revenue act Congress does begin to move in the right direction by directly increasing disposable income and yet it has not done enough. The report on the bill which came out of the House seems to claim that no one living below the poverty level will have to pay taxes if we pass this revenue act of 1971. But if you examine the facts more closely and if you look at the detailed projections of the House committee—I have cited them in my written report—you will see that this act does not come close to bringing about removal of taxation of people who are at the poverty level, and I would like to suggest that the bill do just that.

The poor whose needs are pressing have a higher propensity to consume than the wealthy, and therefore, tax reduction that concentrates on low income families have a quick stimulative effect.

The bill recognizes that but does not go far enough. We recommend that the minimum deduction and the personal exemption be increased as a measure that would immediately increase demands in the economy.

And finally, I would like to speak about a full employment economy. We don't believe that a full employment economy can be achieved solely through the stimulation of consumer demands although that is a necessary first step.

Too much of our unemployment is structural. The jobs that have been created in the last 10 or 20 years are increasingly white collar jobs in the service industries.

We have fewer and fewer jobs for unskilled people. Therefore, the Government must begin to invest in human capital. If it is our purpose to reduce unemployment the way to do it is to provide jobs for people who want them and not by tax credits to private industry but rather by direct Government expenditures that will create jobs.

The cost of job creation can be compensated for by the spending power of those who become employed. We hope that the administration and the Congress are serious about achieving a full employment economy. If we are to have that, jobs must be created not vaguely and rhetorically "developed." And if we are serious perhaps the time has come to guarantee full employment by providing that the Government become the employer of last resort.

Let's not give business an unnecessary gift of billions of dollars for machinery in the futile hope that the benefits will trickle down to the people. Rather let's invest in human beings and watch the benefits percolate up through a healthy economy.

Thank you.

Senator BENNETT. I would like to join the lady in one comment—let's close down all of the manufacturing, let the machines run out, get obsolescent, and let's take in each other's washing.

Mrs. BRAITERMAN. I wouldn't say that.

Senator BENNETT. That is the ultimate of what you are suggesting.

Mrs. BRAITERMAN. I don't think so at all.

Senator FANNIN. What do you think we are going to do to compete with the other countries of the world if we follow your line of thinking?

Mrs. BRAITERMAN. I believe our industry can become competitive with other countries in the world.

Senator FANNIN. And pay four times the salaries and in some cases 10 times the salaries?

Mrs. BRAITERMAN. I am not suggesting anything about salaries.

Senator FANNIN. You should be thinking about that.

Mrs. BRAITERMAN. I am thinking about that.

Senator FANNIN. How can we possibly compete with the other countries in the world when the unions have been able to force labor costs up so tremendously?

Your theoretical conclusions might work if we were not competitive with the other countries.

Mrs. BRAITERMAN. I think we can be. We have the resources and we can work at that. We are going to become less competitive if we allow business to close out competition. That is the basic principle of a free enterprise economy.

Senator FANNIN. We are not working under a free enterprise economy when we have the labor costs forced up with lower productivity. Take the steel industry as the basic industry. We are paying 4 times the wages that the Japanese are paying and they have greater productivity than we have.

So how are you going to overcome that?

Mrs. BRAITERMAN. I recently heard a figure from someone who apparently knows what he is talking about that says the labor hours that go into an automobile amount to only $500. 70 man-hours that go into an automobile. At the average rate of pay, that that represents $500 in labor costs and we all know how much the price of the automobile goes up every time that there is an increase in wages.

Senator FANNIN. I am afraid that you haven't followed all the way through from the start to the finish. I am not going to debate this at this time. This is a very ridiculous statement for you to make. It only involves that much money, labor only involves that much money.

Mrs. BRAITERMAN. I think the cost of labor has been exaggerated in the price increases we have had in recent years.

Senator FANNIN. I certainly disagree with you on that.

(Mrs. Braiterman's prepared statement follows:)

PREPARED STATEMENT OF THEA BRAITERMAN, ASSISTANT PROFESSOR OF ECONOMICS, BALTIMORE COLLEGE OF COMMERCE ON BEHALF OF WOMEN'S INTERNATIONAL LEAGUE FOR PEACE AND FREEDOM

My name is Thea Braiterman, and I am Assistant Professor of Economics at the Baltimore College of Commerce. I am appearing before this Committee at the request of the Women's International League for Peace and Freedom. The United States Section of the League is composed of 150 branches across the country and membersh-at-large, both men and women. There are sections in 19 other countries. The League was founded in 1915 by Jane Addams.

I. Job Development Investment Credit and Asset Depreciation Range System (ADR)

The Revenue Act of 1971 has been advertised to the public as a measure to reduce unemployment. If it could do that, it would be most welcome. Unemployment stands at over 6%, which means that we must find at least five million jobs. Yet the most optimistic prediction for President Nixon's new economic policies—that offered by Dr. McCracken, Chairman of the Council of Economic Adivsors—promises only 500,000 new jobs. If Dr. McCracken is correct, less than 10% of the unemployed would get back to work in the next year. Although the bill before this Committee is an improvement over the President's original economic proposals, it still does not offer any serious hope of creating anything close to a full employment economy. The reasons are very clear. The enormous benefits it provides for business in the form of the job development investment credit and the Asset Depreciation Range System (ADR) will cost the United States Treasury a permanent annual loss of between $6 billion and $9 billion in revenues, without any indication that this loss will be compensated for by a corresponding increase in jobs. This represents an aggregate cut of 15 to 20% in corporate taxes at a time when profits are rising. The second quarter of 1971 was the highest quarter in aggregate profits in history. We know that the economy needs stimulation, and that profits are low in some businesses. But widespread improvement in prosperity is not likely to be found in measures directly benefitting profits across the board. Stimulation needs to be provided elsewhere.

At the present time, American industry is operating at only about 73% of capacity. As a result of insufficient demand, we have a deflationary gap of $70 billion—the difference between the present Gross Nationl Product and what the Gross National Product would be at full employment. In such a situation, most economists agree that investment incentives are not what is needed. Idle plants and machinery will begin to be put to use when this is warranted by growing demand. If it is tax measures that are proposed to stimulate demand, not an investment credit but more direct job-oriented and consumer-oriented measures are what is called for.

The investment credit cannot exert much impact until late 1973, if at all; and after that, there is evidence that it might prove inflationary. It could lead to overinvestment, or investment in foolish frills that do not enhance technological efficiency. There is good reason to believe that it will destroy some jobs, because it may encourage unnecessary or excessive automation. Dr. Pierre A. Rinfret makes it clear in his testimony on this bill before the House Ways and Means Committee that the investment credit is intended to replace men with machines:

"The service business is basically a small business. Now a small business does not have the capital to buy the equipment it needs . . . It must have equipment to replace human beings. The investment credit . . . will materially help the service business."

The so-called "Job Development Investment Credit" may dry up as many jobs as it develops. It is not an employment measure, but a windfall for business.

If there is any doubt about the windfall nature of this measure, one need only remember President Kennedy's original investment credit, introduced in 1962, which applied only to new investment above and beyond the routine replacement of existing plant, equipment, and machinery. Somewhere along the line, this qualification has been dropped. Now business is offered a credit on all new plants and equipment. Thus it is quite possible for a business to *reduce* its investment, and yet be richer by the investment credit. The lucky businessman gets a credit on both gross and net investment; but it is only net new investment that brings about a rise in the Gross National Product.

Mr. James M. Roche, Chairman of the Board of General Motors, makes it very clear that business policy is not determined by tax incentives. On August 31, 1971, he said:

"It should be understood that most companies of any size determine their purchases of equipment by the needs of the business and not by any short-term tax advantages."

Later in the same speech he said:

"It must be noted that the tax credit and accelerated depreciation applies only after equipment is purchased and put to use. This, like the other elements of the program, means very little unless we can achieve the improved economy the President has called for."

Dr. Harley L. Lutz, professor emeritus of public finance at Princeton University, writing in the *Wall Street Journal* on October 7, sums the matter up this way:

"The tax credit is popular among businessmen because it benefits many for doing what they had planned to do anyway. Whatever its form or purpose it is essentially a gimmick."

II. Domestic International Sales Corporation (DISC)

The reasoning behind the proposed DISC provisions seems a bit murky to the average citizen unless he happens to know that foreign subsidiaries of American corporations have a lucrative tax loophole under existing law. American owned businesses abroad do not have to pay taxes on profits unless and until those profits are paid out as dividends to the United States parent corporation.

In addition to being costly to the Treasury, tax-free foreign investment by American business generates problems in our balance of payments, commercial problems in our balance of trade, and dislocations in our foreign relations with developed countries such as Western Europe, Japan and Canada—favorite outlets for American investment abroad. Beyond that, those tax loopholes for investment abroad create problems of unfair competition for American exporters and American labor. All of these inequities and dislocations need repair.

But the way to repair them is not through the proposed DISC provisions to provide counterpart tax windfalls for American exporters at a cost to the Treasury of between $600 million and $955 million each year. This will not significantly increase American exports. It simply rewards existing exporters for doing what they are already doing. And it rewards them at the expense of the economy as a whole.

It would be far better to equalize the competition between exporters and American business abroad by removing the tax benefits that follow American investment around the world. This could be done by taxing profits of foreign subsidiaries of American corporations on a current basis—the way we tax business generally—without deferring or postponing taxation until profits return home in the form of dividends. The present proposal in H.R. 10947 is a misdirected effort to equalize one loophole by creating another, and should be rejected by this Committee.

III. Individual Income Tax Reductions

In the tax reduction provisions of the Revenue Act of 1971, Congress begins to move in the right direction by directly increasing disposable income. And yet it is not enough. The report on the bill seems to claim that no one living below the poverty level will have to pay taxes. The 1972 definition of the poverty level is $4,290.00 for a family of four. Yet Page 15 of the Report of the House Ways and Means Committee on the effects of the bill shows the following: Of those taxpayers earning between $0 and $3,000 gross, only 170,000 out of 5,555,000 who are presently taxable will become nontaxable by the accelerated exemption and standard deduction provisions of the Act of 1971. Only 1,774,000 out of 5,531,000 will become nontaxable in 1972. In the income class between $3,000.00 and $5,000.00 only 95,000 out of 9,460,000 will become nontaxable in 1971; and in that same class in 1972 only 691,000 out of 9,273,000 presently taxable will become nontaxable. Clearly there is a need to increase the minimum standard deduction and the personal exemption so that no one living at the poverty level need pay income taxes.

(As a further stimulus to demand, we urge passage of Senate Bill S. 2372, the Adequate Income Act, which is before this Committee. Among other things, it would place an income floor of $6500.00 for a family of four into our economy.)

The poor, whose needs are pressing, have a higher propensity to consume than the wealthy; therefore, tax reductions that concentrate on low income families have a quick stimulative effect. This bill recognizes that, but does not go far enough. We recommend that the minimum standard deduction and the personal exemption be increased as a measure that would immediately increase demand in the economy.

IV. A Full Employment Economy

Yet we do not believe that full employment can be achieved solely through the stimulation of consumer demand, although that is a necessary first step. Too much of our unemployment is structural. The jobs that have been created in the last ten or twenty years are increasingly white collar jobs in the service industries. We have fewer and fewer jobs for unskilled people. Therefore, the government must begin to invest in human capital. If it is our purpose to reduce unemployment, the way to do this is to provide jobs for people who want them. And not by across-the-board tax credits to private industry, but by direct government expenditures that will create jobs. The cost of job creation can be compensated for by the spending power of those who become employed. The government can make jobs in the neglected fields of health, education, conservation, housing, urban development, social services, and public works. We hope that the Administration and the Congress are serious about achieving a full employment economy. If we are to have that, jobs must be *created*, not vaguely and rhetorically "developed". And if we are serious, perhaps the time has come to guarantee a full employment economy by providing that government takes on the burden of being the employer of last resort. Difficult as is this burden, it now rests on the unemployed themselves. Let us not give business an unnecessary give of billions of dollars for machinery in the futile hope that the benefits will "trickle down" to the people. Rather, let us invest in human beings and watch the benefits "percolate up" through a healthy economy.

Senator ANDERSON. Mr. Gilvin.

STATEMENT OF L. P. GILVIN, CHAIRMAN, LEGISLATIVE COMMITTEE, ASSOCIATED GENERAL CONTRACTORS OF AMERICA, ACCOMPANIED BY RICHARD C. CREIGHTON, DIRECTOR OF THE HIGHWAY DIVISION, AND TRAVIS BROWN, TAX COUNSEL

Mr. GILVIN. Mr. Chairman and members of the committee, I am L. P. Gilvin from Amarillo, Tex.

I am appearing before you today in my capacity as chairman of the Legislative Committee of the Associated General Contractors of America, a national trade association of more than 9,000 general contractors, with members and branch offices in all 50 States, Puerto Rico, and the District of Columbia.

Members of the association perform building, heavy construction, utilities, and highway construction. I am a highway contractor and president of Gilvin-Terrill, Inc. My firm performs about $8 million worth of highway construction in the State of Texas annually. In addition to being chairman of the AGC's legislative committee, I am also a past president of the association.

I am accompanied this morning by Richard C. Creighton, director of the AGC highway division and Mr. Travis Brown, tax counsel for special programs.

You have before you a copy of our complete statement: however, in the interest of brevity I would like to limit my remarks today to the repeal of the excise tax on light trucks and buses.

This is noted under item 6 of the summary and is also contained in my full statement.

Unlike the repeal of the 7-percent excise tax on new automobiles, the repeal of the 10-percent excise tax on trucks and buses whose gross vehicle weight is 10,000 pounds or less would reduce funds accruing to the highway trust fund by $2.235 billion between now and its presently scheduled expiration on September 30, 1977.

Time and again, when appearing before congressional committees, the AGC has opposed both the diversion of funds to other purposes and administrative limitations on the level of expenditures. We have taken this position against diversion not because the purposes for which it was suggested that the money diverted were not worthwhile.

But because it is our firm belief that when the highway trust fund was established in 1956, a solemn commitment was made to the motoring public that these funds would be dedicated for the construction of the National System of Interstate and Defense Highways, the ABC systems, and the administrative expenses of what was then the Bureau of Public Roads, now the Federal Highway Administration.

While the repeal of the excise tax on light trucks and buses is not a diversion as such, the net result would be the same—to deprive the motoring public of needed roads.

In my own firm, through reduction in the highway program, I laid off some 150 men last November and December of which we only put back to work 12. So that is what happens to employment.

Estimates of future highway needs, presented to the Congress by the Department of Transportation in 1968 and again in 1970, have indicated that their cost will far exceed revenue accruing to the trust fund from all existing highway user taxes.

We are confident that when the national transportation needs study is forwarded to the Congress next year it will again confirm that highway construction needs exceed estimated revenue, including that resulting from the present 10-percent excise tax on light trucks and buses. We therefore oppose this provision as contained in section 401 of H.R. 10947.

House Report No. 92–533 states that "* * * the tax on light duty truck is repealed because, to a substantial degree these trucks are used by many families in farm areas, as well as by other individuals, as a means of personal transportation comparable to the use made of passenger cars."

If it were not for the fact that the revenue derived from the excise tax on automobiles goes to the general fund of the Treasury and that the excise tax on trucks and buses goes into the highway trust fund, we would agree to repeal the former; however, it is our contention that the value derived from the motoring public and the economy in general, as a result of the construction and improvement of new and existing roads, justifies the retention of this tax.

Furthermore, we sincerely believe that if the excise tax on all trucks and buses weighing 10,000 pounds or less is repealed, we will exceed the intended purpose of exempting those vehicles which are used for personal transportation.

This tax break, as contained in H.R. 10947, will in many instances benefit companies owning large fleets of such vehicles. Construction contractors, as well as rental agencies, manufacturers, wholesale and retail businesses and utilities such as telephone, gas and light companies, all fall into this category.

The principal vehicle in the light truck category which is used for personal transportation is the one-half ton pickup. These are also modified and used as campers. The gross weight of this vehicle, however, is approximately 5,000 pounds, far less than the 10,000-pound limit contained in the proposed legislation.

Inasmuch as it may well be administratively impossible to tax those vehicles which are used solely for business purposes and not those which are used for personal transportation, and if this committee concludes that the use of light trucks and buses for personal transportation justifies the repeal of the tax, then we respectfully suggest that the weight limitation be reduced from 10,000 to 6,000 pounds.

Our estimates have indicated that if the 10-percent excise tax on trucks and buses is repealed for only those vehicles whose gross weight is 6,000 pounds or less, the loss to the trust fund between now and September 30, 1977, will be reduced from $2.2 billion to $1.4 billion.

The CHAIRMAN (presiding). Thank you.

Mr. GILVIN. In my own State I got some information from our highway department where you pay half on the farm license, and so they have a farm license different from the commercial. They had 1,213,870 commercial trucks last year, and 192,955 farm trucks. These did not include any heavy semitrucks or truck tractors but it did include all of the trucks; however, the ratio of 6 to 1, I believe, would hold true on the lighter ones.

Thank you.

The CHAIRMAN. Thank you very much. We appreciate your testimony.

Senator FANNIN. Just one question. There seems to be a great discrepancy in what is really happening as far as the trust funds for highway construction. I know, I happened to have been chairman of the highway committee of the Governor's committee when I was Governor and we had great difficulty in getting the funds to keep flowing through.

They were being held up and I understand that is still true today and I noticed you had a letter from an Ohio contractor association that they have 21 percent unemployment in the construction industry and they attribute a lot of that to the inability to get those funds.

Is that true, generally, around the country?

Mr. GILVIN. In most areas, Senator, as I said earlier, we laid off about 40 percent of our work force last winter due to the cutbacks.

Senator FANNIN. I can't understand the previous testimony where they said we had an excessive amount in the Highway Trust Fund.

Mr. GILVIN. You don't mean today, in my testimony?

Senator FANNIN. No, no; in previous testimony. Thank you very much.

The CHAIRMAN. Thank you very much.

(Mr. Gilvin's prepared statement and attachments follow. Hearing continues on p. 646.)

PREPARED STATEMENT OF L. P. GILVIN, THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA

Mr. Chairman and members of the Committee, my name is L. P. Gilvin. I am the immediate past President of the Associated General Contractors of America, an association of more than 9,000 of the nation's leading construction contractors. I am also President of Gilvin-Terrill, Inc., a general contracting firm located in Amarillo, Texas.

GENERAL STATEMENT

The purpose of this testimony is to recommend a construction-oriented economic program that will serve the best interests of the nation. The construction industry is the largest single industry in the United States by the very fact that its goods and services have consistently been between 13 and 15 percent of our gross national product. Therefore, an investment credit program applied to this industry will go a long way toward a quick return to stable economic growth and curtailment of severe unemployment.

WAGE AND PRICE FREEZE

For the record, Mr. Chairman, our association has repeatedly asked the Administration and Members of Congress to impose a wage and price freeze which should not be lifted until labor and management with the encouragement of Government have agreed on a wage stabilization program. In June of 1970, we urged the adoption of the Economic Stabilization Act of 1970 to grant the President of the United States powers to issue orders and regulations as he may deem appropriate to stabilize wages and prices. At that time, we presented strong arguments on why controls were necessary in the construction industry. Since then and in February of this year, we again appeared before the Congress urging an extension of the Economic Stablization Act of 1970 stating that the situation had grown steadily worse. There were 498 strikes in 1970 causing a loss of over 41 million man-days of work. The size of settlements continued to mount to the point where it was generally recognized that increases negotiated for the current year would be 18% over previous rates.

On February 23, 1971, President Nixon declared that an emergency existed in the construction industry and suspended the Davis-Bacon Act through an Executive Order. The President was correct in recognizing the existence of an emergency at that time. During the 52nd Annual Convention of our association (March 5–11, 1971), a Wage-Price Freeze Resolution was passed and sent to the President and to every Member of the Congress. A copy of this resolution is attached.

Implementation of Executive Order 11588 is continuing with labor and management participating in the operation of Craft Boards and the Construction Industry Stabilization Committee. We believe Congress was right in enacting the Stabilization Act of 1970 a year ago. Today, it is of even greater importance that the delegation of emergency powers to the President be continued and there be no break in the stabilization program which is now underway.

We are in favor of the continuation of a control board, the Construction Industry Stabilization Committee and the Craft Boards, and we support the President's economic program.

INVESTMENT CREDIT

The 10 percent Job Development Credit proposed by the Administration is a key element of the economic program. We agree that enactment of an investment credit into law will help to:

1. Reduce unemployment
2. Improve productivity
3. Increase American industry's ability to compete in foreign construction markets.

Our business includes all types of heavy, highway and building construction. Members of the association build about 75 percent of the contract construction in the United States. Therefore, we need not dwell at length on the place the construction industry has in the American economy. The health of the construction business is essential not only to contractors, their employees and suppliers, but as well to every economic activity in the nation. Wires submitted for the record from California, Ohio and Washington provide current unemployment information in those states.

An adequate investment credit program that provides the incentive to industry to invest in plant and equipment would reduce unemployment. The benefit becomes obvious when you consider that a million dollars worth of construction generates approximately $350,000 in wages or an average of 28 jobs.

Capital Recovery

General contractors throughout the country are experiencing difficulty in earning and retaining adequate funds to purchase necessary new and used equipment. In this highly competitive industry, it is essential that the contractor have efficient new or used equipment to reduce costs and to permit his winning of contract awards as the low bidder. But high taxes and labor costs, coupled with narrowing profit margins in the construction industry, impose a hardship in acquiring the essential reserves for equipment replacement.

We believe the investment credit should apply to acquisition of used equipment and that provision should be retained in H.R. 10947. Many times contractors are unable to buy new equipment while efficient used equipment would adequately serve a project on which they are bidding. Retention of the investment credit for used equipment will result in an important stimulus to economic growth in construction.

The purchase price of construction equipment is high, yet its useful life is relatively low. It is worked hard, out of doors, and under widely varying conditions. The life of this equipment is shortened by differences in the competence of operators, the unavailability of proper maintenance in the field, the inherent difficulty of excavation, and other aspects of construction work. For any one contractor, the useful life of his equipment varies with the type of work he does and the abilities of the men in his employ. The same machine may be useless after six months on one kind of job, but have a life of several years in other work. Our continuing need to find and accept technological change further quickens the obsolescence of our tools and equipment. And to compound these difficulties, many members of our association are called upon to specialty and nonrecurring work which requires equipment that is useful only to that contractor and only on that job. These unusual circumstances require that construction contractors be permitted wide latitude in determining the useful lives of their equipment, and that they be able to replace their old equipment with more efficient units when necessary. Codification of the Asset Depreciation Range System would provide assurance of a stable, long-range economic growth. Many American firms seek construction jobs abroad. Their success benefits the American economy, while diminishing balance of payment and gold flow problems. The principal foreign industrial nations, as a foremost matter of tax policy, give the maximum possible incentive to their nationals to assist in renewal of capital equipment. We cannot compete meaningfully unless our incentives to American firms approximate the practices of other countries and permit us the cash flow necessary to maintain a competitive position

Application to Plants

Although it is not clear, we understand that the 10 percent credit as proposed to the Committee does not apply generally to buildings. However, in our opinion, an extension of this credit to plants erected to house newly acquired machinery and equipment would serve further to reduce unemployment and to increase the efficient American industry.

Productivity

We agree that increased productivity is a major way of achieving reasonable price stability and steadily rising real income for workers and savers. This emphasis, however, is mainly associated with the availability of advanced machinery. The emphasis should be stabilized wages and decreased prices to provide an untaxed wage increase. We believe the President of our Association, John E. Healy II, places the emphasis in its proper perspective in the attached editorial.

RELEASE OF DEDICATED TRUST FUNDS

This country requires sound public works programs scheduled on an orderly and planned basis, to continue to meet the needs of our growing nation. The rate of construction must be carefully scrutinized so that appropriated funds equate to a contractor's ability to perform work efficiently through optimum use of his men, machines and materials. When the level of funding is decreased or remains the same, the effect is that contractors will work at a rate less than their normal capability.

Slowing down or interrupting construction projects results in the inefficient use of manpower and machines. These costs are difficult to estimate and are never fully recovered. Other costs such as interest on borrowed funds, direct overhead, price increases, and loss of federal revenue are more accurately analyzed. Sufficient allowance for these costs, however, cannot be placed in the next bid because the contractor would never be a low bidder on another job since this work is done through open competition.

Reducing a contractor's capability to perform work will lead to additional costs to the government and to unemployment. Executive impoundments are a major cause of cost increases for needed public works such as highway projects. Construction cannot be performed economically on a stop and go basis.

Based on the fact that more than 25 percent of highway construction consists of labor, slightly more than $2 billion in accelerated payments would go into the pockets of construction employees if the $8.1 billion (includes FY 1973 apportionment) held up were released to the states and contracts awarded. In addition to this, the employees responsible for the production of supplies and materials and the manufacturer of equipment would also benefit significantly through increased employment.

REDUCTION OF UNNECESSARY GOVERNMENT PERSONNEL

It is our observation that there is a need for Congress to evaluate the necessity and the performance of many of the Government agencies relating to construction. It is our view that some of the agencies are not doing what Congress intended, when it enacted the legislation they administer, and there is serious doubt whether some of the Congressional programs are still serving any useful purpose. The discrepancies, duplication and conflicts that exist among the various Federal agencies and bureaus in the field of equal employment opportunity is a case in point. Attached is a Resolution adopted by the Association referring to this problem.

We think it is time for a Committee such as yours to check into this most wasteful situation involving regulatory harassment and millions of dollars in Federal funds.

The waste of personnel, and the waste in inflated wage rates, involved in the administration of the Davis-Bacon Act and related laws is another case in point.

These laws serve no useful purpose, and on the contrary, are administered in a manner that is clearly not in the public interest. When President Nixon suspended the Davis-Bacon Act and related laws, the order lasted for thirty-four days, ending March 29, 1971. During that period of time, a large volume of Federal and Federal-aid construction contracts were awarded without the Davis-Bacon requirements. This period offers an unprecedented opportunity for the Congress to study the effects of the suspension of these laws and the millions of dollars saved by the taxpayer through lower construction costs. AGC recommends that your Committee consider ways of having such a study made in the near future, while the facts and figures pertaining to contracts awarded during this period are still freshly available.

An example of the inflationary effects of the Davis-Bacon Act arose recently in connection with the ABM missile construction projects in Montana. The construction contractors that would normally do this work preferred to bid and perform on the basis of "heavy construction" wage and overtime schedules. The Montana Labor Unions, however, prevailed upon the Davis-Bacon Division to declare that these projects were to be categorized as "building construction" which called for a significant increase in labor costs. In spite of hearings before the Davis-Bacon Administrator, the Union's views were supported by the Davis-Bacon Division at the taxpayers' expense, and at the expense of President Nixon's anti-inflationary policies.

Our Association strongly recommends repeal of the Davis-Bacon Act and related laws in order to reduce the unnecessary "red-tape" and the inflationary effects of union wage rates in Davis-Bacon wage decisions, and in addition, the waste of Federal funds for payrolls involved in the administration of these laws in all levels of government. Not only is there a large staff involved in the determination of Davis-Bacon wage rates, but a much larger number of personnel exists in the Wage-Hour Standards Office of the Labor Department assigned to Davis-Bacon compliance work. Many Federal and Federal-aid agencies also employ large staffs to obtain and process Davis-Bacon wage determinations for their respective construction projects, including contract compliance with the Davis-Bacon requirements of the contract. We would estimate that several millions of dollars would be involved in the support of the overall number of personnel in government whose assignments include the processing of Davis-Bacon Act matters. Therefore, repeal of these laws would provide a major savings, in addition to eliminating unnecessary "red-tape" and inflationary wage effects from their maladministration.

REPEAL OF EXCISE TAX ON LIGHT TRUCKS AND BUSES

Unlike the repeal of the 7 percent excise tax on new automobiles, the repeal of the 10 percent excise tax on trucks and buses whose gross vehicle weight is 10,000 pounds or less would reduce funds accuring to the Highway Trust Fund by $2.235 billion between now and its presently scheduled expiration on September 30, 1977. Time and again, when appearing before Congressional Committees, the AGC has opposed both the diversion of funds to other purposes and Administrative limitations on the level of expenditures. We have taken this position against diversion not because the purposes for which it was suggested that the money be diverted were not worthwhile, but because it is our firm belief that when the Highway Trust Fund was established in 1956 a solemn commitment was made to the motoring public that these funds would be dedicated for the construction of the National System of Interstate and Defense Highways, the ABC Systems and the administrative expenses of what was then the Bureau of Public Roads, now the Federal Highway Administration. While the repeal of the excise tax on light trucks and buses is not a diversion as such, the net result would be the same—to deprive the motoring public of needed roads.

Estimates of future highway needs, presented to the Congress by the Department of Transportation in 1968 and again in 1970, have indicated that their cost will far exceed revenue accruing to the Trust Fund from all existing highway user taxes. We are confident that when the National Transportation Needs Study is forwarded to the Congress next year it will again confirm that highway construction needs exceed estimated revenue, including that resulting from the present 10 percent excise tax on light trucks and buses. We therefore oppose this provision as contained in Section 401 of H.R. 10947.

House Report No. 92–533 states that ". . . the tax on light-duty trucks is repealed because to a substantial degree these trucks are used by many families in farm areas, as well as by other individuals, as a means of personal transportation comparable to the use made of passenger cars." If it were not for the fact that the revenue derived from the excise tax on automobiles goes to the General Fund of the Treasury and that the excise tax on trucks and buses goes into the Highway Trust Fund, we would agree that to repeal the former, without at the same time repealing the latter, would be unfair. However, it is our contention that the value derived by the motoring public and the economy in general, as a result of the construction and improvement of new and existing roads, justifies the retention of this tax. Furthermore, we sincerely believe that if the excise tax on all trucks and buses weighing 10,000 pounds or less is repealed we will exceed the intended purpose of exempting those vehicles which are used for personal transportation.

This tax break, as contained in H.R. 10947, will in many instances accrue to companies owning large fleets of such vehicles. Construction contractors, as well as rental agencies, manufacturers, wholesale and retail businesses and utilities such as telephone, gas and light companies all fall into this category.

The principal vehicle in the light truck category which is used for personal transportation is the one-half ton pickup. These are also modified and used as campers. The gross weight of this vehicle, however, is approximately 5,000 pounds—far less than the 10,000 pound limit contained in the proposed legislation.

Inasmuch as it may well be administratively impossible to tax those vehicles which are used solely for business purposes and not those which are used for personal transportation, and if this Committee concludes that the use of light trucks and buses for personal transportation justifies the repeal of this tax, we respectfully suggest that the weight limitation be reduced from 10,000 to 6,000 pounds.

Our estimates have indicated that if the 10 percent excise tax on trucks and buses is repealed for only those vehicles whose gross weight is 6.000 pounds or less, the loss to the Trust Fund between now and September 30, 1977 will be reduced from $2.2 billion to $1.4 billion.

JUNE 25, 1970.

THE PRESIDENT,
The White House,
Washington, D.C.:

We the undersigned representatives of major national employers associations in the construction industry who are members of the Council of Construction Employers believe, in the light of runaway wage increases for the building trades, that the restraint proposals in your address of June 17 fall far short of meeting the critical problems of wage inflation in this, the country's largest industry.

This construction wage inflation averaged a minimum of 14% in 1969, will add an additional 18% in 1970 and at least another 18% in 1971. This is far beyond the 6.7% increase for 1969 mentioned in the Government analysis handed out at the White House last week and is in fact on a cumulative basis nearly 60% over three years.

These conditions result not only in increased economic burden to the owners of construtcion projects, public as well as private, but the entire economy is threatened by the spillover effects of exorbitant wage increases in construction.

The construction industry itself is suffering heavy economic loss as a result of employer attempts to resist the demands of organized labor. Increased construction costs threaten our markets. Finally, productivity generally has tended to decrease as the rate of wage increases has accelerated.

Even more serious than the effect on our industry is the inevitable spread of these increased rates to other industries. Construction unions are now playing a gigantic game of leap frog: it is only a matter of time until others learn there are no effective limits and join the game.

These inevitably result in higher costs with less value added to construction buyers, which include the Federal Government with its major national construction programs in the fields of housing, health services, highways and urban renewal.

We are engaged in discussions looking toward improving the economic imbalance on the employers' side which now exists in collective bargaining in the industry. While we expect to move as rapidly as possible, our realistic view is that any tangible results will necessarily take time and will have no more effect on the immediate crisis than the proposals you made June 17. Meanwhile, our huge ind stry, with its 3.8 million employees, is planting the seeds for an inflation which will far outstrip anything this country has yet experienced and every additional wage settlement made as the months pass will nurture those seeds. We need action now, not months from now, to control the wild inflation in this industry and this action must come from Government.

We respectfully request you to give favorable consideration to controls in our industry for such length of time as may be necessary to cool union demands and the resultant increases in prices and thus encourage labor and management at the local level to negotiate reasonable agreements. We request that construction wages be established as those in effect on January 1, 1970.

In order to accomplish this stabilization of construction wages and prices, we propose that an approximate tax be placed on the contractor's domestic construction operations to prevent any windfall profit by the employer as the result of the redetermination of wages.

During the period of these controls management and labor, with Government encouragement, should cooperate to develop a national stabilization agreement containing a no strike, no lockout pledge with provisions that the arbitration of wage disputes should be developed and implemented. This procedure was used most effectively in previous emergencies.

The increase in construction wages is a threat to our economy which has been building for several years. Nevertheless, it is with us and its perilous thrust can easily be documented and verified. You showed great political courage in many other crises. This problem demands the same courage now.

Fred W. Mast, Chairman, Labor Committee, Associated General Contractors of America, Inc.;
Jeremiah Burns, Chairman, Labor Liaison Committee, International Association of Wall and Ceiling Contractors;
George A. Miller, Executive Vice President, Mason Contractors Association of America;
Fred N. Estopinol, Jr., President, Mechanical Contractors Association of America;
James E. Curry, President, National Association of Plumbing, Heating, Cooling Contractors;
Philip S. Lyon, President, National Constructors Association;
Ed S. Torrence, Executive Director and Secretary, Painting and Decorating Contractors of America;
James H. Ferguson, Director of Industry Relations, Sheet Metal, and Air Conditioning Contractors National Association, Inc.

THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA

WAGE PRICE FREEZE

Whereas, the AGC appreciates President Nixon's recognition of the current nationwide emergency in the construction industry, and

Whereas, this emergency is due to the wage push inflation which is completely out of control, and

Whereas, we have long sought the repeal of the depression-spawned Davis-Bacon Act which has been providing governmental support to the spread of inflationary wage patterns, and

Whereas, recent actions regarding the Davis-Bacon Act do not cure the major ill, unchecked union demands, and

Whereas, the present rate of unemployment has had no dampening effect on the excessive demands of the Building Trade Unions.

Now, therefore be it resolved, That the Associated General Contractors of America assembled in its 52nd Annual Convention, March 5–11, 1971, immediately, again, inform President Nixon and Members of Congress of these facts and state in the strongest possible terms that we see no possibility that the disasterous rate of increase in construction wages can be slowed in 1971 unless a wage and price freeze is promptly imposed which will establish wage rates as those in effect on December 31, 1970. Such controls must be promptly imposed and not lifted until labor and management, with the encouragement of Government, have agreed on a wage stabilization program establishing effective procedures for reaching future wage settlements in line with changes in living costs and increases in worker productivity, and that President Nixon be given full information on needed labor legislative reform (including the restructuring of bargaining) to establish a more equal position at the negotiating table to the end that collective bargaining may become effective in maintaining a balanced relationship between construction wages and the growth of the economy of the Nation.

OCTOBER 15, 1971.

WILLIAM DUNN,
Executive Director,
Associated General Contractors of America,
Washington, D.C.:

Unemployment in the construction industry in Ohio is riding at 21 percent due to lack of funds to carry out a substantial program. We urge AGC to continue to enlighten Congress of this drastic fact and urge steps be taken whereby Federal funds can be released from the highway trust fund to help eliminate this poor economic condition. Restoration of Federal funds at this time would put some 7,500 people back to work.

KARL L. ROTHERMUND JR.,
Executive Director, Ohio Contractors Association.

OCTOBER 15, 1971.

WILLIAM DUNN,
AGC of America, Washington, D.C.:

Request information on construction employment situation in California be made a part of AGC testimony before Finance Committee on Monday. Prior to extensive strike activity in Northern California, State Department of Human Resources Development prepared figures indicating construction unemployment in State nearly twice national average in construction. With unemployment running quite high in California because of aerospace cutbacks figures indicated construction unemployment nearly 10 percent higher than general unemployment. State indicated construction unemployment varied between 10 percent and in excess of 25 percent in different parts of the State. Primary contributing factor is present cutback in highway and public works construction programs. Serious unemployment situation will exist as long as highway program remains in present depressed condition. Major release of impounded highway funds only guarantee to improve construction employment in California.

RICHARD MUNN,
AGC of California.

SPOKANE, WASH., *October 15, 1971.*

WILLIAM E. DUNN,
Executive Director, Associated General Contractors, Washington, D.C.

The unemployment rate in Washington continues to increase at this time of year when historically it normally falls to its lowest rate. Construction contractors in Eastern Washington and Northern Idaho report in recent survey that their contract volume is 30 to 35 percent of capability. Contractors report that their backlog carryover which is normally carried over to next construction season will be the lowest since 1962. The dollar volume of construction represented by plans in our plan room is roughly ½ of volume on hand a year ago this date. Health and welfare reports reflect reduced number of man hours worked in our area. Executive impoundment in Washington as of July 1st amounted to 127 million dollars on all highway programs interstate ABC and topics. The recent release of funds and its effect on the amount impounded is not known. Indications are that this will increase to 150 to 155 million dollars by end of fiscal year. State Highway Departments have plans on shelf for 40 million dollars worth of work which would be advertised immediately upon release of impounded funds. Further the department could contract for 95 million dollars by end of fiscal year. The turning off and turning on of highway funds has caused a number—three this year and four last year—of contractors to retrench or go completely out of business. If there were prospect of uniform release schedule coupled within investment tax credit contractors in area assure me they would increase hiring.

SAM C. GUESS,
Executive Director,
Inland Empire Chapter, AGC.

GUEST EDITORIAL BY JOHN E. HEALY II, PRESIDENT, ASSOCIATED GENERAL CONTRACTORS OF AMERICA

PRODUCTIVITY IS THE KEY

The road to greater productivity in construction is not a one-way street.

Labor and management must combine their efforts to stabilize the cost/productivity factor before the cost of construction passes beyond the ability of the owner to afford it. The construction industry can be priced out of the market, and we may be approaching that point now.

Increased productivity obviously makes good sense from an economic point of view, leading as it does to stabilized costs; therefore, to a slowing down of the inflationary trend that is hurting all of us.

The time is past due for labor and management to stop pointing accusing fingers at each other and trying to assess the blame for the situation in which we find ourselves. We have to cut out the kid stuff and show some genuine leadership—on both sides.

The credo of the building trades unions through the years has been to give "a fair day's work for a fair day's pay." Surely no one in the industry will question that a "fair" day's pay has become, to say the least, a "good" day's pay in the last decade. But has the productivity of the individual worker kept pace with his earnings? Regrettably, in far too many cases, no.

Our whole economic system in America has been based on production and pride in what we produce. Somehow, in our industry we have allowed a few chronic malcontents to con us into the idea that only a sucker will exert himself to do a really good days work. The spreading late-start, early-quit concept has reached the point of absurdity. It is an insidious philosophy that must be destroyed.

Although I am a spokesman for construction management, I am convinced that management as well as labor must look at this problem from an industry-wide point of view. Management, too, has responsibilities which it must meet in striving for increased productivity.

We must extend and expand our efforts to bring safety to our construction projects.

We need to keep trying to eliminate seasonality in construction to the greatest extent possible. Much progress has been made along this line, but more can still be done.

We must develop better training programs for more people.

If both of us—labor and management, working together—can restore pride in workmanship, pride in craftsmanship, and pride in a job well done, we will be able to build more and better than ever before at costs which are within the realm of reason. And that is what has to be done if America is to continue to progress through construction.

Resolution on Equal Employment Opportunity

Whereas, the Associated General Contractors and its members are desirous of implementing equal employment opportunity in the construction industry. and

Whereas, the AGC and its members are extremely handicapped in their efforts due to the following legislative and administrative discrepancies and conflicts:

1. Among the Civil Rights Act of 1964, the Executive Order (11246), Davis-Bacon Act and the Taft-Hartley Act.
2. Between the Office of Federal Contracts Compliance and the Equal Employment Opportunity Commission.
3. Among Bureaus and divisions within the Labor Department such as the Office of Federal Contracts Compliance, the Bureau of Apprenticeship and Training, and the Manpower Administration.
4. Between the Comptroller General of the United States and the Secretary of Labor and others.
5. Among Federal, state and municipal agencies.
6. Among field officers and headquarters of Federal agencies.
7. In the written terms of government construction contracts and the administratively-imposed obligations over and above the written conditions.
8. In the minority plans issued by the Office of Federal Contracts Compliance, such as between the so-called Philadelphia Plan and the Washington Plan.
9. In the application of the Office of Federal Contracts Compliance regulations and requirements, such as the express exemption of the construction industry from Order No. 4, and the indirect application of substantially the same requirements under another guise.
10. In the policies applied by Housing and Urban Development, by the Department of Defense, and by the Department of Transportation, and by other agencies.
11. In the government pressure on contractors to develop minority training and employment programs and the government's failure to give prompt consideration and approval to contractor's proposals.
12. In the legal requirement to hire and employ without regard to race (under the Civil Rights Act) and the requirement to have certain quotas and ranges of minorities on the government contract (as under the Washington, Philadelphia, and other Plans).
13. In requiring contractors (as a practical matter) to enter into hiring hall agreements and holding the contractors responsible for union discrimination in the operation of the hiring halls.
14. In racial discrimination by unions and the government policy of holding contractors responsible for such discrimination by the unions.

15. In requiring contractors to recruit minorities and in the government's failure to provide reasonable recruiting assistance through various federally-funded employment organizations.

Now, therefore be it resolved, That the officers and staff recommend to the Federal Government that it unite all equal employment opportunity functions under one agency to eliminate these discrepancies, conflicts, duplication, and the resulting waste of federal, state and local funds to the end that equal employment opportunity may become a reality through the nation.

The CHAIRMAN. The next witness will be Mr. Thomas H. Stanton in behalf of the Public Interests Research Group.

STATEMENT OF THOMAS H. STANTON, IN BEHALF OF PUBLIC INTERESTS RESEARCH GROUP, ACCOMPANIED BY ALBERT H. TURKUS, STAFF MEMBER

Mr. STANTON. Mr. Chairman, members of the Senate Finance Committee: I am Thomas H. Stanton, an attorney and member of Ralph Nader's Public Interest Research Group. Mr. Nader had hoped to be here today as well, to discuss the Nixon administration tax proposals. These are proposals essentially to cut corporate taxes by 20 percent permanently—by an annual average of about $7.3 billion—and without adequate economic justification by the administration.

For reasons of time, these remarks shall not be as extensive as our prepared testimony, which we would ask be submitted in full for the record. In our prepared testimony, we have listed seven questions which we urge this Committee to ask, before the administration stampedes you into the same precipitous and expensive action taken by the House on this bill.

The Treasury Department, upon whom this Committee and the American people must be able to rely for professional analysis and carefully considered proposals, has failed in its task. Rather, it offers misleading rhetoric and deceptive statistics in support of this exorbitant tax package.

Let us briefly look at each part of the package.

ADR is defended as a necessary means of administering the depreciation provisions of the tax code. Treasury has omitted to note that this Congress has provided the IRS with slightly over a billion dollars in fiscal year 1972 for administration of all of the parts of the code including the depreciation provisions. Since ADR will cost $3.9 billion annually, Treasury might well be requested to devise a somewhat less expensive administrative device.

ADR is secondarily defended as a means of promoting jobs and stimulating the economy, and here again Treasury has deceptively omitted to note a crucial fact: That, in spite of the haste which the administration has urged on this bill, ADR will have no significant economic impact for at least 18 to 24 months. One might add that the Senate and Congress are being asked to ratify a set of ADR depreciation regulations which Treasury issued despite knowledge of their doubtful legality.

The DISC proposal is said to be needed for export promotion. Yet the Treasury has been unable to show that DISC would actually increase exports significantly. The figure $1.5 billion of new exports has been bandied about, but the Secretary himself has conceded that Treasury is not able to provide solid support for the figure.

The familiar business investment credit has been deceptively labeled a "job development tax credit," with no supporting facts from the Treasury to justify the misnomer.

The individual tax cuts proposed by the President were said by Samuel Pierce, the Treasury General Counsel, to benefit the poor taxpayer more than the rich. In fact, the opposite is true.

A good example of misleading Treasury statistical presentation may be seen in the letter which Treasury Under Secretary Walker wrote to the New York Times comparing the individual tax reductions with the corporate tax reductions over the years 1971 to 1973 in an attempt to show that the individual cuts in the House bill are relatively substantial.

He deceptively omitted to note that the individual tax cuts are mostly temporary, with a primary impact before 1973, while the corporate tax cuts are permanent, and have a primary impact after 1973. Senator Byrd managed to catch Secretary Connally off guard on this point, when he asked for the 1974 revenue loss figures, which the Secretary himself had omitted to mention. It is only after 1974 that ADR, DISC, and the investment credit really begin to pay off for the corporations.

We do not make these charges lightly; I would like to introduce supporting materials into the record for the benefit of those who wish to pursue these matters in greater detail.

The CHAIRMAN. All right.*

Mr. STANTON. We must come, then, to the important question of how Treasury decisionmaking can be improved in the area of tax policy. The economy cannot be allowed to become another Vietnam—where the public is told that the subject is so complex that only the executive branch can provide answers.

The lessons of Vietnam are clear and serious: For awhile the American public and Congress passively accept the poor decisions, deceptive rhetoric, and misleading statistics put forth by the executive branch.

But after the period of tolerance, the people begin to distrust the glib executive—a credibility gap develops and the executive is disbelieved even when it attempts an honest presentation.

As a first step toward preventing this kind of dangerous Vietnamization of the Treasury Department, we propose creation of a small taxpayer advisory group within Treasury. The group would be staffed by attorneys, economists, professors, and other citizens not having special interest clients.

It would provide advice to the Secretary and Assistant Secretary for tax policy, and would have access to the work of the Office of Tax Anaylsis and the Office of Tax Legislative Counsel. It would be similar to the Treasury Liaison Committee of the Business Council, and might even have a small staff.

We would suggest that the Treasury itself would benefit from such a group, as would the Congress and the American people. Take the ADR depreciation regulations, for example. Treasury Secretary David Kennedy stated on January 11, 1971, that Treasury had consulted with business groups and the President's Business Taxation Task Force before deciding to issue the regulations.

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*See p. 657.

In short, Treasury had consulted those who were to benefit but not representatives of the American small taxpayer, who will pay the bill later. Treasury didn't even consult law professors to determine whether the regulations would be legal.

We are all familiar with the results of this closed decisionmaking process.

The public controversy became so intense that the Treasury was only able to issue the final regulations on June 22, even though they had been announced over 6 months earlier as an accomplished fact.

And business still hesitated to rely on the regulations after June 22 because of the subsequent lawsuit, backed by about a dozen legal opinions from tax experts across the country that the regulations were illegal. In short, Treasury's closed decisionmaking process meant that Treasury even failed to serve its corporate constituents well, much less the cause of law and order in tax administration or the small taxpayer.

Consultation with small taxpayer representatives and law professors on a small taxpayer advisory group would have helped Treasury to anticipate difficulty with its attempted end run around Congress, and might have led Treasury to propose ADR as a change in the tax law—but in January instead of today, 8 wasted months later.

In terms of the future, the existence of a small taxpayer advisory group might enable Treasury to avoid the serious mistake of proposing a value added tax—which is a type of regressive national sales tax—to make up for the multibillion-dollar corporate tax break before you today.

The Treasury could be made aware of the potential outrage of American taxpayers at having their taxes raised in order to fill the coffers of General Motors, United States Steel, and the other powerful corporations who will gain so much from the Revenue Act of 1971.

We urge this committee to foster the establishment of a Small Taxpayer Advisory Group within Treasury so that the average taxpayer will have some voice in Treasury tax policy decisions along with the already well represented powerful corporate interests.

We have ourselves asked Treasury to consider the matter, but still await a response from Assistant Secretary Edwin Cohen to our correspondence of almost 2 months ago. We would like to introduce that correspondence into the record.

The CHAIRMAN. All right.*

Mr. STANTON. Finally, we urge this committee to carefully consider the statements of the economists who are to appear this afternoon, as well as the other economists who have criticized the administration proposals. There are many alternatives to the wasteful combination of ADR, DISC, and the investment credit which could better and more equitably help the economy at less cost.

However, after watching the Ways and Means Committee draw up this bill in only 3 days of secret session, and after watching the House pass the bill under a closed rule after only 1 hour and 39 minutes of floor debate, and with only about 30 Members of the House present for the nonrollcall vote—after watching that unfortunate democratic spectacle, I would have to forecast that this committee also will not heed the recommendation of those economists, and that the Nixon administration juggernaut will roll over the Senate Finance Committee as it rolled through the House.

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*See p. 658.

Mr. Chairman, members of the committee, I would be the first to rejoice at the failure of my prediction; but it appears that Treasury deception and misstatement have led to an atmosphere in which knowledge and economic fact will not play a role in the passage of the corporate tax relief bill of 1971.

Sir, we are prepared for questions in detail on any of these points.

The CHAIRMAN. Thank you very much.

Senator FANNIN. I think it is worthless to ask some questions on such biased testimony. How do you think that our tax rates, tariffs, and incentives compare with other industrial countries of the world, our competitors?

Mr. STANTON. Well, sir, this is an important point because the Treasury has talked about something called the capital cost index which deals with important questions of the effects of our tax structure on capital investment. I believe that is the point you are referring to.

There are several reasons why the capital cost index mentioned by Secretary Connally is a deceptive and misleading figure.

Senator FANNIN. Deceptive and misleading? It is not generally speaking.

Mr. STANTON. My point would simply be, if my words were too harsh, that the figures were not presented in proper context.

Senator FANNIN. How are you to consider——

Mr. STANTON. Let me explain in detail.

Senator FANNIN. Let me ask you this. What is your background and experience in business and Government?

Mr. STANTON. Well, sir, relatively little. I have simply studied——

Senator FANNIN. Still you are criticizing people with long experience in Government affairs and I accept your testimony on that basis. Mr. Chairman, I have no further questions.

Mr. STANTON. I would like to present some discussion of those figures.

Senator BENNETT. I object. I think this witness has had his time and he has indicated his bias and I think we should go on to the next witness.

Senator FANNIN. I think we have had enough.

Senator NELSON (presiding). What was it you wanted to say?

Mr. STANTON. I was asked a detailed question about capital incentives in the country.

Senator NELSON. Yes.

Senator FANNIN. I withdraw the question.

Senator NELSON. I think he ought to be able to answer the question.

Senator FANNIN. We only have a certain length of time for these hearings and receiving the testimony of our witnesses that are qualified to speak on the subject.

Senator NELSON. He sounds as qualified to me as the most of the rest I heard here.

Senator BENNETT. May I make the point he misstated the question deceptively. Was your question in tax incentives?

Senator FANNIN. Absolutely. My question was how do you think our tax rates, tariffs, and incentives compare with other industrial countries of the world?

Senator BENNETT. I heard the rates and tariffs. He is ignoring those.

Mr. STANTON. We are discussing a tax package and I thought I would concentrate on that.

Senator BENNETT. On what?

Mr. STANTON. On the tax part of his question, sir.

Senator NELSON. What is the tax part of the question?

Mr. STANTON. The question was basically how our tax system compares with the systems of other countries as an incentive for capital investment. And in this regard I made reference to the statistics presented by Secretary Connally before this committee I believe last week, the week before I guess it was.

First of all, if we take a look at the chart presented by Secretary Connally we find that there is surprisingly little correlation between tax incentives and the rate of economic growth.

For example, Japan has had a phenomenally high rate of economic growth and yet the United Kingdom, which has a relatively lower rate of economic growth, has more tax incentives.

Senator BENNETT. Is this going to be a lecture that will take us into this afternoon?

Mr. STANTON. You criticized by bias first; now I would like to present the facts.

Senator BENNETT. In how much depth?

We have six more witnesses including that panel you talked about. It is 10 minutes to 12. How long are we going to have to sit here and listen to you?

Mr. STANTON. I am sorry you don't wish to listen to my presentation in detail and I will submit something for the record.*

Senator NELSON. The chairman is back. If you wish to submit something in addition for the record on the points raised here I am sure——

Senator BENNETT. I will be glad to read it.

Mr. STANTON. Thank you, sir.

(Hearing continues on p. 662.)

(The prepared statement of Tom Stanton and Ralph Nader and material referred to at pages 647 and 648 follow. The witnesses also submitted the following items which are made a part of the official files of the committee:)

1. An article from the Congressional Record, page H6681, July 13, 1971, entitled "Ralph Nader discusses $3 Billion a Year Depreciation Giveaway";
2. A White House press release dated Jan. 11, 1971, re: Depreciation provisions of the tax laws;
3. Department of the Treasury news release—"Statement by Treasury Secretary David M. Kennedy on Asset Depreciation Range";
4. A White House press release dated Sept. 22, 1969, re: Task Force on Business Taxation;
5. An article from the Economist dated May 8, 1971, entitled "A Matter of Depreciation";
6. An article from the New York Times dated Jan. 26, 1971, entitled "Hearing Assured on Depreciation";
7. An article from the New York Times dated May 4, 1971, entitled "Bayh Terms Business Tax Cut Hearing a 'Charade'";
8. An article from the Wall Street Journal dated May 4, 1971, entitled "Treasury's Hearings on Easier Guidelines for Depreciation Begun";
9. A statement by Ralph Nader before the Internal Revenue Service, on proposed Treasury regulations on accelerated depreciation;
10. An article from the Congressional Record, page E4560, May 18, 1971, entitled "Expert Opinion Underscores Nixon Administration Error on Depreciation Proposals";

*See p. 661.

11. Memorandum to Hon. Peter M. Flanigan, assistant to the President, from Hon. John S. Nolan, Acting Assistant Secretary of Treasury, re: Administrative authority in liberalizing depreciation allowances;

12. An excerpt from President Nixon's news conference in San Clemente, Calif., as recorded by the New York Times, May 1, 1971;

13. An article from the Congressional Record, page H4002. May 17, 1971, entitled "The $3 Billion Rapid Depreciation Giveaway—Congress Should Not Be Bypassed";

14. Communications from the State Governments of California, North Carolina, and Pennsylvania, re: ADR;

15. An article from the Wall Street Journal dated Sept. 27, 1971, entitled "'Job Development Credit': Some Doubts":

16. An editorial from the Wall Street Journal dated Sept. 30, 1971, entitled "That Shiny DISC"; and

17. An article from the Nation, dated Nov. 9, 1971, entitled "The Billion-Dollar Subsidy".

Prepared Statement of Ralph Nader and Tom Stanton

The House Ways and Means Committee spent only three days in secret session before favorably passing substantially the entire Administration tax package. Before this Committee allows itself to be similarly stampeded into such precipitous multi-billion dollar tax expenditures, we urge that it demand from the Treasury careful and satisfactory answers to the following questions:

I. Will ADR, DISC, and the one-tier Investment Credit provide any significant stimulation of the economy within the next 18–24 months, even if enacted immediately?

II. Are there any alternatives to ADR which would cost substantially less than $3.9 billion annually recommended by Treasury (or the $2.9 billion annually passed by the House) and which would enable the Treasury effectively to administer the depreciation provisions of the tax code?

III. How many jobs will the "Job Development Credit" create, and, more importantly, how long will it take to create those jobs?

IV. Is Treasury able to propose any more effective means of stimulating exports than the inefficient DISC, which would virtually exempt all export profits from Federal income taxation at an annual cost of up to a billion dollars?

V. Would the Administration be willing to retain the auto excise tax and provide a general consumer tax cut so that consumers could freely spend their money in the marketplace?

VI. Would the Administration be willing to support individual tax cuts which would not provide primary benefits for the rich, in contrast to the present Administration proposals?

VII. Why has the Administration proposed permanent corporate tax cuts of about 20% annually, in comparison with the one-time proposed acceleration of small individual tax cuts? How valid are the Treasury statistics comparing individual and corporate tax cuts since 1969?

The Revenue Act of 1971 is being considered in an atmosphere of crisis. The Administration urges passage of its proposed 20% cut in corporate taxes without careful deliberation by this Committee or the Congress.

The President's corporate tax proposals, including ADR, the investment credit, and DISC will cost an average of about $7.3 billion annually over the next decade. If the corporate tax cut were instead given to individuals, it would reduce taxes by over $100 annually per taxpayer. By way of comparison, the entire budgets for Fiscal 1972 of the Environmental Protection Agency, the Department of State, the Department of Housing and Urban Development, and the entire Federal Judiciary, all taken together, total less than the average amount which he Administration proposes annually to give away to the corporations.

Such immense amounts of money should not be spent without full and careful deliberation. We urge that the unfortunate spectacle of the House of Representatives passing a multi-billion dollar corporate tax bill after only 1 hour and 39 minutes of debate and without a rollcall vote not be duplicated by the Senate. The Ways and Means Committee spent only three days in secret session before reporting out the tax cuts.

What is the nature of the economic crisis which would confront the country if a few weeks of careful deliberation were to elapse before the bill were passed?

The August 15 Presidential announcement, and declaration that day of a "national economic emergency," came after almost two years of inaction by the Administration. There appear to have been no new economic events in the prior week except for publication of economic statistics showing how poorly the economy was performing under the game plan. In short, although the President's actions of August 15 were important events economically, the crisis itself is a pseudo event rather than an actual economic phenomenon.

Given the hasty consideration being urged, there are several guidelines we suggest to reduce the disadvantages which inevitably must accompany curtailment of the normal deliberative process:

(1) The need to stimulate the economy in the short-run should not be used as a justification for unwarranted and expensive permanent tax cuts.

(2) Claims made on behalf of the Administration proposals should be carefully examined. Since it is the Administration which is urging haste, the Treasury should be willing to come forward with data and careful analysis in support of its expensive proposals.

(3) Alternative short-run tax measures should be considered, but also subjected to tough analysis.

It is in terms of these criteria that the Administration proposals should be examined.

Is this Committee really satisfied with the quality of information put forth thus far by Treasury in support of its case?

I. Will ADR, DISC, and the one-tier Investment Credit provide any significant stimulation of the economy within the next 18-24 months, even if enacted immediately?

Economists generally agree that the economic impact of these measures will not be immediate since the average lag in investment expenditure requires about 18-24 months.

If this is the case, then there is no need for the Senate to sacrifice the process of careful deliberation just to gain an extra week or two. The benefit of careful consideration might be that this Committee and the Senate could find better ways to spend the $7.3 billion annually, on programs which would create more jobs more quickly and stimulate consumer purchasing at substantially less cost.

For example, many economists have proposed stimulation of the economy through significant consumer tax cuts, especially for the lower income groups. The increase in low income allowance and standard deduction in the House Bill are commendable, and could beneficially be increased even more. These tax cuts are especially valuable to the average and low income taxpayer, and will provide significant simplification of tax returns for many taxpayers.

In addition, this Committee might wish to consider an immediate stimulus to the economy in the form of a one-time consumer tax credit, to be given against 1971 income taxes. For example, a $50 refund to each individual taxpayer would have a revenue cost of about $4 billion, but for one year only. This compares somewhat favorably in cost with the proposed $7.3 billion permanent corporate tax cut, and would very likely have a much more immediate impact.

II. Are there any alternatives to ADR which would cost substantially less than $3.9 billion annually recommended by Treasury (or the $2.9 billion annually passed by the House) and which would enable the Treasury effectively to administer the depreciation provisions of the tax code?

The President announced the ADR Regulations on January 11, 1971, as a "reform to create jobs and growth."[1] On June 22 of this year the Treasury duly issued the regulations in final form, in spite of considerable question as to their lawfulness.

Since January 11, the ADR Regulations have been subjected to healthy public scrutiny. As a result of that examination, the Administration no longer emphasizes ADR as a necessary economic move.[2] Rather, the Regulations are now

[1] Treasury Secretary David Kennedy opened a January 11, 1971 press conference on ADR as follows: "The changes in tax administration announced today by the President are a major and timely reform of depreciation policy, and will be good for our national economy, all of our citizens, and every American business."

[2] See, for example, the testimony of Deputy Assistant Secretary Nolan before the Ways and Means Committee on September 8: "In other words, we built a whole structure for dealing with the depreciation system which was immensely important from the administrative standpoint. . . . So we look at the ADR system as serving a wholly different and immensely important system quite apart from its effects as serving as a stimulant. The job development credit is where we want to put our money from the stimulation standpoint. . . ." Ways and Means *Hearings*, September 8, 1971, pp. 117-118.

stressed, incredible as it may sound, as a means of effective administration of the depreciation provisions of the tax laws. Possibly the best rebuttal to that contention has been voiced by Dean Bernard Wolfman of the University of Pennsylvania Law School, who has observed that $3.9 billion annually is a somewhat exorbitant price to pay for more effective administration of the Tax Code's depreciation provisions. One might add that Congress has seen fit to appropriate slightly more than a billion dollars to the IRS in fiscal 1972 for the proper administration of all of the provisions of the tax laws, including the depreciation section of the Code.

The question which should be directed to the Administration is a simple one: Is the Administration able to develop any alternatives to ADR, for consideration by this Committee, which would cost substantially less than $3.9 billion annually and which would enable Treasury effectively to administer the depreciation provisions of the tax code?

Remarkably, it appears that the Administration may again be changing its basic rationale for ADR, arguing this time that the expensive measure is needed to promote American competitiveness abroad. Careful analysis will show, however, that the Treasury has overstated the significance of the multi-billion dollar depreciation system in improving the U.S. ability to meet overseas competition. Economists suggest that it is revaluation of the dollar that will do the most to improve the American competition position. Already the effects can be seen in price increases announced by the Datsun and VW auto companies. In sum, Treasury has presented no meaningful economic analysis of why we should spend a further $3.9 billion annually (or even the $2.9 billion figure the House chose) on the ADR system to subsidize American businesses. As the Wall Street Journal has observed editorially, "there is a serious flaw in the idea that subsidizing industry somehow makes it more competitive." [3] The Administration should not be allowed to stampede this Committee into an expensive industrial subsidy without careful discussion of the costs and benefits.

III. How many jobs will the "Job Development Tax Credit" create, and more importantly, how long will it take to create those jobs?

The President has estimated that his program will create 500,000 new jobs. He relies primarily on the "job development credit" to produce this result at an annual cost of $4.5 billion over the next decade. But Economist Leon Keyserling testified last week that there were approximately $7.2 million unemployed in the United States today. This suggests two further questions which it is important that the Treasury answer:

1. Is the Administration able to provide alternative job development proposals for consideration by the Committee which would create more jobs at less cost?

2. What is the best estimate of the Treasury as to the proportion of the $4.5 billion annual tax loss which would go to subsidize investments usually made in the course of business, as compared with new investments made only because of the credit? [4]

A number of noted economists, including James Tobin of Yale and Robert Eisner of Northwestern, have proposed two modifications to the investment credit which would make it far more effective for the money. The first modification would be to restore the investment credit for only one year and make it applicable only to equipment ordered during that year. The temporary nature of the restoration would increase the immediacy of the stimulatory effect.

A second modification would be to apply the investment credit on an "incremental" basis; in other words, allow the credit only for expenditures which would not otherwise have been undertaken. There is no need to subsidize industry for the bulk investments which take place in the ordinary course of business. Professor Eisner has suggested that the desired investment could be stimulated with a smaller revenue loss by allowing a substantially higher rate of tax credit but only for equipment spending in excess of the normal rate of investment.

Or, a similar effect could be achieved by adopting the proposal presented recently to the Joint Economic Committee by Professor Tobin. He suggested that

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[3] *Wall Street Journal*, September 30, 1971, p. 10, "That Shiny DISC."

[4] When asked this question during his testimony before the Ways and Means Committee, OMB Director George Schultz was unable to provide an answer. *Hearings*, September 9, 1971, p. 334. Surely the proponents of a multi-billion dollar tax expenditure should have such information for presentation to Congress. One estimate is that the investment credit will provide 80% of its benefits to corporations for purchases which would have been undertaken anyway. Executive lack of responsiveness on this point is inexcusable.

the credit be limited to net investment; this figure is derived by deducting the depreciation expenses for a particular year from the gross investment for the period. In this way the credit is limited to investments in excess of those representing replacement costs.

In short, the Administration has not yet managed to justify its multi-billion dollar job development proposal. Should this Committee be inclined towards the adoption of an investment credit, then it might be more effective to enact a credit for a specified period of one or two years with provision for careful consideration of the investment credit concept during a session of Congress prior to the lapse of the period.[5]

IV. Is Treasury able to propose any more effective means of stimulating exports than the inefficient DISC, which virtually exempt all export profits from Federal income taxation at an annual cost of up to a billion dollars?

The Treasury Department has resurrected DISC from its demise in this Committee last year. While recognizing the advisability of revaluation of the dollar, we deplore DISC as a wasteful gift to corporations, primarily for exports they are already undertaking for profit.

The treasury has been unable to provide a meaningful answer to the most important question about DISC: how many exports will it promote in return for its cost of $600–$955 million? The Secretary of the Treasury estimated last week that DISC would result in an increase in annual export sales of $1.5 billion. Last year the Treasury claimed figures ranging up to $2.5 billion. In support of these exhuberant statements, the Treasury has submitted self-serving statements from the corporations which are to profit from DISC if it is enacted. We urge this Committee to request that the Treasury try to justify its DISC proposal on the basis of more candid economic analysis.

DISC will allow tax-wise companies to set up dummy corporations to receive their foreign sales income. These shell corporations (known as DISCs) will not be subject to tax so long as they fulfill a multitude of technical requirements. A DISC's accumulated untaxed profits can then be put at the disposal of the parent company through intra-company "loans" at low interest rates.

DISC's inherent structure makes it most unlikely that its adoption will lead to significant export gains. The basic flow is that DISC confers its benefits without requiring an exporter to increase his exports by even a single dollar. He will receive a huge tax benefit for simply doing what he is already doing.

In 1969, American exports totalled $36.5 billion. Even under the optimistic Treasury estimates, these exports will not increase by more than four percent (1.5 billion dollars) as a result of the DISC plan. This means that 96 percent of DISC's benefits will be squandered by paying businessmen to continue already profitable exports. Only 4 percent of DISC's benefits will relate to new export sales. This is the reason why DISC costs a lot, but yields few benefits.

Corporations can be expected to squeeze ever-increasing fractions of their exports through the DISC loophole, until DISC finally shelters all export profits—on the whole $37 billion of sales—from U.S. taxation.

DISC's inefficient incentive structure means that the American taxpayer will get little in return for the immense subsidy that will be granted to exporters through DISC. If we accept Treasury's optimistic figures regarding DISC's costs and benefits, it appears that the American taxpayer will have to pay a tax subsidy of 40 cents for each dollar of DISC-induced exports. And if we compare DISC's costs and benefits using a more realistic computation[6] we find that

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[5] See, for example, the testimony of Deputy Assistant Secretary Nolan before the Ways and Means Committee on September 8: "There is no question but that if time were available a better kind of investment credit could be developed. . . ." *Hearings*, p. 110. Again, one must ask whether this urgency on the part of the Treasury has not been primarily self-imposed.

[6] Congressional staff economists who have undertaken careful analysis of DISC have found little basis for the Administration's exuberance. Sober analysis of the price effects of DISC sets the likely export gain at $300 to $480 million per year. This calculation is based on a recent study by Hendrik S. Houthakker of the President's Council of Economic Advisers which concludes that the price elasticity of U.S. merchandise exports is about −1.5. This means that for each dollar of price reduction, only $1.50 of exports will result (which is only $.50 of actual new revenue). Charitably, assuming that all of the tax subsidy will be passed on to overseas consumers in the form of lower prices, the Houthakker price elasticity means that exports will increase by a maximum of $480 million if the DISC proposal costs $955 million. If DISC were to cost $600 million as Treasury hopes, then the maximum export gains would be only $300 million. The speculation that DISC will alter the outlook of corporate executives toward export markets cannot, of course, be quantified in terms of increased export revenues. The Treasury Department has presented no proof that this psychological factor will result in increased exports, let alone an extra billion in exports.

the American taxpayer will be required to subsidize DISC's by $2 for each $1 of increased exports. In either event, DISC is a bad bargain.

This inefficiency of the DISC proposal has aroused the concern of professional officials of the Treasury Department and reportedly also the staff of the Joint Committee on Internal Revenue Taxation. There is also concern because DISC introduces over a dozen new tax concepts, which will require considerable definition in a multitude of rulemaking and adjudicatory proceedings.

DISC's main benefits will go to giant, fully integrated corporations. The Commerce Department estimates that about 100 of the largest U.S. firms account for over half of all U.S. exports. This means that over half of DISC's windfall benefits will automatically go to those same firms.

Fully integrated firms can shift profits into a DISC from the earliest stages of production. In contrast, firms that simply assemble parts made by others, or are otherwise unintegrated, will not be able to shift profits forward in this way. As a result, creation of a DISC will be much more valuable to large integrated corporations than to small processors that have fewer manufacturing profits to shift to the tax-free DISC.

Moreover, under the proposed DISC pricing rules, a parent company may sell its export products to its DISC subsidiary at less than arms-length market prices. This means that profits can be shifted to a DISC and go untaxed, even though they are actually profits of the parent company. The larger the parent's profits, the more valuable DISC's benefits will be.

These factors add up to favoritism for large, fully integrated firms at the expense of unintegrated producers—a policy that runs directly contrary to DISC's professed goal of aid for small exporters.

Although the Administration has presented its new economic program as a unified whole, there appears to be no economic justification for treating it as such. With the DISC proposal the Administration is attempting to use the current crisis atmosphere as an excuse for a permanent revenue loss and permanent cut in corporate taxes which has been estimated to be as high as $955 million annually. Surely Treasury must be able to devise a more effective and less expensive means of promoting exports.

V. *Would the Administration be willing to retain the auto excise tax and provide a general consumer tax cut so that consumers could freely spend their money in the marketplace?*

The President's request for the repeal of the auto excise tax is another example of an unsupported proposal. Last month the President told Congress: "It's removal will stimulate sales, and every 100,000 additional automobiles sold will mean 25,000 additional jobs for America's workers." And Secretary Connally in his testimony before the Ways and Means Committee asserted that the repeal of the excise tax and the temporary import surcharges would result in 600,000 additional domestic automobiles sales which could be "translated directly into 150,000 additional jobs. . . ." But the Treasury has produced no supporting data for these assertions. In fact, the indications from Detroit are that much of any increased production likely to be stimulated by the repeal of the excise tax will be absorbed through overtime rather than hiring of the unemployed. On August 25, 1971, at a press conference, GM President Ed Cole stated that General Motors alone has overtime available which could put out 300,000 to 400,000 more vehicle units in the coming year.

In addition, Secretary Connally has asserted that "the benefits of the repeal will be passed on to the consumers." But the day after the President first announced his new economic proposals Ford President Lee Iacocca admitted that his company could not control the dealers in this regard. Back in May 1964, then GM President, John F. Gordon, told Congressman Charles Chamberlain that the company could not be responsible for what auto dealers do if the auto excise tax was abolished because they were independent businessmen. Thus, despite Administration assurances, the repeal of the auto excise tax may ultimately result in higher profits for the auto industry instead of savings for the car purchasers. In fact, once the Wage and Price Freeze ends, the car manufacturers could manipulate new car prices upward through adjusting standard and optional equipment, so as to absorb much of this excise tax reduction, without the fear of losing sales to their only price competition, imports whose prices have now increased with the import surcharge and projected devaluation.

Finally, the auto industry seems a peculiarly poor choice for stimulating purchases. In the United States today there are already over 100 million registered vehicles; the problems of air pollution and traffic congestion they cause create enormous difficulties for our cities. This year has been a record year thus far in sales, and profits and employment are already substantially up. Auto company spokesmen had already predicted another record car sales year for the 1972 models before the August 15, 1971 announcement by the President. Rather than repealing the auto excise tax to encourage consumers to buy more cars, consumers should get a general tax cut allowing them to purchase whatever they like. Wouldn't that be the freest and most equitable thing to do for the 192 million consumers who are not buying new cars this year?

VI. *Would the Administration be willing to support individual tax cuts which would not provide primary benefits for the rich, in contrast to the present Administration proposals?*

The Treasury has fostered considerable confusion regarding the individual tax cut proposals of the President. On September 24, 1971, the General Counsel of the Treasury Department, Samuel Pierce, made the following claims on behalf of the President's proposals:

"Opponents of the President's new economic program have argued that it is unfair; that it favors the rich over the poor. On analysis, such remarks are without substance.

"For example, take the recommmendations to Congress to reduce certain taxes. The recommendation to increase personal exemptions is of far greater benefit to the low or middle income person than it is to the rich individual. The same can be said about the recommendation to repeal the excise tax on automobiles."

This is false rather than merely deceptive. A $50 increase in personal exemption will give the high income taxpayer in the 70% tax bracket $35 in tax saving, but the low income, 14% bracket, taxpayer only $7.[7]

The auto excise tax cut will primarily benefit higher income consumers who can afford to buy new cars, if indeed it is actually passed on to the consumers by the industry. The effect on prices of used cars is at best uncertain. And, of course, those not wealthy enough to buy a car will not benefit at all.

The important question which this Committee might ask of the Administration is why they have persisted in deceptive rhetoric rather than presenting a more professional case on behalf of the President's proposals.

VII. *Why has the Administration proposed permanent corporate tax cuts of about 20% annually, in comparison with the one-time proposed acceleration of small individual tax cuts? How valid are the Treasury statistics comparing individual and corporate tax cuts since 1969?*

Finally, let us examine the statistics presented by Secretary Connally to this Committee comparing individual tax cuts with those granted corporations, in the period 1969–1973.

These statistics are misleading for four main reasons: (a) First, the statistics used by the Secretary are themselves inadequate and misleading. For example, by counting proprietorship and partnership taxes as individual taxes, the Secretary is able to use the ADR machinery depreciation regulations to contribute over $2 billion to the claimed individual tax cuts.

(b) In comparing the House Bill treatment of individuals and corporations, the Secretary omits to note that most of the individual tax cuts will have their primary impact before 1973, while the business cuts have their major impact after 1973. With the exception of the low-income allowance, the House Bill grants one-time individual tax cuts compared with permanent corporate tax cuts.

(c) The 1969 Tax Reform Act was designed to close loopholes. As it turns out, more corporate than individual loopholes were closed. For example, in 1969, Gulf Oil Company had a net income of $992 million and paid less than one-half of one percent Federal income taxes. Shell Oil Company had a net income in that year of $308 million, and paid less than two percent Federal income taxes, as reported by *U.S. Oil Week*. It is this kind of inequity which the 1969 Act was meant to remedy. The Secretary appears to argue that since the Tax Reform Act closed loopholes and thereby increased corporate taxes, corporations should now be given the 20% permanent corporate tax cut which the President has proposed.

(d) The very use of the deceptive statistics by the Secretary serves to draw attention away from the important question concerning the President's multi-billion dollar corporate tax break proposals: Namely, whether the tremendous

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[7] For a careful discussion of the regressive nature of the Administration tax proposals and the generally inequitable burdens already present in the Federal tax system, the testimony of economist Leon Keyserling, October 13, 1971, especially pp. 2–6 and Charts 1–6.

revenue loss and likely increase in the Federal deficit are worth the very limited benefits to the economy.

In summary, then, we respectfully suggest that the President has artificially amplified the urgency of the economic situation in order to hasten enactment of his tax program. The Treasury has contributed to the emergency atmosphere and reduced Congressional weighing of costs and benefits through a series of deliberate deceptions, only the first of which was to label the familiar business investment credit as a "Job Development Credit." We strongly urge this Committee and the whole Senate to examine each part of the Administration tax proposals carefully so that the country will not suddenly awaken to find the deficit increased by many billions of dollars a year, with very few benefits for those Americans other than corporate managers and their stockholders. The use of a crisis atmosphere as an excuse for permanent corporate tax cuts would mean that there will either have to be higher taxes for others or less money available for demonstrably necessary government programs.

[From the New York Times, Oct. 5, 1971]

(Material referred to at p. 647)

NIXON'S NEW ECONOMIC PLAN: TO MAKE THE RICH RICHER

To the Editor:

In his New Economic Policy, President Nixon proposed a permanent reduction in corporate taxes of almost 20 per cent, accompanied by small individual tax cuts. Tax policy is dull and complicated, and this perhaps explains why there has been so little public discussion about the wisdom of giving corporations about $7 billion annually and individuals about $2 billion one time (not counting the auto excise tax cut), as the President proposed.

Another reason must be stream of soothing but deceptive statements from Treasury officials on the tax issue.

Last week, for example, Treasury Under Secretary Charls Walker compared individual and business tax cuts in the years 1971 to 1973 to show that they were "balanced." This is less than candid since the individual tax cuts will have their major effect before 1973 while the permanent corporate tax cuts (the A.D.R. depreciation system and the investment credit) will really begin to pay off after 1973.

Also last week, Samuel Pierce, Treasury general counsel, stated:

"Opponents of the President's new economic program have urged that it is unfair; that it favors the rich over the poor. On analysis, such remarks are without substance.

"For example, take the recommendations to Congress to reduce certain taxes. The recommendations to increase personal exemptions is of far greater benefit to the low- or middle-income person than it is to the rich individual. The same can be said about the recommendation to repeal the excise tax on automobiles."

This is false rather than merely deceptive. A $50 increase in personal exemption will give the high-income taxpayer in the 70 per cent tax bracket $35 in tax saving, but the low-income 14-per-cent-bracket taxpayer only $7.

The auto excise tax cut will primarily benefit higher-income consumers, who can afford to buy new cars, if indeed it is actually passed on to consumers by the industry. The effect on prices of used cars is at best uncertain. And, of course, those not wealthy enough to buy a car will not benefit at all.

The Treasury has not made a serious and honest effort to convey to the public the incredible magnitude of the proposed tax gift to corporations. If the tax cut were instead given to individuals, it would reduce personal taxes by over $100 annually.

The budgets for fiscal 1972 for the Environmental Protection Agency, the Department of Housing and Urban Development, the Department of State and the entire Federal judiciary all taken together total less than the average amount—over $7 billion—which the Administration proposed annually to give away to the corporations. The Treasury has not made a convincing economic case that such a great sum should be given to the corporations.

More seriously, Treasury deception has discouraged the public debate, which, in a democracy, should accompany a decision to make such fantastic expenditures.

RALPH NADER,
TOM STANTON,
Public Interest Research Group.

[From the New York Times, Sept. 30, 1971]

ALLOCATING PROPOSED TAX CHANGES

To the Editor:

In The Times for Sept. 26, Eileen Shanahan states that perhaps the fairest way to allocate between business and individuals the tax changes proposed in the New Economic Policy (as adjusted by the House Ways and Means Committee) is to strike a "grand total" that includes the Administration's depreciation reforms announced last January and allocates the auto excise cut to individuals. On this basis, Miss Shanahan reports that the net result of the committee's action would be to grant, in the three years 1971–73, $14.1 billion in tax relief to business and $11.5 billion to individuals.

So far, so good. But perhaps an even better perspective could be gained by adding the pre-1972 impact of the Tax Reform Act of 1969, which massively reduced tax payments for individuals in the low- and middle-income brackets, while increasing them for high-bracket individuals and business.

When this further adjustment is made, we find that individual tax payments in the full five-year span will have been reduced by $37 billion. Those for corporations will actually increase by $4 billion.

But this is not all. By and large, income tax payments by individuals cannot be shifted—the taxpayer bears the incidence of the tax. But the precise incidence of the corporate tax is a matter of debate. There seems to be general agreement that the "corporation," which is simply a business arrangement, can in no way bear a tax itself, or gain the benefit of a tax cut, without individuals being affected in one way or another.

If corporate tax cuts are shifted forward to buyers in the form of lower prices, consumers benefit. If they are used to increase dividends, stockholders benefit. If they are reinvested in new and better equipment, jobs will increase in the industries that supply the equipment, further price pressures may be reduced as productivity rises, and our trade position may improve as a result of increased competitiveness in world markets.

All this is to say that a simple comparison of "business tax cuts" and "individual tax cuts" can give only a superficial answer to the question: Who benefits from tax reductions? As we have consistently argued, we believe that the tax proposals of the New Economic Policy were indeed balanced—taking into consideration the complexities of our tax system and the pressing need to modernize our equipment.

We are pleased that the House Ways and Means Committee, in revising the President's proposals, did not significantly alter that balance.

CHARLS E. WALKER,
Under Secretary of the Treasury.

(Material referred to at p. 648)

WASHINGTON, D.C., *August 11, 1971.*

Hon. SAMUEL R. PIERCE, Jr.,
General Counsel, U.S. Treasury Department,
Washington, D.C.

DEAR MR. PIERCE: It was good to read in the *Federal Register* of July 27, that the Treasury is taking steps to broaden public participation in rulemaking and public access to information.

I hope that this will be part of a general expansion of public participation in Treasury tax policy decisions. It would be a pleasure for me to discuss with members of your staff other possible constructive approaches to that issue.

There is one idea which I would like now to propose for your consideration. That is the formation of a citizen advisory committee on tax policy. It would be analogous to the Treasury Liaison Committee of the Business Council.

The citizen advisory committee could be composed of tax law professors, economists and public interest attorneys. Attorneys and economists having client relationships with private interests should be excluded, given the already ample channels of communication open to private interests concerned about tax policy.

The benefits to Treasury of a citizen advisory committee might include valuable advice on tax reform as well as potential public support for Treasury tax reform proposals.

Thank you very much for your consideration. I look forward to your response.

Sincerely,

THOMAS H. STANTON.

THE GENERAL COUNSEL OF THE TREASURY,
Washington D.C., August 17, 1971.

THOMAS H STANTON, Esq.
Washington, D.C.

DEAR MR. STANTON: Thank you for your letter of August 11 expressing satisfaction with the steps taken by the Treasury Department, reported in the Federal Register of July 27, to broaden public participation in rulemaking and public access to information. Your comments are appreciated. Since your interest is primarily in public participation in Treasury tax policy decisions. I suggest that you seek further discussion with appropriate persons in the Internal Revenue Service rather than with my staff.

Your letter proposes the formation of a citizen advisory committee on tax policy, analogous to the Treasury Liaison Committee of the Business Council, to be composed of tax law professors, economists and public interest attorneys. You will be glad to know that the Commissioner of Internal Revenue presently has the benefit of such an advisory committee, which is called the Advisory Group to the Commissioner of Internal Revenue, and was established in 1959. In conformity with Executive Order 11007, the Annual Reports of the Secretary of the Treasury have published information about this group, its membership and dates of meeting during the preceding fiscal year, I am enclosing a copy of the latest such published information in the Annual Report for fiscal year 1970. You may obtain more current information by writing to the Commissioner of Internal Revenue.

Sincerely yours,

SAMUEL R. PIERCE, Jr.

Enclosure.

[Excerpt From the 1970 Report of the Secretary of the Treasury]

ADVISORY GROUP TO THE COMMISSIONER OF INTERNAL REVENUE

This group was established by the Commissioner of Internal Revenue on June 17, 1959.

This Committee, which represents professional and other private groups concerned with Federal taxation, provides constructive criticism of Internal Revenue policies and procedures and suggests ways in which the Service can improve its operations.

The advisory group met on October 16–17, 1969, and January 29–30 and June 4–5, 1970.

The membership in fiscal 1970 follows:

Donald C. Alexander, Dinsmore, Shohl, Barrett, Coates & Deupres, Cincinnati, Ohio 45202.
William T. Barnes, Lybrand, Ross Bros. & Montgomery, Washington, D.C. 20036.
Norton M. Bedford, Professor, University of Illinois at Urbana-Champaign, College of Commerce and Business Administration, Urbana, Ill. 61801.
J. Keith Butters, Professor, Harvard University, Graduate School of Business Administration, Boston, Mass. 02163.
Sheldon S. Cohen, Cohen & Uretz, Washington, D.C. 20036.
F. Cleveland Hendrick, Jr., Hendrick & Lane, Washington, D.C. 20036.
William M. Horne, Jr., Reed, Smith, Shaw & McClay, Washington, D.C. 20005.
Harry K. Mansfield, Ropes & Gray, Boston, Mass. 02110.
Bishop Francis John Mugavero, Brooklyn, N.Y. 11238.
Fred C. Scribner, Jr., Chairman, Atwood, Scribner, Allen & McKusick, Commerce Building, Portland, Maine 04110.
Rabbi Ralph Simon, Congregation Rodfei Zedek, Chicago, Ill. 60615.
Richard J. Whalen, Washington, D.C. 20016.
Rene A. Wormser, Wormser, Koch, Kiely & Alessandroni, New York, N.Y. 10022.

WASHINGTON, D.C. *August 18, 1971.*

Hon. SAMUEL R. PIERCE, JR.,
General Counsel,
U.S. Treasury Department,
Washington, D.C.

DEAR MR. PIERCE: Thank you for your letter of August 17, concerning a citizen advisory committee on tax policy.

There appears to be some misunderstanding, which I would like to attempt to clarify. You enclosed with your letter a copy of page 484 of the 1970 *Annual Report of the Secretary of the Treasury.* On that page it is said that the Advisory Group to the Commissioner of Internal Revenpue, "provides constructive criticism of Internal Revenue policies and procedures and suggests ways in which the Service can improve its operations."

That advisory group is substantially different in function from the citizen advisory committee on tax policy which I would like to suggest.

The citizen advisory committee would provide advice on specific tax reform proposals—for instance, overall simplification of the Internal Revenue Code—as well as the possibility of public support for Treasury tax reform legislative proposals. This is a considerably different role from that of the Commissioner's Advisory Group, which provides advice on the administration of the tax laws presently in force.

I look forward to your response now that I have clarified my suggestion. Again, thank you for your consideration.

Sincerely,

THOMAS H. STANTON.

THE GENERAL COUNSEL OF THE TREASURY,
Washington, D.C., August 25, 1971.

THOMAS H. STANTON, Esq.,
Washington, D.C.

DEAR MR. STANTON: Your letter of August 18 clarifies your proposal of a citizen's advisory committee on tax policy as relating to advice on tax reform, as distinguished from tax administration, which you state is the subject area of the present Advisory Group to the Commissioner of Internal Revenue.

I am informed that the Advisory Group considers tax policy and legislation from time to time with the participation of the Office of the Assistant Secretary for Tax Policy. However, I am forwarding your correspondence to that Office for consideration and such further comment as they may find appropriate.

Sincerely yours,

SAMUEL R. PIERCE, Jr.

TREASURY LIAISON COMMITTEE OF THE BUSINESS COUNCIL

The Secretary of the Treasury proposed this Committee on May 8, 1965, "to keep up a two-way exchange and dialog on areas of material concern to the Treasury and the business community." The Committee consists of members informally recommended and appointed by the Business Council and the Secretary of the Treasury. The functions of the Committee are advisory and consultative. Formation of the Committee was announced on July 8, 1965.

During fiscal 1970 the Committee met on October 7, 1969, and May 9, 1970.

Membership of the Committee in fiscal 1970 was as follows:

Thomas S. Gates, Jr., (Chairman), Chairman, Morgan Guaranty Trust Co., New York, N.Y.
William A. Hewitt, Chairman, Deere & Co., Moline, Ill.
Frank R. Milliken, President, Kennecott Copper Co., New York, N.Y.
Eugene N. Beesley, President, Eli Lilly & Co., Indianapolis, Ind.
Howard L. Clark, Chairman, American Express Co., New York, N.Y.
Fredric G. Donner, Former Chairman, General Motors Corp., New York, N.Y.
Charles F. Myers, Jr., Chairman, Burlington Industries, Inc., Greensboro, N.C.
Albert L. Nickerson, Former Chairman, Mobile Oil Co., New York, N.Y.
David Rockefeller, Chairman and Chief Executive Officer, Chase Manhattan Bank, New York, N.Y.

(Material referred to at p. 650)

WASHINGTON, D.C., *October 21, 1971.*

The following is submitted to the record in response to Senators Fannin and Bennett:

Mr. Fannin asked whether I have had experience in government or business. Of course, the Constitution provides that all people—not just government officials and businessmen—be allowed to petition their government.

Mr. Fannin then interrupted my response that I have studied the components of the Revenue Act of 1971 in considerable detail. As it happens, I have spent much of the past year studying the DISC and ADR proposals, including consultations with leading economists and tax attorneys. However, this should not be taken as an argument that only informed people be allowed to provide information to their Senate on public issues. I respectfully suggest that all people of this country, however well or poorly informed, should be allowed to express themselves—so long as they are courteous. After all, the people vote and pay taxes. It is they, not just government officials or businessmen, who pay the bills which make the government possible.

Senator Fannin opened his questioning by stating that "I think it is worthless to probably ask some questions on such biased testimony," and Senator Bennett also charged me with bias. My response is simply that I favor better representation of the average individual taxpayer who will not significantly benefit from the Revenue Act of 1971. This is a viewpoint quite possibly shared by many of the 75 million individual taxpayers of the country, and it ought to be welcomed by this powerful Committee. It is strange that accusations of bias were not so freely hurled as the many witnesses representing the influential special interests who have dominated most of the Committee's time.

The response of Senators Fannin and Bennett to my appearance gives one insight to some of the causes of the ferment stirring America today. There are many members of the younger generation who seek to work within the established system for constructive but meaningful reform. If Senators Fannin and Bennett will not allow younger people other than government officials and businessmen to have a fair and open hearing before our elected delegates in the Senate, how do they propose that we participate in our government? Merely by casting an infrequent vote, more frequently being called into the Army—and always paying taxes which they would impose without fair hearing?

The specific answer to Mr. Fannin's tax incentive question, which I was offering when Mr. Bennett interrupted, is as follows:

A close look at the numbers themselves shows surprisingly little correlation between tax incentives (as measured by the capital cost index calculated by Treasury) and the rate of economic growth. For example, Japan has had a phenomenally high rate of economic growth and yet the United Kingdom, which has a relatively lower rate of economic growth, has more tax incentives.

Furthermore, there has been no guidance offered by the Secretary as to what the statistics actually mean. How important is the alleged "tax incentive gap"? In fact, as a dissenting opinion in the Ways and Means Committee Report notes, capital costs constitute only about 20% of the final price of a manufactured good. Thus, an alleged 10% tax incentive gap between the U.S. and another country would mean only a 2% difference in the final price of the manufactured good—an amount which is negligible compared to differences in transportation, labor, and other cost factors. Devaluation and the healthy effects of competition will serve much more efficiently to stimulate our industry to modernize.

Implicit in the figures is an idea that the United States should pattern its economy after the economies of other countries. However, the United States leads the world in many sectors of industrial production. In contrast to the benefits which might accompany tax incentives for countries not as well developed as the U.S., the economic growth benefits in this country will be much more limited, indeed only marginal in the opinions of some economists. In addition, there is a serious question whether the U.S. should hasten to misallocate resources within its economy merely because other countries have undertaken to do so.

The very presentation of the figures serves to mislead this Committee from attention to the basic question at stake: Is the multi-billion dollar 20% cut in corporate taxes worth the limited gains promised?

Since my testimony before the Committee, in which I remarked that Treasury is not playing a professional role with respect to its presentation of information, Economist Paul Taubman of the University of Pennsylvania has revealed the results of a study showing that the Treasury capital cost statistics are themselves incorrectly calculated. In fact, the "tax incentive gap" is far less than that stated by the Treasury. In light of this development, I feel confirmed in my judgment that the Treasury should be required to uphold its burden of proof in a professional and comprehensive manner when it proposes such immense tax expenditures to the Congress.

In conclusion, my experience leads me to ask whether it is of any use for citizens and taxpayers such as myself, who have studied the issues but are neither from government nor from business, to attempt to participate in the democratic process through testimony before this Committee.

THOMAS H. STANTON.

The CHAIRMAN. The next witness will be Mr. James A. Gavin, legislative director of the National Federation of Independent Business.

STATEMENT OF JAMES A. GAVIN, LEGISLATIVE DIRECTOR, THE NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. GAVIN. Mr. Chairman and distinguished members of this committee, I am James A. Gavin, legislative director of the National Federation of Independent Business. In behalf of our 293,000 members I wish to thank you for this opportunity to testify on certain aspects of H.R. 10947.

Gentlemen, the National Federation of Independent Business has the largest single membership of any business organization in the United States. Our membership represents a cross section of the entire small business community in the Nation. Small business encompasses 95 percent of all the business establishments in the country, employes 60 percent of our private and nonagricultural work force and accounts for at least 37 percent of the gross national product. Therefore, the role of small business in our Nation's economic community is vital and certainly must be considered if we are to truly achieve a nationwide economic recovery.

During the year we periodically poll our members by mandate ballot on issues pending before the Congress. We do this in order to make certain that we accurately represent their views.

The results of these polls determine our position on all issues including these I present before this distinguished group.

REPEAL OF 7 PERCENT AUTO EXCISE TAX

Historically, in mandate votes, our members have opted for elimination or reduction of the 7 percent auto excise tax, and we note that the 7 percent repeal has cleared the other body of the Congress.

Although this measure favors the automotive industry, we believe its benefits are far ranging since in every seven Americans one is purportedly employed either directly or indirectly by that industry.

Also, the savings realized by the consumer in the purchase of a new auto has been estimated to be approximately $200. This should not only increase automotive sales, but should spur spending in other consumer goods industries as well.

ADVANCEMENT OF INCOME TAX CUTS

As to the proposal for advancing to January 1972 (from January 1973) the personal income tax exemption increase of $50 per dependent, a mandate vote earlier this year revealed our members opted 70 percent "for," only 26 percent "against," with some 4 percent having no opinion. The mandate ballot was taken on S. 1727 (Title I) a bill sponsored by Senator Walter F. Mondale to put into effect immediately the $750 personal income tax exemption now scheduled for 1973. Thus we and the members of the federation strongly favor this proposal.

(The CHAIRMAN. Thank you very much.

(Mr. Gavin's prepared statement follows:)

PREPARED STATEMENT OF JAMES A. GAVIN, LEGISLATIVE DIRECTOR, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. Chairman and Distinguished Members of the Committee. I am James A. Gavin, legislative director of the National Federation of Independent Business. In behalf of our 293,000 members, I wish to thank you for this opportunity to testify on certain aspects of H.R. 10947.

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REPEAL OF 7 PERCENT EXCISE TAX

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Also, the savings realized by the consumer in the purchase of a new auto has been estimated to be approximately $200. This should not only increase automotive sales, but should spur spending in other consumer goods industries as well.

ADVANCEMENT OF INCOME TAX CUTS

As to the proposal for advancing to January 1972 (from January 1973) the personal income tax exemption increase of $50 per dependent, a mandate vote earlier this year revealed our members opted 70 percent "for", only 26 percent "against", with some 4 percent having "no opinion". The mandate ballot was taken on S. 1725 (Title I), a bill sponsored by Senator Walter F. Mondale to put into effect immediately the $750 personal income tax exemption now scheduled for 1973. Thus, we and the members of the federation strongly favor this proposal.

RESTORATION OF INVESTMENT TAX CREDIT

In order to stimulate the economic rejuvenation and growth of the Nation we support, and in fact applaud generally as recommended by the administration, the restoration of the investment tax credit. Yet, we cannot help but think that perhaps a restoration at a permanent level—perhaps at 7 percent would—in the end, be better for both the economy and the Nation's small business community. We would urge, moreover, that a reasonable ceiling be placed on this allowance, similar to that recommended in both S. 1615 and H.R. 7692, on a sliding scale to $50,000 for manufacturers or perhaps $100,000 as we have suggested in the past. Also, we feel that it is vitally important that this credit be extended to purchases of used equipment—because even in periods of flourishing economic conditions—many smaller firms simply cannot afford to acquire new, more expensive machinery.

Such limitations, I assure you, are not urged out of antagonism for big business or to placate the strident demands of labor, but rather to make funds available for use in another area that is just as vital to independent business. Our surveys point out that over 60% of the Nation's smaller firms are engaged in retailing and the service trades. In these business areas, investment in inventories and account receivables are of vastly greater importance than that in capital equipment.

Therefore, we would strongly recommend that the concept of the investment tax credit be extended to these areas in the form of a "plowback" allowance. Without such action, it is seriously doubtful that this important small business sub-sector will be able to adequately regain the economic health it has lost during the recent period of spiraling inflation and unrestricted credit.

Perhaps, if these limitations are adopted, it will also be possible for this committee to consider remedies for one of the Nation's most depressing problems—rural job development. The constant, heavy migration of America's young adults from the farm to the city has reached critical proportions and is placing significant burdens on both our rural and urban areas.

This committee, we believe, has the opportunity to help stem this flow. Introduced with strong bipartisan support and assigned to you for consideration is the Rural Job Development Act of 1971, a measure that would employ tax incentives to create a national policy of distribution of opportunity in order to voluntarily redistribute population. Some seven committee members have co-sponsored the legislation. Unfortunately, no hearings, to our knowledge, have been scheduled on this legislation.

The distinguished Senator from Kansas, Mr. Pearson, has proposed an amendment to this bill that seeks to accomplish much of the same goals as does the Rural Job Development Act. It would help stimulate the overall economy of the Nation by encouraging the establishment in our rural areas of business and industry, which would produce additional jobs for an ever-expanding work force.

With most of our country's leaders, both within and outside of the Government, seeking ways to lower the unemployment rate in the United States, we ask that this amendment receive serious consideration.

The federation has made available, on a public service basis, a series of spot radio announcements to stations throughout the country. In these brief messages, we encourage the building of rural America. Time will not permit me to go into detail about the vast number of responses we have received. However, I think you will be interested to know that we have received inquiries from every geographical region in the United States—ranging from average individual Americans, to small businessmen, as well as from scores of elected public officials in small cities and towns.

A typical example that perhaps best sums up the concern of those who are writing to us is a response we received just last week from a college senior, who explained he was considering returning to his hometown of some 4,000 population. "But," as he wrote, "the prospects of suitable employment are not promising . . ."

This is, regrettably, a present day American tragedy—a tragedy which the federation, with the assistance of the Congress, hopes to alleviate in the near future.

And especially is it tragic when we consider that between 1960 and 1970, there was no recorded growth of U.S. rural population. During this decade, more than one half million young people migrated each year to the cities. In the 25 years between 1945 and 1970, the net migration of these young people from rural America totaled a staggering 25 million!

Although the population of the United States has doubled since 1900, the total population count of the Nation's large cities has grown by more than 350 per cent. This is the primary reason why today we find that more than 74 per cent of us live on only 2 per cent of our land. And, by the year 2000, it has been reliably estimated that an additional 100 million more Americans will live in our already overcrowded and teeming cities.

We have all heard much about the terrific financial strain created on our larger cities by the constant flow of immigrants. Recent studies of the effect of in-migration on 94 large U.S. cities clearly show that the cost of this phenomenon is appalling. In 1960 alone, this placed a net burden of $2,500,000 on each city, and the median net burden per migrant was nine times greater than per city resident.

Population distribution alone is closely related to availability of employment, and most of America's major industries are heavily concentrated in a few economically advantageous areas. This has caused the vast majority of our people to gravitate toward these urban centers in hope of securing steady, well paying jobs in order to provide a decent living for their families.

The federation believes that the key to reversing this harmful trend is the dispersement of business and industry throughout America. This would stem the out-migration and immediately ease urban pressures. Ultimately, through redistribution of population, it would also reduce these urban pressures to more manageable levels.

Therefore, we support the objectives of the amendment and strongly support the Rural Job Development Act. We look upon enactment of this legislation as vital to a recovery of the overall American economy.

The National Federation of Independent Business considers it a privilege to have this opportunity to make this presentation before this distinguished committee. We stand ready to cooperate with the committee at any time in our mutual efforts on behalf of the business community.

Thank you.

Senator CURTIS. Before we call on the witness, I have requested the staff to make up three tables showing tax liability for the low income as it compares with social security taxes. I ask that they be printed in the record.

The CHAIRMAN. I would like to see it myself and will be very happy to have it in the record.

(The documents referred to follows:)

FEDERAL INDIVIDUAL INCOME TAX LIABILITY AND SOCIAL SECURITY TAX LIABILITY UNDER PRESENT LAW (ASSUMING DEDUCTIBLE PERSONAL EXPENSES OF 10 PERCENT OF INCOME) MARRIED COUPLE WITH 2 DEPENDENTS, CALENDAR YEAR 1972, WITH WAGE AND SALARY INCOME [1]

Adjusted gross income	Federal income tax	Social security tax	Total
$1,000	0	$52	$52
$2,000	0	104	104
$3,000	0	156	156
$4,000	$28	208	236
$5,000	170	260	430
$6,000	322	312	634
$7,000	484	364	848
$8,000	635	416	1,051
$9,000	799	468	1,267
$10,000	962	468	1,430

MARRIED COUPLE WITH 2 DEPENDENTS, CALENDAR YEAR 1972, WITH NET EARNINGS FROM SELF-EMPLOYMENT [1]

$1,000	0	$75	$75
$2,000	0	150	150
$3,000	0	225	225
$4,000	$28	300	328
$5,000	170	375	545
$6,000	322	450	772
$7,000	484	525	1,009
$8,000	635	600	1,235
$9,000	799	675	1,474
$10,000	962	675	1,637

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MARRIED COUPLE BOTH 65 OR OVER WITH NO DEPENDENTS, CALENDAR YEAR 1972, WITH WAGE AND SALARY INCOME [1]

Adjusted gross income	Federal income tax	Social security tax	Total
$1,000	0	$52	$52
$2,000	0	104	104
$3,000	0	156	156
$4,000	$28	208	236
$5,000	170	260	430
$6,000	322	312	634
$7,000	484	364	848
$8,000	635	416	1,051
$9,000	799	468	1,267
$10,000	962	468	1,430

MARRIED COUPLE BOTH 65 OR OVER WITH NO DEPENDENTS, CALENDAR YEAR 1972, WITH NET EARNINGS FROM SELF-EMPLOYMENT [1]

$1,000	0	$75	$75
$2,000	0	150	150
$3,000	0	225	225
$4,000	$28	300	328
$5,000	170	375	545
$6,000	322	450	772
$7,000	484	525	1,009
$8,000	635	600	1,235
$9,000	799	675	1,474
$10,000	962	675	1,637

[1] Income earned by one spouse.

Source: Staff of the Joint Committee on Internal Revenue Taxation.

The CHAIRMAN. The next witness is Mr. David J. Steinberg, executive director, Committee for a National Trade Policy.

STATEMENT OF DAVID J. STEINBERG, EXECUTIVE DIRECTOR, COMMITTEE FOR A NATIONAL TRADE POLICY

Mr. STEINBERG. Mr. Chairman, gentlemen, I am David J. Steinberg and I am executive director of the Committee for a National Trade Policy. I shall very briefly, Mr. Chairman, summarize the highlights of the written statement that has been submitted to your committee and which I understand will be made part of the record of these hearings.

Our committee, supported by American businesses, large and small, by trade associations, and by individuals as citizens and consumers, has for the past 18 years been advocating a foreign-trade policy which is calculated to serve the totality of the national interest.

We believe that a policy of consistently freer international trade is that kind of policy. Since our committee confines itself to trade policy issues, we are confining our testimony today to the buy-American provisions of the investment tax credit.

We urge your committee and the Congress to remove the buy-American provisions from that section of the proposed tax legislation. We urge this because we believe that this provision impairs the effort that must be made toward truly freer international trade.

The buy-American provision constitutes a nontariff barrier which would be in violation of the General Agreement on Tariffs and Trade.

I am fully aware of the comparable barriers that many other countries have in their own trade policies, but an additional U.S. barrier of this kind is not a constructive way and effective way to attack comparable barriers abroad.

We believe that this provision tends to magnify the uncertainty and the doubts that surround American intentions and American judgment in trade policy and in the whole area of foreign economic policy. This is hardly the kind of climate in which to most effectively and successfully press for durable reform around the world in trade and monetary policies.

The buy-American provision would also tend, we believe to weaken the effort that must be made to increase productivity and to combat inflation.

American businesses should be free to effect the investment mix best calculated in their judgment to increase productivity and make themselves increasingly competitive in an increasingly competitive world.

Increasing productivity, as I am sure you know, is vitally important to reducing inflation. We believe that the buy-American provision is not a constructive approach to the objective of stimulating the economy and increasing productivity and employment.

I can understand that it may tend to increase employment in certain sectors of our economy, but the job development program ought to apply across the board and there are jobs involved, as you know, in the industries and in the companies that are interested in purchasing foreign equipment they consider essential to their efforts to increase productivity and become more competitive.

And, of course, there are jobs, a great number of jobs, that are involved in our exports. The buy-American provisions is the kind of provision that would tend to foster retaliatory action by other countries directly or indirectly. This would have, we believe, an adverse effect on the American export expansion program.

I understand that the buy American provision is anticipated to last only as long as the import surcharge, but this, in our view, does not justify the buy-American provision.

We believe this provision is objectionable for as long as it does last. Even as a proposal short of legislation it reflects the propensity of the United States to resort to import restrictions as a remedy. We deplore this inclination.

We, therefore, urge the Congress to delete this provision and in this way, we feel, improve the stature and leverage of the United States in the whole area of foreign economic policy and also help improve our productivity program as well.

This is a very, very cursory summary, Mr. Chairman, of what is in the written statement. In the interest of time I have cut it very short.

The CHAIRMAN. We will print the entire statement. Do you think that this provision violates the GATT?

Mr. STEINBERG. Yes, sir; I do.

The CHAIRMAN. Would you mind explaining why it violates the GATT?

Mr. STEINBERG. Because it constitutes, Mr. Chairman, an additional trade barrier. Now, there is buy American legislation dating back to

1933, which, having been established prior to negotiation of the GATT, is not a violation of GATT. But this new measure, being an additional nontariff barrier, would be in violation of GATT. I am greatly concerned, as I am sure all members of our committee are, Mr. Chairman, about the many nontariff barriers that have seriously restricted American access to foreign markets, not just in the area of "buy national" policies but a multitude of other nontariff barriers, and it seems to me that to establish an additional nontariff barrier at this time when we are so concerned about the need to get other countries to reduce their nontariff barriers is a counterproductive measure, indeed a boomerang.

The CHAIRMAN. How does your group view the import surcharge? Do you have a view of that as a violation of the GATT also?

Mr. STEINBERG. I don't really know. I feel that it is a violation of the GATT. I have very serious misgivings about the strategy involved in the use of the surcharge. To be very honest with your committee, I should point out there are some supporters of my committee, some businessmen who support my committee, who, while sorry that the import surcharge has been established and while wanting to see it removed as soon as possible, feel that it was a correct thing to do in the first instance.

I do not share that feeling and I would hope that the import surcharge will be removed as quickly as possible. I would like to see the price for removal of the surcharge confined to a realinement of currency parities, with the removal of the surcharge clearly identified by the United States as only the first step in a dramatic new trade and monetary initiative, an initiative to really free up the trade of the industralized countries of the world and establish a durable and soundly based international monetary system.

The CHAIRMAN. You recognize that these other countries that engage in trade practices that in many cases are far more restrictionist than we are?

Mr. STEINBERG. I recognize that and I have spoken out against those policies for a good number of years, so I share that feeling with you. I do feel, however, that there is a correct way and a constructive way to deal with those barriers. I don't feel that the buy American provision meets this standard and contributes to that objective.

The CHAIRMAN. Thank you very much.

Mr. STEINBERG. Thank you, sir.

(Mr. Steinberg's prepared statement follows:)

PREPARED STATEMENT OF DAVID J. STEINBERG, EXECUTIVE DIRECTOR, COMMITTEE FOR A NATIONAL TRADE POLICY [1]

OPPOSITION TO BUY AMERICAN PROVISION

U.S. trade policy has for years been in a serious state of drift, drifting backward from the goal of truly freer international commerce. Action by the legislative and executive branches of government in this field has not matched—it has sometimes contradicted—their declared concern over artificial trade barriers and distortions that clutter the channels of international trade. What the Congress and the Administration have done or failed to do in recent years has on

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[1] The Committee, supported by American businesses large and small, by trade associations, and by individuals as citizens and consumers, advocates foreign-trade policies calculated to serve the overall national interest. It does not represent or speak for any single sector of the U.S. economy, or any other special interest.

the whole conflicted with their professed dedication to "fair trade" and "freer trade". Nor is there a coherent, constructive approach to the adjustment problem of our economy in a rapidly changing and increasingly competitive world.

Absence of a coherent, credible free-trade policy—a void that fosters continuing departures from the course of consistently freer international trade—is to a large extent responsible for the difficulty the United States has had in persuading other governments to take urgently needed steps toward freer and fairer trade by lowering trade barriers and revaluing exchange rates. Absence of a coherent, credible domestic adjustment/conversion policy, on the other hand, is to a large extent responsible for our failure to produce a definitive free-trade strategy, whose political palatabilty depends on such a domestic program.

The Buy American provision of the investment tax credit would be a further retreat from the free-trade objective that should rank high in our national priorities. Such discriminatory practices would stiffen the resistence of other countries to the efforts the United States unrelentingly must make to get them to lower and hopefully remove their many and varied trade distortions. Such legislation would be in violation of the General Agreement on Tariffs and Trade and could set off retaliatory measures against U.S. exports. The retaliation, direct or indirect, could damage exports from the very industries that might appear to benefit from such legislation.

Nor is it a constructive approach to solving domestic economic problems. The investment tax credit is supposed to improve the competitive position of U.S. producers. They should be free to put together the investment mix that best meets their needs. The Buy American provision does not prohibit the acquisition of such foreign-made equipment as the purchasing company may consider essential. However, the 10 percent import surcharge imposes a deliberate extra cost, in addition to the higher import costs resulting from the reduced dollar exchange-rate. The Buy American provision prevents any relief via the investment tax credit.

Job development is a declared purpose of this tax proposal. While it is possible that in some instances the Buy American provision may divert procurement from imported to domestic equipment (to the advantage of U.S. producers of such equipment), the nation's job development needs far transcend the interest of any particular industry. Increasing the nation's competitiveness and employment should be an across-the-board objective. Nor do obstacles to the procurement of foreign equipment contribute to the campaign against inflation.

The fact that the Buy American provision is tied to the duration of the import sucharge does not significantly lessen the demerits and the danger of such legislation. Resorting to Buy American measures even in his qualified way tends to give respectability to import restriction (in this case discrimination against foreign goods) as a policy device. There is too much evidence already—some of it in this Congress—of propensities in this misguided direction. The measure is harmful, whatever its duration.

Nor do the improvements made in the Administration's Buy American proposal by the Ways and Means Committee, approved by the House at large, make the measure worthy of enactment. The House version would permit exemptions from the Buy American restriction upon a finding by the President that such exemptions are in the public interest. Situations cited as justifying such exemptions are those in which there is no equivalent U.S. product, or there is a monopoly in the U.S. supplying industry, or the foreign manufacturer is selling his product in the United States preliminary to establishing production of the particular item in this country. Exemptions would involve administrative delays and problems of interpretating such standards as no equivalent U.S. product. Problems of administration are not in themselves a persuasive reason for rejecting a policy proposal. But in this instance they add to the already formidable reasons for rejecting the Buy American proposition.

Since the Buy American standard is tied to the duration of the surcharge, it might be regarded as amplifying the pressure being put on other governments to effect the trade and monetary reforms the United States has been advocating. Our Committee supports responsible, constructive steps to persuade other countries to assume their fair share of responsibility in the continuing effort that must be made to build a strong and viable international trade and monetary system. We believe, however, that the surcharge and the floating of the dollar, if handled astutely, are more than adequate as policy leverage. The Buy American provision would, in fact, be counter-productive, in both the short and longer run, and in terms of both domestic and foreign policy objectives.

Removal of this provision would improve the stature of the United States, the climate for international economic cooperation, and the overall effort to achieve international trade and monetary reform. It would also reflect a more enlightened view of trade policy by the Congress itself. And that, too, deserves priority attention.

The CHAIRMAN. The next witness is Mr. W. Scott Smith, Jr., president of the National Equipment Distributors Association.

STATEMENT OF W. SCOTT SMITH, JR., PRESIDENT, NATIONAL EQUIPMENT DISTRIBUTORS ASSOCIATION

Mr. SMITH. Mr. Chairman, and members of the committee, my name is W. Scott Smith, Jr., and I am president of Gash-Stull Co., located in Chester, Pa. Our firm is 53 years old and has always been an independent wholesale distributor of agricultural tractors and machinery.

I represent, and my company is a member of, National Equipment Distributors Association with offices at 300 West Main Street, Richmond, Va. NEDA is comprised of 15 independent wholesale distributors who import David Brown tractors from the United Kingdom. We, in turn, have over 700 David Brown retail dealers in the United States, who depend for their livelihood on the sale of David Brown tractors and machinery.

NEDA was formed by 15 former Ford Tractor distributors in March of 1964 for the purpose of importing and merchandising David Brown tractors and machinery in the United States.

Prior to 1964, this distributor group represented Ford Motor Co. for many years—in our particular case 44 years. On December 12, 1963, Ford Motor Co. cancelled all their tractor distributors and proceeded from that time on to sell direct through their own branches in the United States for all intents and purposes, we were forced out of business and suffered a severe hardship because of the sudden cancellation. Since that time and up until now, we have made a modest comeback and once again we are attempting to compete as independent whole distributors in the U.S. market.

On behalf of the NEDA organization, I am appearing today to present some facts relative to the investment tax credit which is part of the Revenue Act of 1971—H.R. 10497, as passed by the House, in relation to imported agricultural tractors and machinery. We are not opposed to the 7-percent investment tax credit for what it is intended to accomplish, but we believe that the bill is unfair and discriminates against our industry for the following reasons:

First. Agricultural tractors and machinery have traditionally been permitted duty-free entry into the United States. There has never been a duty on this equipment. The administration recognized this fact when it applied the 10-percent surcharge on imports, as no surcharge was applied to agricultural tractors and machinery.

Second. The tax credit provisions of the bill discriminate against our group because we import completely assembled tractors, which are competitive with companies that import tractor components—50 percent or less—and then assemble the components in the United States. The tractors sold by these companies, mainly Ford, International Harvester, Massey Ferguson and John Deere, will qualify for the 7-percent tax credit under the House-passed bill as the companies can, and will, adjust the percentage of imported parts used to qualify the assembled tractors as 50 percent or more American made.

To illustrate the seriousness of this imported component competition, the U.S. Department of Commerce, Bureau of Domestic Commerce published statistics for the first 6 months of 1971 which show that there were only $17,176,000 of imported, complete tractors in this country by the aforementioned companies mostly, the total value of imports in the same period was $46,313,000 of which $13,460,000 came from the United Kingdom and $8,244,000 came from Canada. We feel the House-passed bill provisions are really unfair to us as a great deal larger share of total tractor imports come in as components than as complete tractors, yet complete tractors purchased by American farmers from importers will not qualify for the 7 percent tax credit, under the pending bill.

Third. Under the House-passed bill, the purchase of imported used equipment, up to a maximum of $65,000, would qualify for the investment tax credit, regardless of age. We are not against this, but fail to see how this would help domestic industry as no current domestic labor is involved to any greater extent than in new, complete tractors.

The U.S. agricultural tractor and machinery business is approximately 80 percent controlled by four manufacturers, all of whom import components to varying degrees. There certainly is a tendency toward monopoly, in this industry, and we feel if our importing group is eliminated or seriously damaged by the denial of the tax credit on our sales to farmers, it will tend to lead to further monopolization in the agricultural tractor and machinery industry, eventually resulting in inevitably higher prices to the farmer who, we feel, is already failing to share in the Nation's prosperity.

The tractors that our group import (and we are the largest importers of tractors and components except for the Big Four) amount to only 2½ percent of the total tractor sales in the United States, thus having very minute effect on our trade balance problems.

It seems to us that President Nixon's overall program is inconsistent. Imported automobiles bear an import duty which has been increased to 10 percent by the surcharge. If the 7 percent excise tax on all automobiles is repealed, as he suggests, it would appear to us that it would come off imported cars as well as domestically produced cars. It is hard for us to understand the consistency of such action and at the same time refusing to allow American farmers to use the 7 percent tax credit on purchases of imported tractors and equipment.

The devaluation of the dollar abroad—or revaluation of foreign currencies, if you prefer—has already raised our costs, and thus selling prices by between 4 percent and 10 percent. When this is coupled with a loss of the 7 percent investment tax credit to our former customers, we are no longer competitive.

We are as concerned as others about the balance-of-payments situation. However, agricultural tractors and equipment come mainly from the United Kingdom with minor imports from Canada, Germany and Japan. Our balance of trade with the United Kingdom is and has been favorable for a long time.

I have submitted a chart for the record.

The importing of tractors by NEDA members benefits many American manufacturers of farm machinery. We have contracted with a number of American manufacturers to build equipment to attach to our imported tractors.

Another list is submitted for the record.

This is a sizable volume and increasing rapidly each year. If imported tractors are phased out through a combination of no investment tax credit and monetary revaluation, these American manufacturers will suffer as a result.

We understand that the main purpose of the investment tax credit provision of the bill is to increase employment and production in our country; however, in our particular case, this would do just the opposite and would have an adverse effect on us. By not permitting imported agricultural tractors and machinery to qualify for the 7-percent investment tax credit the result will be a 7-percent increase in net cost to the farmers of all imported agricultural tractors and machinery. In the majority of the cases this will result in a decrease in competition and our David Brown tractor dealers as well as we—NEDA distributors—will virtually be out of business. It will be impossible to compete and once this network of quality farm tractor dealers and distributors are removed from competition, the farmers will be at the mercy of U.S. manufacturers as none of us could afford to return to business when the 10-percent surcharge is repealed and the 7-percent credit would be available to our customers in David Brown tractors.

We respectfully request, Mr. Chairman, in the interest of fairness and equity to ourselves and our farmer customers, that the House bill be amended to provide that imported agricultural tractor and machinery purchases be eligible for the 7-percent tax credit during the period of application of the special 10-percent surcharge. We do not believe we can continue to compete with the "big four" if their sales are eligible for the credit and ours are not. We very firmly believe that this will inure to the detriment of American farmers in the long run.

We thank you for this opportunity to appear before you.

Senator CURTIS. Will you name some of the lines of farm machinery that are imported to this country?

Mr. SMITH. David Brown, Doitz from Germany, Leland from England, and Fiat from Italy. That is just a few; plus there are several large combines.

Senator CURTIS. Massey Ferguson——

Mr. SMITH. Massey Ferguson.

Senator CURTIS. Are manufactured in?

Mr. SMITH. England. And also in Canada and the United States.

Senator CURTIS. Aren't most of them manufactured in Canada?

Mr. SMITH. Their combines are manufactured in Canada, Mr. Curtis.

Senator CURTIS. I wasn't directing my qustion to tractors alone.

Mr. SMITH. Farm machinery——

Senator CURTIS. Farm machinery of all kinds.

Mr. SMITH. They have large plant facilities in Canada as well as in England and the United States. They import.

Senator CURTIS. Are you familiar with the provisions of the House bill in regard to discretionary authority of the President?

Mr. SMITH. Yes, sir; I am.

Senator CURTIS. What is your opinion on that?

Mr. SMITH. I think it is a very good move because not only in our particular case but I am sure in some others where there is a hardship, I think it is well that the President has the executive authority to take exception.

Senator CURTIS. Are you satisfied with that or are you asking for some change?

Mr. SMITH. I can't be assured here today or even later that he or any of his people would take exception. I am here today appealing to the Senate Finance Committee to hopefully put a change in this bill in order to help us because we need help.

Senator CURTIS. That is all, Mr. Chairman.

The CHAIRMAN. Could I ask you one thing about your chart that you attached to your statement here? This is a Xerox copy and I am trying to see where it says example under this first item on the food and beverages and tobacco. Is that an "F.M." on top and, if so, what does that mean, "F.M." period?

Mr. SMITH. That is million pounds sterling, Senator Long.

The CHAIRMAN. Is that sterling?

Mr. SMITH. Yes, sir, sterling. So in dollars you might multiply $2.40.

The CHAIRMAN. $2.40. Then all of these figures are in sterling?

Mr. SMITH. Yes, sir.

The CHAIRMAN. You multiply them all by $2.40 to convert to dollars?

Mr. SMITH. Yes.

(Mr. Smith's prepared statement and chart follow:)

PREPARED STATEMENT OF W. SCOTT SMITH, JR., ON BEHALF OF NATIONAL EQUIPMENT DISTRIBUTORS ASSOCIATION

My name is W. Scott Smith, Jr., and I am president of Gash-Stull Company, located in Chester, Pennsylvania. Our firm is 53 years old and has always been an independent wholesale distributor of agricultural tractors and machinery.

I represent, and my company is a member of, National Equipment Distributors Association with offices at 300 West Main Street, Richmond, Virginia. NEDA is comprised of 15 independent wholesale distributors who import David Brown tractors from the United Kingdom. We, in turn, have over 700 David Brown retail dealers in the United States, who depend for their livelihood on the sale of David Brown tractors and machinery.

NEDA was formed by 15 former Ford Tractor Distributors in March of 1964 for the purpose of importing and merchandising David Brown tractors and machinery in the United States.

Prior to 1964, this distributor group represented Ford Motor Company for many years—in our particular case 44 years. On December 12, 1963, Ford Motor Company cancelled all their tractor distributors and proceeded from that time on to *sell direct* through their own branches in the U.S.A. For all intents and purposes, we were forced out of business and suffered a severe hardship because of the sudden cancellation. Since that time and up until now, we have made a modest comeback and once again we are attempting to compete as independent wholesale distributors in the U.S. Market.

On behalf of the NEDA organization, I am appearing today to present some facts relative to the investment tax credit which is part of the Revenue Act of 1971—H.R. 10497, as passed by the House, in relation to imported agricultural tractors and machinery. We are not opposed to the 7% investment tax credit for what it is intended to accomplish, but we believe that the bill is unfair and discriminates against our industry for the following reasons:

(1) Agricultural tractors and machinery have traditionally been permitted duty-free entry into the U.S. There has never been a duty on this equipment. The

Administration recognized this fact when it applied the 10% surcharge on imports, as no surcharge was applied to agricultural tractors and machinery.

(2) The tax credit provisions of the bill discriminate against one group because we import completely assembled tractors, which are competitive with companies that import tractor components (50% or less) and then assemble the components in the U.S.A. The tractors sold by these companies, mainly Ford, International Harvester, Massey Ferguson and John Deere, will qualify for the 7% tax credit under the House-passed bill as the companies can, and will, adjust the percentage of imported parts used to qualify the assembled tractors as 50% or more American made.

To illustrate the seriousness of this imported component competition, the U.S. Department of Commerce, Bureau of Domestic Commerce published statistics for the first six months of 1971 which show that there were only $17,176,000 of imported, complete tractors: $9,845,000 of this came from the U.K. and $3,653,000 from Canada. In the case of tractor components, which are assembled into complete tractors in this country by the aforementioned companies mostly, the total value of imports in the same period was $46,313,000 of which $13,460,000 came from the U.K. and $8,244,000 from Canada. We feel the House-passed bill provisions are really unfair to us as a great deal larger share of total tractor imports come in as components than as complete tractors, yet complete tractors purchased by American farmers from importers will not qualify for the 7% tax credit, under the pending bill.

(3) Under the House-passed bill, the purchase of imported used equipment, up to a maximum of $65,000, would qualify for the investment tax credit, regardless of age. We are not against this, but fail to see how this would help domestic industry as no current domestic labor is involved to any greater extent than in new, complete tractors.

The U.S. agricultural tractor and machinery business is approximately 80% controlled by four manufacturers, all of whom import components to varying degrees. There certainly is a tendency toward monopoly, in this industry, and we feel if our importing group is eliminated or seriously damaged by the denial of the tax credit on our sales to farmers, it will lead to further monopolization in the agricultural tractor and machinery industry, eventually resulting in inevitably higher prices to the farmer who, we feel, is already failing to share in the Nation's prosperity.

The tractors that our group import (and we are the largest importers of tractors and components except for the Big Four) amount to only 2½% of the total tractor sales in the U.S., thus having minute effect on our trade balance problems.

It seems to us that President Nixon's overall program is inconsistent. Imported automobiles bear an import duty which has been increased to 10% by the surcharge. If the 7% excise tax on all automobiles is repealed, as he suggests, it would appear to us that it would come off imported cars as well as domestically produced cars. It is hard for us to understand the consistency of such action and at the same time refusing to allow American farmers to use the 7% tax credit on purchases of imported tractors and equipment.

The devaluation of the dollar abroad (or revaluation of foreign currencies, if you prefer) has already raised our costs, and thus selling prices by between 4% and 10%. When this is coupled with a loss of the 7% investment tax credit by our customers, we are no longer competitive.

We are as concerned as others about the balance of payments situation. However, agricultural tractors and equipment come mainly from the U.K. with minor imports from Canada, Germany and Japan. Our balance of trade with the U.K. is and has been favorable for a long time. (See Chart attached.)

The importing of tractors by NEDA members benefits many American manufacturers of farm machinery. We have contracted with a number of American manufacturers to build equipment to attach to our imported tractors such as:

(*a*) Plows, disc harrows, and cultivating machinery (Pittsburgh Forging Company, Coraopolis, Pa.).

(*b*) Bumpers and accessories (H & H Manufacturing Co., Wooster, Ohio).

(*c*) Plow bottom and plow shares (Star Manufacturing Co., Carpentersville, Ill.).

(*d*) Hydraulic hose accessories (Anchor Coupling, Inc., Libertyville, Ill.).

(*e*) Loaders (Johnson Hydraulic Equipment Co., Minneapolis, Minn.). (Freeman Industries, Peru, Indiana).

(*f*) Backhoes (Wain-Roy Co., Inc., Hubbardston, Mass.).
(*g*) Rotary Mowers, Corn planters (Covington Planter Co., Inc., Dothan, Ala.).
(*h*) Post hole diggers (Corsicana Grader & Machine Co., Corsicana, Tex.).
(*i*) Mowers and blades (McClenny Machine Co., Inc., Suffolk, Va.).
(*j*) Blades (Arps Corp., New Holstein, Wis.).

This is a sizeable volume and increasing rapidly each year. If imported tractors are phased out through a combination of no investment tax credit and monetary revaluation, these American manufacturers will suffer as a result.

We understand that the main purpose of the investment tax credit provision of the bill is to increase employment and production in our country; however, in our particular case, this would do just the opposite and would have an adverse effect on us. By not permitting imported agricultural tractors and machinery to qualify for the 7% investment tax credit the result will be a 7% increase in net cost to the farmers of all imported agricultural tractors and machinery. In the majority of the cases this will result in a decrease in competition and our David Brown tractor dealers as well as we NEDA distributors will virtually be out of business. It will be impossible to compete and once this network of quality farm tractor dealers and distributors are removed from competition, the farmers will be at the mercy of U.S. manufacturers as none of us could afford to return to business when the 10% surcharge is repealed and the 7% credit would be available to our customers in David Brown tractors.

We respectfully request, Mr. Chairman, in the interest of fairness and equity to ourselves and our farmer customers, that the House bill be amended to provide that imported agricultural tractor and machinery purchases be eligible for the 7% tax credit during the period of application of the special 10% surcharge. We do not believe we can continue to compete with the Big Four if their sales are eligible for the credit and ours are not. We very firmly believe that this will inure to the detriment of American farmers in the long run.

We thank you for this opportunity to appear before you.

Britain's trade with the U.S.

United Kingdom Exports (1970)	£m.	United Kingdom Imports (1970)	£m.
1—Food, beverages, tobacco	131	1—Food, beverages, tobacco	179
Whisky and other spirits	104	Cereals	69
		Fruit and vegetables	19
		Tobacco	57
2—Materials and fuels	21	2—Materials and fuels	102
		Pulp	24
		Ores	20
		Oil seeds	11
		Oil	9
3—Manufactured goods	743	3—Manufactured goods	806
Chemicals	44	Chemicals	110
Diamonds	71	Iron and steel	51
Iron and steel	50	Nonferrous metals	36
Nonferrous metals	31	Paper	24
Textile yarns & fabrics	29	Textile yarns & fabrics	19
Machinery	174	Machinery	372
Cars and vehicle parts	83	Vehicles	11
Aircraft and engines	40	Aircraft and engines	36
Motorcycles and cycles	17	Instruments	46
Instruments	23		
Clothing	16		
4—Other	32	4—Other	23
Total exports	932	Total imports	1,170

The CHAIRMAN. Thank you very much.

The next witness will be David J. Humphreys, Washington counsel of the Recreational Vehicle Institute, Inc.

STATEMENT OF DAVID J. HUMPHREYS, WASHINGTON COUNSEL, RECREATIONAL VEHICLE INSTITUTE, INC., ACCOMPANIED BY WAYNE F. KORN, VICE PRESIDENT, AND DAVID L, ROLL, OF PRF INDUSTRIES, INC.

Mr. HUMPHREYS. Mr. Chairman and members of the committee, I am David J. Humphreys, Washington counsel for the Recreational Vehicle Institute, and I have with me this morning Mr. Ed Burnett on my right who is an attorney in our law firm and assists me in representing the Recreational Vehicle Institute, and Mr. Wayne Korn, vice president of PRF Industries, one of our member companies, and his attorney, Mr. David Roll.

We would like to use our 10 minutes as efficiently as possible. Mr. Korn and I will each make a brief statement and we will be very happy to answer any questions that are generated by our comments.

The Recreational Vehicle Institute is the national trade organization of the recreational vehicle industry. Its members manufacture motor homes, travel trailers, camping trailers, truck or slide-in campers, and recreational vehicle covers (camper caps); and parts, accessories, and services for those vehicles. Its total membership is about 450. The entire recreational vehicle industry encompasses several hundred manufacturers, mostly small businesses and dispersed in many areas.

The 1970 retail sales of the industry exceeded $1 billion. As an inseparable part of the total recreation industry, it is sensitive to economic conditions and the recreation dollar is not likely to be spent when the economy is restrictive. In terms of total value of retail sales, the industry held its own in 1970 but production dropped about 8.2 percent over 1969 reflecting the tight economic conditions. The excise tax provisions of H.R. 10947 would undoubtedly be extremely beneficial to the recreational vehicle industry and to the consumer—user—as well. RVI strongly urges the enactment of the excise tax provisions of the Revenue Act of 1971.

The recreational vehicle industry is highly competitive both within itself and with the automobile industry. There is a great variety of vehicles with many producers and the consumer—user—is provided a wide spectrum of choice of vehicle and price. Unless the tax laws operate uniformly on the various vehicles, some manufacturers receive an advantage, while others, of course, are discriminated against. RVI has stressed evenhanded tax treatment for all recreational vehicles and recommends that the Congress support that viewpoint.

The industry also competes with the automobile. Increased opportunity for recreation and leisure time, and technical improvement in recreational vehicles, has made such vehicles commonplace. Sometimes they serve as a second car and often as the only family vehicle and serving a dual purpose for transportation and recreation. RVI recommends evenhanded and nondiscriminatory treatment as between recreational vehicles and the automobile.

Travel trailers and camping trailers are exempt from the manufacturer's excise tax under section 4061(a)(3) of the Internal Revenue Code. Truck campers (also know as slide-in campers) are living quarters temporarily mounted on pickup trucks. They are exempted from the excise tax under section 4063(a)(1) of the code, the camper coach exemption added by the Excise Tax Reduction Act of 1965. Recreational vehicle covers—camper caps—which are living quarters mounted over the body of a pickup truck, are now specifically exempted from the excise tax under the camper coach exemption as amended by the Excise Tax, Estate and Gift Tax Adjustment Act of 1970. Truck campers and camper caps are particularly popular with the lower income consumer—user—who often combines these recreational vehicle units with the pickup truck he uses for personal or family business or transportation. The truck carries a 10-percent truck tax. RVI firmly believes the exclusion of the 10-percent excise tax on light-duty trucks provided by section 401 of H.R. 10947 would stimulate the use of trucks by the low-income consumer—user—for recreational purposes.

Motor homes have had a rapid growth rate indicative of their popularity as vehicles which provide for many families, including many retired persons, a second or vacation home or a means of travel, vacation, or weekend recreation, which is far less expensive than other modes. The bodies for motor homes are exempt from excise taxation as "bodies for self-propelled mobile homes" under the camper coach exemption cited earlier. The largest proportion of motor homes are constructed by mounting a motor home body on a truck chassis which is taxed as an automobile chassis at the 7 percent rate (Revenue Ruling 69-205, C.B. 1969-1, 277).* Other versions are constructed either by modifying a panel type light-duty truck, taxed at the 10-percent truck tax rate on the entire vehicle, or by removing the van behind the driving compartment and mounting a motor home body in its place; or by modifying an automobile wagon type of light-duty truck, taxed at the 7-percent automobile tax rate on the entire vehicle.

The repeal of the 7-percent automobile excise tax and the exclusion of the 10-percent excise tax on light-duty trucks undoubtedly would be a substantial stimulus to the recreational vehicle industry. Enactment of the excise tax provisions of H.R. 10947 would remove the varied tax treatment of recreational vehicles and would implement the expressed determination of the Congress to terminate this form of taxation many times characterized as undesirable and regressive. RVI strongly recommends enactment of the excise tax provisions of H.R. 10947.

Mr. KORN. Mr. Chairman, members of the committee, I am grateful for the opportunity of appearing before this committee to supplement testimony of the Recreational Vehicle Institute.

My name is Wayne F. Korn and I am vice president—product planning of PRF Industries, Inc., of Mount Clemens, Mich. PRF Industries owns four companies which manufacture recreational vehicles known as motor homes. The PRF companies rank second in sales of motor homes and they are major users of light-duty trucks for manufacturing motor homes known as conversions, cut-aways and chopped vans.

I would like to take a minute or two of the committee's time to briefly summarize some reasons why we support repeal of the 7-percent

*This ruling is reproduced in this volume following Mr. Humphrey's prepared statement.

excise tax on automobiles and the 10-percent excise tax on light-duty trucks as provided by H.R. 10947. I have submitted a complete statement to the committee which I request be placed in the record.

First, H.R. 10947 will eliminate the discriminatory and illogical problems caused by present law. As you know, under present law passenger automobile chassis are taxed at 7 percent, while truck chassis are taxed at 10 percent. In the motor homes business, traditional motor homes are constructed on raw motor vehicle chassis and these chassis are treated as passenger automobiles and thus taxed at 7 percent. However, a growing and significant segment of the motor home business, which PRF and many smaller companies are engaged in, uses van-type light-duty truck chassis to produce motor homes known as conversions and cut-aways and these chassis are for the most part taxed at 10 percent. Thus, even though all types of motor homes are designed and used for the same purpose, there is an artificial tax advantage to traditional motor homes over conversions and cut-aways which is reflected in consumer prices. H.R. 10947 will eliminate this discriminatory and artificial advantage.

Second, H.R. 10947 should result in price reductions on all motor homes and thereby provide more people than ever before with an opportunity to own one.

Third, PRF strongly supports the exclusion in H.R. 10947 for light-duty trucks. PRF is a major user of light-duty trucks for producing conversions, chopped vans and cutaways and there is no question that these trucks would fall within the proposed exclusion since we believe they will all have gross vehicle weights of less than 10,000 lbs. Any amendment to H.R. 10947 which would retain the 10-percent tax on all truck chassis and bodies while at the same time repealing the 7-percent tax on passenger automobiles would be a serious discrimination against PRF and countless other companies similarly situated which manufacture conversions and cutaways and would result in an unwarranted competitive windfall to those companies which rely almost solely upon manufacture of traditional motor homes. In addition, PRF would strongly oppose any such amendment because it would erect serious barriers to entry into the recreational vehicle industry.

Mr. Chairman, members of the committee, I greatly appreciate this opportunity to present the views of PRF with regard to H.R. 10947.

I shall be pleased to answer any questions that the committee has.

The CHAIRMAN. Thank you very much.

(Mr. Korn and Mr. Humphrey's prepared statements and Rev. Rul. 69-205, follow. Hearing continues on p. 709.)

PREPARED STATEMENT OF WAYNE F. KORN, VICE PRESIDENT—PRODUCT PLANNING, PRF INDUSTRIES, INC.

INTRODUCTION

My name is Wayne F. Korn and I am vice president—Product Planning of PRF Industries, Inc. ("PRF") of Mount Clemens, Michigan. PRF owns or controls the stock of four companies which are engaged in the manufacture of recreational vehicles. PRF joins with Recreational Vehicle Institute in firmly supporting the excise tax provisions of the proposed Revenue Act of 1971 and believes that they will be of positive and substantial economic benefit not only to PRF but also to hundreds of other companies in the recreational vehicle industry and to consumers of recreational vehicles.

PRF AND ITS PRODUCTS

The companies in the recreational vehicle industry which PRF owns or controls are Travco Corporation of Brown City and Warren, Michigan, Compact Equipment Company of Irwindale, California, Motor Homes, Inc. of Lorain, Ohio and Irwindale, California, and Sightseer Corporation of Newark, Ohio. The predecessor in name of Travco Corporation was formed in 1960 and we believe it was the first company in this country to produce and market self-propelled motor homes. Our other three companies, like most companies in the recreational vehicle industry, are of relatively recent origin, all of them having been formed since 1965.

Essentially, all of the PRF companies are engaged in the business of manufacturing motor homes of different types and upon varying kinds of chassis. For purposes of this statement, a motor home can be defined as a vehicular unit built on a motor vehicle chassis and primarily designed to provide living quarters for camping or travel use.

Overall, the PRF companies rank second in total sales of all types of motor homes and we estimate that for 1971 we will account for 8 to 9% of all such sales in this country.

None of the PRF companies manufacture motor vehicle chassis. In most instances, the motor vehicle chassis used by PRF to produce motor homes are purchased by dealers direct from the three major automobile companies and are consigned to the PRF companies while being made into finished motor homes.

Simply put, there are four types of motor homes manufactured by the PRF companies which can be described briefly as follows:

(1) "Complete motor homes"—the entire motor home body and driver's compartment are constructed by PRF on a raw motor vehicle chassis consigned to PRF by an auto manufacturer.

(2) "Conversions"—a van-type light-duty truck or automotive wagon manufactured by an auto company is consigned to PRF and PRF modifies or converts the body of such vehicle into a motor home configuration by cutting out the roof and installing a fiber glass top and by installing flooring, carpeting, beds, eating facilities and various utilities. Conversions are priced to sell slightly under low price motor homes.

(3) "Cut-aways"—a van-type light-duty truck or automotive wagon manufactured by an auto company is consigned to PRF and PRF cuts off the body behind the driver's compartment and in place of the body installs a motor home body completely equipped for living purposes usually with an over-the-cab area for sleeping accommodations. Cut-aways are priced to sell in competition with low price motor homes and slightly above conversions.

(4) "Chopped vans"—a van-type light-duty truck or wagon chassis consisting only of a chassis and a covered van-type driver's compartment (the body appears to have been chopped off just behind the driver's compartment) is consigned by an auto company to PRF and PRF installs a completely equipped motor home body behind the driver's compartment without, as in the case of cut-aways, having to cut off the body behind the driver's compartment. Chopped vans are priced by PRF to sell in competition with low price motor homes and slightly above conversions.

IMPACT OF PRESENT EXCISE TAX LAW

For the Committee to fully understand and appreciate our position in support of H.R. 10947, it is necessary to briefly set forth the manner in which the types of motor homes produced by PRF and the various types of chassis used in connection with these motor homes are affected by present excise tax law.

Under Section 4063(a)(1) of the Internal Revenue Code of 1954, the so-called "camper coach exemption" enacted as part of the Excise Tax Reduction Act of 1965 and amended by the Excise, Estate and Gift Tax Adjustment Act of 1970, bodies for complete motor homes, cut-aways and chopped vans are exempt from excise taxation. Furthermore, the Internal Revenue Service has specifically ruled that PRF is not subject to excise tax in connection with the articles used by it to produce conversions.

However, all of the various types of chassis used for the production of motor homes by PRF are subject to the manufacturers' excise tax under Section 4061 of the Code. This excise tax is paid by the auto manufacturer but is passed on to the dealer who sells the motor home.

Although all of the above described types of motor homes are produced by PRF for the same purpose—for use as recreational vehicles and for living or camping purposes—the excise tax paid by the auto manufacturers and reflected in an increased price to the dealer and the consumer is sometimes 7% and sometimes 10%, depending upon the chassis used. For PRF motor homes, the rates vary as follows:

(1) Chassis used by PRF to manufacture complete motor homes are treated by the Internal Revenue Service as automobile chassis and thus taxable at the 7% rate provided by Section 4061(a)(2) (A) and (B) of the Code.

(2) If a van-type "light-duty truck" containing a driver's seat only and without standard windows (and containing certain other minor truck-type features) is used by PRF for their conversions, the unit before conversion is treated by the Internal Revenue Service as being subject to the 10% truck tax under Section 4061(a)(1) of the Code. If a van-type "wagon" with standard windows and containing a passenger's seat as well as a driver's seat (and containing certain other minor automotive features) is used by PRF for their conversions, the Internal Revenue Service will treat this unit prior to conversion as being subject to the 7% passenger automobile tax. The distinction between the two vans from an engineering and appearance point of view is very slight but from a tax standpoint these distinctions result in a significant 3% differential. At present, 80% to 90% of the vans used by PRF for production of conversions are taxed to the auto companies at the 10% truck rate.

(3) The van-type "light-duty truck" used by PRF to produce cut-aways, unless it has standard windows, a passenger's seat as well as a driver's seat and other minor automotive features, is treated by the Internal Revenue Service as being subject to the 10% truck tax. At present, 80% to 90% of the vans used by PRF for production of cut-aways are taxed to the auto companies at the 10% truck rate.

(4) One of the three major auto companies now markets a chopped van chassis which is treated by this company as being subject to the 7% tax. This treatment is undoubtedly justified on the ground that certain features and design characteristics make it likely that this type of chasis will be predominately used by motor home manufacturers. We also understand that a second major auto company will be marketing a chopped van chassis after the beginning of the year but we have not yet learned whether this company will treat this chassis as a 7% or as a 10% item. The third major auto company has not yet introduced a chopped van chassis. We are not aware of any published Revenue Ruling with regard to which of the two rates applies to such chopped van chassis although Rev. Rul. 69–205, CB 1969–17, 13 certainly provides precedent for treatment as a 7% item.

We submit that the above variations of excise tax rates under present law with respect to chassis used for manufacture of motor homes, all of which are used for essentially the same purposes, are illogical (or at least not easily explainable) and obviously difficult and burdensome for the auto companies to administer. In addition, variations in excise tax rates on these chassis creates an artificial distortion in ultimate prices to dealers and consumers.

IMPACT OF THE PROPOSED REVENUE ACT OF 1971

We wholeheartedly support the excise tax provisions of H.R. 10947, the proposed Revenue Act of 1971. We firmly believe that these provisions will not only be of positive economic benefit to PRF but that they will also provide substantial benefits to the entire recreational industry and to consumers of recreational vehicles. Moreover, the provisions will eliminate illogical and artificial distortions created by existing law.

As we understand it, H.R. 10947 will not change the so-called "camper coach" exemption afforded by Section 4063(a)(1) of the Code and therefore the motor home bodies manufactured by PRF will continue to be exempt from excise tax as they are under present law. Our comments are therefore directed to support of the provisions of H.R. 10947 by which the 7% excise tax on passenger automobile chassis and the 10% excise tax on light-duty truck chassis (up to 10,000 lbs. gross vehicle weight) are to be repealed. We submit the following reasons in support of H.R. 10947:

(1) Enactment will result in lower sale prices on all motor homes manufactured by PRF as well as companies similarly situated, and should cause corre-

sponding increases in total sales volume, thereby stimulating the growth of PRF and other companies in the recreational vehicle industry.

(2) Enactment will eliminate the confusing and illogical problems now faced by the auto companies as a result of having to classify chassis used for motor homes as being subject to either the 7% passenger automobile excise tax or the 10% truck tax, depending upon rather finely drawn distinctions.

(3) Enactment will eliminate interference with free consumer choice which is inherent under existing law because of the artificial 3% differential in excise tax rates between types of chassis utilized for motor home manufacture.

(4) The bill will provide a significant stimulus to PRF and countless other companies similarly situated which manufacture conversions and cut-aways (and also chopped vans if their chassis have been or are determined to be 10% items) because an elimination of the 3% excise tax differential will mean that conversions and cut-aways (and chopped vans) will be able to compete more effectively with low priced complete motor homes. At present, there are in the market a number of complete motor homes, many of which are made by larger recreational vehicle manufacturers, which are priced at or very near price levels of cut-aways and chopped vans and not much higher than conversions, and this is due in part to the fact that such complete motor homes have a 3% advantage because of present excise tax law.

(5) Enactment should result in price reductions on all motor homes produced by PRF as well as other companies similarly situated, and thereby provide more families and retired people than ever before with an opportunity to own a recreational vehicle for use as a vacation home or a means of travel, vacation or weekend recreation.

EXCLUSION FOR LIGHT-DUTY TRUCKS

Because the most rapidly growing segment of the recreational vehicle industry and the fastest growing part of PRF's business is in the area of conversions, chopped vans and cut-aways, the chassis for which are for the most part subject to the 10% truck rate (except for chopped vans where the classification is not yet entirely certain), PRF strongly supports the exclusion in H.R. 10947 for light-duty trucks of up to 10,000 lbs. gross vehicle weight. To the extent that any chassis and vans used by PRF are not treated for excise tax purposes as automobile chassis, PRF believes that there is no question but that such chassis and vans will fall within the proposed exclusion for light-duty trucks contained in the revision of Section 4061(a)(2) of the Code provided by H.R. 10947. We believe that all chassis and vans used by PRF for conversions, chopped vans and cut-aways have gross vehicle weights of less than 10,000 lbs.

This exclusion, together with the repeal of the 7% automobile excise tax, would result in equivalent treatment of complete motor homes, conversions, chopped vans and cut-aways and eliminate the artificially created discrimination against conversions and cut-a-ways (and perhaps chopped vans) which exists under present law.

We emphatically contend that any amendment to this bill which would retain the 10% tax on all truck chassis and bodies while at the same time repealing the 7% tax on passenger automobile chassis would be a serious discrimination against PRF and the countless other companies similarly situated which manufacture conversions and cut-aways (as well as chopped vans if and to the extent they are determined to be 10% items) and would result in an unwarranted competitive windfall to those companies which rely almost solely upon manufacture of complete motor homes. In addition, such an amendment repealing the 7% automobile excise tax without at the same time repealing the 10% tax for light-duty truck chassis would have the following effect:

(1) Sale prices of conversions, cut-aways and chopped vans which utilize truck chassis taxed at the 10% rate would be at a price disadvantage and would no longer be able to effectively compete price-wise, as they do now, with lower priced complete motor homes. Sales of such conversions, cut-aways and chopped vans would probably decline sharply.

(2) There are a number of companies, most of them small, which, unlike the PRF companies, rely almost totally upon sales of conversions, cut-aways and/or chopped vans. These companies would be very seriously hurt by such an amendment and the result would be that they would either have to cut their production and lay off workers or raise the additional capital investment necessary to enter into the complete motor home business.

(3) Such an amendment would erect serious and perhaps insurmountable barriers to entry into the recreational vehicle industry. At present, a much smaller capital investment is required to enter into the recreational vehicle industry by manufacture of cut-aways, chopped vans or conversions, than is required for the manufacture of complete motor homes because the manufacturer of conversions, chopped vans or cut-aways does not require the personnel and facilities needed by a complete motor home manufacturer to build a raw chassis into a complete motor home, nor is it necessary that such a manufacturer concern himself with many of the safety standards because these standards will have already been complied with by the auto manufacturer by the time the van, wagon or chassis reaches him. In addition, manufacturers of conversions, cut-a-ways and chopped vans have a ready-made marketing organization, the automobile dealerships, which a complete motor home manufacturer in most instances does not have.

(4) Finally, such an amendment would compound the impediment to freedom of consumer choice which exists under present law as previously noted.

CONCLUSION

Based on the reasons set forth above, PRF strongly urges that the Committee approve in full the excise tax provisions of H.R. 10947.

PRF is aware of the expressed intent of the House Ways and Means Committee that the full amount of excise tax repealed by H.R. 10947 be passed on to consumers. As pointed out above, chassis or vehicles used by PRF to manufacture motor homes are for the most part sold directly to dealers for resale to consumers and are not ordinarily sold to the PRF companies. Therefore, in these cases PRF is not in a position to represent to this Committee that it will pass on the full amount of the excise taxes repealed. However, we will pledge to this Committee that if H.R. 10947 is enacted as presently written, we will inform all of our dealers of the intent expressed by the House Ways and Means Committee. In addition, to the extent that any of the PRF companies do purchase chassis or motor vehicles for motor home manufacture, we intend to see that the repealed excise taxes are passed on to consumers if H.R. 10947 is enacted as presently written.

Prepared Statement of David J. Humphreys, Washington Counsel, Representing the Recreational Vehicle Institute

Mr. Chairman, members of the committee. My name is David J. Humphreys. I am the Washington Counsel for the Recreational Vehicle Institute, known as RVI, the national trade organization representing manufacturers of recreational vehicles and suppliers to those manufacturers as well as a number of firms and organizations interested in recreational activities. The national office of RVI is in Chicago, Illinois. RVI also has an office here in Washington and one in the Los Angeles, California area. The present membership of RVI includes about 175 manufacturers of recreational vehicles, 250 firms which supply parts, accessories, and services for recreational vehicles, and a number of associate members. A list of the membership is attached for the use of the Committee as well as an RVI publication, Facts and Trends, which provides more detail about the industry.[1]

With me, and prepared to testify either separately or in supplementation of the RVI testimony, as the Committee may desire, is Mr. Wayne F. Korn, Vice President, Product Planning, PRF Industries, Inc. accompanied by Mr. David L. Roll of the firm of Hill, Lewis, Adams and Goodrich, Detroit, Michigan, General Corporate Counsel to PRF Industries. PRF Industries, Inc. of Mount Clemens, Michigan, is a major manufacturer of recreational vehicles and one of the largest users of light-duty trucks for this purpose.

We appreciate very much the opportunity to appear before the Committee on Finance and testify in support of H.R. 10947, the proposed Revenue Act of 1971. RVI firmly believes that the excise tax provisions of the proposed Revenue Act of 1971 will be of positive and substantial economic benefit to that segment of the economy represented by the recreational vehicle industry *and* to the consumer (user) of recreational vehicles.

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[1] The membership directory was made a part of the official files of the committee.

I should explain that by recreational vehicles we mean motor homes, travel trailers, camping trailers, truck or slide-in-campers, and recreational vehicle covers (sometimes referred to as camper caps; or pickup truck covers, caps, or canopies). Also, it might be well to point out that there are several hundred manufacturers of recreational vehicles who are not members of RVI, the national organization. By and large, recreational vehicle manufacturers are small-business concerns dispersed in many areas of the country. In many instances, their scale of operation is so small that, for varying reasons, they do not feel they can afford membership in the national organization or even in regional or local associations. RVI endeavors, however, to express viewpoints representative of the entire industry and of the recreational vehicle consumer (user) as well.

Two facets of the recreational vehicle industry are especially pertinent to H.R. 10947:

(1) The recreational vehicle industry is an inseparable part of the burgeoning recreation industry. RVI estimates the total retail sales of the recreational vehicle industry for 1970 at well over a billion dollars. Both industries are closely related and sensitive to economic pressures. Recreation for many is a luxury and, when economic conditions are restricted, the recreation dollar is most likely to be the one not spent. Stimulation of the economy is reflected in recreation spending spread widely.

(2) The recreational vehicle industry is highly competitive in two particular ways:

(*a*) It is competitive within itself with many producers and a variety of vehicles providing the consumer (user) with many choices including some with prices as low as $200.00 and moving upward through a wide spectrum. The recreationist is a careful buyer who spends his money for the best bargain he can find. If the tax laws do not operate uniformly on the various types of vehicles, those taxed less are given an economic advantage and those taxed more are discriminated against. For this reason, RVI has stressed the importance of uniform, even-handed tax treatment for all recreational vehicles. It strongly recommends that the Congress support that viewpoint and treat all recreational vehicles alike in the pending legislation.

(*b*) The recreational vehicle competes strongly with the passenger automobile. Increased time for recreation, the enlargement of recreational facilities, the emphasis placed by both the private and public sectors on recreation, and the technical progress in the recreational vehicle industry itself, have combined to make such vehicles commonplace. Sometimes the recreational vehicle serves as a second car on an attachment to the first. Often it is the only family vehicle and serves a dual purpose. Anyone who travels the highways cannot help but notice their numbers and their variety. For the same reasons that RVI urges even-handed treatment of all recreational vehicles, it urges uniform and non-discriminatory treatment as between such vehicles and passenger cars.

THE SPECIFIC IMPACT OF THE PROPOSED REVENUE ACT OF 1971 ON RECREATIONAL VEHICLE MANUFACTURERS

It may be helpful to the Committee if I explained as briefly as possible the manner in which recreational vehicles are affected by the manufacturer's excise tax on automobiles and trucks as related to the different types of vehicles earlier described.

TRAVEL TRAILERS AND CAMPING TRAILERS

These items are exempt from the manufacturer's excise tax under existing law (Section 4063 (a) (3) of the Internal Revenue Code which exempts "house trailers" from the tax imposed by Section 4061 (a)). *H.R. 10947 would not change this exemption.* These vehicles are towed by either passenger automobiles or trucks and are used extensively for recreational purposes.

TRUCK CAMPERS (SLIDE-IN-CAMPERS)

RVI estimates the 1971 production at about 112,000 (95,900 for 1970). These items are portable or wheeled units normally designed to be temporarily carried on a one-half ton or larger sized pickup truck and used for living quarters. They can be utilized as living quarters either mounted on the truck or detached therefrom. *These living quarters bodies are specifically exempted from the manufac-*

turer's excise tax as "camper coaches" by Section 4063 (a) (1) of the Internal Revenue Code. The truck camper is a very popular recreational vehicle and its popularity undoubtedly was enhanced by the action of the Congress in providing the specific exemption described above. This recreational vehicle is particularly popular with those who use the pickup truck, which carries the camper, for personal transportation, both for the family and for business purposes. It's use with a pickup truck enables the lower income consumer (user), to combine with his pickup truck, as he needs it, an item which provides an opportunity to enjoy more fully recreational and leisure time opportunities and at a more reasonable price.

The Revenue Act of 1971, by exclusion of the 01% manufacturer's excise tax on light-duty trucks, would enhance further the use by the lower income consumer (user) of these campers for travel and recreation. RVI believes that the 10,000 lb. gross weight limit established by Section 401 of H.R. 10947 for the exclusion would encompass most if not all trucks used with such campers.

RECREATIONAL VEHICLE COVERS

These items have been described as a one-piece top (often called a camper cap) which is designed to be mounted on the body of a pickup truck. When the top is installed, it, together with the truck body sides and the truck floor, provides an area used for living quarters. In some cases, various living amenities are added including sides and floors. Recreational vehicle covers are used extensively by the lower income consumer (user) to provide means by which the pickup truck used for personal or family transportation for business or pleasure can be converted to a recreational and travel accommodation. These are the lowest cost recreational vehicle items and covers can be purchased for as little as $200.00. RVI estimates the 1971 production of recreational vehicle covers at about 79,000 (91,700 for 1970).

The Congress enacted, in 1970, an amendment to the 1965 camper coach exemption cited earlier which specifically exempted camper caps designed to be mounted or placed on automobile trucks, automobile truck chassis, or automobile chassis to be used primarily as living quarters or for "camping accommodations". (Public Law 91-614, 91st Congress, Section 303, the Excise, Estate and Gift Tax Adjustment Act of 1970). The problem which necessitated the amendment arose from varying constructions by the Internal Revenue Service, of the camper coach and house trailer exemptions, that certain camper caps were not exempted from the excise tax.

RVI also believes the exclusion of the 10% excise tax on light-duty trucks, provided by H.R. 10947, would stimulate the purchase and use of trucks by the low income consumer (user) for combination with a camper cap for travel and recreation.

MOTOR HOMES

The application of the excise tax to motor homes requires a somewhat more detailed explanation because of the different types and the varying chassis used in the construction of motor homes. We define a motor home as a vehicular unit built on a motor vehicle chassis primarily designed to provide living quarters for camping or travel use. RVI estimates the 1971 production of motor homes at about 51,000 (30,300 for 1970). Motor homes of all types encompasses a wide price spectrum. They naturally are more costly than either the truck camper (slide-in-camper) or recreational vehicle cover (camper cap) discussed earlier. The growth rate in their production is indicative of their popularity as vehicles which can and do provide for many families, including many retired people, a second or vacation home or a means of travel, vacation, or weekend recreation, which is far less expensive than other models.

The specific camper coach exemption enacted as a part of the Excise Tax Reduction Act of 1965, cited earlier, also exempted "bodies for self-propelled mobile homes". The proposed Revenue Act of 1971 would not affect this exemption. Chassis are treated by the Internal Revenue Service as automobile chassis and thus taxable at the 7% rate provided by Section 4061(a) (2) (A) and (B) of the Internal Revenue Code (Revenue Ruling 69-205, C.B. 1969-1,277). Under the cited Revenue Ruling, the tax category is governed by the body mounted on the chassis. If mobile home bodies were not exempted from tax they would be taxed as automobile bodies. The ruling is predicated on Section 4061(a) (2) of the Internal Revenue Code which provides that "a sale of an automobile, or of a trailer or semitrailer suitable for use in connection with a passenger automobile, shall, for the purposes of this paragraph, be considered to be a sale of a chassis and of a body enumerated in this subparagraph".

About 60% of the motor homes produced are in the category which RVI designates for statistical purposes as *Type A*, i.e. the entire motor home body and driver's compartment are constructed by the motor home builder on a raw vehicle chassis obtained either directly from an automobile or truck manufacturer or through a dealer. A second type of motor home, which RVI for its statistical purposes designates as *Type C*, is constructed of a motor home body permanently attached to a van chassis consisting of a chassis and a "chopped" van driver's compartment. These chassis are designed by some chassis manufacturers specifically for motor home use so that the recreational vehicle manufacturer does not have to purchase a complete van and remove the section of the van behind the driver's compartment for installation of a motor home body.

The repeal of the 7% automobile excise tax under the proposed Revenue Act of 1971 would relieve these recreational vehicles of any manufacturer's excise tax retroactive to August 16, 1971. Such action should act as an effective stimulus to a growing industry and constitute a benefit for the customer (user). *RVI urges approval of the repeal of the automobile excise tax.*

One other type of motor home in the general grouping thus far discussed should be described. This type is generally known as a chassis-mount camper. Here, a motor home or camper body is permanently mounted on a truck chassis with regular cab attached. *The camper body would be exempt.* For statistical purposes only, RVI treats these vehicles as truck campers and their production is reflected in the truck camper (slide-in-camper) production statistics cited earlier. Their number is relatively small. However, it is a segment of the recreational vehicle industry which is still active although diminishing in favor of the other types of motor homes produced.

Two other types of motor homes present somewhat different tax situations. Here, the recreational vehicle manufacturer purchases a van-type light-duty truck of either a panel type or an automobile type and either (a) modifies the van body into a motor home configuration by raising the roof, extending the van body, or by other modification or (b) cuts off the van body and in place of the van body installs a motor home body usually with an over-the-cab area for sleeping accommodations. The current tax situation involves the inclusion of the 10% truck tax in the price of panel van-type truck, and 7% automobile tax on a wagon type, to the recreational vehicle manufacturer. There is no additional tax to the manufacturer who modifies the van or to the manufacturer who replaces the van body with a motor home body.

RVI believes that all such van-type trucks converted into motor homes would fall within the exclusion for light-duty trucks proposed by H.R. 10947 since they will not exceed 10,000 lbs. gross weight. *Thus excise taxes on such van-type trucks purchased for conversion into motor homes either would be relieved by repeal of the 7% automobile excise tax or would be excluded from application of the 10% excise tax generally retained on truck chassis and bodies by H.R. 10947.*

RVI, of course, strongly supports the exclusion for light-duty trucks. The Congress has repeatedly indicated its belief that recreational vehicles should be exempted from various aspects of the manufacturer's excise tax as indicated by the exemption actions for "house trailers", for "campers coaches" and "bodies for self-propelled mobile homes", and "camper caps". Such an exclusion, together with the repeal of 7% automobile excise tax, would result in generally equivalent treatment for all types of recreational vehicle manufacturers, some of whom produce the various types and many of whom produce only one or two types. To retain the 10% truck and truck body excise tax on some types of motor homes where other types would be free of any tax on the chassis or body, of course, would be discriminatory as between different producers of similar vehicles engaged in the same competitive market.

General impact of the Revenue Act of 1971 on the recreational vehicle industry and summary:

RVI estimates the total retail sales of the recreational vehicle industry for 1970 as about $1,149,924,000. There was a drop in 1970 production as contrasted to 1969 of about 8.2% but the value of total retail sales increased in 1970. However, this increase was largely attributable to more sales of larger, more deluxe vehicles. Of the vehicles subject to the excise tax, motor homes and truck campers are expected to show production increases in 1971 but truck campers are still well below the 1968 figure of about 125,000. Recreational vehicle covers are expected to fall substantially below 1968–1970 figures. Certainly, the repeal or exclusion of the excise tax applicability to chassis and trucks used for and with recreational vehicles should provide a needed stimulus to the industry—one which would be spread among a large number of manufacturers, mostly small, dispersed in many areas of the country. The recreational vehicle consumer (user) would be similarly benefited through making the vehicles more readily available to them at less cost.

With specific regard to the consumer (user), RVI is aware of the expressed intent of the Ways and Means Committee that the full amount of the excise taxes repealed or excluded be passed on to the consumer. RVI, as a trade organization, of course is not in a position to commit all members of the recreational vehicle industry to this action. However, it does pledge that, if H.R. 10947 is enacted, it will use the facilities of the Institute to be sure that all recreational vehicle manufacturers are informed of this intent.

Mr. Chairman, Members of the Committee, RVI, is deeply appreciative of this opportunity to lay before the Committee on Finance its views on the proposed Revenue Act of 1971. The Congress has indicated that it considers such manufacturer's excise taxes as undesirable and regressive. The repeal and exclusion proposed would implement the expressed determination of the Congress to terminate this form of taxation and would remove the existing varied application of these excise taxes to recreational vehicles. *RVI urges the approval by the Committee on Finance of the excise tax provisions of H.R. 10947.*

We shall be glad to endeavor to respond to any questions the Committee may have.

26 CFR 48.4061(a)–1: IMPOSITION OF TAX

A chassis produced from truck-type components by a manufacturer of nontaxable mobile homes is subjected to tax under section 4061(a)(2) of the Code when sold by the manufacturer in combination with the nontaxable body.

REVENUE RULE 69–205

The Internal Revenue Service has been asked whether a chassis produced by a manufacturer of self-propelled mobile homes is an automobile truck chassis subject to tax under section 4061(a)(1) of the Internal Revenue Code of 1954, or whether it is an automobile chassis other than those taxable under paragraph (1) and therefore subject to tax under section 4061(a)(2) of the Code, under the circumstances described below.

A mobile home manufacturer purchases truck-type chassis components such as engine, springs, axles, brakes, and tires. He combines these components with, or assembles them on, a thirty-foot frame constructed of two-by-eight-inch channel iron to produce a motor vehicle chassis. The manufacturer then installs a body, complete with living quarters, that comes within the scope of the exemption afforded bodies for self-propelled mobile homes by section 4063(a)(1) of the Code, as amended by the Excise Tax Reduction Act of 1965, Public Law 89–44, C.B. 1965–2, 568, at 588.

A tax is imposed by paragraph (1) of section 4061(a) of the Code upon the sale by the manufacturer, producer, or importer of certain articles including automobile truck chassis and bodies, and by paragraph (2) upon the sale of automobile chassis and bodies other than those taxable under paragraph (1). Paragraphs (1) and (2) each provide that the sale of a complete vehicle shall be considered the sale of a chassis and of a body enumerated in the specific paragraph.

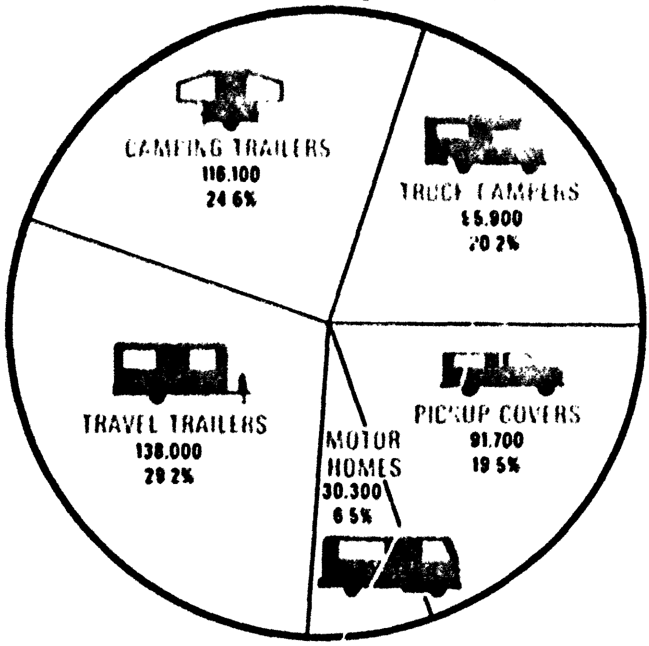
Section 201(a) of the Excise Tax Reduction Act of 1965, C.B. 1965–2, 568, at 569, amended paragraph (2) of section 4061(a) of the Code to impose lower rates of tax on articles enumerated therein than on articles enumerated in paragraph (1).

The following comment regarding the foregoing provisions of law is made in Senate Report No. 324, Eightly-ninth Congress, C.B. 1965–2, 676, at 693:

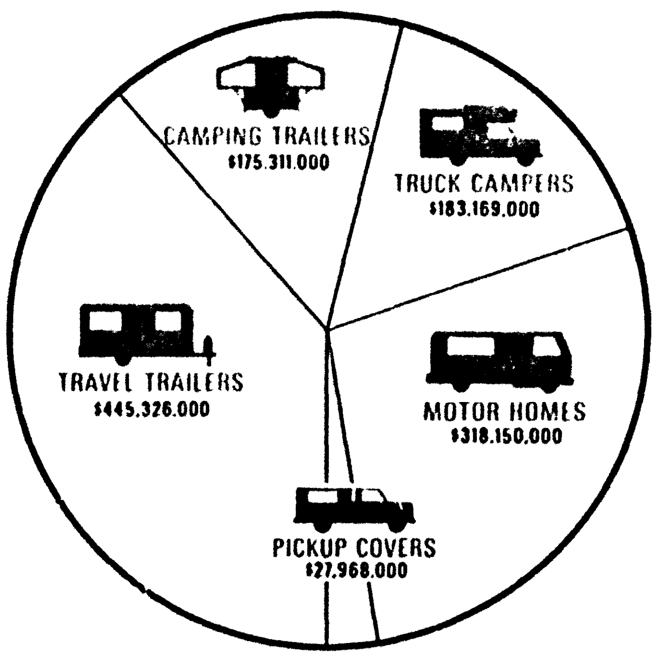
"Combination of chassis and body.—Since the 10-percent manufacturers' excise tax is retained for truck and bus chassis, bodies, and trailers, while the rates applicable to passengers car chassis and bodies are gradually reduced to 1 percent, questions may arise with respect to the imposition of tax on the sale of a chassis which may be used interchangeably with either a passenger auto-

INDUSTRY MARKET STATISTICS

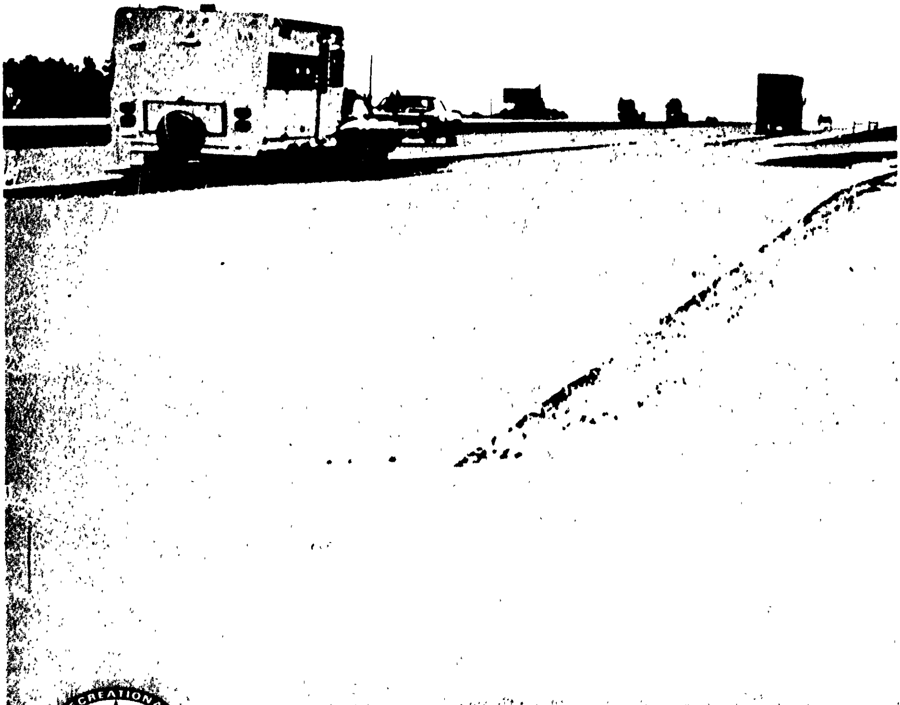
1970 RECREATIONAL VEHICLE PRODUCTION
(Units and Percentage of Market)



1970 RECREATIONAL VEHICLE RETAIL SALES



1970 RECREATIONAL VEHICLE FACTS AND TRENDS

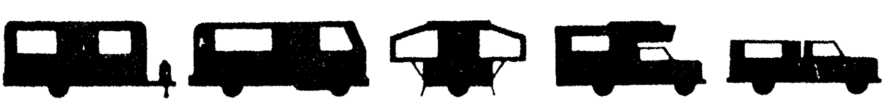


RECREATIONAL VEHICLE INSTITUTE

RECREATIONAL VEHICLE INDUSTRY FACTS AND TRENDS

CONTENTS

RECREATIONAL VEHICLE INDUSTRY "FACTS & TRENDS" was compiled and edited by the RECREATIONAL VEHICLE INSTITUTE – the national trade association exclusively serving the Recreational Vehicle Industry.



RECREATIONAL VEHICLE INSTITUTE

The National Trade Association Exclusively Serving the Industry

The Recreational Vehicle Institute was started in 1963 by 37 chartered manufacturers and supplier members. The original name of the association was the American Institute of Travel Trailer and Camper Manufacturers, Inc.

Since its inception, RVI has absorbed the National Camping Trailer Manufacturers Association and the Travel Trailer Division of Mobile Home Manufacturers Association. RVI is now one, consolidated voice speaking for a major industry. RVI membership numbers 175 leading recreational vehicle manufacturers, 245 major supplier-service firms and 25 associate members. Associate memberships are comprised of automotive and petroleum companies, park developers, campground owners and other firms and private groups vitally interested in or associated with this industry, RVI headquarters are in Des Plaines, Illinois with branch offices in Los Angeles, California and Washington, D. C.

Within the structure of RVI, various committees are responsible for coordinating the numerous activities and services that are required to insure continued growth in an important national industry.

A major RVI accomplishment in 1970 was the removal of the 8% Federal Excise Tax applicable to pickup covers. After months of study, meetings, planning and testimony by the RVI Washington Office, the President of the United States signed a bill into law exempting pickup cover manufacturers from paying Federal Excise Tax. The savings to the industry is estimated to be three million dollars annually.

Each year the Recreational Vehicle Institute sponsors and directs the world's largest recreational vehicle trade show. In December 1970, more than 5,000 dealer personnel representing over 2,000 dealerships attended the show held in Louisville, Kentucky. An RVI west coast show in Long Beach, California was run concurrently with the national Louisville Show. This 2nd annual western show, directed by the RVI Los Angeles office, attracted some 150 dealerships totaling over 400 dealer personnel.

The RVI supplier/service firm members sponsor an annual show for all industry manufacturers. This important event is designed to keep manufacturers abreast of latest components and accessories available for new product planning. A monthly Suppliers Newsletter is published for manufacturers to inform them about new product releases and services.

Industry market statistics are one of the most important services RVI provides its membership. An industry-wide shipments report on all product classes is compiled and issued monthly. This report also includes a projected 3-month forecast, cumulative totals for the year and a summary of highlights.

RVI national advertising and promotion programs are designed to inform and make dealers and consumers aware of recreational vehicle standards. RVI Standard Seal promotion materials are made available to all manufacturer members for their use. Additional advertising activities are aimed at promoting interest in the development of recreational vehicle parks and campgrounds.

The RVI Reporter and news releases covering important events, special activities and specific industry data are distributed to members, national news media and major trade and consumer publications.

Literature available from RVI includes sales tools and marketing aids to help industry dealers sell recreational vehicles. Publications annually edited by RVI are "Industry Facts & Trends," "Suppliers & Accessories Buyer Guide" and a consumer oriented "Recreational Vehicle Yearbook."

RVI's Annual Awards Program gives recognition to individuals and organizations who have contributed to the industry's growth and progress of the association. Awards are presented in the following categories.

- National Press Awards (4) – to outdoor writers for excellence in reporting the use and enjoyment of recreational vehicles through newspaper, magazine, radio and television articles and programs.
- National Scholarship Awards (3) – to state or regional directors of associations or organizations who make outstanding contributions to industry advancement in their areas.
- National Service Award (1) – to an individual, corporation or organization outside the industry making an outstanding contribution to industry progress.
- Paul Abel Award (1) – to an individual within the industry who has distinguished himself by outstanding service.
- National Legislative Award (1) – to an individual who has distinguished himself in important legislative matters pertaining to the industry.

A vitally important RVI function deals with the American National Standard A119.2 covering recreational vehicles' electrical, plumbing and heating systems. RVI also maintains continuous liaison with federal agencies pertaining to industry safety standards. These activities are covered more extensively under the heading of Recreational Vehicle Standards on page 13.

INDUSTRY HIGHLIGHTS

The tight 1970 economy was felt in the recreational vehicle industry. Following the tremendous growth of the 1960's, 1970 production dropped off 8.2 percent with a total output of 472,000 units compared to 514,100 units in 1969.

The off-year was brightened by a slight increase of $72,879 000 in industry retail sales. This increase over 1969 is attributed to more sales of larger, more deluxe recreational vehicles. An outstanding increase of 31.2% in motor home output the past year is largely responsible for sustaining industry sales.

Potential recreational vehicle buyers in the lower to middle income groups were hardest hit by the tight money market. Discretionary spending was curtailed with income dollars directed toward necessities and any surplus directed to savings. The industry's products are primarily recreational commodities, and sales of smaller, lower priced units were adversely affected. Camping trailer output in 1970 was down 17.7%.

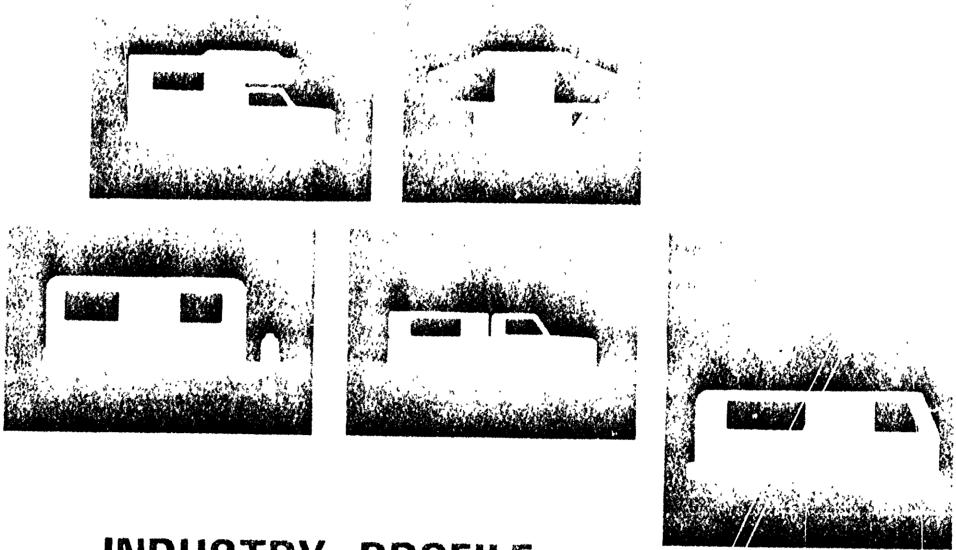
A brief summary of the industry's progress shows that travel trailer production on a commercial basis started in the 1930's. Significant growth began in 1956 when a small group of manufacturers, mostly based in California, produced 15,370 travel trailers. In 1964, travel trailer production grew to 90,370 units. Between the period of 1961–1969, camping trailers, truck campers, pickup covers and motor homes were introduced and the industry boom was off and running. During that prosperous era, industry production increased over 500%.

Future industry growth is dependent upon the economy regaining its strength. Trends expected to support further industry expansion are: shorter work weeks, longer vacations and three-day holiday weekends. With the advent of more leisure time, consumer demand for the industry's products should increase substantially.

The travel economies of recreational vehicle ownership permit owners to travel and live on the road as inexpensively as at home. Families can afford to fulfill their desires to explore and see the country; sportsmen can hunt, fish and camp on minimum budgets.

1971 industry production output is expected to continue at the 1970 level with two exceptions: motor homes are expected to record a 25–30% increase and travel trailers an 8–10% increase.

Additional conglomerate corporations are expected to enter and expand the industry in their quests for growth and diversification. By 1980, industry sales are estimated to reach 2-billion dollars annually, nearly two times the 1970 volume of $1,149,924,000.



INDUSTRY PROFILE

Recreational vehicles are vehicular type units primarily designed as temporary living quarters for recreation, camping or travel use, which either has its own motive power or is mounted on or drawn by another vehicle. There are five basic recreational vehicle categories – travel trailers, camping trailers, truck campers, pickup covers and motor homes.

The industry products are designed and produced by nearly 800 recreational vehicle manufacturers located throughout the U.S.A. and Canada. Recreational vehicles are sold in all 50 states and Canadian provinces by approximately 10,000 dealers. In addition to manufacturers and dealers, the industry is comprised of an expanding group of supplier/accessory and service firms.

TRAVEL TRAILERS

Travel trailers range from 10 feet up to 35 feet in overall length and 8 feet in width. They are designed to be towed behind passenger vehicles. Smaller sized models are equipped with one set of wheels and larger units with two sets of wheels in tandem. Travel trailers built within the 10 to 35 feet range do not require special permits when transported over public highways.

Travel trailers are the most popular type of recreational vehicle. During 1970, they ranked first in number of units produced and retail sales, among the five recreational vehicle classifications. In 1970, travel trailer manufacturers produced 138,000 units. This figure represented a retail sales volume of $445,326,000.

Travel trailers are available in a wide variety of sizes, styles and price ranges. There are three basic travel trailer designs – conventional, aircraft and telescopic.

Conventional type travel trailers are rectangular in shape and constructed of pre-finished sheet aluminum or molded fiberglass over wall studs – similar to the construction of a frame home.

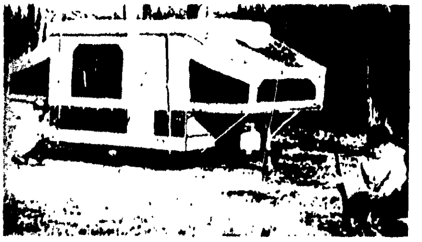
Aircraft type travel trailers feature construction consisting of anodized or polished aluminum rivited to an aluminum or metal body frame.

Telescopic type travel trailers are similar in appearance and construction to conventional built travel trailers. The major difference is a unique telescopic design with an upper half that raises up for living and lowers down over bottom half to form a low profile structure for towing and storage.

Retail prices of travel trailers start at around $700 for the smaller compact models and range upward to $18,000 for the fully equipped, luxury styled units in the 30 foot class. Trade-in value of used travel trailers is high because consumer demand for this type of recreational vehicle continues to rank first.

1970 TRAVEL TRAILER FACTS

- Average retail price – $3,227.00
- Total production – 138,000 units (4.2% decrease)
- Total retail sales -- $445,326,000 ($7¼-million decrease)
- Industry production rank – 1st
- Percentage of market (units) – 29.2%



CAMPING TRAILERS

Camping trailers are designed to be easily towed behind passenger vehicles. They are sometimes described as fold-down campers or tent trailers.

This smaller, more compact type of recreational vehicle is constructed with roof and collapsible sidewalls that can be quickly raised up and folded out into a spacious living area. When top section is lowered, it forms a neat, low profile unit for towing and storage. The lower or floor section of most models is usually constructed of light-weight aluminum or fiberglass mounted on a frame chassis. Collapsible upper half sections consist of heavy-duty canvas sides with canvas, fiberglass or aluminum tops. Some recently introduced models feature pliable plastic exteriors on bottom, top and fold-out sections.

Camping trailers are available in a wide variety of styles and sizes to comfortably sleep from four to eight persons. They are rarely equipped with full self-containment conveniences because of limited interior space. The larger, more sophisticated models offer interior lights, built-in cooking facilities, water supply and cold storage. Some campers feature cooking facilities that slide out from the exterior sidewall for outdoor use, adding to the room inside.

Recreational vehicle market was affected by the 1970 economic slow-down, producing 17.7% fewer camping trailers than 1969. The 1970 production output was 116,100 units. Retail sales of $175,311,000 recorded a small increase over 1969. This increase is attributed to greater consumer demand for the more spacious and higher priced models.

Selling prices for the smaller units with sleeping accommodations for four start at around $300. Bigger models sleeping six or eight people and equipped with cooking facilities are priced in the $1,000 to $2,500 range.

Camping trailers continue to rank high as the industry's most popular product line among the younger outdoor-oriented camping families. Owners of camping trailers are usually prime prospects for travel trailers, motor homes and truck campers as they eventually trade up to a more spacious unit offering full self-containment.

1970 CAMPING TRAILER FACTS

- Average retail price – $1,510.00
- Total production output – 116,100 units (17.7% decrease)
- Total retail sales – $175,311,000 ($12½-million increase)
- Industry production rank – 2nd
- Percentage of market (units) – 24.6%

TRUCK CAMPERS

Truck campers are portable or wheeled units designed to be temporarily carried or permanently affixed on a one-half ton or larger sized truck. These two different types of units are classified as slide-in campers (portable) and chassis-mount campers (permanently affixed to the truck chassis).

Slide-in campers range from 6 to 11 feet in length and fit onto the bed of a pickup truck. They are secured to the truck bed with various types of hook clamps and bolts or specially welded frame mount bars and bolt-on devices. Electrical power and exterior lights for the camper are provided by a simple plug connection into the electrical system of the camper-built truck. Slide-in campers are equipped with jacks to support the unit when removed from the pickup truck bed. Since slide-in campers are temporarily mounted onto pickup truck beds, they usually do not require special state licensing or extra fees when traveling toll roads.

Chassis-mount campers range from 11 to 18 feet in length. The camper (living quarters) is permanently mounted directly onto a truck frame with bolts and welded connections. Some models feature a passageway from the truck cab to the camper living area. Basic design of the chassis-mount truck camper is similar to the motor home. However, the original cab or operators' compartment of the truck is used by the recreational vehicle manufacturer in building chassis-mount truck campers.

Truck camper retail sales and production output for 1970 ranked third among the five industry categories. Production figures recorded an increase of 3.7% over 1969 totaling 95,900 units. Retail sales for the same period also showed a gain reaching $183,169,000.

There is a wide variety of specially developed truck models available for use with campers. The nation's truck manufacturers are continually introducing camper specials featuring heavier suspension, power handling ease, safer operation and more attractive styling.

Truck camper consumer price tags (slide-in camper) start at less than $1,000 and range up to $4,000 for larger, fully equipped models. Selling prices of the larger chassis-mount campers (including truck) begin at $5,000 and range up to $10,000.

1970 TRUCK CAMPER FACTS

- **Average retail price (less truck) – $1,910.00**
- **Total retail sales – $183,169,000 ($7½-million increase)**
- **Total production output – 95,900 units (3.7% increase)**
- **Industry production rank – 3rd**
- **Percentage of market (units) – 20.2%**

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PICKUP COVERS

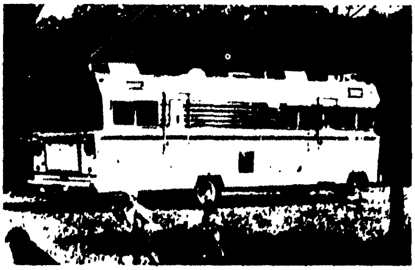
Pickup covers are portable units designed to provide an all-weather protective enclosure over the bed of pickup trucks. Exterior appearance resembles a slide-in camper without the over-cab section. They are also referred to as caps or shells.

This type of recreational vehicle provides sportsmen with an economical unit to escape from rugged outdoor elements. Construction is simple; the living area within most models consists of interior paneling, windows and insulated sidewalls. Built-in living conveniences and self-containment features are not commonly included. Some models are equipped with bunks and interior lights. One and sometimes two rear doors, either hinged or sliding, provide entry.

Recreational vehicle manufacturers produced 91,700 pickup covers in 1970. This production figure represents a 19.2% decrease from the preceeding year. Retail sales declined slightly over 6-million dollars to a 1970 figure of $27,968,000. The retail price of pickup covers starts at around $200 for a simple cover enclosure and ranges up to $1000 for a more spacious unit with bunks, interior lights and louvered windows.

1970 PICKUP COVER FACTS

- **Average retail price – $305.00**
- **Total production output – 91,700 units (19.2% decrease)**
- **Total retail sales – $27,968,000 ($6-million decrease)**
- **Industry production rank – 4th**
- **Percentage of market (units) – 19.5%**



MOTOR HOMES

Motor homes are self-powered units designed to provide complete living facilities for camping pleasure. They are equipped with sleeping accommodations, compact kitchens, dining or lounge area and full bath, usually including a shower. Greater consumer demand for a self-powered mobile unit with complete self-containment features has made motor homes the industry's fastest growing product line.

Recreational vehicle manufacturers produce three variations of motor homes – conventional, van-conversion, and the newest type, chassis-mount.

Conventional type motor homes are constructed directly on a heavy-duty truck chassis. Drive components and engine are included with the original chassis. The complete motor home – size, styling, living area, exterior shell and driver compartment – is designed and produced by the recreational vehicle manufacturer. Conventionally built units are usually larger than the other two variations of motor homes.

Van-conversion motor homes are van type trucks with interior cargo space converted into a living area by a recreational vehicle manufacturer. Windows are added and some models include rear or top extensions to provide more interior room. Most van-conversion models are self-contained but more compact than larger conventionally built motor homes or chassis-mount units.

Chassis-mount motor homes are built directly onto the aft frame section of an intermediate-size van type truck. Original forward body exterior and interior section, including drive components and engine, are retained as supplied by the van manufacturer. Interior living area, size, styling and exterior shell are designed and produced by the recreational vehicle manufacturer. This type of motor home is considered in between the conventional and van-conversion units because overall weight and length are limited in accordance to the specifications of the smaller designed van trucks.

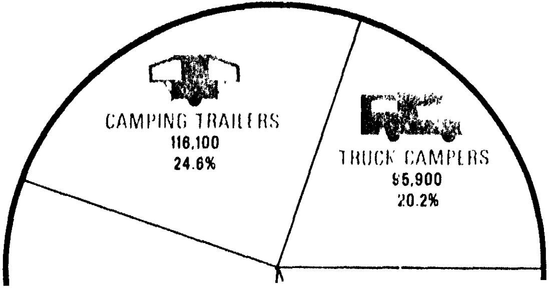
Recreational vehicle manufacturers produced 30,300 motor homes in 1970 representing a tremendous increase of 31.2% over the previous year. Retail sales surpassed 1969 by nearly $66¼-million with a total figure of $318,150,000. Motor homes offer buyers a wide price range starting around $5,000 and exceeding $20,000 for larger, more custom styled models.

1970 MOTOR HOME FACTS

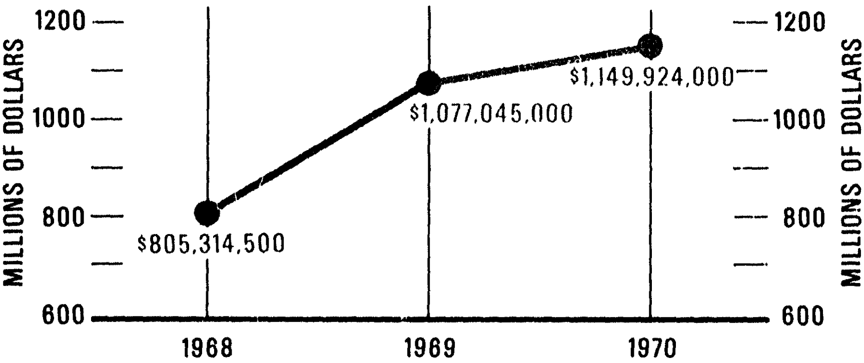
- **Average retail price – $10,500.00**
- **Total production output – 30,300 (31.2% increase)**
- **Total retail sales – $318,150,000 ($66¼-million increase)**
- **Industry production rank – 5th**
- **Percentage of market (units) – 6.5%**

INDUSTRY MARKET STATISTICS

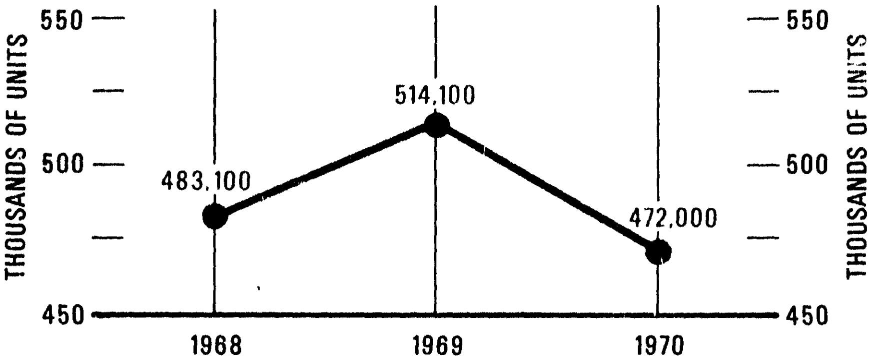
1970 RECREATIONAL VEHICLE PRODUCTION
(Units and Percentage of Market)



ANNUAL RECREATIONAL VEHICLE RETAIL SALES



ANNUAL RECREATIONAL VEHICLE PRODUCTION



The reporting of industry production output under the Recreational Vehicle Institute Marketing Program started with the month of January, 1968. Production statistics prior to that time were not collected for or by RVI.

RECREATIONAL VEHICLE STANDARDS

One of the most significant developments in assuring greater industry progress is a recently self-imposed standard for recreational vehicle manufacturing. Official designation of this national standard is American National Standard A119.2. The ANSI Standard A119.2 specifies installation details for electrical, plumbing and heating systems in recreational vehicles. All appliances and fixtures within these systems are to be approved or listed by nationally recognized testing agencies. Installation according to the appliance and fixture manufacturers' instructions is an integral part of approval or listing.

All travel trailer, truck camper and motor home manufacturers must certify compliance with the A119.2 Standard as a condition of membership in the Recreational Vehicle Institute. Camping trailer manufacturing members will be required to conform with the Standard effective September, 1971. Manufacturing members' product lines are regularly inspected by RVI Standards inspectors to check their conformance with the Standard. The complete written ANSI A119.2 Standard, in booklet form, is available from the Recreational Vehicle Institute for $2.00. Work is also under way on the development of a standard for electrical and plumbing installations in recreational vehicle parks (A119.4).

In addition to the A119.2 Standard, RVI is actively engaged in all phases of safety standards pertaining to recreational vehicles at the federal government level. Through the RVI Washington office, a meaningful relationship has been developed with the U. S. Department of Transportation and their affiliated divisions and agencies. RVI is primarily concerned with the functions of the National Highway Traffic Safety Administration. This important administrative department is responsible for federal standards regulating such items in recreational vehicles as passenger restraints, glazing, bumpers, brakes, hitches, and many other safety related components.

The RVI Standards staff works closely with the National Highway Traffic Safety Administration on matters relative to recreational vehicle safety standards and regulations. RVI publishes all new Federal Standards and Regulations for its members to keep them up to date with interpretive information through bulletins and personal visits by the Standards inspectors.

RVI sponsors periodic joint RV Industry/Federal Government meetings to promote better mutual understanding through communications.

RENTAL MARKET

The rapidly expanding rental market is playing an important role in exposing recreational vehicles to greater numbers of people. Many recreational vehicle and automotive dealers, rental equipment operators, travel and leasing firms are now renting travel trailers, truck campers, motor homes and camping trailers.

Renting enables people to try the fun, economy and convenience of recreational vehicle travel. Some rental customers are people living in apartment complexes, condominiums and places where recreational vehicle parking and storage is not available. Other rental users are persons financially unable at the present time to purchase their own vehicle. Renting also offers prospective owners an opportunity to determine the size, style and type of unit they want before buying.

The latest trend in recreational vehicle rental is the entry of major car leasing companies into the pleasure travel business. National airlines and travel agencies are utilizing recreational vehicles in special camping vacation packages with planned itineraries and reservations at an all-inclusive price.

Rental rates of recreational vehicles will depend on the section of country rented, unit size, model type and accommodations provided. Average rental costs for compact camping trailers range from $45 to $75 per week. Travel trailer rental rates start at around $50 for smaller units and range up to $125 per week for larger, fully self-contained models. Slide-in campers to fit on the owner's pickup truck rent for $50 to $100 per week. The weekly rates for complete camper truck combinations are $90 to $150, plus a 5¢ to 10¢ charge per mile. Fully self-contained motor homes cost between $100 to $350 per week with a 5¢ to 15¢ mileage fee.

Most operators require a deposit, which is applied to the rental rate when the unit is returned in satisfactory condition. Some rental agreements will allow the amount expended as a down payment towards the purchase of the unit or another model of the user's choice. Additional expenses usually involve rental of tow hitches, special driving mirrors, camper mount clamps and accessory items that are required for proper and safe use of the unit rented. Installation of this equipment and electrical wiring hook-ups are charged to the rental user on an hourly basis. In some instances, accessory items and installation charges are included in the rental rate.

The expansion of recreational vehicle rental outlets is expected to continue in direct proportion to the increased leisure time of the nation's work force.

PARKS AND CAMPGROUNDS

Several major publishers offer parks and campgrounds guides for recreational vehicle owners. One 1970 edition lists a nation-wide total of 9,513 privately owned campgrounds available for recreational vehicles. The states with the most campsites are: California – 59,056; Florida – 44,874; Ohio – 35,925; New York – 35,192; Pennsylvania – 28,349. States numbering the most campgrounds are: California – 1,933; Florida – 786; Wisconsin – 671; Texas – 552; New York – 514.

Overnight parking fees in private campgrounds and parks range from $1.50 up to around $8.00 per night. Fees will vary in accordance to the type of facilities offered. Some state, federal and industry operated overnight parking sites are free.

The latest camping directory issued for National Parks by the U.S. Department of Interior lists nearly 28,000 campsites at 529 campgrounds in 83 areas of the country. These campsites are available to the recreational vehicle user on a first come, first served basis. Advance reservations are not accepted.

National Park campsite fees range from $1 to $3 per night in campgrounds classified as improved. There is no charge for back country camping.

The $10 Golden Eagle Passport can be purchased at entrance points to most national parks or at specified government offices and private travel agencies. This annual entrance permit will admit the purchaser and others in his private vehicle to all parks and federal recreation areas where fees are collected.

"Camping in the National Park System" can be obtained from the Superintendant of Documents, U. S. Government Printing Office, Washington, D. C. 20402 under catalogue number I29.71:971 for 25¢ a copy.

The "U.S. Travel Barometer," compiled by Discover America Travel Organizations, shows that the 1970 sluggish economy had little effect on pleasure travel. Attendance figures registered at 500 private travel attractions, national parks and recreation areas recorded a 10.37 percent increase in 1970 compared to the previous year. Pleasure travel in December 1970 was up 14.74 percent over December a year ago.

It is obvious that more campgrounds and parks are needed to accommodate the 3½ million recreational vehicles in use today. By 1980, this number is expected to increase to 7½ million.

OWNER PROFILE

A recent industry survey profiles the average recreational vehicle owner. The findings of this survey represent response from 280 owners in 38 states.

Eighty-five percent of the recreational vehicle owners reported they own their homes. A total of 96% are married. The average age ranged between 41 and 50 years. Twenty-seven percent of the owners have children between 13 and 17 years of age. Nearly twenty-five percent of the household heads have annual incomes between $10,000 to $12,000.

Half of the 280 respondents indicated they were first-time recreational vehicle owners. Seventy-five percent of their vehicles are self-contained, 21% are air-conditioned, 91% have 12/110 volt electricity and 25% are equipped with a gas powered electric generator. Thirty percent of respondents owned their recreational vehicle less than one year.

Interior arrangement of the recreational vehicle was indicated by 18% of the owners as the most popular feature in determining their purchase. Twenty-nine percent purchased their unit on the recommendation of a friend who owned one.

Some of the owners reported that their final purchase decision was greatly influenced by the recreational vehicle dealer. They visited an average of six dealerships prior to buying. Dealership characteristics influencing their purchases were cited as price, model selection, service facilities and dealer's business reputation. The survey showed that 75% of the owners considered industry standards as an important factor in their purchase.

OWNERSHIP COSTS AND EXPENSES

Depending on the purchase price and number of trips taken with a recreational vehicle, it will quickly pay for itself by eliminating expensive room rentals and restaurant meals. Travel cost per trip with a recreational vehicle owned by families numbering 6 to 8 will result in a greater savings and faster unit payoff. Recreational vehicle ownership makes week-end and vacation travel economically feasible for more people. Projecting all costs over the life of the vehicle, travel costs little more than living at home. Trips that normally would be too expensive are brought within the most modest travel budget.

The major cost outside of the original purchase price is gasoline. Industry surveys show the average gasoline mileage for a car towing a recreational vehicle to be around 10 miles per gallon. This figure also applies to truck campers and motor homes. Recreational vehicle maintenance is a minor expense.

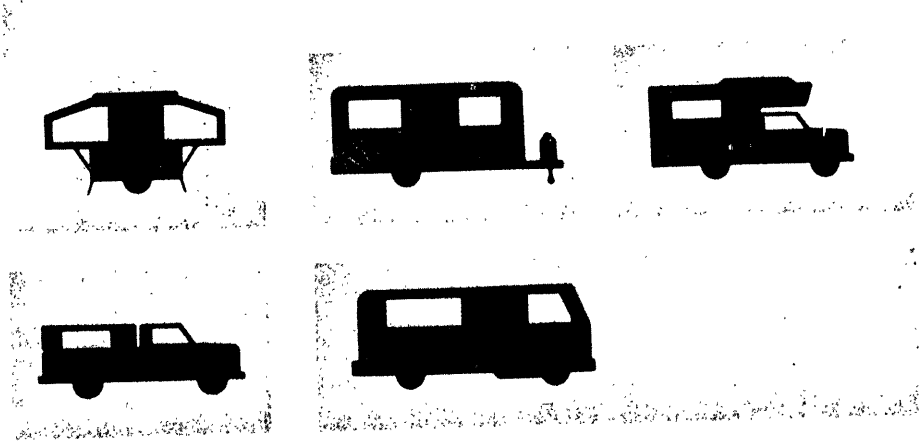
Eight-cylinder cars equipped with special options for trailer towing are recommended to obtain maximum operational efficiency. Strain and load on the tow vehicle is controlled by the balance of the recreational vehicle and specially designed weight equalizing hitches. Hitch and installation costs are not usually included in the purchase price of a tow type recreational vehicle.

Some optional expense items to be considered after vehicle purchase are outdoor folding furniture, awning extensions and screens, high power battery lights, leveling gear, driving mirrors and extensions, first-aid kit and maintenance tools.

Other accessory items might include jacks, additional appliances, hoses, special brake equipment, heaters, portable toilets, electrical extension cords and other extras providing greater comfort and convenience.

Depending on the type and price of recreational vehicle purchased, most of the self-containment items will be included. Higher priced luxury options available for most travel trailer, truck camper and motor home models are air-conditioning and television installations.

Most supply/accessory items can be purchased from a recreational vehicle dealer. The majority of industry dealers offer complete repair services, including recreational vehicle winterization. Some dealers also provide year-round parking and storage space.



SELF-CONTAINMENT IN RECREATIONAL VEHICLES

Self-containment in a recreational vehicle means that it can be lived in for extended periods of time and contains heating, electricity and plumbing facilities. Self-contained units are designed to provide a family of 3 to 4 with approximately one week's supply of water, LP gas fuel and sanitary disposal storage.

A fully self-contained recreational vehicle is usually equipped with combination gas/electric refrigerator and range, gas and electric lights, kitchen sink, heater, lavatory with bathing facilities, dining and sleeping accommodations. Liquid petroleum stored in cylinders outside the unit provides the fuel required for all gas operated appliances and lights. A fresh water tank, pressurized or gravity type, supplies water for drinking, cooking, bathing and sanitation. Holding tanks store the used water and waste materials until they can be disposed of at a sanitary station.

Electrical power can be temporarily provided by 12-volt (automotive) batteries for specified appliances and lights. The 110-volt electrical system can be fully utilized when a hook-up to an outside power source is available. Some larger self-contained recreational vehicles are equipped with gasoline powered electric generators.

It is estimated that 80% of the travel trailers, truck campers and motor homes now being produced offer a self-containment package. The trend to self-containment in recreational vehicles is the result of greater consumer demand for independent, live-anywhere freedom.

INDUSTRY PROBLEMS

A shortage of recreational vehicle storage facilities is the industry's most pressing problem. Large numbers of travel-oriented people living in apartment complexes and other types of congested housing areas are usually unable to own a recreational vehicle because parking and storage is not available.

One solution helping to eliminate the storage problem is the recent development of recreational vehicle parking lots located around major metropolitan centers. These storage areas provide parking convenience, safety protection, maintenance and repair services. The owner's vehicle is available and ready for immediate use whenever needed. Storage lot rates differ in various regions. A rule of thumb rate would be about $1.00 per month per foot of space used. Camping trailers and smaller units are usually charged a flat minimum fee. Servicing, repairs and unit delivery services are separate charges.

Development of a recreational vehicle storage lot requires very little cash outlay other than a few improvements such as lighting, fencing and blacktopping. The establishment of additional recreational vehicle storage facilities in the nation's major markets will strengthen industry sales.

Another industry problem is the development of recreational vehicle parks and campgrounds sites. During recent years, a rapidly expanding number of quality camping sites and overnight park facilities have been developed in an effort to meet industry demands. Major motel chains across the country are offering campsite accommodations adjacent to their existing facilities. Restaurants located on major travel routes are utilizing vacant land in their area for overnight camping.

A major shortage of campsites still exists in the popular vacation sections of the country, especially during the peak summer season. It is hoped that private investors will help meet the industry needs by developing available land into camping areas. The Recreational Vehicle Institute has developed a complete planning kit to aid interested parties in the development of recreational vehicle parks and campgrounds. This kit is available for $5.00 and includes: basic layouts, sanitary station plans and specifications, material requirements, operational instructions, promotional suggestions and other related data.

Recreational vehicle parking and storage in residential areas, where restricted ordinances have been imposed, is another problem that continues to confront the industry. The Recreational Vehicle Institute has prepared a model ordinance for recreational vehicle owners which can be applied to their individual situations. A copy of this ordinance is available upon request.

The Recreational Vehicle Institute has recently organized a long-range planning committee to meet and deal with problems that may develop in this fast growing industry.

The CHAIRMAN. We will call the panel on behalf of taxation with representation. Mr. Gary Fromm, C. Lowell Harriss, Elliott R. Morss, Richard A. Musgrave, Alan Schenk, and Paul Taubman.

PANEL ON BEHALF OF TAXATION WITH REPRESENTATION

STATEMENT OF TOM FIELDS

Mr. FIELDS. My name is Tom Fields from taxation with representation. We wish to thank you for the opportunity to present today a distinguished panel of tax experts representing a variety of viewpoints.

With the committee's permission, we would like to have each of our panelists present a very brief opening statement and then open the entire panel for questions after the opening statements are completed.

Our first witness today is Prof. Gary Fromm, of American University. He is the editor of Tax Incentives and Capital Investment, a recent Brookings Institution publication.

STATEMENT OF GARY FROMM, PROFESSOR, AMERICAN UNIVERSITY

Mr. FROMM. Thank you.

Taken as a whole, the administration's new economic program, as amended by the House Ways and Means Committee, should lead to substantial improvement in the U.S. economy in 1972. The Data Resources forecast, which is predicated on the success of phase II and an effective average devaluation of the dollar of 6 percent, forecasts a rise in real GNP of 6.7 percent and in current dollar GNP of 9.4 percent—about $100 billion—so we have a rate of inflation of about 3 percent. The rate of unemployment falls from an average of 6 percent in 1971 to 5.5 percent in 1972, and is just over 5 percent at the end of the latter year. With this growth of the economy and the tax structure proposed in H.R. 10947, personal disposable income rises about 8.8 percent and corporate profits after taxes by 23 percent between 1971 and 1972. These are certainly substantial increases and should provide additional welfare for many people in our economy.

From this vantage the current tax proposals are highly desirable. However, a number of its specific provisions can seriously be questioned.

First, the assumptions underlying the impact of the DISC tax deferral are extremely dubious; it seems like that alternative measures to stimulate exports could result in far greater surpluses at much less cost.

Second, if account is taken of the progressivity of individual income tax rates and the need to reduce personal taxes as nominal incomes rise—due to real growth or inflation, or both—then the tax cut for individuals under the combination of the 1969 Reform Act and the Ways and Means Committee action is negligible. For individuals, the combined actions return the 1972 relationship between taxes and income to that which held in 1967—before the 1968–70 surtax. For corporations, on the other hand, the effective tax rate on profits falls from 43.5 percent in 1967 to an expected 42 percent in

1972. Perhaps this greater relative cut for corporations can be justified on equity grounds or because of a need to stimulate investment for reasons of long-term growth and international competitiveness of U.S. producers.

Third, however, the responsiveness of investment to raising the aftertax rate of return—or lowering capital costs—is far lower than its responsiveness to higher capacity utilization rates—currently only about 75 percent in manufacturing—and operating the economy near its output potential.

Now, it is quite possible and most economists can conceive of situations that taking the similar funds that are being proposed to be expended on the investment tax credit in the ADR would yield a much higher GNP and even investment if they were used for alternative purposes, for example, increases in Government expenses. Suppose, nevertheless, that we decide that we want direct intervention to raise investment, then it is clear we still want to use the most efficient instruments for doing so and it turns out that investment tax credits are far more effective in this regard than accelerated depreciation. We get about $3 of investment for comparison to what we would get with accelerated depreciation. But probably the most egregious deficiency in the administration's proposal and the Ways and Means Committee action is the neglect of taxes for contributions to social insurance. As currently structured these taxes are highly regressive. Removal of the ceiling on the tax base—scheduled to go from $7,800 to $10,200 under H.R. 1 in January 1972—would yield about $9 billion, which could be used for reductions in the contribution rate, lowering the burden for low- and moderate-income wage earners, or for other governmental purposes. It should also be recognized that total employer, employee, and self-employed contributions for social insurance—Federal collections—have nearly tripled as a proportion of personal income over the past 20 years and are approximately one-half personal Federal taxes. Consequently, and because of relative neglect in the past, they should be subject to serious scrutiny by this committee at an early date; reform in these taxes is greatly needed.

Mr. Fields. Our second witness is Prof. C. Lowell Harriss, of Columbia University. He is the author of the "American Economy and American Public Finance."

STATEMENT OF C. LOWELL HARRISS, COLUMBIA UNIVERSITY

Mr. Harriss. Gentlemen, there are four comments which I shall summarize very briefly. First, it seems to me the tax discussions which talk of corporations as if they were somehow different from "persons" can mislead. Fundamentally, corporations are organizations of individuals who as producers seek to serve individuals as consumers. The "shorthand" which separates business from personal income tax seems to divert attention from the basic challenge, how best to serve the whole population today—and into the future.

As consumers, everyone looks to corporations and other businesses. Most Americans earn their income as employees of business firms. Many of us as suppliers of capital have direct interest in the success of business firms.

Corporations are not something to be thought of, as tax policy is made, as set off from individuals. Taxes imposed on corporations affect consumers, employees, and suppliers of capital. Business taxes are "people taxes."

Second, one merit of the investment tax credit deserves emphasis. New machinery and equipment embody the most advanced technology. The fruits of invention and scientific progress appear in ripest form in the kinds of machinery and investment goods favored by the credit. As a stimulator of progress, the investment credit has exceptional worth. Public policy, I believe, can wisely favor this particular bias—something which accelerates the actual utilization of advances of science and technology.

Our ability to reduce inflation and expand employment over the near and more distant future must depend significantly upon improvement in productivity. Technological progress accounts for much of the advance in productivity. The investment tax credit, by aiding the earlier, quicker, and fuller use of technological advance, aids the vitally important process of productivity increase.

Third, depreciation—capital recovery—provisions recognized by the tax laws still do not allow explicitly for inflation. Yet replacement costs have risen. For years, tax laws have been treating as taxable earnings what in an economic sense is a return of capital. To some extent the increase in the personal exemption rests on recognition of the loss in purchasing power of the dollar. The tax treatment of business income and expense ought, somehow, to allow for inflation as it affects the replacement cost of machinery and equipment. Indirectly and imperfectly, but I believe constructively, the ADR and the investment credit offset some of the weaknesses of our longstanding practice of ignoring inflation in computing depreciation.

Fourth, repeal of the excise tax on autos has been criticized as encouraging more cars which will then pollute the atmosphere and conflict with policies for improving the environment. But are not the new cars very much improved over those of the past as regards the emission standards?

Thank you. There are a few additional comments on depreciation which I would like to include in the record.

(Mr. Harriss' prepared statement and attachment follows. Additional correspondence has been received from Mr. Harriss which appears at pp. 717 and 860.)

Prepared Statement of C. Lowell Harriss

1. Businesses are people. Tax discussions which talk of corporations as if they were somehow different from "persons" can mislead. Fundamentally, corporations are organizations of individuals who as producers seek to serve individuals as consumers. The "shorthand" which separates business from personal income tax seems to divert attention from the basic challenge, how best to serve the whole population today—and into the future.

As consumers, everyone looks to corporations and other businesses. Most Americans earn their income as employees of business firms. Many of us as suppliers of capital have direct interest in the success of business firms.

Corporations are not something to be thought of, as tax policy is made, as set off from individuals. Taxes imposed on corporations affect consumers, employees, and suppliers of capital. Business taxes are "people taxes".

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and scientific progress appear in ripest form in the kinds of machinery and investment goods favored by the credit. As a stimulator of progress, the investment credit has exceptional worth. Public policy, I believe, can wisely favor this particular bias—something which accelerates the actual utilization of advances of science and technology.

Our ability to reduce inflation and expand employment over the near and more distant future must depend significantly upon improvement in productivity. Technological progress accounts for much of the advance in productivity. The investment tax credit, by aiding the earlier, quicker, and fuller use of technological advance, aids the vitally important process of productivity increase.

3. Depreciation (capital recovery) provisions recognized by the tax laws still do not allow explicitly for inflation. Yet replacement costs have risen. For years, tax laws have been treating as taxable earnings what in an economic sense is a return of capital. (To some extent the increase in the personal exemption rests on recognition of the loss in purchasing power of the dollar). The tax treatment of business income and expense ought, somehow, to allow for inflation as it affects the replacement cost of machinery and equipment. Indirectly and imperfectly, but I believe constructively, the ADR and the investment credit offset some of the weaknesses of our longstanding practice of ignoring inflation in computing depreciation.

4. Repeal of the exise tax on autos has been criticized as encouraging more cars which will then pollute the atmosphere and conflict with policies for improving the environment. But are not the new cars very much improved over those of the past as regards the emission standards? On environmental grounds, I suggest, new autos should be favored by public policy. Faster replacement of old cars will help in the program for purer air.

Another excise tax with even more pervasive effect as a business expense and as an element in the cost of living deserves consideration as a candidate for repeal—the tax on telephone service.

COLUMBIA UNIVERSITY, DEPARTMENT OF ECONOMICS,
New York, N.Y,. April 20, 1971.

COMMISSIONER OF INTERNAL REVENUE,
Attention: CC: LR: T, Washintgon, D.C.:

Last April I submitted the following observations on ADR to the Internal Revenue Service.

Econmic reasons provide support for the proposed regulations, depreciation allowances using asset depreciation range system. In my personal capacity as Professor of Economics at Columbia University I should like to testify on May 3 in favor of the general principles, with special emphasis on the fourth point of this memorandum. My views do not necessarily reflect those of any organization with which I am associated.

The Treasury's statements, and those in opposition as reported in the news, touch upon several points. My observations will make no attempt to deal with each about which I might, if time permitted, comment—sometimes in criticism, sometimes in support. The question of the scope of the Treasury's legal authority, e.g., to limit new provisions to acquisitions after 1970, lies beyond my competence. Moreover, I do not want to enter discussion of the near-future economic outlook. My points deal with certain longer-run economic aspects.

In general, the conclusions of The President's Task Force on Business Taxation seem to me deserving of support. The evidence and analysis in the Report are too persuasive to be dismissed by casual assertion, no matter how well intentioned the criticism.

1. First, let me record distress at an anti-business tone which appears in some of the reported opposition to ADR. Business is the country's main instrument for getting production. Human well-being depends heavily upon the success with which people, through "business," utilize their time and other resources to produce—fully, efficiently, and progressively. Businesses are associations of people as owners, employees, and suppliers. They function to serve us as consumers.

"Business" is not separate and somehow apart from "the people" but central to the ways we produce and distribute.

Thinking about tax and other matters would often be clearer, and attitudes more constructive, if instead of saying "business" we used a more complete and correct expression, "employees, owners, and consumers." If a tax change "favors"—or reduces obstacles to—"business," then the improvement goes to people, to consumers, shareholders, and employees. (The bigger the corporation, the larger the number of workers, consumers, and owners benefitted—or hurt—when its taxes are changed.)

2. Depreciation and obsolescence present issues which are more complex in more ways than are generally recognized. One conclusion, however, will stand: Nothing inherently right or wrong attaches to the present provisions. Some critics of the ADR proposals seem to believe that correctness somehow lies in today's rules, that they constitute a proper base from which the proposed departure will be a "giveaway." True, extensive study was conducted in the late 1950's and early 1960's before the changes of 1962. But within the philosophy of that system possibilities for improvement must be assumed to have existed then; more opportunity for constructive change must have developed over the succeeding decade. Moreover, the basic principles of 1962 are not necessarily those most conducive to best results, however, the latter are conceived.

The reserve-ratio test, for example, first seemed to me an ingenious way to make costs for tax purposes more or less consistent with the realities of each company's practices of purchase and disposal of equipment. An academician may be excused for underestimating the difficulties raised by the practical problems of compliance and administration. My qualifications do not extend to the matters of implementation. But as an economist I soon came to deplore one result as being contrary to economic wisdom. The test creates inducement for disposing of depreciated equipment as against holding it for use, as in peak periods, emergencies, and for other more or less exceptional situations.

Is it not foolish for a government to create incentives for producers to scrap or to get rid in other ways of capital facilities which would sometimes be useful? The answer, I submit, should not rest on the scarcely veiled aspect of the reserve-ratio test, to prevent producers from "getting away with something." In view of the tremendous variability in all aspects of the world of production and technology, tax "neutrality" as regards capital outlays and capital consumption allowances will be impossible. In fact, neutrality may be less desirable than biases toward acquisition of new equipment. In any case, however, the creation of inducements for disposal and scrapping will have some wasteful results which can be unfortunate for the company and for the whole economy.

In themselves, the compliance problems may exert reason for abandoning the test; or they may not. The weight of argument may well lie with businessmen who face the actual problems of compliance; the time, effort, and skill required for complying with tax laws do not contribute to the more ultimate objectives of more real output or less real cost per unit produced. Less rather than more complexity brings real social benefits even if they are not openly evident.

If companies have been deterred from tax depreciation methods which would be desirable because of the test's complexities, then it works against justice and equity among taxpayers. In any case, an economic reason for ADR lies in getting rid of the inducement to reducing the amount of capital equipment available, albeit machines of low productivity.

3. ADR would make a move, not large in relation to "need" but in the direction which seems to me wise, to enhance the productive capacity of the working force. Capital equipment lies at the heart of much of economic progress. Standards of living rise largely because the worker's output per hour goes up. Better "tools" are a major source of such improvements in productivity. More capital facilities per person, and capital equipment of increasingly advanced types, are essential for achieving the living standards which Americans expect.

Moreover, a growing labor force needs to be equipped. Rarely indeed will a worker entering the labor force be able to finance the job. Yet as a worker and consumer, he (and she) will expect real earnings which are utterly impossible without thousands, even tens of thousands, of dollars of productive capital.

Does the working man, and the consumer, really have any better friends than the suppliers of capital? Without capital facilities our levels of living would be low indeed. Yet the U.S. tax system (despite the effective exemption of earnings of pension funds and the generally favored treatment of capital gains) bears heavily upon (owners of) capital. Corporation earnings are taxed (at the margin, with state taxes) at around 50%, often more; shareholders pay full personal tax on dividends over $100 a year; property taxes frequently exceed 3% a year on the full value of new machinery and equipment; estate, inheritance, and gift taxes now absorb over $5 billion of private wealth (capital) a year; state-local sales taxes often apply to capital goods as well as to the values they help to create.

ADR would not, of course, appreciably reduce the bias against capital. But ADR would reduce tax payments, as friends and critics agree. Competition would pass some of the benefits of lower tax to consumers; employees would get some through bargaining. But some would remain to encourage and to facilitate modernization and even expansion. How much? The answers for a future which must differ from the past cannot be forecast with certainty. I see many difficulties in suggesting magnitudes from even the most advanced econometric techniques. And I wish to record an uneasy feeling that supporters of depreciation liberalization attach to it more force for improving the ratio of capital to labor than logic and evidence will support. At most it does very little to increase saving. Yet some benefits would result.

4. An economist concerned with the longer run, which is my emphasis here, will insist that present depreciation practices are sadly obsolete in one respect. It is too vital to be ignored—except at our peril. The failure to recognize inflation! Obviously, the dollar has lost buying power in the market for machinery and equipment as well as in the supermarket. The "machinery and equipment" element of the Wholesale Price Index of early 1971 was nearly 25 percent above that of 1961. The Producers' Durable Equipment portion of the Gross National Product Deflator is almost one fifth above that as late as 1963.

Historical cost as the basis for computing depreciation results in treating some of the return of capital as if it were return to capital. The tax law then takes 48 percent of what it calls profits. These, however, are not limited to the true and real earnings of capital. The tax law (and generally accepted accounting principles) treat as income, not merely the fruits of capital, but in fact include part of the source of earnings. (When critics of relaxation of depreciation provisions speak of the "interest-free loan" from government to business, they might consider the fact that no small number of firms have been making, not merely "interest-free loans" to the Treasury but forced contributions of capital. I am, of course, well aware of other cases, e.g., real estate tax shelters; but they are not now at issue, and recapture provisions have become much stricter.) Literally, we have for years been sending to the Treasury, as tax on earnings, funds that in the basic economic sense are costs; these include dollars which are needed to replace productive capacity at higher prices. As a result, in our government spending we are to some extent consuming capital; the spending of revenues from the tax on corporation earnings, in other words, is not merely using part of the annual produce of capital.

This result of inflation ought to be faced forthrightly; Congressional action on a broader scale would be desirable. Accurate correction would be difficult. ADR would not directly deal with the inflation aspects of tax treatment of depreciation. But there would be some better opportunity for businesses to compute costs in more realistic economic terms. Not everything desirable in adjusting for loss in the purchasing power of the dollar could, or should, come by administrative action. But the modest change involved here would allow a little for the erosion of capital due to inflation.

5. A final point constitutes a persuasive economic reason for public policy to encourage investment in new machinery and equipment. An economist who generally favors the principle of neutrality in tax policy, one who prefers general reliance upon free competitive markets, who requires a strong force to overcome the presumption against governmental intervention—and I am such an econo-

mist—may nevertheless consistently favor a bias for new facilities. (This position does not for consistency require junking older equipment.) The argument was cited in 1961–62 as one reason for the Investment Tax Credit.

Much of the fruit of technological progress is embodied in new facilities. A significant fraction of the total increase in economic achievement results from technological innovation. Scientific advance often gets to the consumer through a process which involves new machinery and processes, sometimes entirely new types. Cost-reducing methods may require new facilities. Advances in product quality may need new productive equipment. The public will get benefit from invention and innovation progress more rapidly with prompt than with somewhat retarded introduction of machinery. In such earlier utilization of the best of technology, society can get a larger total gain from research and invention.

The ADR by giving producers greater freedom in deducting depreciation costs would thereby improve somewhat the attractiveness of installing new machinery earlier. The public would get an "extra dividend," an "external benefit." This result would consist of the fruit of more top quality facilities, more of the most advanced productive capacity, earlier than otherwise.

The "useful lives" criterion tends to sacrifice flexibility needed to take advantage of technological progress. ADR will aid in adjusting to the realities of obsolescence.

Respectfully yours,

C. LOWELL HARRISS,
Professor of Economics.

Mr. FIELDS. Third, Dr. Elliott R. Morss, associate professor of economics at George Washington University, who has taught in the Harvard Law School international tax program and has written extensively on international tax and economic affairs.

STATEMENT OF ELLIOTT R. MORSS, ASSOCIATE PROFESSOR, GEORGE WASHINGTON UNIVERSITY

Mr. MORSS. Mr. Chairman and members of the committee, I will focus my remarks on the DISC proposal per se.

It is certainly true that U.S. business in the last few years has not shown itself to be particularly competitive with foreign business. However, I do not believe that enactment of the DISC proposal at this time is a proper way to address this situation.

First off, just in terms of what DISC would cost, I am very disturbed about the amount of research that has been done on actually what the cost of DISC would be and what its effect would be. Just as an analogy I suggest to the committee think of the amount of time and effort that has already been put in on the family assistance program by the President and even with all of this research that has been done you and others have felt that there should be more research done. I think quite unlike the family assistance program there is a lot of very, very easy to do research on DISC that would make this much more aware of what its benefits and costs would be.

As to its costs, the estimates range all the way from $600 million to $1.1 billion. As to its benefits, there are two sources of estimates here in terms of benefits and terms of additional exports. The first is based on work done by Henry Houthhaker, former member of the Council of Economic Advisers, at Harvard, which were followed by the staff, your staff, in terms of what their implications were for the additional exports of DISC. The estimates that your own staff has prepared suggest that in the first full year of operation DISC would only increase exports somewhere between $300 and $450 million.

The second estimates of increase in exports comes from the Treasury and they are now talking in terms of $1.5 billion.

I have made some effort to determine how they have arrived at these figures without much success. The only thing I do know is that they are submitting for testimony letters from a number of large U.S. firms who have been testifying on what additional exports they will generate if DISC comes into effect and I would question these letters both in terms of the possible bias of the people writing them, although I am certainly not suggesting that they are directly lying on it, and secondly, as to whether these large U.S. firms are truly representative of U.S. exporters in general, and one of these grounds in the material I would like to submit I will make some specific comments.

Senator BENNETT. At this point may I ask Mr. Morss to submit the material he has in mind. I think it would be very helpful to us and that it be included in the record.

Mr. MORSS. I would have had it today except for the——

Senator BENNETT. While I have interrupted him, Mr. Chairman, may we invite each member of the panel to submit additional material backing up or amplifying his testimony and that it be put in the record along with his testimony.

Mr. MORSS. Just going back to the point in terms of what I think needs to be done to find out what the effect of DISC and other measures to improve our competitive position are, first, I think we need a much better idea of how far away we are at this point from being price competitive with foreigners. It makes a tremendous difference in terms of the response of U.S. firms as to whether the amount he must reduce his price to get foreigners to buy his goods is a very small percentage of the existing price or very large percentage. If it is a very small percentage steps such as DISC may well lead to an increase in our exports. On the other hand, if we are very far from being price competitive, the natural response and the understandable response of the American businessman when offered such as DISC would be to pocket the benefits he gets from DISC and not bother to try to, it wouldn't make any point in terms of having reduced price. In fact the small reduction in price he may be able to accomplish as a result of DISC isn't going to make him price competitive. Unfortunately, the work on an industry by industry basis in terms of the amount of analysis done as to whether U.S. business is close to being price competitive, is or not, similarly has not been done. Treasury started a study in this a few years ago on an industry by industry basis and for reasons I can't understand abandoned it.

Now, if one takes the Treasury figures of $600 million cost to $1.5 billion benefits as accurate, I personally would question that as a meaningful and useful tradeoff at this particular point in time, but as I said, I would much rather focus at this point on trying to get better measures here.

Now, very often in testimony before Senators and Congressmen have raised questions concerning what is needed to put U.S. business on an equal competitive footing with foreign firms and very often this has been raised in terms of what sort of tax subsidies or tax credits do we give in comparison to foreign countries? I think this is an overly narrow question to ask in terms of trying to figure out what we need to do to get U.S. business on equal——

Senator BENNETT. The panel was to have 10 minutes.

Mr. MORSS. All right.

Senator BENNETT. You have had a little more than 10 yourself. I suggest that we give each of the remaining members of the panel 5 minutes each, stretching it above what they might have had otherwise. We still have one more witness held over from another——

The CHAIRMAN. Why don't we let them have 7 minutes each?

Senator BENNETT. OK.

That is a good legislative compromise.

Mr. MORSS. Let me apologize for running on and very briefly conclude by pointing out that if one looks at, just following from Professor Harriss, which is corporations are no different than individuals, if one accepts that, then a relevant tax comparison figure would be total taxes of percentage of GNP for both the United States and its foreign competitors, and as of 1967 the figures suggest that the U.S. tax burden is lighter than all of the major industrial competitors of the United States with the exception of Japan. Specific figures are, that is tax percentages of GNP, Japan, 19.1 percent; United States, 23.9 percent; Canada, 26.7 percent; United Kingdom, 30.6; Italy, 30.8; Germany, 33.5; Netherlands, 34.4 percent; and France, 38.5 percent.

Senator BENNETT. I see Dr. Harriss shaking his head.

Mr. HARRISS. U.S. figures are certainly higher than 23 percent now by quite a bit.

Senator BENNETT. Would you like to submit a list too?

Mr. HARRISS. I am sure we can get the U.S. figure.

COLUMBIA UNIVERSITY, DEPARTMENT OF ECONOMICS,
New York, N.Y., October 20, 1971.

Hon. RUSSELL LONG,
Committee on Finance, U.S. Senate.

DEAR SENATOR LONG: At the hearing Monday I agreed to submit data on taxes in relation to GNP for the United States and certain other countries. The enclosed table from Tax Foundation's FACTS AND FIGURES ON GOVERNMENT FINANCE, 1971, shows data for 1968. Inquiry at the United Nations, which is the source of the data for other countries, reveals that later data are not yet available.

At the present time I would judge the figure for the United States to be nearer 31 percent (including, as I believe is necessary, Social Security taxes). Personally, I believe that comparisons of taxes with GNP are less generally useful than comparisons with Net National Product or National Income. But the issues involved are complex and need not be presented here. The clear fact is that our total taxes are very much higher than those indicated in the figures given by Dr. Morss; he was, I believe, giving an amount closer to Federal taxes alone—but we all pay state and local taxes as well, and they are higher here in relation to the total than in many other countries.

Please believe me to be
Very truly yours,

C. LOWELL HARRISS, *Professor of Economics.*

SECTION 1—19. TAX REVENUES IN RELATION TO GROSS NATIONAL PRODUCT IN SELECTED COUNTRIES—1955 1960 AND 1968[1]

[Taxes as a percentage of GNP]

Country[2]	Total taxes			Major tax categories, 1968			
				Direct taxes[3]			
	1955	1960	1968	On households[4]	On corporations	Social security[5]	Indirect taxes[6]
Australia	21.9	22.9	24.4	8.9	3.9	(7)	11.6
Austria	29.3	30.5	[8]35.9	10.6	1.9	8.0	15.4
Belgium	22.6	25.2	33.0	8.1	2.1	9.5	13.3
Canada	23.7	25.0	31.2	8.8	3.9	3.4	15.1
Chile	16.9	24.8	29.9	2.5	4.4	8.8	14.3
China (Taiwan)	15.9	14.7	16.7	1.4	.8	(7)	14.6
Colombia	12.3	11.3	14.2	2.1	2.3	1.5	8.3
Denmark	24.0	25.3	34.7	15.3	1.0	1.9	16.5
Ecuador	15.0	15.2	[8]16.1	.7	2.9	2.9	9.7
Finland	26.6	27.6	33.3	11.5	2.5	4.3	15.0
France	32.1	[9]33.8	37.0	4.7	1.8	14.5	15.9
Germany	31.9	[9]33.9	34.7	8.2	2.3	10.5	13.6
Ireland	21.5	21.6	28.4	5.4	2.0	2.3	18.7
Italy	24.3	27.9	30.5	6.8	----	11.1	12.6
Jamaica	11.9	[9]14.3	[8]17.2	2.7	3.5	(7)	11.0
Japan	18.2	18.4	19.0	3.9	4.0	3.6	7.5
Korea, Republic of	6.1	10.2	12.2	1.2	1.6	(7)	9.4
Netherlands	26.2	30.1	37.8	10.4	2.8	13.4	11.2
New Zeland	26.4	27.4	26.0	13.0	5.1	(2)	7.9
Norway	29.2	32.4	38.2	12.3	1.5	9.2	15.2
Philippines	9.5	9.7	11.1	1.4	1.6	(2)	8.1
Portugal	15.9	16.7	19.6	1.8	3.8	3.9	10.1
South Africa	14.9	15.4	18.1	4.6	5.7	.3	7.5
Sweden	27.9	30.9	42.2	18.6	1.5	8.2	13.9
United Kingdom	28.5	27.1	34.4	10.6	2.5	5.1	16.2
United States	24.9	27.3	30.0	10.9	4.7	5.3	9.1

[1] Primarily calendar years; however, data for some countries are reported on a fiscal year basis.
[2] Selection of countries depends in part on availability of data.
[3] Direct taxes are imposed on receivers of income, e.g. households, corporations, and private nonprofit institutions; indirect taxes are imposed on goods and services.
[4] Excludes social security taxes. Includes non-profit institutions.
[5] Includes contributions of both employers and employees.
[6] Includes real estate and land taxes.
[7] Social security taxes are not listed separately; they are included under direct taxes on households.
[8] The data are for 1967.
[9] Figures are not comparable to those of previous years.

Source: Percentage computations by Tax Foundation based on data from United Nations National Accounts Statistics, 1969. From Tax Foundation, Inc., "Facts and Figures on Government Finance," 16th biennial ed, 1971.

Mr. MORSS. Just one final point. I would strongly recommend instead of introducing DISC at this time, to simply go with the devaluation, find out what the effect of this would be. I estimate that 10 percent devaluation would benefit U.S. business in terms of additional profits to the tune of something like $3 billion.

(Additional testimony submitted by Mr. Morss follows:)

ADDITIONAL TESTIMONY OF ELLIOTT R. MORSS

Mr. Chairman and Members of the Committee on Finance, I will limit my remarks to two subjects: The Domestic International Sales Corporation (DISC) proposal and the distribution of tax breaks for business and individuals.

A. THE DISC PROPOSAL

The international competitive position of U.S. business has not been particularly robust for a number of years, and something needs to be done about it. Of the many things that could be done, the DISC proposal is among the least advisable. In saying this, I am echoing the views of most of the experts in the field, aside from those working for firms who would benefit directly from its enactment. Among others, the opponents include the Congressional tax experts on the staff of the Joint Committee on Internal Revenue Taxation.

Why the DISC Proposal should not be enacted

While the actual cost of DISC is unknown, there is unanimous agreement it will be expensive. It is so expensive in fact, that considerably more research should be done on its probable costs and benefits before it is enacted.[1]

Specifically, estimates as to its budgetary costs range from $600 million in the first year of enactment to $1.1 billion. On the export generating side, estimates range from $300 mililon (see the "confidential" report of the Joint Committee staff) to the $1.5 billion estimate by the U.S. Treasury.

There are two sources for export estimates. The first is some econometric work on international price elasticities done by Houthakker and Magee. Using these data, the Joint Committee staff has estimated the DISC proposal will generate only $300 million in additional exports in the first full year of operation. The bases for Treasury estimates are uncertain; it would appear that they are based on submissions by individual firms. I would question the accuracy of this latter data on two grounds:

1. Can firms likely to benefit be counted on to make unbiased estimates?
2. Can the firms that have made submissions be taken as representative of all U.S. exporters?

Take the Hewlitt-Packard submission as an example. It claims, without justification, the following:

Estimated additional export promotion costs (percent):	*Resulting Percent Increase in Exports*
3	0- 5
5	6-10
7	11-15
10	16-20

This suggests that for a 10% increase in the amount of money used to promote exports, they could increase exports from 16-20 percent. If this is the case, it would seem, assuming the firm is trying to maximize profits, that it would incur the additional costs with or without DISC because such actions would increase their overall profits. Why then, is DISC needed?

In point of fact, research is needed on the export response question. This research should focus initially on how close U.S. industry is to being price competitive to foreign firms. If U.S. industry is close to being price competitive, inducements such as DISC should lead to substantial additional exports; if, on the other hand, there is a wide price differential, the U.S. firm would see no reason to try to expand its exports and would simply pocket whatever inducements it is offered to expand exports. I don't pretend to know what the situation is. Studies are needed on an industry-by-industry basis. I would hope the Committee would ask the Treasury to provide such studies prior to further action on DISC. In addition, further work is needed on the quantitative limitation on the importation of U.S. goods by foreign nations. If these are substantial, no amount of U.S. government inducements will be very effective in increasing our exports.

It is often argued that the DISC proposal should be enacted in order to eliminate the tax advantages foreign firms have over U.S. firms. I would argue that this is an overly narrow view of the matter. Government activity can affect the costs of exports in a number of ways beyond the specific inducements written into the tax code. For example, it can be argued that the tax burden on individuals is as important to business costs as direct taxes on business. If so, the overall tax burdens of countries (total taxes as a percent of GNP are relevant). As Table 1 indicates, the U.S. has a lower overall tax burden than nearly all of its industrialized competition.

[1] It is interesting to compare action on DISC with action on the Family Assistance Program (FAP). More than $10 million has already been spent investigating the work incentive effects of FAP, but it has been decided to devote more research to it prior to its enactment. Research on the DISC proposal is virtually non-existent, despite its high cost.

TABLE 1—*Tax burdens of industrialized countries, 1967*

Japan	19.1
United States	23.9
Canada	26.7
United Kingdom	30.6
Italy	30.8
Germany	33.5
Netherlands	34.4
France	38.5

But other things than taxes should be taken into consideration. Governments differ in the ways they spend their funds. To the extent that funds are spent on cost-reducing infra-structure, the costs of doing business in a particular country will be lower.

Also, it should be recognized that the United States has a set of significant export promotion schemes of its own. For example, grants, both military and economic, are tied in most cases to the purchase of U.S. goods. Foreign nations can buy U.S. goods by borrowing at less than market interest through PL 480, the Export-Import Bank, and our foreign military sales programs. Taken together, these export promotion schemes are responsible for at least $5 billion annually in exports.

All this is not to say that U.S. business does not work at a competitive disadvantage. It does suggest, however, that a far broader view (and considerably more research) is needed before reaching such a conclusion.

It is also argued that DISC is needed to put U.S. exporters on an equal competitive footing with U.S. foreign subsidiaries. I would suggest that the best way to eliminate this "inequity" is to eliminate the preferential tax treatment given foreign subsidiaries. As is documented in a paper appearing in the *Papers and Proceedings of the American Economic Association* of 1970 by George Kopits, a U.S. Treasury economist, such a step would lead to a substantial capital inflow into the United States, and this would, at least for the short run, improve our balance of payments considerably.

If not DISC, what?

The above considerations, coupled with the obvious political and administrative problems associated with enacting DISC, argue against its enactment at this time. What then, should be done?

We are in the process of a dollar devaluation. I feel this is the vehicle we should rely upon to bring U.S. industry back into competition with other nations. Unlike the hostile views towards DISC, foreign nations wholeheartedly support a U.S. dollar devaluation. Further, a devaluation involves none of the administrative complexities of DISC. To give some idea of the quantitative importance of devaluation, consider the following: if there were a 10% dollar devaluation, and if U.S. businessmen increased their dollar prices to foreigners to compensate exactly for this devaluation, I estimate that the resulting increase in before-tax profits to U.S. exporters would come close to $3 billion.

In short, I oppose enactment of DISC at this time. Insufficient research to justify its enactment has been done to date. I favor devaluation as the vehicle to bring U.S. firms back into competition internationally. And since we are in the process of a devaluation, let's at least hold off enactment of DISC until we can see what the results of the devaluation will be.

B. TAX BREAKS FOR BUSINESS AND INDIVIDUALS

A lot has been made of the extent to which business and individuals share in the tax reductions being offered by the Administration. To me, this is a red herring issue. Who initially gets the tax breaks is not important. What is of primary importance is getting us back to full employment without starting another inflationary spiral. My own feeling is that a substantially larger stimulus than the Administration is currently offering could be tolerated without risking a new inflationary spiral. This is because the current inflation stems not from supply-demand imbalances in our domestic economy, but from the expectation that the current inflation will continue. These expectations can be changed if the Administration continues to control wage and price increases for the next six months. And it will take considerably more than six months for the economy, even with a substantially larger fiscal stimulus, to get the unemployment level down low enough to start worrying about a new inflationary spiral starting as a result of excessive demand conditions.

I want to make one further point before closing. I am concerned about proposals to expand the personal exemption level at a time when the nation is concerned about population pressures. Expanding the exemption level makes it cheaper to have children, and while I would not urge a reduction in the exemption level, I can hardly see any reason for increasing it. Rather, I would favor offering a double exemption for adopted children.

STATEMENT OF RICHARD A. MUSGRAVE, PROFESSOR, HARVARD UNIVERSITY

Mr. FIELDS. Mr. Chairman, we will try to get Dr. Morss and Professor Harriss to concentrate on the questions that you have just raised and, if possible, to delineate what the differences between them may be in a statement for the record.

Our fourth witness is Prof. Richard Musgrave of Harvard University. He is the author of the "Theory of Public Finance and Fiscal Systems."

Mr. MUSGRAVE. Mr. Chairman, I have a somewhat longer statement which I would like to submit for the record.

I was also asked by my colleague, Professor Surrey, to submit a statement of his as part of this.

I would like very briefly to comment on three aspects bearing on how the tax bill now being considered fits into the administration's general new economic policy.

The first point bears on the expansionary effect of these measures by matching tax with expenditure cuts, the expansionary effect of the former will be largely wiped out, and remaining net effect will be insufficient. The proposition that expenditure reduction is necessary to avoid inflationary effects whereas tax reduction evidently will not have this consequence I believe is fallacious. Any net expansion in demand which, of course, would be needed on employment policy would accent the inflationary problem and that would be the case whether it results from tax deduction or expenditure increase.

From a priority point of view I think that the proposed tax reduction is unfortunate. I would much rather have seen a speed up of the welfare program and increased benefit payments.

Second, I agree with Professor Harriss that it doesn't make too much sense to compare taxes on business with taxes on people, but I do think it makes sense to compare taxes on profits with profits on wages and this aspect seems to me to be especially relevant in the present situation where our main problem will be that of decision as well as incomes policy.

I believe that such an income policy require effective wage controls but that effective wage control will not be possible without an equally effective constraint on profits.

I feel that the heavy emphasis on profits, tax relief in the present bill from that point of view is quite untimely, that it would have been helpful instead, that the tax legislation would have contributed by combining the investment credit on the one side with more effective taxation of profit income on the other, such as tightened capital gains taxation.

I also believe that in the future consideration of excess profits tax cannot be entirely ruled out. I differ in this with my friend Atley, but I do think in the long run the problem of getting an acceptable incomes policy is going to prove indeed a very difficult one.

Finally, the Domestic International Sales Corporation proposal, I believe, contradicts the spirit if not the law of GATT. It invites retaliation, creates ill will and opens new loopholes in the tax structures. Similar objections apply to it by U.S. provision of the investment credit.

I agree with with Professor Morse that for the very least we should wait until we can see what adjustment can be secured through exchange rate adjustments, so no action on DISC should be taken at this point.

I also feel that if tax action is to be taken to deal with the exchange problem primarily consideration should be given to limiting or perhaps doing away with the tax deferral on foreign source income. I believe that this in its effect on capital outflow and in the resulting enormous increase of sales of American subsidiaries abroad which are about three times our manufacturing exports, that this has been a worsening factor in the balance-of-payments picture.

Thank you.

(Mr. Musgrave's and Professor Surrey's prepared statement with attachment follows. Hearing continues on p. 738.)

PREPARED STATEMENT OF R. A. MUSGRAVE, PROFESSOR OF POLITICAL ECONOMY, HARVARD UNIVERSITY

My comments are directed at certain broader issues bearing on the role of this legislation in the Administration's new economic policy, especially its second phase.

EXPANSIONARY EFFECTS AND SOCIAL PRIORITIES

The fiscal strategy proposed in the President's new economic policy combines tax reduction with expenditure cutbacks, calling for an expenditure cut in the current fiscal year of from $4.6 to $6 billion. The Report of the Ways and Means Committee concurs and holds that "strict expenditure control is an essential part of the program to check inflation and your committee believes that it is essential that these expenditure reductions be achieved". What are the implications of this dual approach for both stabilization and social policy?

As a matter of stabilization policy, the two adjustments move in opposite directions. Expenditure cuts are restrictive, while tax cuts are expansionary. What matters, therefore, is the net effect or change in demand which results if both adjustments are considered. With tax reduction amounting to about $7 billion for fiscal 1972 and an expenditure decrease of $5 billion, we would be left with a net expansionary effect (due to the changes called for under the new policy) of about $2 or $3 billion, an amount which seems of negligible importance in a trillion plus economy. In other words, if we take the Administration and the Committee literally, there will be little if any additional net expansionary effect from the fiscal side. Expansion will have to be fed mainly from an increase in net exports, and here the target is set so high as to involve a begger-thy-neighbor policy which is hardly compatible with good trade relations. I am told that neither the Administration nor Congress takes the prospective expenditure cuts seriously, so that there may be a substantial net expansionary effect after all. I hope I have been informed correctly, but even so, you will forgive my noting the flaw in the argument as presented to us, an inconsistency which can hardly escape any beginning student of economics.

I would similarly call your attention to the implication that public expenditures must be reduced because they are inflationary, while the increase in private outlays due to tax reduction is not. This is an erroneous position. To be sure, an increase in private capital formation will be less inflationary in the longer run than would an increase in public or private consumption outlays. But this is a long-run difference only and not of major importance with the horizon now considered. The truth of the matter is that higher expenditures are needed to return us to higher employment and that such an increase in expenditures will aggravate the inflation problem, whether they be public or private. There is no case therefore for the proposition that public expenditures are inflationary, while private are not.

The proposed substitution of private for public expenditures makes a difference, however, once considerations of social policy are introduced. The question then is what public expenditures are being postponed and what private expenditures are being increased. Instead of postponing welfare reform, or acquiescing in such postponement, I would have urged acceleration of the program, combined with an increase in minimum benefit levels. I would have given this priority over profit tax reduction. Moreover, I would have preferred this even to the proposed increase in the low income allowance. I do not follow the logic of pushing the floor of income tax liability up to the poverty line, while leaving that of income maintenance payments nearly 50 per cent below it.

Nor is this only a short-run problem. Over the past years, we pursued a policy of periodic tax reduction, enacted against a background of rising social needs. As it now stands, there will be little or no fiscal dividend emerging by the mid-seventies, yet substantially expanded programs will be needed if we are to come to terms with the problems around us, including provision of the necessary support to state and local finances. Thus, I have serious doubts about the wisdom of the entire approach. I find the fiscal proposals much the weakest link in the Administration's three-pronged program. The revised version in the House bill is somewhat better, but not good enough.

RELATION TO PHASE II

The preceding considerations lead me to prefer speeding up of tax reductions already provided for to the granting of additional reductions. The former will be helpful in the short run without diminishing our future tax base. I therefore support the speed-up provisions contained in the Administration proposal and the House bill. However, both measures provide for substantial additional reductions. In the House bill these amount to over $10 billion (fiscal 1973), including $1 billion for the further increase in the minimum standard deduction to $1,300, $3.9 billion for the 7 per cent investment credit, $2.5 billion for the acceleration of depreciation,[1] $2.5 billion for reduction in automobile excises, and $200 million for the DISC proposal.

There has been a good deal of debate over how the relief is divided between "individuals" and "business". This is a misleading distinction. In the end, all taxes must fall on individual, whether they are collected from business or households in the first instance. What matters is whether the tax cuts benefit high or low-income groups, and whether they occure to profits or to wage income. My concern here is mainly with the latter distinction, since it is of particular importance to Phase II.

Thus, two thirds of the proposed reductions will go to benefit profit income with only one third going to wage earners. While it is only fair to mention that this reverses the pattern of the 1969 Act when reductions were largely in the individual income tax, I doubt the wisdom of providing such extensive profits tax relief at the very time when we are to undertake the design of an incomes policy.

I begin with the premise that labor cannot (and should not) be expected to accept effective wage controls without the assurance that an equally equitable treatment will be given to profits. The question is how this can be done. Holding down prices, of course, will help, but no one contemplates general price controls, so that this constraint will be far from perfect. Control over dividends, which

[1] The figure of $2.5 billion is obtained by reducing the estimated revenue cost of the initial Treasury action of $4 billion by the estimated tax saving (due to the elimination of the first year convention provision) of $1.5 billion. The Ways and Means Committee report only cites the latter saving without counting the cost of the former. Since the Treasury ruling was of dubious legality and is now being legalized by the Committee action, it would seem prudent to look at the net revenue implications of both measures.

has been mentioned as an alternative, is no substitute. Indeed, I find it disingeneous to see them advertised as a substitute. Postponed dividends are reflected in capital gains (which, incidently, are given preferential tax treatment) and become available for later distribution, whereas postponed wages are lost forever. The restraint on dividend distribution therefore is no substitute for profit control; nor does it do much in checking immediate inflation pressures, since it tends to involve substitution of one for another type of expenditures. The difficulty is not removed by nothing that the current levels of profits is low and that profits should rise in the cyclical upswing. Such will and should be the case, but the question is whether excessive gains may not develop in the process.

One possible approach of dealing with the problem is an excess profits tax. This possibility has been ruled out of court—I believe somewhat rashly so—by my friends Heller and Ackley. While I am aware that such a tax is difficult to implement, especially if applied for a lengthy period. I am not confident that an effective alternative can be developed. Let us hope that it can. In the meantime there remains the more limited question whether this is the day to untax profits. Would it not make more sense to tighten the tax treatment of profits, especially of capital gains, as a contribution to the basic issue of equity which must be faced in the design of an incomes policy? Given such a measure, the proposed investment credit could be retained but be seen as part of a more balanced picture.

Turning to more specific aspects of the proposed legislation, I would suggest the following considerations:

(1) I believe that the original Administration proposal for an initial investment credit rate of 10 per cent, to be reduced to 5 per cent in 1973, is preferable to the flat 7 per cent rate provided in the House bill. I take this view because the immediate effect of the former on the level of capital expenditures will be substantially greater, and also because I favor use of the credit as a flexible device which can be adjusted to changing economic needs.

(2) To the extent that investment is to be encouraged, the credit approach is preferable to the acceleration of depreciation. I thus prefer the truncated ADR provision of the House bill to the Treasury ruling, but would rather see this ruling suspended altogether.

(3) I am not enthusiastic about the proposed repeal of the automobile excises. On the whole, automotive services are under—rather than overtaxed, if the social costs of crowding and pollution are included in the picture. Among selective excises the automotive tax is thus one of the superior taxes. I should like to see it retained in the tax structure. If a permanent reduction in excise taxes is to be made, I would prefer elimination of the tax on telephone services. As an alternative I favor a recent proposal to limit the reduction on automobile excises to one year.

RELATION TO FOREIGN BALANCE

The introduction of the Administration's new economic policy was triggered by our deteriorating balance of payments, and its success will be measured to a large degree by improvement therein. The most important tie-in with the tax bill is in the DISC proposal, advanced earlier by the Administration and included with some limitations in the House bill. Another is the limitation of the investment tax credit to domestically produced equipment.

I believe that these provisions are undesirable on two grounds. For one thing, they contribute to the rather unfortunate—"it's all your problem anyhow"—stance which U.S. policy has taken. The DISC plan is hardly acceptable under GATT rules and undoubtedly will lead to extended controversy and eventual retaliation. An outright export subsidy or continued import surcharge would be simply and more above board. The "buy U.S." limitation of the investment credit similarly is the kind of hidden subsidy which is obnoxious to liberalized foreign trade and which is sure to contribute greatly to international ill will. It reflects precisely the kind of policy to which the U.S. has objected in foreign countries. Now that exchange rates are to be realigned, it will be much better to rely on this general mechanism, even though the latter might have been useful under the old setting. In any case, we should postpone action until the exchange rate has been adjusted.

There is further reason, quite apart from these considerations why DISC should be rejected. At a time when we hope to make some progress in the elimination of tax preferences and loopholes, a new potential source of tax avoidance is being opened. The exemption of export profits from tax, which is the essence of the DISC proposal, may purchase some additional exports, but this will be done at a cost not only in revenue but also (and this worries me more) in terms of heavy loss of tax equity. While the scope of the DISC has fortunately been reduced in the House bill (by limiting it largely to incremental exports) its equity implications remain substantial and new complexities will be added to the law.

There is, however, another area of the tax law in which action may well be appropriate. This is reduction or elimination of the deferral of U.S. tax liability on foreign investment income until repatriation. In my judgment, U.S. capital export has been one of the major factors in generating the balance of payments crisis which has now come to a head. U.S. long-term foreign investment in 1970 reached a record annual rate of 6.2 billion, most of which goes to highly developed countries. Such outflow appears as a debit on the balance of payments account, no less than imports. This outflow, to be sure, is now more than matched by the repatriation of profits on past outflows, but in last year's picture, the worsening of the crisis could have been improved greatly if the boom in outflow had been restrained. In any case, this is only a small part of the picture. Quite likely, the massive growth of foreign production by U.S. subsidiaries has cut heavily into U.S. exports and has thus been a major factor in worsening the balance of payments picture. Thus, sales by foreign manufacturing affiliates were $59.7 billion in 1968, as against exports of manufactured goods of only $20 billion. This development has been encouraged and continues to be supported by the present deferral provision. If tax action is to be taken to support our balance of payments position, reduction or removal of the deferral provision rather than DISC should be given priority.

Indeed, such a policy would be desirable quite apart from balance of payments considerations. In 1970, total expenditures on plant and equipment made abroad by the affiliates of U.S. corporations amounted to $13 billion, as much as 20 per cent of corporate domestic investment. If increased domestic investment is so urgently needed (as indicated by the compounding of accelerated depreciation and investment credit), some redirection of this flow should be welcome. All this seems evident enough, but it has received little attention in the discussion. Indeed, the Secretary of the Treasury has argued that a $13 billion export surplus will be needed, in part to pay for this investment outflow, a surplus which would tend to generate serious difficulties among our trading partners.

In all, I am pleased to applaud the President's program as far as incomes policy and exchange rate adjustments are concerned, but I find little to praise on the fiscal side. Not enough is being done, and much of what is being proposed is of the wrong kind.

Prepared Statement of Stanley S. Surry, Professor of Law, Harvard Law School: DISC Proposal—Either Treasury Full Exemption or House Incremental Exemption—Is Undesirable

Summary

The Treasury Department version of the DISC proposal means virtual exemption from the income tax for the export trade of the United States. The House version of the proposal, in H.R. 10947, provides such exemption for exports in excess of 75 percent of the average export sales for the period 1968–1970—the so-called incremental version.

Either version is clearly undesirable. The full exemption provides a costly annual windfall approaching $1 billion a year to exporters, principally our largest corporations, out of all rational proportion to whatever problematical increase in our export trade may result. The incremental version reduces the revenue loss by substituting great complexity, again out of all rational proportion to the problematical benefits for the United States. The undesirability of either approach sharply illustrates that the DISC idea itself is basically wrong.

The only rational approach is to reject the DISC proposal. The question of Government assistance to our export trade should then be reassessed after we know the outcome of the international monetary and trade developments now underway. Only after the new pattern of foreign exchange rate relationships is

in operation and the trade restrictions of the various countries, including our 10% import surcharge, altered can we be in a position to assess realistically the needs of our export trade Only then can we determine what further governmental steps, is any, are required.

I. UNDESIRABILITY OF TREASURY DISC PROPOSAL—FULL INCOME TAX EXEMPTION FOR EXPORTERS

The Treasury DISC proposal was launched in 1970 as a gimmick to increase our experts. It came at a time when the Administration was nibbling at the edges of our trade problem, and represented a Government handout of a billion dollars a year to exporters, in the hope this would induce them to increase their export activity. In 1971, under the New Economic Policy, we are at last focusing on the crucial factor affecting our trade, that of the need for a realignment of foreign currencies in relation to the dollar. It is this realignment, together with removal of trade restrictions elsewhere and a resharing of defense burdens, that is designed to give us a needed turn-around in our balance of payments picture, with an increased trade surplus at the center of the new picture. Yet the faded DISC proposal, a relic of an outmoded posture, is still be pushed by the Treasury.

Indeed, it is ironical that under DISC the very success of our New Economic Policy will hand over to our large exporting corporations a completely undeserved windfall. Their exports will increase—and provide tax exempt profits—not because of any efforts on their part but simply because the dollar will be devalued relative to other currencies. This windfall exists under either version of DISC, full exemption or incremental exemption, since such devaluation is a guarantor of increased exports. We must not forget that the devaluation means a price to be paid by some Americans. Those parts of our economy that depend on imports, and those consumers of imports or products with import components, must pay in higher costs the price for the increase in exports. It is their higher costs and consequent burdens that are being traded against the larger profits for our exporters and the benefits for those associated with export commodities. These readjustments may be appropriate in the national interest. But it is not in the national interest to accompany this trade-off with additional automatic tax exemption for the larger profits virtually being handed over to our exporters

The tip-off that the DISC proposal is simply wrong and ill-advised is seen in the refusal of the President's Commission on International Trade and Investment Policy to recommend DISC in its recent report. That Commission was charged with providing principles to guide U.S. trade policy in the nineteen-seventies. The Treasury came before that Commission and urged that it support DISC. Yet the Commission refused to do so, saying instead:

"However, we have reviewed the DISC (Domestic International Sales Corporation) proposal, which would permit deferral of U.S. income tax on export sales profits, and we were unable to reach a consensus on it" (121–122)

This refusal to support DISC is all the more meaningful in view of the fact that the President's Task Force on Business Taxation had endorsed the proposal in 1970, though indeed its endorsement was lukewarm and accompanied by the statement that it did not anticipate adoption of DISC would dramatically improve our balance of trade. With this tepid endorsement followed by a refusal of the Presidential Commission in 1971 to endorse DISC, the basic mistake of the Treasury in still urging DISC is underlined.

I have included as Appendix A an earlier statement criticizing the DISC proposal for full exemption—a proposal the Treasury is still urging. Those remarks are still relevant. Indeed, even in the Senate and even after its errors have been pointed out, the Treasury persists in presenting a distorted description of the proposal to hide its defects. Thus, Secretary Connally's statement before this Committee says that "the deferral of tax on DISC income is available only so long as the income is, in effect, used for export-related activities." Yet in fact the DISC income can be used for domestic activities having nothing to do with exports; moreover, if there is an expansion of purely domestic activities the DISC income can be used to permit expansion of foreign manufacturing activities so that exports may even be retarded.

There is also attached, as Appendix B, a more detailed statement critical of DISC as urged by the Treasury.

One suspects that the House Ways and Means Committee has become highly suspicious of DISC, as well it might. This may account for that Committee's adopting DISC but only on an "incremental basis." We may therefore consider that version.

II. UNDESIRABILITY OF HOUSE DISC VERSION—INCOME TAX EXEMPTION FOR EXPORTERS ON AN INCREMENTAL BASIS

The House version places DISC on an incremental basis, by granting DISC benefits to exports in excess of 75 percent of the average of export sales for the particular company in the period 1968–1970. Even within the logic of an incremental approach, the House version has its defects:

There is no reason to use only 75% of the base period export sales as the base and thus allow windfall exemption for the remaining 25% of exports;

The base period should not remain static but should constantly move forward; otherwise windfall exemption is granted for the growth in exports that normally occurs as our economy and those of other nations expand.

Moreover, as pointed out earlier, even on an incremental basis the inevitable jump in our export trade that will follow on a realignment of world currencies—for that is the whole point for the U.S. in the realignment—will automatically bring windfall tax exemption to exports under the House Bill.

While the House incremental approach obviously lessens the windfall character of the Treasury DISC proposal, since the 75% base does not get tax exemption, that approach has its own set of problems. The incremental approach is complex, creates inequities as between different classes of business depending on their histories in the 1968–1970 base period; will disrupt normal trade channels as taxpayers seek to divert their exports into new organizations so as to create the artificial existence of a low or zero base period. Thus, suppose a manufacturer is exporting thru an independent merchant export corporation whose sole function is to handle the exports of various manufacturers. Such a corporation, when structured as a DISC, will have base period sales. But if the manufacturer ceases to use the merchant export corporation and instead creates his own DISC for his exports, that DISC will have a zero base period. Hence all its exports will be exempt, even though there has been no change in the volume of exports by the manufacturer.

This is not to say an incremental approach is wrong compared to the full exemption approach of the Treasury. Indeed, given the ill-advised nature of the Treasury DISC proposal, an incremental approach, improved as suggested earlier, is obviously necessary to keep down the windfall revenue losses. But this also is not to say that an incremental DISC version is a worthy and useful addition to our tax system. Indeed, the contrary is true. The incremental version will add complexity to the tax law, cause dislocation and confusion in the structuring of our export trade, and involve our lawyers, accountants and corporate executives in a wasteful drain of time and effort. Yet all of this merely underscores the fact that the effort to grant income tax exemption to our exporters should never have been started.

III. REJECT ALL DISC PROPOSALS—AND AWAIT THE RESULT OF CURRENT INTERNATIONAL MONETARY DEVELOPMENTS AND RELATED CHANGES

Superficially, it may seem the Congress has only a choice between two unsatisfactory courses. The House, wary of the large windfall element in the Treasury DISC proposal of full exemption, chose to reduce that element by placing DISC on a partially incremental basis. The Treasury says, however, that the incremental basis will frustrate the purposes it had in mind in proposing DISC. Along with others, the Treasury also points to the complexities and inequities of an incremental approach.

If a choice had to be made, Congress should choose the incremental approach, and strengthen the House bill. But Congress need not consider itself limited only to the painful task of choosing between two unattractive alternatives, each with its own set of problems and defects. Indeed, the very painfulness of the choice is an indication that DISC itself—income tax exemption for exporters—should not be a part of our tax law and never should have been proposed to the Congress. It is an indication that if our exporters do need governmental assistance, the use of income tax exemption, strewn on the one side with windfalls and on the other with complexities and inequities, is not the route to be chosen. This is especially so when there is no showing at all that following either approach will really help our export trade. The Treasury claims the incremental approach will not do so, and it has not presented any study, data or analysis to show just how the full exemption approach is to bring about a real improvement, let alone an improvement commensurate with an annual revenue loss of a billion dollars.

Given the unsatisfactory results either with full exemption or an incremental approach, there is a further reason not to be forced to a choice at this time. The preferable course, instead, is to place the DISC proposals aside and await the outcome of international developments now underway. The United States has set in motion forces that will greatly alter the present currency relationships and the future international monetary system. These forces will also bring about a dismantling of some of the existing trade restrictions in other countries. The final shape of these changes and their effect on our trade cannot yet be fully seen. But clearly we and the rest of the world know already that the end result is bound to be a real improvement in the United States trade position. This being so, in the light of the unsatisfactory nature of the DISC proposals, it is advisable to await the outcome of these international developments to see what further steps, if any, are needed to assist our exporters. Only then will we be in a position to assess the future of our trade position under these new world-wide changes and to weigh the new position of our exporters.

It would therefore be folly to lock ourselves into a permanent DISC at this time, whether it be the Treasury full exemption or the House incremental approach. There is no need for such a permanent commitment between unwise alternatives. Far greater forces are in motion that will improve our trade, and it would be wise policy to await their outcome.

[From the Congressional Record]

DISC: A Billion-Dollar Tax Loophole Hidden in New Economic Policy

(By Stanley S. Surrey)

The President's speeches on the New Economic Policy do not mention the "DISC" proposal, and so it receives almost no notice in the daily press discussions.

The silence cloaks the efforts of the Treasury Department once again to slide the DISC proposal into the tax law. Last year the attempt was made as part of the Trade Bill, when the fierce legislative battle waged over import restrictions permitted the DISC proposal to pass through the House, almost unnoticed and unseen and certainly not understood. Fortunately, the Senate Finance Committee then viewed the proposal with suspicion and it died at the end of the session.

There is good reason to keep the DISC proposal out of the spotlight. The proposal opens up a billion-dollar loophole in the income tax, through permitting U.S. exporters—especially our largest corporations—to escape that tax.

It would be a cruel irony to have the first significant technical income tax legislation to pass the Congress after the 1969 Tax Reform Act—the kind of legislation that only technicians and experts can follow—open up one of the largest tax escapes ever legislated by the Congress. Yet we find the Treasury Department being the moving force behind this attempt.

A DISC—Domestic International Sales Corporation—would be a new type of corporation conjured forth by this change in the tax law designed to "defer" the income tax on the "export profits" received by a domestic corporation engaged solely in the export trade. The quotation marks are used because the words they enclose turn out, as is so often the case in tax legislation, to have a significance far beyond their normal usage.

American businesses manufacturing goods that are sold abroad would be expected to organize DISC's—which need be only paper subsidiaries—through which their present exports would be channeled. The profits of a DISC from its export sales would not be subjected to income tax if the profits are used in export activities of the DISC or loaned to the parent-manufacturer corporation for "export-related activities"—again the significant quotation marks. This is the way the Treasury describes the proposal.

But under the terms of the actual legislation, it turns out that "deferral" would in practice become exemption; that "export profits" would very often include manufacturing profits; that "export-related activities" of the parent-manufacturer become activities having nothing to do with exports, extending even to investment for manufacture abroad; and that the references in title and description to "domestic" export subsidiaries cloak in practice and inducement to form foreign subsidiaries and, moreover, to form them in tax-haven countries, thus bringing back a pattern of abuse against which Congress legislated in 1962.

These are aspects that the Treasury does not talk about when it urges the proposal. For example:

1—The Treasury stresses in urging DISC that only a deferral of tax is involved, in terms that imply deferral is really not much—the tax is not paid now but must be paid a bit later on. Indeed, "deferral" for most Congressmen is a word that lulls them into believing very little is being given away. But the Treasury and corporate controllers know better. Thus, a high Treasury official, in talking recently to a professional group on aspects of accounting, said:

"I need not tell this group that tax deferral is the name of the game. A tax deferred one, two, or several years is simply a lower amount of tax on those who achieve such deferral—a burden that must be assumed by all other taxpayers."

For a profitable company, the present value of 15 years deferral—at the least the period the Treasury and business have in mind under DISC; indeed the deferral for many will be indefinite—is just about worth the amount of the tax itself, which makes deferral the equivalent of exemption. The reason is that the deferred tax-money that a company keeps over such a period (in effect an interest-free loan for that period) can be put to work earning additional money. In a typical case, the real cost to a profitable company for each $100 in deferred taxes would only be $18 to $20.

2—The Treasury stresses that domestic subsidiaries will be used and that this is helpful to unsophisticated businesses. But the tax experts who study the technical details know that the arrangement which gives the greatest tax windfall under the proposal is to combine DISC with a foreign tax haven subsidiary—a Swiss or Panamanian company. In 1962 the Congress rightly legislated against tax haven abuses. Now in 1971 under the cloak of a few technical words in the DISC proposal, the Treasury is sweeping away that legislation and directly legalizing and encouraging the widespread use of these tax havens.

3—The Treasury stresses that the profits of a DISC, freed from taxes, will be used to promote export activities. But the tax experts who study the technical details know that these tax-free funds can be used for activities that have nothing to do with exports. Thus, the funds can be used by large manufacturing companies, who are presently exporters, for purely domestic activities where the favored companies are able to compete with tax-free DISC money against companies not so favored. They can be used even to build manufacturing plants abroad—and thus reduce the export trade of the United States. The DISC money is simply made available to the companies and the Treasury will ask no questions on how it is so used.

The purpose claimed for this proposed tax-favored treatment of our exporters—exempting an entire activity from the income tax—is that it will stimulate our export trade and thereby help our balance of payments. But the revenue loss in the billions occurs even if not a single dollar of new exports occurs. Moreover, no one—not even the Treasury—has offered any public documentation and serious economic study of just how and to what extent and for what goods this windfall to exporters will increase our exports. On the contrary, most economists believe just the opposite, that the change will have only a slight effect on our exports out of all proportion to the revenue loss involved. No other country, even among those most incentive-minded, has adopted such a sweeping tax escape from its income tax.

When the questions are asked why is our tax system so unfair, why are there such gross escapes for some from the tax burdens borne by others, why do we have so much difficulty in focusing our scarce funds on pressing needs, the DISC proposal is a sharp and bitter answer.

Some corporations are of course pushing for the legislation, as are some law firms which see profits for them in reorganizing the business structures of their clients to fit DISC into the corporation organization charts. But to their credit, many a business concern and its executives, as well as their tax advisers, know the proposal is wrong—wrong for them because it means a windfall received which will not materially affect their level of exports and wrong for the country in terms of our national priorities. But it comes hard not to offer support when the Treasury pushes for their backing of the proposal.

In fact, I suspect almost everyone concerned knows DISC to be a bad tax provision. Surely the House Ways and Means Committee which initiated the tax reform legislation in 1969 should know better. One can believe that it does know better—after all, a dissenting report filed last year by some committee members explained in detail how the proposal was seriously wrong and had no place in our tax system. One suspects also that the Treasury tax experts know better.

Nevertheless, the proposal has found a place in the New Economic Policy of the President.

One suspects a cultural lag. Last year, pushed by Commerce, the Treasury came up with the DISC proposal to show it was trying to "do something" about exports. This year in August, however, the Treasury moved directly to get at the crux of our trade imbalance—the unfairness to our trade that resulted from the relationship of our dollar to foreign currencies—and is now seeking a realignment of those currencies. It is also using a temporary device—the 10% surcharge on imports—to emphasize the need for currency adjustments and other trade related changes such as removal of unfair restrictive practices in other countries.

But the DISC proposal, which will not really help our exports and instead will create a large tax escape, was left around from the earlier blueprints. It is now being quietly carried along as a windfall to business, even though we have a new set of blueprints really designed to do the job that must be done to improve our trade position.

The DISC proposal should simply be dropped as a bad idea—a major loophole if viewed as a tax provision; utterly in conflict with our national priorities if viewed as an expenditure device; ineffective and now supplanted by meaningful, direct steps if viewed as a trade measure.

Appendix B

Summary of Arguments Against DISC Proposal

I. Proposal eliminates an entire activity—exporting—from income tax.

II. Proposal involves a revenue loss of nearly $1 billion over the next two years and close to $1 billion annually thereafter—almost $2 billion in 1972–1974.

III. This sweeping exemption of export income, with its resulting large revenue loss, is taken without any presentation by the Treasury of any economic study or data to demonstrate why, where, and how this step will increase our export trade. Indeed, the revenue loss will far exceed any possible benefits to our export trade.

IV. Direct steps now underway to improve the U.S. trade position, such as the realignment of foreign currency exchange rates, are the key to trade improvement and make the Proposal obsolete.

V. Proposal involves tax reduction for our largest corporations.

VI. While Proposal is phrased in terms of "deferral of tax" and for "export profits"—it becomes complete exemption and for much more than export profits, reaching into manufacturing profits.

VII. Proposal provides corporations with tax-free money for domestic use—or foreign investment—having nothing to do with exports.

VIII. Proposal, though described in terms of domestic export subsidiaries, will in reality encourage foreign subsidiaries and bring back tax-haven operations.

IX. Proposal is inconsistent with our other tax rules and does not find any parallel in the tax rules of other countries.

X. Proposal is likely to cause foreign retaliation and emulation which will hurt our trade balance.

XI. Proposal is complex, with many surveillance problems and many inroads on existing rules, so that its weaknesses and further loophole potential will be fertile hunting ground for tax avoiders.

XII. Proposal is contrary to 1969 tax reform efforts.

THE DISC PROPOSAL TO SUBSIDIZE EXPORTS

The President's Economic Policy program contains a tax Proposal, called DISC, designed to subsidize exports through freedom from income tax. This memorandum outlines arguments why the DISC Proposal is undesirable.

I. PROPOSAL ELIMINATES AN ENTIRE ACTIVITY—EXPORTING—FROM INCOME TAX

The DISC Proposal is intended to exempt as much as possible of the export trade of the U.S. from income tax for a lengthy period, perhaps indefinitely. Such a major change in our tax system is contrary to the basic concept of an income tax, has no counterpart elewhere in the world, and is a complex, costly, and undesirable step.

The Proposal in effect exempts an entire commercial activity from the U.S. income tax. On its face, such a sweeping change seems wrong in itself—"exporting" is suddenly made free of tax. Such a step, if taken at all, should be taken only on the soundest of arguments, on the basis of careful and full documentation, on an analysis that clearly demonstrates—not just states—that the United States will realize demonstrable benefits from the step, and that no alternative of direct assistance is available and feasible. There is no such showing here.

II. PROPOSAL INVOLVES A REVENUE LOSS OF NEARLY $1 BILLION OVER THE NEXT 2 YEARS AND CLOSE TO $1 BILLION ANNUALLY THEREAFTER

The DISC Proposal is no minor tax measure. The Congressional Tax Staff placed the annual revenue loss at close to one billion when the Proposal is fully operative. This is the loss that will occur even if the Proposal does not stimulate an additional dollar of exports. It is a built-in, inevitable revenue loss since the Proposal provides a tax subsidy for existing exports and is not limited to the export growth, if any, induced by the subsidy. Even in the first two years, 1972–1973, the Proposal will lose a $1 billion dollars. Thus in the three years, 1972–1974, the Proposal involves about a $2 billion revenue loss.

The Administration is seeking to defer expenditures in important social areas to balance tax reductions. But in the DISC Proposal it turns over nearly $2 billion in three years to exporters—most of the money going to our largest corporations. Yet there is no case made—nor can it be made—that such a high and expensive expenditure priority is merited by these exporters and their activities. Nor is there any concrete analysis or data that the revenue loss will achieve demonstrable benefits for the United States—in marked contrast to the recognizable benefits to be achieved through expenditures to meet our social problems—expenditures that must now be kept back to make way for $2 billion to exporters.

III. PROPOSAL NOT SUPPORTED BY DATA, ANALYSIS, OR ECONOMIC STUDIES

In the public presentation of this Proposal by the Treasury, both in 1970 and 1971, and in the Ways and Means Committee Reports of 1970 and 1971 describing it, there is no study presented, no data made available, no economic case put forth to demonstrate the effect of this subsidy on the export trade and to demonstrate why, where and how the purpose of the subsidy—an increase in U.S. exports beyond what would result in the absence of the subsidy—will be accomplished.

The House Ways and Means Committee 1970 Report says the "Treasury has estimated that overall the additional exports generated by the Proposal, when it is fully effective, will increase by $1¼ to $1½ billion a year on the average" (p. 18). There is no public documentation—which others can examine—to support this statement. There is no indication as to the goods, the areas, the activities in which the increase will occur. There is no economic analysis of just why and how the increase will come about, as compared with hoping or asserting it will come about. Is it through lower prices—but since lower prices initially reduce our export volume, how will we get an increase in exports that not only offsets the initial decrease in dollar volume but also provides an affirmative increase sufficiently large to justify the revenue loss involved? Is it through a better "image" for exports ("it's tax free"), and hence increased activity and thinking about exports—but will these psychological factors really move our agricultural exports over European barriers and direct subsidies, or move many of our consumer goods past the hurdles of competition?

The prime basis for the Proposal—and the Treasury's belief that it will increase exports—seems to be in these words of former Secretary Kennedy, quoted (p. 18) in the Committee Report:

"I believe this shift in taxation would help signal to industry that improved export performance is a national objective of high priority; it would help build the consciousness and attitudes toward exports that this country has been sorely lacking."

The "signal" and the "consciousness" come at a $2 billion price over three years. Where else is Congress spending so much money on so intangible a ground? No expenditure program—even a minor one—would be presented to the

Congress or adopted by it on the basis of such a woefully inadequate, almost non-existent, supporting case. Yet since this is a "tax incentive", the Treasury presumably feels that it is permissible to spend $2 billion without even the support that an expenditure program of a few million dollars requires.

Even accepting the Treasury's guess of $1¼ billion in increased exports "when the Proposal is fully effective," we can ask: What kind of a deal is this?—the Government will be spending, on the Congressional Tax Staff figures, at least over $3 billion to achieve this increase of a little over $1 billion. Indeed, the Treasury may be spending more since the Treasury really doesn't say just when the increase is to be achieved. Former Secretary Kennedy, when he first presented the Proposal, said its effect "*should* be to generate *over time* a level of exports a billion dollars or more greater than might otherwise develop" (italic added). (The House 1970 Commitee Report, using the phrase "when it is fully effective", is no more definite, for it merely says that the increase in exports will occur when the Proposal has exercised its effect in stimulating exports—but *when* is this).

We must remember that as against this problematical (*should* generate, not *will* generate) indefinite export increase, the U.S. will be losing $2 billion (under the Congressional Tax Staff figures) the next two years and thereafter close to $1 billion or more annually in revenue—these revenue losses are an *actual*, not problematical matter. How many annual losses of $1 billion or more will occur before we see the increase in exports, and what will the total balance sheet add up to of revenue loss as against exports added—the Treasury presentation is silent on this.

IV. DIRECT STEPS NOW UNDERWAY TO IMPROVE THE U.S. TRADE POSITION, SUCH AS REALINEMENT OF FOREIGN CURRENCY EXCHANGE RATES, MAKE THE PROPOSAL OBSOLETE

The DISC Proposal is really an obsolete item left over from earlier blueprints on how to improve U.S. trade. The United States is now engaged under the President's New Economic Policy in direct steps that go to the central international factors which have adversely affected our trade position. Gimmicks such as DISC which hold no real promise of trade improvement should now be discarded along with the other blueprints and the new direct steps pushed vigorously instead.

The U.S. trade position has suffered from a basic maladjustment in the relationship of the dollar to foreign currencies. The President's New Economic Policy has recognized this central issue and involves direct steps to deal with it. The dollar has been cut loose from gold, forcing a realignment of foreign currencies and the negotiation of new parities. The temporary 10% surcharge on imports emphasizes the seriousness of the competitive disadvantage forced on the United States by the previous maladjustment and is a catalyst to negotiation and ultimate agreement on new alignments. The process of revision of the international monetary system, of reduction in non-tariff barriers to trade, and of sharing of defense burdens, set in motion by the President's measures, should have a beneficial effect on our long-term trade position.

With these direct steps underway, the DISC Proposal becomes obsolete. Certainly we do not need a gimmicky tax device with no promise of improving our trade position when we are now engaged in major steps designed directly to sweep away the crucial handicaps we faced under the previous international monetary arrangements. At a time when we are working toward rational new arrangements, a permanent tax windfall to exporters is an out of place, obsolete carryover from a past that dealt in patches and gimmicks rather than the central issues.

V. PROPOSAL INVOLVES A TAX REDUCTION FOR OUR LARGEST CORPORATIONS

The subsidy and revenue loss will in large part go to our largest corporations and represent a windfall to them. It becomes tax reduction for the 100 or so of our largest corporations who account for a major share of all U.S. exports—about half of our manufacturing exports alone are made by 93 companies. Such a reduction and such an expenditure are not in keeping with our fiscal situation or our national priorities.

VI. WHILE PROPOSAL IS PHRASED IN TERMS OF "DEFERRAL OF TAX" AND FOR "EXPORT PROFITS"—IT BECOMES COMPLETE EXEMPTION AND FOR MUCH MORE THAN EXPORT PROFITS, REACHING INTO MANUFACTURING PROFITS

The Proposal stresses that it will just *defer* the tax on *export profits.* But clearly the Treasury does not expect a mere few years deferral, for it recognizes that businesses will not alter their operations and organization for that. So the Proposal must envisage a long period of deferral. Such a deferral becomes the equivalent of exemption.

Indeed, in the description which it first circulated to business groups, the Treasury said the deferral for export profits would go for at least ten years and where exports increase—and they do naturally year to year—the period would be longer. But in these days of high interest rates, a postponement of tax—a borrowing interest-free from the Government—is the equivalent of exemption. The Treasury earlier said as much—"deferral for a substantial period reduces significantly the impact of a tax and, of course, deferral that lasts indefinitely can have substantially the same effect as an exemption from tax." The NAM in its earlier 1970 testimony has described the Proposal just that way: "Its specific purpose is to increase exports by deferring, *perhaps indefinitely,* the U.S. tax on some part of profits from exports." (Italics added)

But even indefinite deferral is not required. For a profitable company, the present value of fifteen years deferral of tax is just about worth the amount of the tax itself—which makes deferral the equivalent of exemption.

Moreover, the deferral is even extended further under the part of the Proposal that on liquidation or disqualification of a DISC it can spread payment of the tax ten years forward into the future.

The Proposal is presented in terms of deferring tax on "export profits." Presumably it is intended to cover the profit attributable to the sales activities associated with exports. But its specific provisions for the determination of export profits sweep in manufacturing profits as well. Under the arbitrary formulas presented to determine export earnings much—in some cases all—of the manufacturing profits will be freed of tax. Indeed, it is this inroad into the manufacturing profits that attracts most of the supporters.

The formulas used permit exemption for 50% of the difference between cost and sales price, or 4% of the sales price, whichever is greater. In many cases, it is likely that 4% of sales price could place the entire profit on the sale outside of the income tax. For those industries with low rates of return on sales—agriculture for example—the entire profit from manufacture to sale will be completely exempt from tax on goods going abroad. It is clear that far more than export earnings is being relieved of tax. Indeed, for companies selling goods abroad, the tax on the *entire profit from manufacturing and sale* will switch from a 48% rate to at least no more than 24%, and then may drop even to zero if the profit rate on sales is less than 4%.

Moreover, even where the profit rate on sales is above 8% so that the rule exempting 50% of the profit comes into effect, the *use of a foreign sales subsidiary* tied on to a DISC can increase that 50% figure to a much higher figure. As a consequence, even here the tax rate on the *entire profit from manufacturing and sale* will be below 24% and somewhere between 24% and zero (See VIII below).

In addition, the 50% rule which allocates 50% of the overall profit to manufacturing and 50% to the export sales activities is intended to produce a result more generous to the DISC and its exempted sales activities than would occur under the usual tax rules of pricing applicable to sales by a manufacturer to a distributor. The result is to *exempt some manufactruing profit in* addition to the profit resulting from the sales activities: the overall rate on the *entire profit from manufacturing and sale* switches from 48% to at least no more than 24%, with the sale component in effect being taxed at zero and the manufacturing component at less than 48%.

VII. PROPOSAL REALLY MEANS PROVIDING CORPORATIONS TAX-FREE MONEY FOR DOMESTIC USE OR FOREIGN INVESTMENT—HAVING NOTHING TO DO WITH EXPORTS

A DISC is permitted—indeed encouraged—to lend its tax-free income to its parent company to be used to buy plant and equipment, or for research. The loan is costless to the parent. Indeed, this is the key to the Proposal. But the assets obtained through the loan proceeds—or the research done—need have nothing to do with exports. The funds can go entirely to domestic production or—and this is in complete negation of the whole Proposal—entirely to manufacturing activities overseas. There is absolutely no tracing of the tax-free income into export activities.

The Proposal permits the DISC to lend its funds at 4% interest to the parent manufacturer. The parent can deduct the 4% interest and the DISC does not pay tax on the 4% interest. The DISC must then distribute to the parent the 4% interest, which is income to the parent. But the income item is offset by the previous deduction of the parent, and the parent also has its 4% interest payment back—so no cost is involved.

The loan can be in the proportion, of the total existing production assets of the parent, that its export sales are to total sales. Hence if a parent has $20 million of facilities, and its export sales are 20% of total sales, $4 million can be loaned by the DISC to the parent. But the $4 million can be used for purely domestic purposes—or for investments overseas—that do not relate to exports. There is no tracing required of the loan to facilities or equipment actually used in production for export. This could go on year after year for an established corporation which started with export sales. Indeed, the whole Proposal is geared to this, since a DISC is required to reinvest its profits and most DISCs would soon run out of real export activities on which to use their profits. Hence the permission under DISC to the parent to use the export sales income for its production activities becomes the key to indefinite deferral (House 1970 Committee Report, p. 17)—and the absence of tracing becomes the key to use for non-export activities.

The Proposal in effect gives financial assistance to companies who have exports even though they do not use the money for export activities. The statement in Secretary Connally's testimony before the Senate, "the deferral of tax on DISC income is available so long as the income is, in effect, used for export related activities," is simply inaccurate.

The requirement added in the House version that the loan to the parent must be matched by an increase in plant, machinery, equipment, supporting production facilities or research and experimental expenditures in the United States does not change the above remarks. These activities are not required to have any relation at all to exports. Moreover, for our major corporations ordinary domestic expansion will provide satisfaction of this requirement, and leave the DISC funds available for foreign manufacturing if the corporation so desires.

VIII. PROPOSAL, THOUGH DESCRIBED AS INVOLVING THE USE OF DOMESTIC EXPORT SUBSIDIARIES, WILL IN REALITY ENCOURAGE FOREIGN SUBSIDIARIES AND BRING BACK TAX-HAVEN OPERATIONS

The DISC Proposal is described in terms of the creation of domestic export subsidiaries—Domestic International Sales Corporations. In many cases these will be only shell corporations. At any event, the emphasis in title and description on the "domestic" character of the DISC corporation does not portray the full effect of the Proposal. The technical structure of the Proposal is an encouragement to the use of foreign sales subsidiaries—FISC—in addition to the DISC, since a DISC plus a FISC gives more exemption than a DISC alone. Moreover, the structure encourages the use of tax-haven countries in which to locate the foreign sales subsidiaries. Much of the 1962 anti-tax haven reform legislation is thus discarded and tax-havens are brought back to the scene.

If a DISC buys from its parent manufacturer and sells to a foreign customer, at least 50% of the overall profit is exempt. If the manufacturer's cost for example, is 50 and the final sales price is 150, then 50 is exempt. But if the DISC creates a foreign subsidiary—FISC—sells to it and lets it sell to the foreign customer, the profit of the FISC when declared as a dividend to DISC is fully exempt. If DISC sells to FISC at 100, and FISC sells to customer at 150, then the FISC profit of 50 is exempt and also half of the DISC profit of 50—a total of 75. The addition of FISC has raised the exempt portion from 50 to 75. (The precise effect, of course, depends on the sale price of DISC to FISC).

The taxpayer's goal, when adding the FISC, will be to locate it in a tax-haven country so that foreign taxes are not a problem. The Proposal permits tax-haven operation for a FISC by here sweeping away the 1962 reform provisions designed to prevent tax-haven abuse. Moreover, the taxpayer will want to keep the DISC price low on sale to a FISC tax-haven, and thus he will become involved in controversies over price with the Internal Revenue Service on a wide scale.

The Treasury presentation did not describe these aspects in detail and the 1970 Committee Report does not consider their implications. As a consequence, apparently their effect was not considered in the revenue loss estimates, so that those estimates are on the low side. Morever, the stimulus to use foreign subsidiaries makes DISC more helpful to the larger corporations than to small business.

IX. THE PROPOSAL IS JUSTIFIED BY THE TREASURY IN THESE TERMS

(*a*) Export Income is Partly Foreign Source Income.

(*b*) Deferral of Tax On Export Income is Similar to Deferral of Tax on Foreign Manufacturing Subsidiaries.

(*c*) Other Countries Are Not Taxing Exports.

These justifications are not valid

(a) To say that export income is partly foreign source income proves nothing. The U.S. has always taxed income from foreign sources as well as domestic sources when the income is obtained by U.S. corporations and individuals. Royalties, dividends, interest, etc., when paid by foreigners are foreign source income in the same sense, but are taxed when received here in the U.S. by a U.S. corporation. And so export sales to foreigners made by U.S. corporations are taxable—and always have been—though they can be called foreign source income in the same sense.

The treaty policy of the U.S. goes to great lengths to insist that the export income of the U.S. is income to be taxed by the United States and not by other countries. That policy therefore seeks to prevent other countries from taxing our export trade and will permit such foreign taxation only where the U.S. exporter is operating through a permanent establishment in the foreign country.

The Treasury says that the DISC "approach is consistent with the basic philosophy of the U.S. tax system" (Statement of Sec. Kennedy). The contrary is the case—it is completely inconsistent with the application of the income tax to export income ever since 1913. It is completely inconsistent with our entire treaty policy since our first tax treaties in the nineteen-thirties.

(b) The fact that our foreign manufacturing subsidiaries are not generally taxed by the U.S. until their income flows to the U.S.—the tax is "deferred"—does not justify this Proposal. For the price of deferral in the case of these foreign manufacturing subsidiaries is payment of foreign income taxes. Those taxes are substantial and in many cases close to—or more than—our own income tax. Deferral for our foreign manufacturing subsidiaries has not meant exemption from income tax—it has meant payment of income taxes to other governments. But the deferral of DISC means exemption from all tax—domestic and foreign—and in no way resembles the treatment of investment in our foreign subsidiaries.

The Treasury says that the effective foreign tax rate on all foreign subsidiary operations of U.S. businesses was about 38.6% in 1964. But the DISC "deferral" can mean a zero tax. It is very hard to see how a zero tax is similar to—the Treasury's words—a 38.6% tax. Even the entire range of possible DISC tax—from zero to 24% (see VI above) is considerably below a 38.6% tax.[1]

Any deferral for our foreign manufacturing subsidiaries, moreover, ends when the income is brought back into the U.S. as dividends, or even when it is still owned by the foreign subsidiary but is invested in U.S. assets such as domestic facilities of the U.S. parent. But the DISC income is already in the U.S. Moreover, it can be invested in U.S. domestic facilities or activities of the U.S. parent having nothing to do with exports—and still it is not taxed.

Moreover, if deferral for our foreign manufacturing subsidiaries is a material benefit and inducement to investment abroad, the obvious course is to end the deferral and leave the U.S. tax system in a neutral posture between investment abroad and investment at home. But this the Treasury will not do.

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[1] The 38.6% foreign tax rate on our foreign subsidiaries, referred to by the Treasury, moreover, is an effective tax rate, the overall rate on all types of subsidiaries and on all their income. The Treasury then compares that rate with the U.S. marginal rate of 48% which it says applies to exports—but marginal rates are different from effective rates. Foreign marginal corporate tax rates are often in the 50% or upper forties range—while the U.S. effective corporate tax rate in 1965 for all industries was 37.8%. Comparisons that mix up the two forms of rates are not helpful, or accurate.

Instead, it says we should keep our tax incentives to investment abroad and then it says we must exempt export income because of the tax incentive to foreign investment. The whole approach is clearly a boot-strapping operation, and one that ends up leaving a large gap in the income tax and being highly discriminatory in favor of those taxpayers engaged in foreign activities as compared with domestic activities.

(c) The Treasury presentation talks of other countries which "defer their tax on export income or exempt such income from tax, to a greater or lesser extent." But nowhere is it flatly stated that other important exporting countries—countries with which the U.S. may be compared—systematically seek to exempt from income tax their entire export trade. The fact is that the exemption inherent in the DISC Proposal goes far beyond the treatment of export income in any comparable country.

The House 1970 Committee Report, following the Treasury presentation, states as justification for the Proposal that "A number of foreign countries, for example, have the so-called territorial concept of taxation under which they do not tax foreign source income at all" (p. 16). This is simply inaccurate. Such countries do tax export sales to foreign independent customers. It should be noted that about 85% of U.S. export sales are to foreign independent customers, and there is no indication that foreign patterns differ materially. Here foreign countries do tax the profit—but under DISC 50% or even all of the profit will be exempt. Where the sale is to a foreign affiliate, such as a subsidiary, some countries may not tax the profit realized by the subsidiary when repatriated to the parent, but they will tax the profit on the sale to the foreign subsidiary. But the Proposal will equally exempt the profit of the subsidiary—and then also exempt one-half of the profit on the sale to the subsidiary.

Moreover, these "territorial approaches" are usually a relic of tax history, traceable to schedular tax systems and colonial trade, with no affirmative intent to subsidize exports. The Finance Ministries of some of the countries using this approach understand its weaknesses and defects and are moving thru tax reforms to reach the present U.S. system. It would be irony indeed for the U.S. now to take the leadership in setting the tax clock back.

Some foreign countries do have some specific income tax incentives for experts. But the U.S. should be countervailing against such provisions, should be insisting they are contrary to GATT, and should be taking whatever other action is feasible in negotiation. That should be the U.S. role—and not the role of going much further by exempting all export income from tax and setting in motion a spiral or more and more tax escapes in the export field.

X. PROPOSAL IS LIKELY TO CAUSE FOREIGN RETALIATION AND EMULATION WHICH WILL HURT OUR TRADE BALANCE

In the Treasury presentation of the Proposal there is no material presented to demonstrate that this sweeping change in our tax rules and the resulting subsidy to exporters will not produce retaliation or emulation in other countries. Such a reaction abroad will tend to offset or exceed any potential gains to our trade balance sought through additional exports stimulated by DISC. If other countries emulate—and why shouldn't they since their exporters will demand equal treatment from their Governments—then the U.S., the largest and strongest nation, will have been the leader in exempting export income from taxation over the world and in tearing a big hole in the income tax. The U.S. the leading economy country in the world, should not be the instigator of this tax chaos.

If the leading economic country in the world exempts its export trade from income tax, other countries are bound to take action in self defense. Other countries may see DISC as a violation of GATT—whatever the U.S. Treasury says as to the status of DISC—and resort under GATT to countervailing duties against our exports. Or other countries may decide to emulate us and themselves adopt Disc or some variation—or event some new device—seeking thereby to advance their exports. But whatever the form of the reaction abroad, it is bound to hurt our trade balance and reduce if not remove, or indeed reverse, the export benefits claimed for the Proposal. If it is emulation, then after all the legislation is enacted the income taxes of the exporting countries will not reach the export trade—we will be in the same or worse position as to trade levels but the income tax system will be severely weakened and the strongest country in the world will have led the attack on the income tax system.

Presumably the Treasury believes this Proposal is not contrary to GATT. It is a strange world, however, if this Proposal—seeking completely to exempt the export trade of a country—is not a barred subsidy. It is hard to see what would remain of GATT in the tax area after this step and those taken abroad in retaliation or emulation.

Foreign countries in self-defense will also have to revise their tax treaty rules and other tax rules and administrative practices, which up to now have been beneficial to U.S. exporters. The result will be an increase in the ways by which foreign countries will now tax our exports in situations in which our exports have been previously unaffected by foreign tax systems.

Tax treaties now uniformly exempt an exporter selling goods within a country from that country's income tax unless those activities constitute a "permanent establishment" in that country, a phrase which the treaties define narrowly so as to relieve an exporter from being involved in the tax system of the countries to which he is exporting. This treaty policy rests on the assumption—valid up to now—that the exporter will be taxed in his own country and double taxation can thus be avoided by freeing him of tax in the country of destination. But under DISC the U.S. exporter will no longer be subject to tax, and hence other countries will begin to remove their liberal treatment of the U.S. exporter.

Moreover, where a DISC is selling through a permanent establishment of foreign subsidiary in a country with a significant corporate tax, the DISC will seek to fix the inter-company price at a high level, since the higher the price, the greater the exemption from U.S. tax under DISC. The foreign country, to protect its revenues, therefore must administratively check these DISC prices. Up to now, since the U.S. taxed the export sale, our exporters were largely free from this price check abroad; under DISC they will attract the examination of foreign revenue agents.

Many of the less-developed countries have been seeking to expand their tax systems to reach the profit on exports to their countries, and have sought to chip away at existing international tax standards which exempt exports in the countries of destination unless a permanent establishment exists. Under DISC, these countries will be considerably encouraged in pursuing our exporters, both because of the exemption under DISC from U.S. tax and because the technical rules of DISC treat export income as foreign source income (income arising outside the United States) when the goods are sold for consumption outside the United States. This use of a "destination" rule to determine foreign source income is an open encouragement to those countries to apply the same destination rule and make our export income their source income and subject to their tax.

XI. PROPOSAL IS COMPLEX—WITH MANY SURVEILLANCE PROBLEMS AND MANY INROADS ON EXISTING RULES—SO THAT ITS WEAKNESSES AND FURTHER LOOPHOLE POTENTIAL WILL BE FERTILE HUNTING GROUND FOR TAX AVOIDERS

The Proposal is no simple, readily applicable method of assistance. It is seriously complex—with its complexities and its technical rules likely to grow as time goes on. For taxpayers will want to push more and more income into the DISC device—royalties and services are examples—and seek more and more ways to use the income without disturbing the deferral. The Treasury will have to cast its surveillance over a vast array of activities to seek to confine the deferral to "exports"—goods coming to the U.S. for processing and then sent out; goods sent abroad for some processing and then returned; foreign subsidiaries of DISC with their own activities that may involve services and other assistance to foreign manufacturing subsidiaries; transportation activities of DISC companies that intermingle exports, imports and all kinds of goods over the world; companies that shift the place of production around and fill foreign orders in the U.S. but then manufacture abroad for use in the U.S. (just a switching of the place of manufacture).

The Proposal also cuts across many established rules—for example, it would validate the use of tax-havens all over again.

It is hard to see the justification for so much complexity and gadgetry—it is really impossible to see it in this situation when there is no assurance that any real benefit to the U.S. will come from all of this technical maze.

In all probability, many a tricky maneuver exists in these technical rules. Thus, the formulas for determining export income create more "foreign source income" than would exist under regular allocation rules. Suppose a company with manufacturing subsidiaries abroad creates a DISC, runs it exports through it, distributes the profits each year since it is not concerned with deferral—but by so doing and without actually increasing its exports, does technically increase the amount of "foreign source income" attributed to its existing exports and hence is able under the foreign tax credit rules to use the foreign taxes on its foreign manufacturing to shelter the U.S. income from its exports. The DISC here thus becomes an incentive to help investment abroad, despite higher foreign tax rates on that investment, rather than to increase our exports. (1970 Minority Report, p. 178).

The technical DISC rules will permit a taxpayer, contrary to existing rules, to shift the allocation of some of his costs of production away from exports and attach them to domestic sales, thereby increasing the amount of "export income" exempt under DISC.

XII. PROPOSAL CONTRARY TO 1969 TAX REFORM EFFORTS

The Congress spent in 1969 an arduous year in legislating tax reform. Most of the effort went into reducing money spent through the tax system on matters that were not a necessary part of the income tax structure but were back-door ways of spending Government funds—the use of the tax system for non-tax ends. The Treasury now wants to turn its back on that Congressional effort and spend $2 billion over two years for non-tax purposes, but cloak it as a part of the income tax. If this occurs, some future Congress will have to struggle with removing this tax preference—when the income tax windfall of exempting the whole export trade becomes clear to the public. But why start down this road at all, why reject all that was learned in 1969? If assistance is to be given by the U.S. Government to our export trade, as a priority matter under our budgetary policies, it should be done directly and not as part of the income tax.

The Proposal is a negation of the entire 1969 tax reform effort. That effort showed how hard it is to dislodge tax preferences—tax incentives—once planted in the Internal Revenue Code. Tax history is replete with the cycle of today's tax incentive becoming tomorrow's tax preference and tax loophole. But the entrance into the Code of an incentive—just present it with no back-up study, no analysis, no economic data but only the statement it will help by creating the right image—is in marked contrast with the efforts to dislodge the incentive once its wastefulness and preference aspects become plain to all. For then it is part of the status quo and its beneficiaries will resist any change. This can be especially true in the case of the DISC device, which will require corporate organizational changes and different methods of doing business for all our exporters. Once the business patterns and structures forced by the DISC become imbedded in business operations, it will be extremely difficult if not impossible to alter the DISC tax rules even though those rules simply mean tax reduction for some but no benefit to the United States at large.

Mr. FIELDS. Our fifth witness is Prof. Alan Schenk of Wayne State Law School in Detroit. He is a direct contributor to professional journals in the field of Federal taxation.

STATEMENT OF ALAN SCHENK, PROFESSOR, WAYNE STATE LAW SCHOOL

Mr. SCHENK. Mr. Chairman and members of the committee, I strongly support the principle that the United States needs to be able to increase export trade and that the Government needs to provide some leadership to reducing discrimination against American exports. In my opinion the DISC proposal is not the way and I will limit my comments to the DISC proposal also.

The proposed DISC is too limited in scope and too inflexible to accommodate for changing conditions with respect to the balance of trade and the U.S. balance-of-payments position. The DISC extraordinary technical complexity will cause administrative nightmares to the Treasury and compliance problems to the affected taxpayers. It will not effectively discourage the use of foreign manufacturing subsidiaries. The assumption that DISC will encourage American rather than foreign manufacturers fails to consider the importance of nontaxed factors in locating manufacturing facilities abroad. These nontax factors include labor costs, transportation costs, and the avoidance of tax barriers by location of manufacturing abroad, especially the common market.

In addition, DISC may actually encourage capital exports to certain foreign corporations against adversely affecting our balance of payments even though the whole impact of DISC is to improve the balance of trade and, therefore, the balance-of-payments position. There is a poor correlation between the goal of increasing exports and DISC benefits. Some of the DISC part has been reduced by the House enacted incremental concept but there is still poor correlation between the goal and the benefit. There has historically been an annual increase in export in absolute dollar amounts without any Government subsidy. This increase in export trade will be exaggerated due to the recent economic action in floating the dollar. They should make the price of U.S. goods cheaper in foreign markets. Many foreign nations still use quantitative restrictions to control many of their imports. For countries that still severely limit the importation of specified products neither the DISC deferral benefits nor any other Government stimulant to export will effect the export of the products to those nations. DISC will predominantly benefit big business. The expenses of additional DISC subsidiaries, including costly sophisticated tax advice necessitated by the DISC complexity will inhibit its use by small companies.

The DISC intercompany price rules also discriminate in favor of large integrated manufacturers and against the small producers.

An important point that has already been mentioned this morning is that DISC may trigger retaliation abroad. A common market official recently suggested that DISC violates GATT and that affected nations would be permitted to retaliate. Whether or not on the theoretical level a tax deferral is a prohibited subsidy under GATT if GATT is effective, if DISC is effective and substantially alters the trading pattern among nations, the nations will claim DISC had this effect, and, therefore, will retaliate in imposing countervailing duties.

Some Canadian leaders have also recently suggested if the DISC proposal is enacted Canada would have to take some measure to counter its effect.

If the United States decides as a matter of policy to encourage export trade it should adopt policies that will benefit all American exports. The United States should press for GATT amendments that would permit the United States to adopt border tax adjustments as they have in the Common Market, within prescribed limits. I suggest independent of the internal tax structure of the country. This would permit an export tax rebate and, of course, corresponding import duty. There is no immediate need to enact DISC on the heels of the Government's recent economic action at home and abroad.

The recent action needs time to work. In fact the combination of permitting the U.S. dollar to float, imposing the 10-percent import duty and granting the DISC tax benefit would probably precipitate retaliatory action that could more than offset any benefit to export resulting from the DISC tax deferral.

If the recent economics is coupled with the DISC proposal I am concerned that this will be the beginning of international economic warfare. I therefore urge this committee to defeat the DISC proposal.

(A supplementary statement of Professor Schenk follows:)

Supplementary Statement of Alan Schenk, Professor of Law, Wayne State University Law School, Detroit, Mich.

Opposition to the Domestic International Sales Corporation Proposal

Mr. Chairman and members of the committee, I wish to express my appreciation for this opportunity to submit some of my views on the Domestic International Sales Corporation (DISC) provisions of H.R. 10947.

I. The extraordinary technical complexity of DISC will cause administrative nightmares

Subparts F and G of the Internal Revenue Code, enacted in 1962, created some of the most difficult administrative problems in recent years. Some of these provisions appear simple compared with the statutory complexities in DISC. The bill has numerous subjective qualification tests. There are also problems caused by the termination of the Export Trade Corporation (ETC) benefits and, if the ETC is liquidated into a DISC, continuation of tax deferral for ETC's previously-deferred export trade income. These provisions will cause administrative nightmares to the Treasury and compliance problems to the affected taxpayers. These ramifications do not appear to have received sufficient Treasury consideration.

The highly complex provisions seem to reflect Treasury and Congressional concern about potential abuses with this tax deferral benefit. The anticipated benefits should be quite clear before Congress enacts another complex subpart of the Code. It is worth remembering that taxpayers and the Government are still unraveling the complex provisions of subparts F and G, enacted nine years ago.

II. Poor correlation between goal of increasing exports and the DISC tax benefit

The announced goals of the DISC proposal are to expand U.S. exports and aid the U.S. balance of payments position. The Treasury has limited the potential effectiveness of DISC by limiting the tax benefits to U.S. corporations which meet the complicated DISC requirements and earn a profit from export operations. In the formative years of a new exporter's venture abroad, it is likely that losses may be sustained.

The DISC proposal would grant tax deferral windfalls to the American corporations that presently engage in profitable export trade. There has historically been an annual increase in exports, in absolute dollar amounts, without any government subsidy. This increase in export trade will be exaggerated due to the recent economic action in floating the dollar. It should make the price of U.S. goods cheaper in foreign markets.

GATT has attempted to limit the use of quantitative restrictions to control imports. Many countries still severely limit the importation of specified products. Where these restrictions are in effect, neither the DISC deferral benefit nor any other governmental stimulant to exports will affect the export of the products to those nations.

III. DISC actually encourages capital exports

In order to make the DISC incentive more attractive, the proposal permits a DISC to invest tax deferred income in certain related foreign export corporations. These investments must have some direct relation to the export of U.S. goods. They include stock interests in (1) a selling arm of the DISC principally engaged in marketing export property, (2) a foreign corporation organized to hold title to real estate used by the DISC, or (3) a DISC's foreign customer where such investment is to obtain export sales by extending export credit to the customer. While the DISC proposal is designed to aid the U.S. balance of trade, the liberal investment provisions will actually worsen our balance of payments by encouraging exports of capital into these foreign investments.

IV. DISC WILL PREDOMINANTLY BENEFIT "BIG BUSINESS"

The DISC proposal is structured so as to benefit only a limited group of exporters, not all companies engaged in export trade. To obtain the DISC tax benefits, an exporter must organize a separate corporation and satisfy the statutory qualifications. The expected tax benefit must exceed the legal, accounting and other costs attendant the organization and operation of an additional corporation. The highly complex set of tax rules with numerous subjective tests will increase the cost of tax advice and inhibit the potential use of DISC by small companies.

V. TAX DEFERRAL BENEFITS ENACTED IN THE PAST HAVE NOT BEEN EFFECTIVE

During the past two decades the U.S. has, by legislation and Executive Order, attempted to unilaterally alter the U.S. balance of trade portion of our balance of payments account. This legislation has included two tax deferral privileges which have not materially altered corporate decisions on the allocation of resources. This patchwork legislation has had only short-term favorable effects upon the U.S. balance of payments position. DISC is merely another attempt to unilaterally alter our balance of trade.

VI. CONGRESS SHOULD EXPAND RATHER THAN CONTRACT U.S. TAX JURISDICTION

The Administration cites the present discrepancy in tax treatment between export income of U.S. companies and foreign income of foreign subsidiaries. It chooses to correct this discrepancy by granting special tax benefits to export profits of U.S. corporations. Rather than contracting the U.S. tax base, Congress should consider expanding U.S. tax jurisdiction to currently tax foreign source income of foreign corporations owned and/or managed and controlled by United States persons. This approach would reduce the U.S. tax incentive to manufacture abroad.

VII. DISC WILL NOT EFFECTIVELY DISCOURAGE THE USE OF FOREIGN MANUFACTURING SUBSIDIARIES

The DISC concept is based in part on the assumption that major corporate decisions relating to the location of plants and facilities (in the U.S. versus abroad) will be affected by the proposed tax deferral benefits. While the DISC tax deferral may lower after tax profit on an exported article, it does not provide a realistic substitute for the tax and non-tax benefits available with foreign manufacturing operations. The non-tax factors that affect a corporate decision to establish a foreign subsidiary include, but are not limited to (1) the cost of labor in the foreign country, (2) the transportation costs to the foreign markets, and (3) the ability to avoid foreign import duties and quantitative import restrictions by manufacturing or processing in the foreign country. This last factor may, in itself, demand the organization of a foreign subsidiary.

VIII. DISC MAY HAVE A LONG-TERM DETRIMENTAL EFFECT ON WAGE RATES AND EXPORT PRICES

According to the present position of the Accounting Principles Board of the American Institute of CPA's, the tax deferral would not be reflected as a tax liability of the parent corporation. This would result in the parent reporting higher after tax corporate profits. Higher corporate profits may be reflected in labor demands for higher wages. Even if a portion of the tax deferral benefit is reduced by higher labor costs, the combination of the higher wage rates plus the potential future tax liability may have an adverse effect on the pricing and profitability of exports.

IX. DISC MAY TRIGGER RETALIATION ABROAD

A Common Market official recently suggested that the DISC tax deferral was an export "subsidy" prohibited by GATT. He suggested that the GATT rules would permit the Contracting Parties to take retaliatory action (such as imposing countervailing duties) in order to offset the impact of the DISC tax deferral. On a theoretical level, there may be arguments that a tax deferral is (1) not a "subsidy" within the meaning of GATT or (2) has not caused the "dumping" of U.S. products abroad. If DISC would be as effective in promoting increased exports as the Treasury suggests and would substantially alter the trading pattern with other nations, the affected nations may claim that the DISC benefit has caused the harm and may then take steps to eliminate its effect. They may impose import quotas, remove trade concessions or impose countervailing duties.

Some Canadian leaders have recently suggested that if DISC is enacted, Canada would have to take measures to counter its effect.

X. PRESENT COMPETITIVE DISADVANTAGE TO AMERICAN EXPORTERS NOT CURED BY DISC

Gatt and the International Monetary Fund (IMF) are the international institutions which restrict a member nation's freedom to unilaterally alter international trade. GATT's Most Favoured Nation clause assures contracting parties that a member nation will treat the import of a product on the most favorable tariff term negotiated with any contracting party, regardless of the source of the import. GATT permits members of a customs union (such as the Common Market) to discriminate (contrary to the Most Favoured Nation clause) in favor of imports from other members of the Customs Union. Recently the Common Market customs union has negotiated tariff preferences with some nations that are not members of the customs union but has not applied these preferences consistent with the Most Favoured Nation clause. Thus what began as an authorized exception to GATT has evolved into almost wholesale disregard of the Most Favoured Nation clause by some member nations to the detriment of other nations, including the U.S.

Presently, GATT permits member nations to rebate indirect taxes, but not direct taxes, on export. This border tax adjustment procedure has enabled Common Market countries to rebate their ten to twenty percent sales taxes (value-added tax) on exports while the United States rebates only a nominal excise tax on limited situations. The DISC proposal grants only tax *deferral* on certain export profits, not the complete tax rebates granted for exports of most of our foreign competitors. Rather than granting deferral benefits to a limited number of American exporters, the United States should press for GATT and IMF changes which will remove the competitive handicaps that presently hamper American exports and provide adequate, flexible machinery to deal with the U.S. balance of payments position.

XI. THE U.S. SHOULD ADOPT A BORDER TAX ADJUSTMENT SYSTEM

The United States should press for GATT amendments that would permit member nations to adopt border tax adjustments, within prescribed limits, independent of their internal tax structure. Whether the border adjustments directly relate to an internal tax such as the value-added tax (as in the Common Market) or are independent of the internal tax structure, a nation should be able to impose import duties and grant export tax rebates within a prescribed range. This procedure would give a nation the flexibility to cure a payment imbalance (surplus or deficit) without having to take the more serious step of altering its currency exchange rate. Border tax adjustments may be more effective than a tax deferral privilege because they grant benefits to exports and impose corresponding duties on imports. This device could have a substantial impact on our balance of trade. The newly imposed 10% duty on imports could be the first stage of a U.S. border tax adjustment system.

XII. CONSIDERATION OF THE DISC PROPOSAL SHOULD AWAIT THE IN-DEPTH TREASURY STUDY OF U.S. TAXATION IN THE INTERNATIONAL AREA

I understand that the Treasury is currently studying the impact of present United States tax policy in the international area. The DISC tax deferral privilege designed to encourage export trade and the use of domestic rather than foreign manufacturing facilities is interrelated with the scope of U.S. tax jurisdiction in the international area. This current Treasury study may produce broad tax reform proposals. These recommendations may be limited if Congress now enacts legislation which, in effect, further contracts United States tax jurisdiction.

XIII. CONCLUSION

In the final analysis, the long-term balance of trade position of the United States will depend upon American know-how, the competitiveness of American products in international commerce, and more flexible and equitable provisions with respect to border tax adustments. Stop-gap measures such as the proposed DISC may, even if successful, only alleviate the payments imbalance in the short run. The elimination of this deferral privilege in the future could then have a very serious impact on the U.S. balance of trade.

The proposed DISC is too limited in scope and too inflexible to accommodate for changing conditions with respect to the balance of trade and the U.S. payments position. Chronic disequilibrium in the balance of payments requires a thoughtful overall study of the entire area. The recent Government action permitting the dollar to "float" and imposing a 10% import tax should have a substantial impact on international trade. This action should make U.S. products more competitively priced in the international marketplace. If the export problem is a "pricing" problem, there should be increased American exports without any DISC government aid. If it is not a "pricing" problem, then DISC, in estimated revenue losses, is an expensive advertising campaign to encourage U.S. export trade. There is no immediate need to enact DISC on the heels of the Government's recent economic action at home and abroad. In the 10% import duty and (3) granting the DISC tax benefit would probably precipitate retaliatory action that could more than offset any anticipated increase in exports resulting from the DISC tax deferral.

Mr. FIELDS. Our final witness is Prof. Paul Taubman of the University of Pennsylvania who is the coauthor of "Policy Simulations With an Econometric Model" and numerous other articles dealing with depreciation and investment credit.

STATEMENT OF PAUL TAUBMAN, PROFESSOR, UNIVERSITY OF PENNSYLVANIA

Mr. TAUBMAN. Mr. Chairman, in his testimony before this committee, Secretary Connally stated that "the clinching argument" for granting the investment tax credit and House version of the ADR plan was that foreign governments had granted subsidies that reduced the price of an asset 10 to 20 percent that of the United States. This clinching argument, however, is factually incorrect and logically unsound for several reasons.

First, the formula the Treasury used inadevertently contains an error which unfortunately causes the value of foreign subsidies to be overstated. Some rough calculations indicate if the proper allowance is made for value-added taxes on foreign subsidies, the capital differs if at all from U.S. subsidy.

Second, the Treasury study improperly assumes that many elements in the subsidy formula such as the after tax discount rate do not differ between countries.

Third, as far as I can tell there is no economic justification to the argument that the United States should introduce distortions throughout its domestic economy even if it were true that foreign countries have done so and, finally, even if subsidy of capital are needed ADR is one of the worst possible ways to grant them. ADR is bad because it distributes subsidies in a very random fashion over industries and eliminates the connection between economic reality and tax rolls.

The overall effect of granting both ADR and investment tax credit is to give substantial benefits to profits or to businessmen while at the same time there are very little benefits given to individuals. Indeed the way the tax plan is currently set up in the House version that this committee is hearing, people at the very lowest end of the income scale receive no benefits. After all, the 1969 tax act was designed so that some 10 million families in the United States would not have to pay taxes. Any taxation along these lines cannot help them. Some other action such as increases in social security payments or even a matching grant for people who receive State welfare payments would be more appropriate.

Thus at this time I think the Senate and the Congress should revoke the ADR plan. should enact a temporary investment tax credit that the poor- and lower-middle class share in the tax benefits of the tax act. Since the need for a permanent investment tax credit has not been convincingly demonstrated, Congress should only act on this issue after holding deliberate hearings based on better facts and logic and on this point let me quote Secretary Connally who said in hearings before this committee, "We must ask how the total tax systems affect the cost of acquiring and using new manufacturing equipment." I think we should have that information before we act.

Mr. FIELDS. The panel is open for questions, Mr. Chairman.

The CHAIRMAN. Thank you, gentlemen. We are not going to be able to engage in much interrogation of the witnesses because of the tight schedule, although any Senator can ask any questions he wants to at this time.

I would like to assure you gentlemen that those of us who have heard you testify, as well as our staff, have a way of picking up everything we find from the witness with the kind of credentials your group has to offer here. I have heard several of you say things with which I agree and I expect to use your testimony to buttress my arguments when we go into executive session. Our staff makes it a point to protect the interest of the absentees by directing their attention to things that are said by witnesses here or presented for the record, to help support their position.

Several of you have suggested amendments, either opposition to some things that I oppose in the bill or amendments that I would favor in the bill. I will certainly benefit from them and use them to fortify my position as we go into executive session.

Any further questions?

Senator BENNETT. I would again like to encourage each member of the panel to react to anything that any other member of the panel has said and amplify the information he has given to the committee. We would welcome additional information. The only problem is it must come fairly soon because we must move on to the second step.

Mr. FIELDS. We welcome that invitation and we will take advantage of it and I will encourage each of these witnesses to submit a written statement if they have not already done so.

(A prepared statement submitted by Charles Davenport follows:)

STATEMENT BY CHARLES DAVENPORT, ACTING PROFESSOR OF LAW, UNIVERSITY OF CALIFORNIA: THE TAX FEATURES OF THE ADMINISTRATION'S NEW ECONOMIC POLICY

INTRODUCTION

Taxation with Representation is pleased to have this opportunity to sponsor testimony regarding the federal tax system.

Taxation with Representation does not take organizational stands. Consequently, sponsorship of testimony by Taxation with Representation does not mean that the opinions expressed by a witness are necessarily those of the members, officers, or directors of the group. Sponsorship by Taxation with Representation does indicate, however, that the group regards a witness' view as worthy of serious consideration by those concerned with the improvement of the federal tax system.

Taxation with Representation is a nonprofit, nonpartisan, public interest tax lobby that deals solely with federal tax issues. Its goal is to make sure that the general public is adequately represented when tax issues are under discussion in Congress and in the Executive Branch.

Further information about Taxation with Representation is set forth in the group's descriptive brochure, which can be obtained by writing to the address shown above. Membership in Taxation with Representation is open to all who share the group's commitment to improving the federal tax system through more effective representation for the general public.

BIOGRAPHICAL NOTE

Charles ("Bill") Davenport is a member of the California bar. He engaged in the private practice of law in San Francisco prior to joining the staff of the Office of Tax Legislative Counsel in the U.S. Treasury Department in 1967. Since 1969, he has been a member of the faculty of the law school at the University of California at Davis, where he teaches tax law and related subjects.

Mr. Chairman and members of the Committee on Finance, the tax recommendations made by the President are the wrong tax changes at this time. They would reduce revenues by many billions each year. These cuts would be concentrated in the higher brackets and business investment, and particularly in the automobile industry. The favoring of these groups is unjustified because we have excess plant capacity now. In addition, such cuts are wasteful because tax reductions could be structured to spur consumer spending. Such cuts are not only economically wise but also socially desirable.

While the foregoing is the general thrust of my testimony, I offer the following specific comments.

ASSET DEPRECIATION RANGE SYSTEM

Of all the features of the House bill, the Asset Depreciation Range System is the most inequitable and expensive while at the same time being the least justifiable from an economic or tax policy viewpoint. I urge this Committee to eliminate it and to substitute nothing in place of what will become another raid on the Treasury.

The ADR System is inequitable because it confines all of its benefits to the purchase of equipment. It favors capital intensive industries over labor intensive industries. This euphemistically labelled Job Development Credit will benefit the business that acquires labor-saving devices but will do nothing for those businesses which choose to take on more employees. Although this is the intended result, it appears ironic and contrary to present imperatives.

In addition to being inequitable as between industries, ADR is grossly inequitable as between taxpayers in the same industry who have varying amounts of capital investments and who consume their capital investments at varying rates. The slower the business consumes its capital, the more it is benefitted by ADR. There is nothing which justifies this policy of helping the most those who are doing the least economically.

Similarly, the higher the tax bracket, the greater the tax benefits from ADR. ADR thus offers another shelter, another loophole, which certainly will be exploited.

It is sometimes argued that our depreciation system does not allow adequate capital cost recoveries. In support of this argument the proponents turn to the capital cost allowances of foreign nations. Let me point out that the Western European nation generally considered to have the most vigorous economy, Western Germany, allows somewhat slower recovery than is allowed in this country. On the other hand, the United Kingdom permits the speediest recovery. If we assume some connection between cost recoveries and economic vigor, these data support a constriction of depreciation rather than a liberalization. Or put another way, should we attempt to solve our present economic miseries by emulating the British?

Finally, the ADR proponents argue that technology has made great progress in recent years. The desired inference is that increasing technology means increasing obsolescence. But nothing but the inference is offered in support. The ADR proponents do not offer empirical evidence that advancing technology necessarily means shortened depreciable lives. In some cases, better technology will increase the depreciable life of property. On the other hand where it does shorten the life of plant capacity, our present depreciation system will allow greater depreciation deductions. By so constricting larger deductions, we do not give the bonus to those who are doing the least for the economy.

But even if there were good hard evidence that technological progress had resulted in shortening useful lives, we should review our depreciation more scientifically and ascertain the extent to which such has occurred. The House Bill does not do this. Instead, it would reduce useful lives by 20% across the board. Certainly, the underlying premise that all useful lives have been equally reduced is not supported. And a uniform reduction of tax lives where there is uneven shortening of actual lives is inequitable because it grants the most to the taxpayer who least deserves it.

AUTOMOBILE EXCISE TAX

The repeal of the automobile excise tax will again distribute its benefits to the wrong people, those buying automobiles. There is no justification for distributing a tax in relation to purchases of automobiles which are highly concentrated among the more well-to-do. Instead I urge your Committee to repeal the telephone tax with a much wider distribution of the benefit among the population. Since the reductions to each person would be small and widely distributed, it is likely that those benefitting from the reductions would spend the reductions and thereby increase consumer demand much more effectively than will repeal of the automobile tax.

Give this economic impact, does the major support for repeal of the automobile tax lie in its cosmetic effect on the Consumer Price Index?

THE INVESTMENT CREDIT

The tax changes which should be made at the present moment are those which produce a temporary economic stimulus which can be reversed when necessary. The investment credit is so highly discriminatory that it should not be considered even as a temporary tool, let alone as a permanent feature of our tax law. Instead, this Committee should focus the reductions of revenues on the consumption part of our economy. Our present economic difficulties do not appear to lie in insufficient business investment when plant capacity is running at less than 75%. Instead, there is inadequate demand which can be stimulated by putting more funds in the hands of consumers through the reduction of individual tax rates, or better yet through elimination of the scheduled raises in Social Security taxes.

CONCLUSION

The tax package presented by the President and as passed by the House is heavily weighted in favor of capital intensive industries and the taxpayer who has done the least for the economy. If we are to overcome our present economic stagnation without an unnecessary loss of Federal revenue, this Committee should concentrate its tax cuts among those who will spend the reduction on consumer goods which will create a demand to get our plants rolling again. I urge this Committee to do that by continuing the automobile excise tax and repealing the telephone tax. It should scrap the ADR System entirely. It should also eliminate the scheduled increases in Social Security taxes and substitute a reduction in tax rates for the investment credit.

The CHAIRMAN. Thank you, gentlemen.

We have one other witness today. We will hear from Mr. Robert M. McElwaine, executive vice president of the Volkswagen American Dealers Association.

You are representing more and more a growing empire in this country, if it be only an empire of distribution service and repair for the people in our country.

We are pleased to hear from you.

Senator BENNETT. As an old Ford dealer I think the atmosphere might be safer if I withdraw. I have another situation that is going to force me to withdraw but I couldn't resist the opportunity for the wisecrack.

The CHAIRMAN. Well, you have some very fine people, I am pleased to say, Mr. McElwaine, and we will certainly be glad to consider your position.

STATEMENT OF ROBERT M. McELWAINE, EXECUTIVE VICE PRESIDENT OF THE VOLKSWAGEN AMERICAN DEALERS ASSOCIATION

Mr. McELWAINE. Thank you, Mr. Chairman and distinguished members of the committee. I greatly appreciate your sitting so long in session to hear me. In view of the proposals that have been made to the committee, however, which have almost terrifying impact on the members of our association, we felt it was necessary to impose upon you and ask for you to hear our testimony.

The Volkswagen American Dealers Association represents more than 1,150 Volkswagen dealers, located in each of the 50 States. These independent American businessmen have invested $350 million in plants and equipment in the past 20 years. They employ more than 43,000 American workers, at an annual salary in excess of $315 million.

H.R. 10947, as passed by the House of Representatives, has, in large part, the support of the members of this organization. Actions taken to revitalize the economy of this Nation are needed for the sake of the small businessman, as well as favorable balance of trade with the great majority of our trading partner nations. Only with Canada and Japan do we have a trade deficit of any substantial amount. With Germany, for example, the United States has enjoyed a favorable trade balance every year for more than two decades.

Last year, the United States sold $170,596,000 more to Germany than we bought from this nation of 60 million. This means that each German citizen, on an average, spends $4 on American goods for each $1 the average American spends on German goods. Approximately one-third of Germany's dollars are gained from the sale of Volkswagens and other German-built cars in this country. Without these dollars, where will Germany find the dollars to buy 747's, Levi's, corn flakes, soybeans, and the other American products one sees everywhere in Germany? Deprived of the dollars coming from the sale of automobiles, Germany might feel she has to turn to other nations to find the source of the goods she might buy and the other nation we fear would be in Eastern Europe and U.S.S.R. which is the only other major aircraft manufacturing company in the world.

IMPORTED CARS FROM CANADA

Our deficit with Canada, however, is more symptomatic of the true cause of our dollar drain. This year, our trade deficit with Canada will again exceed $2 billion. The majority of this deficit can be traced directly to the policies of the major American automotive producers in exporting 10 percent of U.S. automobile production to our northern neighbor. In 1964, before the United States-Canadian Automotive Trade Act, the United States enjoyed a trade surplus with Canada of $800 million. In 1970, our trade deficit with Canada surpassed $2 billion. Indications are that in 1971, this figure will be exceeded by a considerable amount.

In 1970, total imports of Canadian-built automobiles into this country reached nearly 700,000 units, making Canada by far the largest exporter of automobiles to the United States. In addition to automobiles, however, Canada exported to this country trucks, buses, parts and accessories, to bring the total value of automotive imports from Canada to more than $3 billion. These cars are Fords, Chevrolet, Chrysler, and American Motors products, sold in this country to Americans who have no way of knowing they are buying an imported product. They enter duty free. They account for more than 10 percent of all so-called domestic cars sold in this country. They far outsell Volkswagens—or Datsuns and Toyotas combined, for that matter. Since 1965, the annual total of cars imported into the United States has increased by 1,310,000 units. Canadian imports account for more than half of that increase.

This committee has heard testimony to the effect that the sale of imported cars in this country is threatening the American automobile industry and the job security of the workers in that industry. Some ominous statistics were cited to show that the domestic industry is imperiled by these imports.

Some of the figures given this committee would appear to be misleading. Certainly there is nothing in the financial statements of the domestic manufacturers to indicate they are facing any crisis. In the first 6 months of 1971, General Motors reported factory sales of cars and trucks and dollar sales at all time record levels. GM reported factory sales of 4,328,000 units, compared with 3,556,000 units in the first half of 1970. A net income of $1,177,000 was realized in the first 6 months of 1971, an increase of 43 percent over the first months of last year. Such figures hardly indicate that the domestic industry has its back to the wall.

This committee also has been told that import competition was responsible for the loss of 91,000 jobs in Detroit last year. Such figures fail to take into account the impact of the lengthy General Motors strike last year, or the fact that 1970 was a recession year. Since 700,000 cars with domestic nameplates were imported from Canada last year, there would seem to be at least 100,000 jobs that have been exported north of the border by our own industry. Although import sales have increased during 1971, it does not seem to have affected employment in Detroit this year. In June of 1971, industry employment stood at 877,300, an increase of 36,000 jobs over the same month last year, and even better than 1969's figures.

The fact that imported automobiles, heading for an annual share of the U.S. market of about 16 percent, jumped suddenly to 22 percent in August of this year also has been cited as evidence that imports are threatening to overwhelm the American automobile industry. This jump, caused by import buyers rushing to purchase cars before the 10-percent surcharge became effective, has been followed by just as severe a slump.

Any fears on the part of domestic manufacturers that imports' level of penetration of the U.S. market would remain at the artificially high level of August sales were promptly dispelled by September sales figures. In this first month after the surcharge took effect, import cars share of market dropped by one-third, to little more than 14 percent of the market. Domestic cars, in the same period, enjoyed the greatest September in their history, retailing 755,253 automobiles.

This was not, by any means, a reversal of the industry's experience so far this year. In the first 9 months of 1971, domestic manufacturers retailed 6,246,476 cars, an increase of more than 11 percent over last year's total for the same period. While the percentage increase in the sale of imports is impressive, it appears significant that for each additional imported car sold in America this year, Detroit has sold two additional cars over last year's record.

Final sales for imports in 1971 will probably account for little more than 16 percent of the domestic market, just as has been predicted all along. We estimate the total sale of imported cars in this country at about 1,500,000 units this year.

Estimates of a 2-million car year for imports are wildly exaggerated.

DOMESTIC DEALERSHIPS VS. IMPORTS

Testimony before this committee also blamed imports for the loss of 850 domestic retail outlets in 1970 and 1971. According to Automotive News, however, there were only 101 business failures by U.S. new car dealers in 1970. By contrast, in 1958, one of the alltime great years for Detroit sales, and before imports begin to gain in the U.S. market, there were 250 failures by new car dealers.

From 1950 to 1960, there was a decline in the number of U.S. dealerships of 13,163—in the decade before imports became a substantial part of the market. From 1960 to 1970, however, the decade of import penetration, the number of U.S. dealerships declined by only 6,587—about half as rapid a decline.

We hold that it is not realistic to state that imports fail to discipline domestic prices. Today, the cheapest American car one can buy is in the $2,000 range. Ten years ago, the cheapest American car was in the same price range. It is safe to say, that were it not for imports, one could not buy a U.S. car today for less than $3,000. This would eliminate millions of Americans from the new car market, with its consequent effect on our economy, not to mention the individual deprivation of the right to own a safer, more reliable automobile.

The distaste of the domestic industry for the manufacture of small cars probably was best summed up by the chairman of the Ford Motor Co., Mr. Henry Ford II, who, when congratulated on the sales success of the Pinto, replied,

"Mini-cars; mini-profits."

Detroit obviously prefers maxi-cars, with their consequent maxi-profits.

Would anyone estimate how long Mr. Ford would give the American public mini-cars, at supposed mini-profits, if legislative action could cut off the competition from imports?

General Motors and Ford already own the lion's share of the German automobile market, where Opels have been outselling Volkswagens of late. American-owned companies are also major factors in the British and French markets. They are not about to export their Vegas and Pintos to Germany, to compete with their own Opels and German Fords.

Detroit made the decision, long ago, to forego exporting American production, and to concentrate, instead, on acquiring or building manufacturing facilities abroad. The tax structure of this country, the willingness of foreign countries to make tax concessions in order to attract U.S. industry, all combined to make it more attractive to produce elsewhere than to manufacture products in the United States for sale abroad.

This decision has, of course, been detrimental to our export position. Now that this exportation of U.S. capital, technology, and jobs to other countries has taken its inevitable toll of our balance of payments, it would hardly seem practical to arbitrarily reduce imports in order to compensate for the balance.

We cannot correct those unfair trade practices by adopting even more restrictive measures ourselves. Nor will it serve any practical purpose to have trade restrictions removed throughout the world unless our industries make a major effort to export domestically-produced products.

Recently, the administration has indicated it may use selective removal of the 10 percent surcharge as a negotiating instrument in resolving our payment differences with other nations. This is, indeed, an awesome weapon. Should the President, for example, remove the surcharge from German automotive imports, in recognition of our trade surplus with that nation and the relatively free float of the German mark, while retaining it on Japanese automotive imports the Japanese cars would be at an enormous competitive disadvantage in this market. The higher tariffs, or excise taxes on imported automobiles suggested to this committee, were put forward in the context of negotiating instruments to win concessions from nations that discriminate against our exports. It is suggested that in the surcharge, the President already has sufficient power to accomplish this end and that further restrictions would amount to an overkill that could be harmful to all sides.

Thank you very much, sir.

The CHAIRMAN. Thank you for a very good argument, Mr. McElwaine. You have made a very good statement here.

Mr. MCELWAINE. Thank you.

(The committee subsequently received the following letter with attachment from Mr. McElwaine:)

VOLKSWAGEN AMERICAN DEALERS ASSOCIATION,
Washington, D.C., October 20, 1971.

Hon. RUSSELL E. LONG,
Chairman, Senate Committee on Finance,
New Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: I would like to express my appreciation for the very cordial and courteous reception I received from you and the distinguished members of your committee during my testimony concerning the Revenue Act of 1971.

In connection with my testimony, Monday's Wall Street Journal carries an article which sheds even more light on the subject of U.S. investment abroad as the source of our balance of payments drain. The article quotes Alfred Schaefer, Chairman of the Union Bank of Switzerland, regarding the substitution of

U.S. exports by the production of goods in subsidiaries abroad. He estimates that American companies have sunk some seventy-seven billion dollars into foreign facilities. Estimates on the annual sales volume of these overseas subsidiaries are quoted at from $120 billion to $200 billion. This is from ten to twenty percent of our gross national product.

Such an amount is, of course, many times the total value of imports into this country and nearly three times the value of our total exports. The theory is advanced that in time, the income from these subsidiaries will accrue with the parent companies in the United States and will therefore be a significant offsetting factor in our balance of payments.

The facts, however, may be slightly different. Since taxes on these overseas subsidiaries are deferred until such time as they are remitted to the United States, a significant encouragement exists to these major corporations to reinvest the profits of these companies abroad, and therefore avoid U.S. taxation. This, in turn, offers further encouragement for greater expansion outside the United States and a lessened effort to produce here for export.

Again, my appreciation for your patience and courtesy in hearing my testimony. If I can be of any assistance in providing further information to you or your committee, I hope that you would have members of your staff call on me. With kindest regards.

Sincerely,

ROBERT M. MCELWAINE.

[From the Wall Street Journal, Oct. 12, 1971]

THE OUTLOOK—APPRAISAL OF CURRENT TRENDS IN BUSINESS AND FINANCE

It's hard to think of any statement in economic policy that doesn't spark an argument. The money supply matters most—or it's nearly meaningless. Budget deficits are bad—or vital. Wage-price controls are the only hope—or they're doomed to failure.

Except one: The U.S. must have a strong foreign trade surplus. Until now, that is, when it really matters.

The Nixon administration believes the U.S. must export more than it imports, certainly, and it's willing to go to great lengths to accomplish this. But just when this goal is finally getting far more than lip service from the government, argument is growing about whether achieving it is possible, or even desirable.

The question is clearly an urgent one, because at the moment the U.S. doesn't have a trade surplus. August was the fifth straight month in which the trade account ran in the red, and so far this year the trade deficit has amounted to a seasonally adjusted $936 million, against a surplus of $2.23 billion in the like 1970 period. The year as a whole, Commerce Secretary Maurice Stans has warned, may well be the first since 1893 to leave the U.S. without a trade surplus.

Why should we have a trade surplus? The State Department puts it succinctly in a basic policy statement: "The present structure of the U.S. international payments—which is likely to obtain for some years to come—requires the maintenance of a significant trade surplus to offset our foreign expenditures for defense, tourism, foreign aid, and investment."

Roughly, that's the way it has worked for decades. Trade surpluses have not been big enough to avoid an overall dollar drain most of the time, but at least they have gone a long way towards covering the dollar costs of the things the U.S. wanted to put money into abroad. The downtrend from the record trade surplus of nearly $7 billion in 1965 marks "an alarming decline in our external competitive position," says Paul A. Volcker, Treasury Under Secretary for monetary affairs.

To reverse the decline, the administration is embarked on a bold and costly crusade. The Aug. 15 cutoff of gold sales and downward floating of the dollar was a step of long-dreaded disruptiveness, aimed at pushing the currency values of other countries higher, thus leaving U.S. goods priced more competitively. The 10% import surcharge is aimed at the same general goal, and particularly at pressuring other countries into reducing all sorts of barriers to U.S. goods.

Moreover, the administration is willing to accept more red ink in its budget in hopes of getting back into the black or foreign trade. If Congress would go along, a Treasury wary of foreign competition would cheerfully give up about $3 billion a year in tax revenues by accelerating depreciation and another $3 billion by reviving the investment tax credit. Its Domestic International Sales Corp. proposal would let companies create DISC to shelter at least $600 million from the tax collector, in hopes of spurring an extra $1.5 billion in exports.

Would it all work? Obviously, the administration thinks so, or it wouldn't try so hard. And it has a large body of optimistic supporters. The U.S. "should have no difficulty" if it tries as hard as other countries, says Daniel L. Goldy, a Houston executive and former Commerce Department official: "the U.S. has the advantages of economies of scale, of advanced technology, of superior management, of a highly skilled work force."

But now doubters are being heard from too. "It is unlikely that in the future we shall again witness export surpluses of $5 billion or more" for the U.S., says Chairman Alfred Schaefer of the big Union Bank of Switzerland. A key reason, he says, is "the substitution of U.S. exports by the production of goods in subsidiaries abroad." American companies have sunk some $77 billion into foreign facilities, he notes.

That base is big enough to support sales volume variously estimated at $120 billion to $200 billion yearly, observes Nat Goldfinger, the AFL-CIO's chief economist. If it weren't for this overseas output, labor and some top administration men fret, U.S. exports might be a lot bigger than last year's $42.66 billion, with proportionate relief from U.S. unemployment.

Gradually, however, the profits from operations abroad should reduce the payments need for a husky export surplus, according to quite a few witnesses before the President's Commission on International Trade and Investment Policy. "The long run factors seem to suggest that a trade deficit rather than a trade surplus will be the appropriate position," says Prof. Irving B. Kravis of the University of Pennsylvania. He figures that the income from U.S. investments abroad will amount faster than either new outflows or government spending abroad.

Such thoughts have even crept into official circles. In testimony submitted while he was still a member of the Council of Economic Advisers, Hendrick S. Houthakker (now back at Harvard) similarly predicted that "equilibrium in the U.S. balance of payments will involve little or no surplus on the trade account not too many years in the future."

Perhaps most importantly, this line is being taken by some of the foreign authorities with whom the U.S. must bargain for trade benefits.

The trade balance is "no longer a primary factor" in U.S. payments, protests the Brussels-based European Common Market, one of its more polite ways of saying that the administration is barking up the wrong tree. Like Switzerland, the U.S. is a "mature creditor nation" now, says an official of the Geneva-based General Agreement on Tariffs and Trade, and thus ought to accept a trade deficit and count more on its capital investments. If these investments won't cover other costs, such as keeping so many troops abroad, then this official advises the U.S. to deal directly with that outflow by pulling troops back.

So the seemingly technical trade surplus question raises much more basic ones: How much can the U.S. count on trade for jobs at home, and what will be the U.S. role in world investment, diplomatic and military affairs?

Whatever else might be said for the long noncontroversial trade surplus, it has the makings of one of the better economic arguments.

RICHARD F. JANSSEN.

The CHAIRMAN. The committee will stand in adjournment until 10 o'clock Wednesday morning at which time we expect to commence executive meetings on this bill.

(Whereupon, at 1:20 p.m., the committee was adjourned until Wednesday, October 20, 1971, to meet in Executive session, at 10 o'clock a.m.)

APPENDIX

Communications Received by the Committee Expressing an Interest in the Revenue Act of 1971—H.R. 10947

THE SECRETARY OF THE TREASURY,
Washington.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: In my testimony on October 7, 1971, on H.R. 10947, the proposed Revenue Act of 1971, questions were raised regarding the new class life system of depreciation authorized in that bill. H.R. 10947 contains the House action on the President's new economic program, and the new class life depreciation system is an essential element of that program.

The House has eliminated one of the two elements of the Treasury-adopted ADR system which accounted for the substantial revenue losses from the new system. The House has eliminated the so-called "modified first year convention" which effectively allowed three-quarters of a year's depreciation in the first year of an asset's use, rather than the normal half-year obtained by averaging acquisitions in any given year throughout the year. This special convention resulted in a revenue loss of $2.1 billion in 1971 of a total loss from the system of $2.8 billion in that year, and $1.7 billion of a total of $3.4 billion in 1972. The loss attributable to this special convention which has been eliminated was a lesser proportion in later years, representing, for example, $700 million of a total revenue loss of $3.7 billion in 1980. We accept that action by the House.

The House has retained the other key feature of the system allowing the taxpayer to use a life within a range from 20 percent shorter to 20 percent longer than the guideline life for the class in which the particular asset falls. This accounts for a revenue loss of $700 million in 1971 and $1.7 billion in 1972. This is the key feature of the new system which we feel must be retained.

The Internal Revenue Code provision merely provides for a "reasonable allowance" for depreciation, including a "reasonable allowance" for obsolescence. Depreciation deductions are presently taken in 10 million tax returns, and it is essential that we have a system that implements this general "reasonable allowance" standard so as to avoid a large number of individual disputes.

On examination, we found that the reserve ratio test adopted as part of the guideline procedures in 1962 was unworkable. It contained both conceptual and practical faults. Its application was suspended for three years in 1962, and in 1965 when it was about to take effect, it was effectively suspended for five or six more years by a series of highly complex transitional and "trending rules. As a result, over these past eight or nine years taxpayers became accustomed to using guideline lives (or shorter lives as allowed in some cases) as a matter of right without interference from the reserve ratio test.

Since the reserve ratio test looked only backward—that is, it reflected only what the taxpayer had done in the past and thus gave guidance for the lives of the newly acquired assests only to the extent history repeats itself—the test necessarily was not exclusive. Thus, the guidelines provided that if the test was violated, the taxpayer could demonstrate his right to continue using his existing tax lives if they were justified by his particular facts and circumstances.

It is not feasible now, for the first time, to begin applying a test to disallow depreciation deductions when the result may be (given the number of returns affected) a very large number of individual facts and circumstances disputes. Further, the test is so complex in its actual application that despite intensive training few revenue agents or accountants are able to apply the test in all its detail. Its application is an unwarranted burden on taxpayers, and it injects unreasonable and unnecessary uncertainties as to allowable depreciation deductions. In summary, we have found it impossible to administer and apply the reserve ratio test.

We felt it necessary to design a depreciation system based on industry-wide standards or norms, giving each taxpayer within a given industry the same rights, while also providing for regular revisions of the industry allowances to reflect industry experience and current conditions. To accomplish a meaningful reform, the system necessarily had to deal also with the integrally related problems of the treatment of repair and maintenance expenditures, salvage value, asset retirements, and other factors not dealth with in the guidelines. The new class life system for the first time represents a comprehensive treatment of all these matters.

The new class life system will largely end the bulk of disputes in the depreciation area, including disputes over salvage value and controversies over deductibility of repair and maintenance expenditures, all in a manner which is entirely reasonable both from the taxpayer's and the Government's standpoint. The new class life system also establishes a comprehensive system of depreciation accounting which permit the retrieval of annual, systematic, nation-wide data on asset acquisitions and retirements and establishes a data analysis program in the Internal Revenue Service which will provide a basis for future changes in guideline classes, guideline lives, and repair allowances in light of experience, trends, and projected future conditions.

In gearing the annual depreciation allowance to industry norms, it was appropriate to provide a range of allowable lives within which the taxpayer could select a life, reflecting the experience in general of those taxpayers in the industry who have shorter than average replacement cycles. This will prevent inequities by allowing all taxpayers within a given industry, competing with each other, the right to the same depreciation allowance. It also taken account of the fact that competitive pressure will tend to cause all taxpayers in an industry to move toward using the most efficient production processes, and thus toward the most efficient turnover of their capital assets, so that their depreciation lives should be the same.

Allowing shorter lives is also necessary in order to avoid having a large percentage of taxpayers continually seeking to establish that their own individualized prior experience, based on a myriad of historical data, justifies shorter tax lives.

On examining the guideline lives for the various industry groups as established in 1962, we also concluded that in general, because of changes in conditions since 1962, shorter periods were justified. There has been extensive technological change since 1962, resulting in asset obsolescence. Factors which contributed to this condition included recently imposed severe federal and state environmental control requirements rendering assets obsolete more quickly; an increasing degree of competition from foreign producers with highly automated modern facilities, newly constructed within the past two decades, forcing more rapid modernization by U.S. producers; and rapid incorporation of recent technological improvements by U.S. industries.

Further, we found that the other major industrialized nations provide substantially more favorable depreciation allowances than our guideline lives.

Taxpayers are *entitled* to depreciation allowances which, in light of current conditions, are indeed a reasonable allowance, including a reasonable allowance for obsolescence. Accordingly, it is in my judgment necessary to allow taxpayers a leeway under which they may select lives within a range 20 percent shorter to 20 percent longer than the guideline lives.

In my opinion, the stimulation of investment in plant and equipment inherent in the new class life system is warranted in addition to the 7 percent permanent Job Development Credit. As your Committee recognized in 1962, an investment credit and liberalized depreciation work hand in hand to encourage economic growth and to allow American industry to compete on an equal basis with the increasingly competitive industrialized nations of the free world. The major industrialized nations today provide not only liberal depreciation deductions but also initial allowances or incentive allowances to encourage investment and economic growth. The table included in my testimony (revised somewhat) showing the effect of these provisions on the net cost of an asset to the taxpayer is attached for your convenience. This table demonstrates that *both* the Job Development Credit and the new class life system are necessary to place American industry on a basis in any way comparable to that of producers in other countries. In actuality, a considerably higher investment credit or depreciation liberalization would be necessary to match the allowances granted by Great Britain, Japan, Italy, West Germany, Sweden, or Belgium, but we are satisfied that the combination in the House bill is adequate.

From the point of view of administration of the internal revenue laws, the new class life system—including the ability to select a useful life from a range of lives from 20 percent above to 20 percent below the guideline lives—is essential. The new class life system cannot be eliminated without creating major administrative difficulties. The new system is a comprehensive approach to the difficulties of capital cost recovery, and retention of this system is imperative. I urge you to adopt the Job Development Credit and the provisions of the House bill establishing the new class life depreciation system.

Sincerely yours,

JOHN B. CONNALLY.

DEPARTMENT OF STATE,
Washington, D.C., Oct. 7, 1971.

Hon. RUSSELL B. LONG,
Chairman, Finance Committee,
U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: The Department understands that your Committee will commence hearings on H.R. 10947, "The Revenue Act of 1971," today, October 7. We wish to refer to the specific provision in that bill which incorporates ocean freight charges, when incurred by using US-flag vessels, in the definition of export promotion expenses for the purposes of calculating the allocation of profits to the proposed Domestic International Sales Corporation (DISC).

As we understand this provision, it would permit the DISC to take up to 50% of its freight costs, if it utilizes US-flag vessels, as "export promotion expenses." It could then claim up to 10% of these expenses to increase its allocation of income eligible for tax deferral. The practical effect of the provision would be to provide to exporters qualifying as DISCs a tax deferral on income equivalent to up to 5% of the freight charges paid to US flag vessels.

The Department has both legal and practical problems with the above-described provision. In brief, the Department considers that most of our Friendship, Commerce, and Navgiation (FCN) treaties with foreign countries prohibit any measure that has the effect of denying foreign flag vessels equal access to commercial cargo whether the measure applies to the vessel, the cargo or to some other party, such as the exporter who makes use of the vessel. In most cases this prohibition derives from an aritcle dealing specifically with shipping. A typical example of such an article is 13(2),(3) of our FCN treaty with Belgium, as follows:

> (2) Vessels of either Party en route to or from the territories of the other Party shall be accorded national treatment and most-favored-nation treatment with respect to the right to carry all cargo that may be carried by vessel.
>
> (3) Goods carried by vessels under the flag of either Party to or from the territories of the other Party shall enjoy the same favors as when transported in vessels sailing under the flag of such other Party. This applies especially with regard to customs duties and all other fees and charges, to bounties, drawbacks and other privileges of this nature, as well as to the administration of the customs and to transport to and from port by rail and other means of transportation.

The United States currently has FCN treaties with over 40 countries including most of the major maritime nations. Most of them contain the prohibition of discriminatory treatment by each treaty signatory of the other party's national-flag vessels.

It is the Department's view that the shipping provision in H.R. 10947 constitutes the type of discriminatory treatment in favor of U.S.-flag vessels which is prohibited in the above-mentioned FCN treaties. It would provide a tax advantage to the shipper or exporter which utilized US-flag vessels, and would therefore constitute an incentive for directing cargoes to US lines at the expense of foreign-flag lines, including those of countries with which we enjoy FCN treaties.

Our existing cargo preference laws and regulations in favor of US-flag vessels are not in violation of our FCN treaties. FCN treaties cover only commercial cargoes and do not apply to government proprietary cargoes or those in which there has been some form of official financial assistance, such as are covered by cargo preference. The provision in H.R. 10947, by contrast, would apply to exports by DISCs, which would be essentially *commercial* cargoes. As a matter of policy and treaty obligation the United States has carefully steered clear of restricting the freedom of shippers to choose the vessel for shipment of commercial cargoes.

From a practical standpoint the Department believes that adoption of the above-described shipping provision, contrary to our treaty obligations, would undercut the effectiveness of the U.S. Government in obtaining relief from similar actions by foreign governments. It is a considerable temptation, especially for a developing country attempting to build up its merchant fleet, to utilize tax rebates and similar procedures for establishing preferences for cargoes shipped in their own national-flag fleets. Where we have FCN treaties prohibiting such discriminatory treatment we can invoke them in defense of U.S.-flag shipping. For us to violate the treaties themselves would vitiate this capability.

In our letter of July 21, 1971 to the Office of Management and Budget, the Department supported the Treasury's proposal on the DISC as it stood at that time, noting that "the proposal is consistent with our international obligations." If the proposal had at that time contained the above-described shipping provision we would of course have expressed our views as outlined above.

In view of the above considerations the Department strongly urges the Committee to agree to the deletion of the provision on shipping from H.R. 10947.

The Office of Management and Budget advises that from the standpoint of the Administration's program there is no objection to the submission of this report.

Sincerely yours,

DAVID M. ABSHIRE,
Assistant Secretary for Congressional Relations.

WHITE MOTOR CORP.,
Washington, D.C., October 5, 1971.

Subject: Proposed Internal Revenue Act of 1971 H.R. 10947, Section 48A.

Senator RUSSELL B. LONG,
U.S. Senate,
Washington, D.C.

DEAR SENATOR LONG: We hereby request that provision be made in the Job Development Investment Credit reference of the subject Act now pending in the Congress to permit purchasers of trucks manufactured in Canada pursuant to the United States-Canada Automotive Products Agreement of 1965 to avail themselves of the proposed tax credit. The Credit in its present form excludes foreign-produced trucks as long as the import surcharge is in effect while trucks produced in the United States will be eligible under the Credit. Should the Credit be enacted into law in its present form the Automotive Product Agreement will be abrogated with the result that White Motor Corporation and its subsidiaries as well as the many other truck manufacturers who acted in good faith in reliance on the Automotive Products Agreement will suffer irreparable damage.

As you are undoubtedly aware, in January of 1965 the Governments of the United States and Canada entered into the Automotive Products Agreement which, in Article I, sets forth the following objectives:

(*a*) The creation of a broader market for automotive products within which the full benefits of specialized and large-scale production can be achieved;

(*b*) The liberalization of the United States and Canadian automotive trade in respect of tariff barriers and other factors tending to impede it, with a view to enabling the industries of both countries to participate on a fair and equitable basis in the expanding total market of the two countries;

(*c*) The development of conditions in which market forces may operate effectively to attain the most economic pattern of investment, production and trade.

Article I of the Agreement further provides that it shall be the policy of each Government to avoid actions which would frustrate the achievement of these objectives.

United States manufacturers who wish to avail themselves of the tariff free advantage of the Automotive Products Agreement must manufacture in both countries and must maintain certain established export-import and price ratios.

As a direct result of such Agreement and the statutes enacted by the United States Government implementing the Agreement and in accordance with the above set forth objectives of the Agreement, White constructed a manufacturing facility in Kelowna, British Columbia. Kelowna is White's first and only facility in the Western part of the North American Continent where two unique White heavy duty highway tratcors are manufactured. They were designed to meet the specifications required by Western highway trucking operators in the United States and Canada. Production at this facility commenced in 1967 with 221 units and, for the year 1972, it is estimated that 1,195 units will be produced. In 1972 as in past years, approximately 75% of the units are expected to be sold into the United States. The value of such expected shipments to the U.S. is approximately $14,000,000. It should be noted that approximately 70% of the value of all component parts of the trucks manufactured in the Kelowna facility are of United States origin.

As a result of White proceeding under the Automotive Products Agreement by expanding its manufacturing facilities in Canada, it has substantially increased its export of United States manufactured trucks into Canada and through its Kelowna, British Columbia, facility increased its market penetration of Western United States and Canada.

Accordingly, if the Credit does not make provision for Canadian manufactured trucks, the entire purpose of the Agreement will be nullified with the result that White's exportation of United States-made trucks will be reduced because of its inability to live up to the ratio of Canadian products to Canadian sales and the resulting requirement that duties be paid to Canada. Specifically if the White Truck Division of Cleveland, Ohio, and the Autocar Division of Exton, Pennsylvania, had not been able to take advantage of duty free shipments into Canada it would have meant that such shipments would have been charged 15% import duty and sales would have been lost as follows:

1969—472 vehicles valued at $9,400,000.
1970—140 vehicles valued at $2,800,000.
1971—250 vehicles valued at $5,000,000.

It is estimated that in 1972 the loss will be the same as in 1971.

Also, White's penetration of the highly specialized Western United States and Canada market for the unique trucks manufactured at Kelowna could be severely curtailed since the manufacture of such trucks would have to be shifted from Kelowna to White's United States facilities which are located in Ohio and Pennsylvania. This change would of course take time and a considerable expenditure and may not be economically feasible, since the market could be lost during the period of transition.

In view of the above, we hereby request that consideration be given to a provision in the pending Job Development Credit which will permit products imported under the provisions of the United States-Canada Automotive Agreement of 1965 to be included for tax credit purposes, or a suitable alternative be developed which would not work a hardship on such companies as White which developed manufacturing facilities to participate in the aforementioned agreement.

If you have any questions or desire additional information, please advise and we will give the matter our prompt attention.

Very truly yours,

WHITE MOTOR CORPORATION,
P. H. HOCKWALT,
Director of Washington Office.

LAW SCHOOL OF HARVARD UNIVERSITY,
Cambridge, Mass., Sept. 24, 1971.

Hon. RUSSELL B. LONG,
Chairman, Senate Committee on Finance,
Washington, D.C.

DEAR SIR: The low-income allowance which provides long-needed relief for hard-pressed taxpayers at or below the poverty level, is being seriously abused. It is used by estate planners to permit income to be accumulated tax-free at the rate of $1,750 per year for the minor children and grandchildren of wealthy individuals.

The bill which the Ways and Means Committee will report shortly is expected to contain a provision which deals with part of the problem. It is, however, seriously incomplete. The enclosed memorandum describes the situation and suggests a more comprehensive remedy for consideration by the Finance Committee.

If a member of your staff should wish to discuss any aspects of the problem with me, my telephone number is (617) 495–4630.

Sincerely yours,

DAVID WESTFALL,
Professor of Law.

Enclosure.

SEPT. 24, 1971.

Memorandum re Abuse of Low-Income Allowance.
From: David Westfall, Professor of Law, Harvard University.

The low-income allowance, which was intended to provide relief for hard-pressed taxpayers with low incomes, is being used in estate planning to accumulate tax-free income for the children and grandchildren of wealthy individuals. This may be done in a variety of ways:

CASE 1

A father or grandfather sets up a trust to continue for ten years, when the principal is to be returned to him. During the ten year term of the trust, the income is payable to the children or grandchildren. If it is not needed for their living expenses, the income is likely to be accumulated by the beneficiaries. The effect of the low income allowance is to make such accumulation tax-free (if the child or grandchild has no other income) to the extent of $1750 per year.

CASE 2

A father or grandfather sets up a trust for his children or grandchildren. During the term of the trust, the income may either be paid to the beneficiaries or accumulated by the trustee. When the trust terminates, the principal and accumulated income will be paid to the beneficiaries and will not revert to the grantor. The effect again of the low income allowance is to make distributed income tax-free to the extent of $1750 per beneficiary per year, if the beneficiary has no other income. Accumulated income will be taxed to the trust, but when it is distributed the low income allowance may permit the beneficiary who receives the accumulation to get a refund of taxes paid by the trust, if he had no other income during the years of its accumulation. This is the result of the throwback provisions dealing with accumulated trust income.

CASE 3

A father or grandfather makes a gift to a trust for his minor child or grandchild which qualifies under § 2503(c) as a present interest trust. During the term of the trust, income may be distributed to the beneficiary which again will be free of tax if he has no other income. If the trustee accumulates the trust income, it will be taxed to the trust but again there may be a refund of such taxes when the income is distributed to the beneficiary at age 21.

CASE 4

A father or grandfather makes a gift to a custodian for a minor child or grandchild under one of the state Uniform Gifts to Minors Acts, or he makes a gift to the minor and a guardian is appointed to hold title to the property for him. The income received by the custodian or guardian is taxable to the minor, but again the low income allowance is available.

In all of the above situations, if the child or grandchild is in fact being supported by his parents, it is difficult to justify giving him the benefit of the low income allowance with respect to the income in question. The Ways and Means Committee is expected to report shortly a bill which deals with Case 1 limiting the low income allowance with respect to income received by a taxpayer from a trust in which the grantor has a reversionary interest. Although this is the most flagrant case, it appears that serious abuses exist in Cases 2, 3, and 4 as well. Such abuses are heightened by the increase in the low income allowance to $2050 under the Ways and Means bill.

A more comprehensive solution would deny the low income allowance to minor taxpayers with respect to unearned income generally, if the taxpayer qualifies for tax purposes as a dependent of another taxpayer. The limitation to minor taxpayers is appropriate to keep the low income allowance available for those adults, such as retired persons, who receive unearned income but often have no other source of support, or, if they do, nevertheless often have the expense of maintaining a separate household. The limitation to those who qualify as a dependent of another taxpayer is appropriate to keep the low income allowance available for minors who do not receive support from another taxpayer.

AMERICAN FISH FARMERS FEDERATION,
Lonoke, Ark., October 12, 1971.

Hon. RUSSELL B. LONG,
Chairman, Finance Committee,
U.S. Senate, New Senate Office Building,
Washington, D.C.

DEAR SENATOR: This is to urge you to support Senator James B. Pearson's Amendment to the Revenue Act of 1971, which would double the investment tax credit for rural areas.

You are aware, of course, that 70% of the population is now concentrated on less than 2% of the land and that the location and expansion of industries in the central cities continuously attract more people to these highly congested areas, creating critical problems of housing, transportation, increased crime, and unhealthful living conditions.

A more balanced distribution of economic opportunities is a necessity to accommodate an increased population. It is my opinion that Senator Pearson's Amendment would be a long step toward decentralization of the population of this country.

I hope your Committee will act favorably on this Amendment.

Yours very truly,

AMERICAN FISH FARMERS FEDERATION,
ROY PREWITT, *Chairman.*

STATEMENT BY JAMES B. CREAL, EXECUTIVE VICE-PRESIDENT, AMERICAN AUTOMOBILE ASSOCIATION

The American Automobile Association, of which I am the Executive Vice-President, appreciates this opportunity to present our views on President Nixon's proposed repeal of the 7 percent automobile excise tax.

The American Automobile Association historically has been for repeal of this onerous tax. Our official policy statement on this issue reads:

"A-6. FEDERAL EXCISE TAXES

The AAA opposes Federal excise taxes on private passenger cars, their accessories and parts."

In addition, we have presented three basic arguments on this matter. First, the auto excise tax is highly regressive and is not truly related to the taxpayer's ability to pay. As a result, the burden of the tax falls most heavily on those least able to pay it.

Secondly, the automobile is a necessity, not a luxury, and it should not be subject to the same sort of federal "luxury" taxes that are levied on the sales of alcoholic beverages and tobacco. It shouldn't surprise you to know that about 82 percent of the commuting workers in this country travel to and from work by automobile, according to the Automobile Manufacturers Association booklet entitled "1971 Automobile Facts and Figures". And a national survey sponsored by the Highway Research Board in 1967–68 revealed that 81 percent of the American public consider their automobiles to be the ideal mode for making those very necessary local shopping trips.

And thirdly, American motorists are the most heavily taxed group in our nation. The Federal Highway Administration reported on December 4, 1970 that total special federal and state taxes, fees and tolls paid by highway users are now running well in excess of $16 billion a year. And there appears to be no end in sight.

Attached is a chart, prepared by the AAA Legal Department, outlining the legislative history of the Federal Excise Tax on passenger cars from only 1955 through 1970. This chart graphically illustrates that year after year promised scheduled reductions in the auto excise tax were postponed by Congress until now the tax is scheduled to run at a progressively reduced rate until December 31, 1981. The time has arrived for the Congress to finally meet its pledge to the American people with respect to the auto exise tax by repealing it outright, and what better time than now when the President has launched a New Economic Program to slow inflation and provide new job opportunities:

Automobiles and jobs are almost synonymous terms. Again, according to the AMA booklet "1971 Automobile Facts and Figures", one person in every six in the nation's work force is employed either directly or indirectly in the automotive field. Through the multiplier effect, the stimulus to the economy from increased production and sales of motor vehicles can be a tremendously important factor in achieving success for the President's program. By repealing the 7 percent automobile excise tax, Congress can in one swift action achieve two goals: It can redeem its long-standing pledge to the nation with respect to this tax and it can take a giant leap forward in stimulating new car sales and the resultant economic growth.

Changing economic conditions make the time for action now. We urge immediate repeal of the 7 percent automobile excise tax as proposed in President Nixon's New Economic Program, which would be retroactive to August 15, 1971. The estimated $2 billion annually returned to the pocketbooks of consumers will do much to stimulate all sectors of our economy.

Excise tax on passenger cars (legislative history 1955 thru 1970)

Tax Rate Extension Act of 1955	10 to 7 percent scheduled for reduction Apr. 1, 1955.
Public Law 84–18; Mar. 30, 1955	Reduction postponed until Apr. 1, 1956.
Tax Rate Extension Act of 1956	10 to 7 percent scheduled for reduction Apr. 1, 1956.
Public Law 84–458; Mar. 29, 1956	Reduction postponed until Apr. 1, 1957.
Tax Rate Extension Act of 1957	10 to 7 percent scheduled for reduction Apr. 1, 1957.
Public Law 85–12; Mar. 29, 1957	Reduction postponed until July 1, 1958.
Tax Rate Extension Act of 1958	10 to 7 percent scheduled for reduction July 1, 1958.
Public Law 85–475; June 30, 1958	Reduction postponed until July 1, 1959.
Tax Rate Extension Act of 1959	10 to 7 percent scheduled for reduction July 1, 1959.
Public Law 86–75; June 30, 1959	Reduction postponed until July 1, 1960.
Public Debt and Tax Rate Act of 1960	10 to 7 percent scheduled for reduction July 1, 1960.
Public Law 86–564; June 30, 1960	Reduction postponed until July 1, 1961.
Tax Rate Extension Act of 1961	10 to 7 percent scheduled for reduction July 1, 1961.
Public Law 87–72; June 30, 1961	Reduction postponed until July 1, 1962.
Tax Rate Extension Act of 1962	10 to 7 percent scheduled for reduction July 1, 1962.
Public Law 87–508; June 28, 1962	Reduction postponed until July 1, 1963.
Excise Tax Rate Extension Act of 1963	10 to 7 percent scheduled for reduction July 1, 1963.

Public Law 88–52; June 29, 1963	Reduction postponed 1 year until July 1, 1964.
Excise Tax Rate Extension Act of 1964	10 to 7 percent scheduled for reduction July 1, 1964.
Public Law 88–348; June 30, 1964	Reduction postponed 1 year until July 1, 1965.
Excise Tax Reduction Act of 1965 Public Law 89–44; June 21, 1965	Scheduled reductions: 10 to 7 percent June 22, 1965 through Dec. 31, 1965. 7 to 6 percent Jan. 1, 1966 through Dec. 31, 1966. 6 to 4 percent Jan. 1, 1967 through Dec. 31, 1967. 4 to 2 percent Jan. 1, 1968 through Dec. 31, 1968. 2 to 1 percent Jan. 1, 1969.
Tax Adjustment Act of 1966 Public Law 89–368; Mar. 15, 1966	Postponed reduction and increased tax to: 7 percent Mar. 16, 1966 through Mar. 31, 1968. 7 to 2 percent Apr. 1, 1968 through Dec. 31, 1968. 2 to 1 percent Jan. 1, 1969.
Revenue and Expenditure Control Act of 1968 Public Law 90–364; June 28, 1968	Postponed and rescheduled reductions to: 7 percent Apr. 1, 1968 to Dec. 31, 1969. 7 to 5 percent Jan. 1, 1970 to Dec. 31, 1970. 5 to 3 percent Jan. 1, 1971 to Dec. 31, 1971. 3 to 1 percent Jan. 1, 1972 to Dec. 31, 1972. 1 to 0 percent Jan. 1, 1973.
Tax Reform Act of 1969 Public Law 91–172; Dec. 30, 1969	Postponed and rescheduled reductions to: 7 percent Jan. 1, 1970 through Dec. 31, 1970. 7 to 5 percent Jan. 1, 1971 through Dec. 31, 1971. 5 to 3 percent Jan. 1, 1972 through Dec. 31, 1972. 3 to 1 percent Jan. 1, 1973 through Dec. 31, 1973. 1 to 0 percent Jan. 1, 1974.
Excise, Estate, and Gift Tax Adjustment Act of 1970 Public Law 91–614; Dec. 31, 1970	Postponed and rescheduled reductions to: 7 percent Jan. 1, 1971 through Dec. 31, 1972. 7 to 6 percent Jan. 1, 1973 through Dec. 31, 1973. 6 to 5 percent Jan. 1, 1974 through Dec. 31, 1977. 5 to 4 percent Jan. 1, 1978 through Dec. 31, 1978. 4 to 3 percent Jan. 1, 1979 through Dec. 31, 1979. 3 to 2 percent Jan. 1, 1980 through Dec. 31, 1980. 2 to 1 percent Jan. 1, 1981 through Dec. 31, 1981.

INVESTMENT BANKERS ASSOCIATION OF AMERICA,
Washington, D.C., Oct. 7, 1971.

Re Interest Equalization Tax Exclusion for U.S. Direct Investments.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Senate Office Building,
Washington, D.C.

DEAR MR. CHAIRMAN: In connection with the Revenue Act of 1971 (H.R. 10947), the Foreign Investment Committee of the Investment Bankers Association urges you to consider an amendment to the Internal Revenue Code which would provide a new exclusion from Interest Equalization Tax for acquisitions by United States persons of securities issued by foreign entities to raise funds to be used together with foreign source funds to make direct investments within the United States.

The Foreign Investment Committee supports this amendment because of its belief that the measure will result in new foreign investment in the United States which will improve the United States balance-of-payments position. Many direct investments by foreign corporations should result in substantial import substitutions and contribute to exports. Also, many such investments should result in new job opportunities through the creation of new domestic industries. Consideration of the amendment in connection with the Revenue Act of 1971 is appropriate since the policies of that Act include the improvement of the United States balance-of-payments position and the stimulation of the domestic economy.

Prior to the introduction of the Revenue Act of 1971, the proposed amendment was discussed at length and in detail with technical personnel of the Treasury Department who indicated informally that the form of the amendment described in this letter was acceptable to them.

In connection with the proposed amendment, the Committee would like to draw your attention to the Report issued by the Presidential Commission on International Trade and Investment Policy in July 1971 which recommends that immediate attention be given to freeing foreign securities from Interest Equalization Tax where the proceeds are used for United States direct investment. The Report points out that the Interest Equalization Tax now serves as an impediment to foreign direct investment in the United States.

The Committee concurs in the conclusion of the Presidential Commission. The limitations on many foreign capital markets, particularly regarding equity securities, make it significantly more difficult to raise money abroad than in the United States. Further, in the international monetary situation, foreign entities may be unwilling to make a dollar investment in the United States unless such investment is made with the proceeds of a dollar liability in order to eliminate foreign exchange risk in United States investment. The proposed exclusion would help eliminate both of these impediments to investment in the United States by foreign entities.

As to that part of the financing of foreign investment which would be raised in the United States, particularly where convertible securities or equities are used, experience would indicate that substantial amounts of such securities would in the course of time flow back to the foreign market where the securities of the issuer are principally traded and thereby add to the inflow of funds.

GENERAL DESCRIPTION OF THE AMENDMENT

The Interest Equalization Tax provisions of the Internal Revenue Code would be amended to establish an exclusion for acquisitions by United States persons of stock and debt obligations issued by foreign persons to raise funds for direct investments in the United States so long as foreign source funds will also be so invested. This would be a new exclusion. The exclusion would be available only after a Treasury Department determination that an amount of foreign source funds, plus the net proceeds of the excluded issue, would be invested in the United States. Assurance would be required that the investment would not be a substitute for an existing United States investment and that it would not be used to finance import activities. Failure to carry out an investment plan approved by the Treasury Department after issuing securities would ordinarily result in the imposition of Interest Equalization Tax liability on the issuer.

DESCRIPTION OF SPECIFIC FEATURES

The principal features of the amendment would be as follows:

The exclusion would apply to the acquisition of either stock (including options to acquire stock) or debt obligations which constituted all or part of an original or new issue, as well as stock acquired pursuant to the conversion of debt obligations which were all or part of an original issue to which the exclusion applied. Securities sold by a foreign affiliate of the issuer would be eligible. Securities issued for property, as well as cash, would be eligible.

Prior to the issuance of the excluded securities, the Treasury Department would determine that the issuer had a well-developed plan which was likely to be implemented pursuant to which the proceeds of the issue would be invested as a new direct investment in the United States or would be used to refinance an issue of securities so invested. This determination would be reflected in a Treasury Department ruling. Ruling requests would be signed by the issuer, the lead underwriter or likely acquirer, the U.S. subsidiary (if any) in which the investment will be made and at least one resident United States citizen employed by the subsidiary or issuer.

The plan would provide that, in addition to the net proceeds realized from the portion of the issuer that is sold to United States persons, the issuer would invest an amount of foreign funds in the United States as part of direct investment. The Treasury Department could determine that the amount of foreign source funds to be invested should be less than, equal to, or greater than the proceeds from the sale of the portion of the issue that is sold to United States persons.

The plan would require that the direct investment be maintained in the United States for a minimum period established by the Treasury Department. We suggest that a reasonable minimum period would be five years or the period to maturity, when shorter than five years. The plan would require the net proceeds of the sale of the excluded issue to be held in the United States pending their direct investment, and the appropriate forms of temporary investments would be prescribed by the Treasury Department.

The exclusion would not apply where a substantial part of the activities in which the direct investment was made fostered the sale or financing of imported products; and would not apply where the direct investment was a substitute for existing direct investments in the United States.

Failure to comply with the above conditions, except where due to a change in the circumstances after issuance, would result in the imposition of an Interest Equalization Tax liability on the issuer. There would be no subsequent liability where failure was due to a change in circumstances after issuance of the excluded issue. The amount of subsequent Interest Equalization Tax liability would be equal to the tax which would have been paid at the time the excluded issue was sold on the portion of the excluded issue which was not used in accordance with the plan.

The Foreign Investment Committee supports an amendment to provide an Interest Equalization Tax exclusion for United States direct investments and urges your consideration of such an amendment in connection with the Revenue Act of 1971.

Very truly yours,

HARVEY M. KRUEGER, *Chairman.*

CAHILL, GORDON, SONNETT, REINDEL & OHL,
New York, N.Y., October 7, 1971.

HON. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: I wish to call your attention to an obvious inequity which exists in the Revenue Bill of 1971 (H.R. 10947).

The proposed amendment to Section 58(g)(2) of the Internal Revenue Code will result in the unfair treatment of taxpayers who relied upon a proposed Treasury regulation unless the amendment is restricted. That section was added to the Code by the Tax Reform Act of 1969, and the pending amendment would retroactively modify that section by providing, in effect, that foreign source capital gains will be treated as items of tax preference in cases in which the capital gains are attributable to countries which impose no income tax.

The proposed regulations interpreting Section 58(g)(2) in its present form were issued on December 30, 1970, and provided that such foreign source capital gains were not items of tax preference. On June 24, 1971 the Treasury reversed its position and modified the proposed regulations so as to treat capital gains earned in foreign countries which impose no income tax as being items of tax preference. The same consequence will result from the adoption of the proposed amendment to Section 58.

It is typical to limit amendments to the Internal Revenue Code to transactions occurring after the adoption or proposed adoption of such amendments. It would seem particularly inappropriate to deviate from that standard in a case such as this where for a period of approximately six months the published position of the Treasury led to a result diametrically opposed to that proposed by this amendment. At a minimum, it would appear that this amendment should be restricted to capital gains realized after June 24, 1971, the date of the change in the Treasury's proposed regulation.

Very truly yours,

WALTER C. CLIFF.

OCTOBER 12, 1971.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate.

DEAR MR. CHAIRMAN: To help overseas financing of U.S. business needs in a manner consistent with Administration policy, H.R. 9040 should be added to the Revenue Act of 1971. This is necessary to make effective an important mechanism authorized by Congress this year. A copy of H.R. 9040 is attached.

Congress permitted U.S. corporations to designate debentures and other debt instruments issued by them and thus make them subject to the Interest Equalization Tax ("IET"). IET Extension Act of 1971, adding Section 4912(c) to the Code. At the same time, the interest on designated debt was exempted from withholding taxes by a new Section 861(a)(1)(G) also added to the Code by the IET Extension Act of 1971. This legislation was designed to help U.S. business raise capital overseas without using foreign finance subsidiaries. It failed, and debt securities have not been issued under it, because they would be subject to U.S. estate taxes when held by foreign investors. Since this estate tax difficulty can be avoided by selling debentures of a foreign finance subsidiary, typically a Netherlands Antilles subsidiary,* these companies continue to be employed in foreign financing despite the Extension Act.

The price of using Netherlands Antilles finance subsidiaries is a local tax "toll charge" which is ultimately borne by our Treasury through our foreign tax credit mechanism. H.R. 9040 would make it unnecessary to use Netherlands finance subsidiaries, and would thus avoid this cost. It would do so by exempting from U.S. estate tax debt instruments which had been subjected to IET by designation. The debt instruments of certain Delaware finance subsidiaries already enjoy this exemption under Section 2104(c) of the Code and so, of course, do the debt instruments of Antilles finance subsidiaries.

No estate tax loss could be anticipated from enactment of H.R. 9040, for estate tax-burdened securities of the type under consideration are not now issued. Indeed, by eliminating the need for Netherlands Antilles finance subsidiaries and thus the credit against U.S. income tax they generate, H.R. 9040 would increase U.S. income tax revenues. It is understood that the Administration supports H.R. 9040.

Respectfully submitted,

M. BERNARD AIDINOFF,
JOHN P. CARROLL, Jr.

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*In some, but not all, cases a special type of Delaware finance subsidiary may also be employed. Ordinarily, IET applies to the bonds of a Delaware finance subsidiary (and the bonds are exempt from withholding and estate taxes) if the proceeds of the bonds are invested abroad but not if the proceeds are invested in the U.S.

[H.R. 9040, 92d Cong., first sess.]

A BILL To amend the Internal Revenue Code of 1954 to provide an exemption from the Federal estate tax for certain debt obligations of domestic corporations in cases where the interest on such obligations would be treated as income from foreign sources for purposes of the interest equalization tax.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the last sentence of section 2104(c) of the Internal Revenue Code of 1954 (relating to treatment of certain debt obligations for estate tax purposes) is amended by inserting "or section 861(a)(1)(G)" after "by reason of section 861(a)(1)(B)".

SEC. 2. The amendment made by the first section of this Act shall be effective with respect to estates of decedents dying on or after April 1, 1971.

AMERICAN FARM BUREAU FEDERATION,
Washington, D.C., Oct. 12, 1971.

Hon. RUSSELL LONG,
Chairman, Senate Finance Committee,
U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: We are writing to you to express Farm Bureau's position on the legislative proposals contained in President Nixon's August 15 economic message which have passed the House in modified form and are now before your Committee.

Farm Bureau has long been concerned with the economy of this nation. This is evidenced by the time and detailed discussion devoted to economic issues each year by the official voting delegates of the member State Farm Bureaus during policy deliberations. The opening paragraph of current Farm Bureau policy reads as follows:

"Inflation is a serious threat to economic stability. Excessive federal government spending is the basic cause of our current problem of inflation. Deficit spending by the federal government and policies which expand the supply of money and credit faster than production clearly lead to inflation. Both Congress and the Executive Branch of government must face up to this fact and bring expenditures into balance with income at tax rates which are not oppressive."

We believe this statement is particularly meaningful at this time and in this setting. The Executive Branch has outlined plans for cutting expenditures by nearly $5 billion during the current year. If and when assurances are received that such expenditure reductions are, in fact, to be realized, the Legislative Branch should consider reducing the tax burdens on individuals and businesses.

Farm Bureau policy states that "federal excise taxes should be limited to nonessentials and user taxes." The present seven percent excise tax on automobiles does not fall into either of the above categories and Farm Bureau favors its repeal as proposed. We agree strongly with the House position that the excise tax on small trucks also should be repealed.

Farm Bureau policy further states: "The personal income tax exemptions should be further increased in recognition of the economic changes which have occurred in recent years."

The statement clearly shows Farm Bureau's support for the proposed speedup in the scheduled increases in personal exemptions.

Turning to the investment credit, our present policy says: "We favor reenactment of the investment credit as a permanent feature of our tax system."

Farmers' and ranchers' most realistic alternative to combat the cost-price squeeze is by increasing efficiency of production. Their ability to become more efficient is in large part determined by their ability to modernize the equipment used in cropping and feeding operations. We can readily see the value of the proposed seven percent investment credit. The longtime benefit to the U.S. economy must come through increased productivity. We urge you to build a legislative record indicating the intention of Congress to make the investment credit a permanent feature of our tax system.

Farm Bureau does not have specific policy on the details of the DISC proposals; however, we favor it in principle. The pertinent part of Farm Bureau policy for 1971 reads as follows:

"We favor tax deferral incentives on export earnings of domestic firms as a method of encouraging exports to offset the tendency for U.S. industries to expand production and processing operations in foreign countries."

As longtime advocates of expanded world trade, it would appear to us that the proposal to tax the profits of export corporations only when distributed to the shareholders would be effective in expanding foreign sales of U.S. food, fiber and manufactured goods. This goal must be met if we are to reverse the decline in our balance of payments position. The final version of any legislation that may be enacted to implement the DISC proposal should encourage exports without permitting abuses in the use of any earnings for which taxes are to be deferred.

We urge the Committee to give favorable consideration to these proposals at the earliest possible date. We thank you for this opportunity to make our position known and ask that you include this letter in its entirety in the record of your hearings.

Sincerely yours,

WILLIAM J. KUHFUSS, *President.*

STATEMENT SUBMITTED BY MILTON MOUND, NEW YORK, N.Y.

WAGE AND PRICE CONTROLS CAN BE ENFORCED BY A CONFISCATORY TAX

It is suggested that the best machinery for implementing the wage and price control policies about to be announced, is not by new criminal sanctions, but rather by a Confiscatory Tax.

It is generally agreed that inflation must be halted permanently, and that (except for correcting gross inequities), it is against the public interest to permit increase in prices, rents, wages, salaries and benefits, except for improved goods and services and improved productivity.

There appears to be a way to implement that policy without creating a huge bureaucracy of investigators and prosecutors, and without transforming large numbers of people into potential law violators. Far better compliance can be obtained by self-interest than by fear of detection and prosecution.

An anti-inflation confiscatory tax is suggested. Accepting an unauthorized increase would not be a crime; but the full amount of that increase would be subjected to a 100% Confiscatory Tax. Enforcement would be almost automatic. Employers could be required to withhold and pay to the Internal Revenue Service the 100% tax on the amount they pay for any unauthorized increase in wages, salaries, and benefits, in addition to withholding the normal income taxes as at present. It could be expected that employers would withhold and not pay any increase until assured that the increase is authorized. If an employer unwisely paid an unauthorized increase and did not withhold it, both he and the recipient would be liable for the 100% tax on the amount of that increase. Thus, by stopping at their source the payment of such unauthorized increases, there should be no increase in costs to be passed along as unauthorized increases in prices and rents.

However, all those who receive unauthorized increases in prices and rents could be required to pay to the Internal Revenue Service, monthly, the 100% tax on such increases in addition to paying their estimated income tax as at present.

STATEMENT OF WILLIAM J. NOLAN, JR., CHAIRMAN, COMMITTEE ON TAXATION, UNITED STATES COUNCIL OF THE INTERNATIONAL CHAMBER OF COMMERCE

SUMMARY

The United States Council, whose membership comprises most of the major business firms in the United States which are engaged in foreign trade, recommends strongly the enactment of the tax proposals of the Administration relating to the stimulation of export trade through the institution of the "job development credit" and the use of a domestic international sales corporation—DISC. These measures will materially assist in bringing the United States tax burdens on international trade more in line with those imposed by other industrialized nations and consequently should have a beneficial effect on the balance of payments and trade deficit. Nevertheless, as Secretary Connally has testified before this Committee, even though the program was adopted, United States corporations engaged in foreign trade would still not receive the tax/investment incentives that other industrialized trading nations offer industry.

There are other impediments in the United States taxation of foreign income which we also believe should be eliminated or modified, and we trust the opportunity for presenting our views thereon will be afforded in the near future.

DISCUSSION

It has been well documented in the last few years that depreciation and other allowances pertaining to capital equipment are considerably lower in the United States than in other industrialized nations. The result has been that United States industry is now facing competition on an increasingly disadvantageous basis from foreign plants of more modern design and with better equipment. Attempts have been made to rectify this competitive disadvantage through liberalization of useful lives and other administrative measures. As desirable as these have been, they have fallen short of creating a tax atmosphere in which the industrial base would be adequately modernized and expanded to keep the work force employed and the economy healthy.

Percentages of industrial capacity currently utilized are inadequate measurements of inefficient operations and outmoded standards of technological development. Obsolescence has apparently reached a high point in many industries. This is clearly indicated by the comparison of the portion of gross national product devoted to capital investment in the United States with those of our trading partners. Except for the Unied Kingdom—which is presenly taking steps to improve its posture—new capacity is less significant in the United States than elsewhere. Recent developments in pollution and environmental control will only make matters worse in the near future as demands for capital for nonproductive facilities increase.

Much has been said about the imbalance of taxation relief for corporations as against individuals under the Administration's program. When one compares the aggregate tax relief for individuals given under the Tax Reform Act of 1969 and under the recommendations of the House Bill now before you with that offered to corporate taxpayers under those two measures, it is clear that the corporate taxpayer has been sorely discriminated against. We believe that the formation of investment capital for the continued well-being and growth of our economy is a matter which this Committee must consider as paramount in adopting taxation measures in this current difficult period of economic slowdown.

The job development investment credit is a simple—automatic—and relatively prompt method of correcting the present imbalance in the capital investment area. The unfortunate off again—on again history of the investment credit has tarnished its stimulative qualities and marred its ability to be most useful in long range planning for productive facilities. It is earnestly hoped that enactment of the job development credit will now become a permanent part of the Internal Revenue Code not subject to pressures.

The general disallowance of the job development investment credit on foreign-producer property is understandable but nevertheless regrettable. Aside from the difficulties of compliance with respect to items partially produced abroad, this discriminatory provision may well be nonproductive overall. Lifting the prohibition upon termination of the surcharge is, of course, desirable but in the meantime temporary actions will be taken which may well be uneconomic in the long run and, at the least, disruptive of normal relations.

The asset depreciation range system (ADR) which provides a much needed and more realistic depreciation treatment, should not be jettisoned, in whole or in part, in the enactment of the job development credit. Simplification of the depreciation computation has been a long-sought goal which became closer of attainment under the ADR procedures. Determination of useful life is frequently difficult and generally uneconomic in argument for either the Government or taxpayers. It is our view that ADR has brought the United States to a more realistic cost-recovery system which will help in foreign competition.

The DISC concept as recommended by the Administration is imaginative and should have a stimulative effect in encouraging U.S. businesses to enter the export field. Other countries—directly or indirectly—have treated export profits more favorably than domestic activities for many years. This, coupled with lower wage rates, has frequently precluded favorable competitive conditions for many United States companies. In addition, some countries have actively solicited the movement of United States plants or facilities abroad through tax deferrals and other incentives.

The Administration's DISC proposal would encourage the retention of facilities in the United States by the granting of tax deferral now only obtainable by locating abroad. It is recognized that in many instances, companies must go abroad for materials and markets but for others the use of a DISC would offset many of the differentials present in foreign manufacture. The increase in domestic employment and capital investment would naturally be beneficial to the U.S. economy and balance of payments problem.

We believe that the House Bill provisions narrowing the benefits of the DISC proposals urged by the Administration will effectively destroy the usefulness of this farsighted program. Discrimination against those taxpayers who have in the past produced domestically for sale abroad is patently unfair. Moreover, the House proposal may well lead to encouraging such producers who have benefited our balance of payments in the past difficult years to relocate abroad. We believe that a strong export industry can best be advanced by the proposals of the Administration.

However, helpful as we believe DISC would be to our foreign trade and balance of payments problems, we believe greater initiative should be taken by your Committee.

It is understood that the Treasury Department has been preparing a legislative package for reform in the area of tax treatment of foreign income. Generally the suggestions made in this regard have been noncontroversial in nature and mainly directed toward the elimination of unnecessary or inequitable impediments to sound business transactions in international trade. For example, under Section 956 of the Internal Revenue Code, the mere investment in United States property by a foreign subsidiary can result in a tax on the United States parent corporation. This is not only inconsistent with our balance of payments goal but frequently operates as a trap against the unwary. Immediate repeal is warranted.

Similarly, Section 367 should be substantially revised to eliminate the mandatory requirements of advance rulings relating to organization, liquidation and reorganization of a foreign subsidiary. Subpart F should be modified in thrust if United States business is to be able to operate effectively in competition with corporations of other industrialized nations. The administration of Section 482 has been frequently criticized as being counter-productive by encouraging manufacture and assembly abroad to avoid prolonged examination or litigation with respect to transfer prices on United States goods or services. Recent Tax Court decisions indicate the costly steps taxpayers must presently take in defending reasonable business practices. Although administrative changes could well eliminate many of the problems in this area, it is believed that Section 482 should be amended to provide that, with proper safeguard, the burden of proof would shift to the Commissioner.

It is hoped that in the near future the Congress will consider recommendations for change in the foreign taxation area. Now that recognition has been generally accorded the disadvantageous position of United States business in world trade the time appears appropriate.

Statement Submitted by Everett A. Eisenberg, Counsel, on Behalf of Machine Tool Importers Group, American Importers Association

I. INTRODUCTION

The Machine Tool Importers Group ("MTIG"), a separate industry group within the American Importers Association, submits this statement in opposition to the exclusion of foreign produced property from the investment tax credit.

MTIG members, a list of whom is attached to this statement as Exhibit A, are American firms engaged in the importation, distribution, marketing and servicing within the United States of foreign made machine tools. The membership of the Group is fairly representative of the machine tool importing industry in the United States. The principal source of supply for MTIG and for all machine tools imported into the United States is Western Europe which accounts for approximately 80 percent of all imports.

The business of importing, distributing, selling, erecting and servicing imported machine tools is an American industry. Large numbers of Americans are employed directly by those engaged in this industry and in the various businesses (transportation, insurance, handling, etc.) which service and support the importers, distributors and dealers. The firms directly and indirectly engaged in the trade are for the most part small businesses built up over the years by the enterprise of American businessmen. For all of these businessmen the foreign property exclusion will result in a virtual embargo[1] on the importation of the products and lines they handle for an indefinite period.

Machine tools have often been referred to as the basic tools of industry. They are used to make the tools and machines which become the production lines from which come the principal products of industry. Their use is important to the largest manufacturers and they are the basic production equipment of small machine shops, die makers and tool manufacturers in cities and towns throughout America.

Some machine tools imported by the members of MTIG are sold by them directly to large industrial users but most are distribued and sold by networks of local dealers who sell to and service more modest customers. On behalf of all those who import, distribute, sell and service foreign made machine tools, MTIG appears before this Committee to oppose the harsh and discriminatory exclusion of these products from the investment tax credit urged by the Administration as part of its tax proposals here.

II. Existing Effect of Tariff Surcharge and Monetary Action on Importers of Machine Tools

Importers of machine tools have already been seriously affected by executive action taken to implement the President's economic program. All types of machine tools are presently affected by a full 10 percent additional customs duty resulting from Presidential Proclamation 4074. The monetary actions taken by the Administration are resulting in adjustment of rates of exchange the effect of which will be to add at least another 6 to 10 percent to the cost of importing these goods. The tariff surcharge, announced as a temporary measure, confronts the importer as an economic fact of life into the indefinite future. He must regard his increased cost resulting from monetary adjustments, whether they come about by revaluation of foreign currencies or by their being permitted to float against the dollar, as something that will remain as a problem for him into the foreseeable future. As he totals his costs today, one thing is supremely evident—his landed cost of merchandise is now from 16 to 20 percent higher than it was in mid-August of 1971.

III. Effect of Foreign Property Exclusion on Sales of Imported Machine Tools

A sudden 16 to 20 percent increase in basic cost is no small problem for anyone engaged in a highly competitive industry. This is something, however, that affects all those who are engaged in foreign trade even-handedly—not so, however, the investment tax credit. The effect of the proposed exclusion of foreign made goods is to single out importers of capital goods and saddle them with a special burden. After their goods have been imported and placed in the chain of distribution, all those who thereafter seek to sell are placed at a new grinding disadvantage. Anybody who buys from such a seller buys with whole dollars of 100 cents each. The purchaser of a comparable domestic machine buys for 93 cent dollars with the federal government picking up the additional 7 cents by virtue of the investment tax credit. And the 7 cent return is in tax free dollars so that for any corporate buyer in surcharge brackets it is the equivalent of 14 cents in increased earnings.

It is to be anticipated that tax conscious American businessmen will act just as the Administration expects them to and will contract now for their expected machine tool needs as far ahead as possible in order to take advantage of the credit. In this way the great bulk of the market for machine tools will be soaked up long before foreign machine tools once again become competitive and the prospect of the seller of imported tools as he peers into the future becomes bleaker and bleaker.

The effect of the credit in accelerating the satisfaction of market needs was vividly demonstrated in early 1969 when the prior investment tax credit was eliminated. Industry had already fulfilled its requirements and the market was glutted when the credit was repealed. The result was that machine tool sales plummeted in late 1969 and 1970.

[1] For a concurring view a copy of an editorial appearing in the New York Times of October 9, 1971 is attached as Exhibit B.

As the seller of imported machines closely examines the Administration's proposals, one final fact emerges to complete his distress. His machine tools are produced and completed abroad and are proscribed from the credit.[2] On the other hand, an American manufacturer can import up to 50 percent of the value of his machines and still not run afoul of the exclusion.[3] For the American machine tool manufacturing industry, this is the crowning bonanza. Over the years American machine tool manufacturers have exported their production abroad. Through a variety of arrangements running from the establishment of manufacturing subsidiaries in foreign countries, through the undertaking of joint ventures with foreign machine tool manufacturers, and the making of licensing agreements, the American industry has established a production base abroad.[4] Now under the proposals submitted to this Committee, an American manufacturer can import from his own subsidiary or from his joint venturer or foreign licensee parts, accessories, components and even full assemblies up to a full 50 percent of the sales value of his machine and still qualify for the credit. He gets the best of both worlds.

IV. The Exclusion of Foreign Produced Goods Creates an Unjustified and Unwise Discrimination Against Their Sale in the United States

Congress has the power to put conditions on the importation of foreign merchandise by way of tariffs or the imposition of quotas and it may in the extreme case even impose an embargo. Recent experience confirms that any proposal for a quota will be very carefully scrutinized and no one as yet has even proposed a direct embargo on any particular product or class of products.

What we are dealing with here, however, relates not to the importation of goods, but to an effort to affect the sale of goods after they have been imported through a discriminatory tax device and that is another thing entirely. The impact here is on the seller, not the importer. The goods involved have already been entered and those dealing with them after their entry should be able to deal under the same rules as are applied to dealers in domestically produced merchandise. To hamstring the seller of the foreign machine in his efforts to compete with his neighbor who sells a domestic machine is a discrimination that must be justified as necessary to the objectives sought to be achieved by the legislation.

One can argue that this criterion of fair play is constitutionally mandated. The Supreme Court under the equal protection clause of the Fourteenth Amendment has decreed, for example, that a state cannot make one rule to govern tax exemptions for its domestic corporations and a harsher rule for foreign corporations doing business within the state and qualified there.[5] If the federal government were to attempt to impose an unjustified discrimination as between citizens in the pursuit of their occupation, such a discrimination will be stricken under the due process law of the Fifth Amendment.[6]

Whether the issue is a normal legislative desire for fairness and even-handedness or the constitutional issue of due process, the fact remains that these measures falling so harshly on a particular segment of our commerce should be enacted in this form only if clearly required by the avowed legislative purpose of the investment tax credit.

V. The Foreign Property Exclusion Could Very Well Result in a Net Loss of Jobs

The purpose of the investment tax credit has been stated as follows:

"The basic thrust of the Credit will be to increase the rate of return on investments in machinery and equipment and thus provide increased investment in these productive facilities. The immediate impact will be felt in the machine tool

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[2] H.R. 10947 § 103, proposed § 48(a)(7)(A)(i).

[3] H.R. 10947 § 103, proposed § 48(a)(7)(A)(ii).

[4] A brief sketch of the extent to which this movement of American production has progressed is attached as Exhibit C.

[5] *WHYY, Inc. v. Borough of Glassboro*, 393 U.S. 117 (1968).

[6] See for example, *Bolling v. Sharpe*, 347 U.S. 497 (1954) where Mr. Chief Justice Warren said: "The Fifth Amendment, which is applicable in the District of Columbia, does not contain an equal protection clause as does the Fourteenth Amendment which applies only to the states. But the concepts of equal protection and due process, both stemming from our American ideal of fairness, are not mutually exclusive . . . [D]iscrimination may be so unjustifiable as to be violative of due process."

and capital goods industries and their suppliers, and will result in an appreciable increase in employment. As experience has demonstrated, this increased investment in machinery and equipment will, in and of itself, result in a further expansion of gross national product and employment. The ultimate impact of the Job Development Credit will be experienced in the expanded real output resulting from improvements in productive capacity." [7]

No effort was made by the Administration's spokesmen before this Committee or before the Ways and Means Committee of the House to show how the exclusion of foreign produced property from the investment tax credit will further the stated purposes of the proposed legislation. Surely, if the exclusion effectively results in an embargo on the importation of machine tools for a period of time, that will have an immediate effect on the sales of American made machine tools and will perhaps make for higher employment in that sector.

In the last full year for which Department of Commerce figures are available United States production of machine tools was valued at 1.597 billions of dollars. In that year imports were valued at 183 million dollars—just over 10 percent. It is obvious that the full 10 percent will not be restored to United States production even by the severe combination of import surcharge, monetary devaluation and investment tax credit exclusion. Some machine tools will be imported, especially by American manufacturers who can easily add 50 percent of domestic value to machines they import from their own facilities abroad. If the exclusion is effective as an embargo on one half of the imports, dollar value of United States production will go up 5 percent. No one has made any effort to show how many jobs will be created by such an increase in production—or, indeed that any jobs will be created at all.

It is clear that if any jobs are to be created by the exclusion of foreign produced property, the number is speculative, minimal at most, and temporary. On the other hand, the certain and immediate result of the embargo on most lines of foreign machine tools for an interminate length of time will be that independent importers, distributors and dealers will dismantle their businesses or retrench and their employees and the employees of business servicing them will be out of jobs. The final balance could very well show a net loss of jobs.

VI. The Foreign Property Exclusion Will Result In Loss of Productivity

The stated ultimate objective of the credit is to increase the productivity of the American working man and of the American industry. The working man's productivity is directly dependent upon his being furnished with the best possible tools and technology. Many new techniques have been imported into this country along with the machine tools coming from abroad. The fruits of foreign research and development have thus been made available to increase the productivity of American industry. In many cases the American machine tool industry, spurred by innovations from abroad, has improved its own technology and products. The proposed discriminatory investment credit will seriously weaken this competitive incentive to adopt and improve new technology.[8]

Price competition from imported machine tools has in many cases impelled United States manufacturers to increase productivity or shave profits in order to reduce prices. The effect has been not only to enhance productivity but also to impede establishment and maintenance of inflationary price levels.

If the American working man is to be given the best tools he should have the immediate advantage of the most recent design and technology wherever in the world they may have been developed. By excluding foreign produced machine tools from the credit, the decision as between competing products most likely will be made not by highly qualified production personnel but by tax experts seeking to increase the credit and reduce the final tax bill. This will make for a better looking current annual statement at the expense of long-term profits flowing from increases of productivity.

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[7] Secretary of Treasury Connally's statement submitted to the House Ways and Means Committee September 8, 1971, p. 16.

[8] For a concurring view, a copy of an editorial entitled "Chinese Wall" from the September 15, 1971 issue of Financial World magazine is attached as Exhibit D.

VII. The Foreign Property Exclusion Will Invite Retaliatory Measures Which Could Seriously Affect U.S. Exports of Capital Goods

One of the healthiest sectors of our economy in terms of balance of trade is the capital goods manufacturing industry. During the last three calendar years for all classes of machinery, United States Department of Commerce figures indicate total imports and exports as follows: (in millions of dollars)

	1968	1969	1970
Imports	3,035	3,565	4,271
Exports	8,309	9,519	1,0151

Metalworking machinery (machine tool) figures for the same period are:

	1968	1969	1970
Imports	204	183	164
Exports	334	343	396

Total exports of all types of machines have increased and their ratio to imports has remained fairly level at almost three to one. Machine tool exports in the last three years have increased while imports in the same period have shown a steady decline.

It should be remembered that the dollar value of machine tool exports has in the recent past been seriously reduced by the arrangements made by American manufacturers for off-shore production (see Exhibit C attached). The figures for imports similarly must include imports by American manufacturers of whole machines, parts, assemblies, components and accessories from their own foreign subsidiaries, joint venturers and licensees and from others abroad. If these activities of the domestic industry were to be evaluated and taken properly into account the ratio of exports to imports would be even higher.

Our trading partners are already complaining about the tariff surcharge which in their view violates the provisions of GATT and our Treaties of Friendship and Commerce with individual countries. If the investment tax credit is enacted with its proposed exclusion of foreign produced capital goods and after the full effect of this is realized abroad, inclination on the part of our trading partners to take retaliatory measures will be immeasurably increased. The figures shown above demonstrate that such measures will very likely fall in a particularly vulnerable area of our export trade—our capital goods manufacturing industry.

VIII. The Use of the Foreign Property Exclusion To Force Concessions by Foreign Governments in Monetary and Tariff Matters Is Unjustified and Indefensible

Finally, it must be pointed out that the Administration's proposal and the House bill, because of their very terms, can hardly be seriously countenanced as a measure intended to increase employment or productivity. By tying the duration of the exclusion to the life of the import surcharge, its real purpose becomes apparent. It is quite obviously intended only to furnish an extra lever to move the other trading nations to accede to adjustments in exchange rates and tariffs sought by our government.

When Secretary Connally appeared before the House Ways and Means Committee on September 8, Representative Gibbons questioning him, wanted to know if the 10 percent surcharge would be removed after other countries made adjustments in their currencies. Secretary Connally made it clear that a mere realignment in exchange rates would not produce the result but that there would also have to be alterations in basic trading arrangements, reduction of tariffs, elimination of no-tariff barriers and also some sharing in the burden of the common defense effort. The Secretary and others in the Administration have repeatedly reiterated this view since then. It is submitted that these purposes, laudable and salutary as they may be, are not admissible objectives of this tax legislation nor can they justify the imposition of these stringent discriminatory selling conditions upon a limited and innocent segment of our trading and commercial population.

IX. Conclusion

The foreign property exclusion:

Is not a job producing measure; it could actually result in a net loss of jobs.

Is not a spur to increased productivity; it will result in closing off the inflow of new technology from abroad and its resulting competitive spur on United States industry.

The foreign property exclusion:

Is an invitation to establishment of higher inflationary prices for United States products by the elimination of effective price competition from imported machines.

Is an unjustified discriminatory measure which will single out and sacrifice that portion of American business which imports capital goods merely to give the Administration a card of extremely dubious value in its avowed monetary poker game with our trading partners.

Is a risky bit of brinkmanship which could easily result in retaliatory measures against one of the healthiest sectors of our trade and jeopardize our extremely favorable export balance in capital goods.

Exhibit A

Alina Corporation, 175 Sunnyside Boulevard, Plainview, L.I., N.Y.
American Bechler Corp., 28 Harbor Street, Stamford, Conn. 06904.
Austin Industrial Corp., 11 Virginia Road, White Plains, N.Y. 10603.
Bentley Trading Corp., 58–18 37th Avenue, Woodside, N.Y. 11377.
Eric R. Bachmann Co. Inc., 25–09 38th Avenue, Long Island City, N.Y. 11101.
Charmilles Corporation, 202 Newton Road, Plainview, N.Y. 11803.
Cosa Corporation, 405 Lexington Avenue, New York, N.Y. 10017.
Continental Schaerer Corp., 155 N. Janacek Road, Waukesha, Wis. 53186.
Given International, 3855 South Santa Fe Avenue, Los Angeles, California 99058.
H.E.S. Machine Tools, Inc., 30 Henry Street, Teterboro, N.J. 07608.
Hirschmann Corporation, 123 Powerhouse Road, Roslyn Heights, L.I., N.Y.
Nichimen Co., Inc., 6 North Michigan Avenue, Chicago, Ill. 60602.
Kurt Orban Co., Orban Way, Wayne, N.J. 07470.
Promecam Inc., 918 Dalton Avenue, Cincinnati, Ohio 45203.
Sir Vis Equipment Co., 11721 South Austin Avenue, Worth, Ill., 60482.
Stoffel Fortuna Inc., 66 Marble Dale Road, Tuckahoe, N.Y. 10707.
Strauss-Artys Corp., Post Office Box 387, Great Neck, N.Y. 11022.
Triplex Machine Tool Corp., Post Office Box 333, East Rutherford, N.J. 07073.
Volkart Brothers, Inc., 90 Crossways Park West, Woodbury, L.I., N.Y. 11797.
Widder Corporation, 1 Deposit Plaza, Mamaroneck, N.Y.

Exhibit B

[From the New York Times, Oct. 9, 1971]

Overtight Squeeze on Trade

The mild optimism stirred at last week's monetary conference by indications that the United States was finally getting ready to negotiate an end to the world currency and trade crisis is beginning to dissipate.

Another turn of the screw, in fact, is being prepared now for America's major allies, even before negotiations have begun. The Administration is continuing to press through Congress two protectionist tax credit proposals that disturb the nation's main trading partners even more than the 10 per cent import surcharge, which alone roughly doubles the American tariff wall.

One of these, the "buy American" feature of the 7 per cent investment tax credit, is described by some critics as a "virtual embargo" on imports of capital equipment. The impact may not be quite that extreme, but it is certain to be heavy. For the 7 per cent price disadvantage it inflicts on foreign venders of machinery comes on top of the 10 per cent surcharge and a 6 to 10 per cent currency revaluation. With a multiplier factor adding a few more percentage points, foreign-made capital goods will be unable to compete any longer on the American market unless sold at 25 to 30 per cent below their pre-August price.

The six Common Market countries and Britain have now handed the United States formal notes protesting this proposal and another projected tax credit that amounts to a substantial subsidy on most American exports. They have warned that they reserve the right to take retaliatory countermeasures if the pending proposals are passed by Congress, as now appears probable.

American imports of capital goods valued last year at more than $3 billion are involved, almost half from Canada and Japan and the other half primarily from the Common Market and Britain. But, if Europe retaliates, the United States stands to lose more. It ran a trade surplus of well over $2 billion a year with the Common Market and Britain through 1970 and appears to be running a surplus of more than $1 billion with these countries even in this year of over-all U.S. trade deficits.

Both the "buy American" clause of the investment tax credit and the import surcharge will be eliminated rapidly, Treasury Secretary Connally promised last week, if other countries revalue their currencies enough and dismantle "specific trade barriers." But the Europeans, while prepared to increase their trade deficits with the United States by shifts in currency rates, insist that the trade barriers on both sides must be reduced jointly in reciprocal trade negotiations, rather than unilaterally by America's trading partners alone.

Such negotiations, which may prove prolonged, must follow rather than precede agreement on elimination of the surcharge and the discriminatory aspect of the investment tax credit. Mr. Connally's insistence that "other nations have to give up something in order that we might gain something," is an invitation to a lengthy trade and monetary war.

EXHIBIT C

FOREIGN ARRANGEMENTS BY U.S. MACHINE TOOL BUILDERS

Information is digested by permission of the publisher from "List of Foreign Arrangements by U.S. Machine Tool Builders and Cutting Tool Manufacturers Revised March 13, 1970" compiled by American Machinist Magazine. Information relating to cutting tool manufacturers has been eliminated. Publisher advises that material may be incomplete because of failure of some manufacturers to furnish information.

1. Eighty-seven (87) U.S. machine tool builders have one or more arrangements abroad involving wholly-owned subsidiaries, joint ventures and/or licenses. A list of these manufacturers is attached.

2. A breakdown of types of arrangements follows:

Wholly-owned subsidiaries	69
Joint ventures	28
License arrangements	110

3. The foreign countries in which U.S. manufacturers have such arrangements and the number of arrangements in each country follows:

England	71	Argentina	3
Germany	25	Mexico	3
Japan	24	Belgium	3
France	18	Switzerland	2
Canada	15	Holland	2
Italy	16	Sweden	2
Australia	8	Brazil	1
India	4	Israel	1

LIST OF U.S. MACHINE TOOL BUILDERS WITH FOREIGN ARRANGEMENTS

Abbey Etna Machine Co., Perrysburg, Ohio.

Acme Mfg. Co., Detroit, Mich.

Andrew Engineering Co., Hopkins, Minn.

Barber-Colman Co., Rockford, Ill.

Beatty Machine & Mfg. Co., Hammond, Ind.

Bendix Automotive & Automation Co., Dayton, Ohio.

Besly Products, South Beloit, Ill.

Blanchard Machine Co., Cambridge, Mass.

E. W. Bliss Group, Grand Rapids, Mich.
The Bodine Corp., Bridgeport, Conn.
Bridgeport Machines Inc., Bridgeport, Conn.
Brown & Sharpe Mfg. Co., North Kingstown, R.I.
Bryant Grinder Corp., Springfield, Vt.
Buffalo Forge Co., Buffalo, N.Y.
Bullard Co., Bridgeport, Conn.
Burgmaster Corp., Division of Houdaille Ind. Inc., Los Angeles, Calif.
Cayuga Machine & Fabricating Co. Inc., Depew, N.Y.
Cincinnati Inc. (formerly Cincinnati Shaper), Cincinnati, Ohio
Cincinnati Milling Machine, Cincinnati, Ohio
Cone Automatic Machine Co., Division of Pneumo Dynamics Corp., Windsor, Vt.
Coulter & McKenzie Machine Co., Bridgeport, Conn.
Crane Packing Co., Morton Grove, Ill.
The Cross Co., Detroit, Mich.
Dahlstrom Machines Works Inc., Schiller Park, Ill.
Dake Corp., Grand Haven, Mich.
Danly Machine Corp., Chicago, Ill.
Detroit Broach & Machine Co., Rochester, Mich.
DeVlieg Machine Co., Royal Oak, Mich.
Do All Co., Des Plaines, Ill.
Dreis & Krump Mfg. Co., Chicago, Ill.
Ex-Cell-O Corp., Detroit, Mich.
Farrel Co., Division of USM Corp., Ansonia, Conn.
Fellows Gear Shaper Co., Springfield, Vt.
Gardner Machine Co., Division of Landis Tool Co., A Litton Co., South Beloit, Ill.
Giddings & Lewis Machine Tool Co., Fond du Lac, Wis.
Gisholt Machine Co., Division of Giddings & Lewis, Fond du Lac, Wis.
Grob, Inc., Grafton, Wis.
Hammond Machinery Builders, Kalamazoo, Mich.
Hardinge Brothers Inc., Elmira, N.Y.
Heald Machine Co., Associate of Cincinnati Milling Machine Co., Worcester, Mass.
HPM Division, Koehring Co., Mount Gilead, Ohio
Hybco Products, Inc., Cleveland, Ohio
Ingersoll Milling Machine Co., Rockford, Ill.
Kearney & Trecker Corp., Milwaukee, Wis.
Kysor-Johnson Mfg., Albion, Mich.
F. Jos. Lamb Co., Warren, Mich.
Landis Machine Co., A Teledyne Co., Waynesboro, Pa.
Landis Tool Co., Waynesboro, Pa.
Lapointe Machine Tool Co., Hudson, Mass.
Lees-Bradner Co., Subsidiary of White Consolidated Industries, Inc., Cleveland, Ohio
Lodge & Shipley, Cincinnati, Ohio
Mattison Machine Works, Rockford, Ill.
The McKay Machine Co., a Wean United Subsidiary, Youngstown, Ohio
Michigan Tool Co., Detroit, Mich.
Micromatic Hone Corp., Detroit, Mich.
Minster Machine Co., Minster, Ohio
Moore Special Tool Co., Bridgeport, Conn.
National Acme Co., Cleveland, Ohio
National Automatic Tool Co., Inc., Richmond, Ind.
National Broach and Machine Division, Lear Siegler Inc., Detroit, Mich.
National Machinery Co., Tiffin, Ohio
New Britain Machine Co., New Britain, Conn.
Norton Co., Worcester, Mass.
Pacific Press & Shear Corp., Oakland, Calif.
Pangborn Division, Carborundum Co., Hagerstown, Md.
Pines Engineering Co., Inc., a Teledyne Company, Aurora, Ill.
Pratt & Whitney Machine Tool Division, Colt Industries, West Hartford, Conn.
Production Tube Cutting Inc., Dayton, Ohio.
Resistance Welder Corp., Bay City, Mich.
Rockford Machine Tool Co., Subsidiary of Greenlee Bros., Rockford, Ill.
Rockwell Manufacturing Co., Pittsburgh, Pa.
Sciaky Bros., Inc., Chicago, Ill.
Simmongs Machine Tool Corp., Albany, N.Y.
Snyder Corp., Detroit, Mich.
Speedfam Corp. Des Plaines, Ill.
Steel Improvement & Forge Co., Cleveland, Ohio.
Stone Machinery, Manlius, N.Y.
Sundstrand Machine Tool Division of Sundstrand Corp., Rockford, Ill.
Taft-Peirce Mfg. Co., Woonsocket, R.I.
Thompson Grinder Co., Springfield, Ohio.
Tysaman Machine Co., Subsidiary of Carborundum Co., Knoxville, Tenn.
U.S. Baird Co., Stratford, Conn.
USI—Clearing Division, U.S. Industries, Inc., Chicago, Ill.
Warner & Swasey Co., Cleveland, Ohio.
Waterbury Farrel, Jones & Lamson Division, Cheshire, Conn.
Wean Industries Inc., Subsidiary of Wean United Inc., Warren, Ohio.
Wiedmann Division, Warner & Swasey Co., King of Prussia, Pa.

EXHIBIT D

[From the Financial World, Sept. 15, 1971]

CHINESE WALL

The applause President Nixon has earned from the business community and from investors for his new economic program is certainly merited. And it is more than simple patriotic duty that moves people to cooperate towards its success.

Inevitably, however, there are flaws in the scheme of things as Mr. Nixon outlined them in mid-August. The most grievous of these deals with an area of technology that is vital to American industry, to the productivity of our industrial plant, and therefore to the labor that uses it and the investors who share in it.

As part of the program, the President imposed what he called an import duty surcharge of 10%. This, he said, was temporary, but unfortunately he set no time boundaries. In effect this means that imported goods, save for a rather select group, are subject to a substantial duty. The new higher rate applies to imported machine tools, among other things. And machine tools, of course, are the machines industry uses to make production machinery.

In addition to imposing the higher import duty on this machinery, the President specifically excluded, imported machine tools from the capital goods that would be subject to the 10% investment tax credit he will ask Congress to enact.

There is little doubt that with the first trade deficit in this century facing us, we have to redress our import-export flow. We cannot buy more from abroad than we sell. Undoubtedly it was these unpleasant facts that prompted Mr. Nixon's decision to deal harshly with machine tool imports. But this year's monthly rate of roughly $9 million worth of such imports amounts to only about 12% of domestic machine tool sales; they are a minute 0.02% of our merchandise import total.

This alone would not be sufficient reason for seeking the exclusion of machine tool imports from the tariff surcharge. Perhaps such exclusion is not really necessary. But there is solid reason to want the investment tax credit extended to embrace machine tools bought abroad.

The machine tool is not a consumer commodity. It is not a luxury item that can be done without. It is in most cases a highly sophisticated piece of machinery into which a great deal of technology has been poured. It is, in large measure, the embodiment of technology. By imposing the tariff surcharge on and at the same time denying the tax credit to buyers of foreign machine tools, we will be effectively barring these instruments from this country.

The assumption must be that American technology is so superior that we can turn our backs to the rest of the world, that we can build a Chinese Wall around U.S. industry and suffer no harm. In point of fact, a significant portion of the technological advances found in our own machine tools today originated abroad.

Just when we are trying to do everything possible to increase our own competitiveness in world markets, when we are trying to improve our productivity to match the improvement of others elsewhere, it seems highly illogical to start laying the foundations for what could become the undesirable isolation of technology.

STATEMENT OF THE AIR TRANSPORT ASSOCIATION OF AMERICA, SUBMITTED BY S. G. TIPTON, PRESIDENT

The air transport industry is in serious financial difficulties. In 1970, the industry lost $200 million and in 1971, we expect to lose almost that much. Growth of air traffic has virtually disappeared. We have long term debt in the neighborhood of $6 billion. On this we pay interest of almost $400 million. Our ratio of debt to equity is 66 percent debt and 34 percent equity. During the past year, we have had to reduce our operations by 700 daily flights. We have had to reduce our work force by some 14,000 people. I think the statement of these facts will make it clear to the Committee why we have submitted this statement and strongly endorse this legislation which has as its purpose the stimulation of economic growth.

In fact, the airline industry believes that enactment of the job development credit, with certain new provisions which would correct inequities existing in the previous credit, is one of the most important steps that can be taken to ease the financial distress within the industry. The credit is also essential to allow the airlines to make a contribution to reducing unemployment. In addition the traveling and shipping public will benefit by receiving a better bargain for their transportation dollar. There is no doubt immediate action to restore the credit is desperately needed now.

As the recovery of the nation's economy accelerates, substantial airline traffic growth should result. This will necessitate an increase in airline employment reversing the current downward trend. Thousands of jobs will be restored in the airline industry and additional jobs created. Increased traffic demand will also generate significant orders for new equipment, thereby adding jobs in the depressed aircraft manufacturing industry.

In the past, the availability of the credit to the industry has encouraged the purchase of technologically superior equipment, thus increasing the productive capacity at a greater rate than otherwise would have been possible. This increase in productivity enabled the airline industry to offset, in part, drastically rising operating costs. The industry has a history of passing on to the consuming public the benefits it has received as a result of such stimulus as the investment tax credit and savings resulting from increased productivity and new technology. In spite of an increase of 30 percent in the Consumer Price Index during the period 1962–1970, passenger fares actually declined until 1969 and are still, in fact, well below the 1962 level. The airlines, therefore, stand unequivocably behind the economic measures currently being considered by this commitee in order that the economy may once again be restored to a healthy condition.

It is also our hope that with the enactment of the job development credit it will be hereafter considered a permanent part of the Internal Revenue Code and not a short term economic stabilizer. We believe that the effectiveness of the credit as an inflation offset within the airline industry has been clearly demonstrated and that it is not a short run tool.

Obviously, the air transport industry has adequate equipment to accomodate public demands for air transportation. As a matter of fact, there is some over capacity in the industry at the present time. However, as air transport management contemplates future development it is clear that the industry must make provision not only for increased capacity but also for the operation of increasing numbers of larger aircraft. Many aircraft ordered today would not be delivered until 1974 or 1975.

Notwithstanding the present lack of growth in air transport demand, careful studies of the future forecast an average growth between now and 1985, of approximately 10 percent per year in passenger traffic and 18 percent per year in freight traffic. This is confirmed not only by industry studies but also those of the Government.

In addition, airport and airways capacity is limited even under existing depressed conditions and in view of the very long lead times required for airport and airways improvement the industry must contemplate measures by which they can reduce the number of actual airplane operations required to meet passenger and freight demands. It is this element in planning which has, in part, justified the production, acquisition and operation of the stretched 727, the stretched DC–9, the Boeing 747, the DC–10 and the Lockheed 1011.

Also, as expenses have risen a great premium has been placed on increasing productivity. The original jets made this contribution and had the effect for many years of permitting the industry to reduce its prices while all of its expenses were rising at a rapid rate. Thus, in contemplating the future, the industry must plan on retiring large numbers of our present 4-engine fleet to be replaced by the larger, more productive aircraft.

Another important development in air transport equipment planning is environmental. As the Committee knows, air transportation has been under great pressure in the past few years to reduce the noise of its operation and to eliminate smoke from the jet engines. For this reason, the designers and manufacturers of the equipment being made available have been required to respond to industry demand for quieter and cleaner aircraft engines. They have responded remarkably. Even though the Boeing 747 is twice as big and powered by engines 2½ times as powerful, it is quieter than our existing 4-engine jets. The DC–10 marks a really amazing achievement in noise and engine emission reduction. The same result is expected of the Lockheed 1011.

Thus, even though the industry has adequate equipment now, these pressures demand a very substantial new equipment program. We welcome, therefore, the restoration of the enactment of the job development credit and have several suggestions for changes in the law relating to it which will aid us in financing these new developments.

If the new law is to have the desired effect as far as air transport or any other depressed industry is concerned, some changes should be made:

1. Assure utilization of credits under the law by
(a) 10-year carryforward period, and
(b) Permitting utilization of oldest credits first;
2. allow for more economical financing through equipment leasing.

I. Utilization of Credit

Because of its depressed financial condition, the airline industry has been unable to take advantage of $450 million of tax credit earned under the old law. If the law provided a better opportunity for full tax credit utilization, there would be a greater incentive for the airlines to exercise the $1.7 billion of options on new equipment that are currently outstanding. An industry that has $33 million of credits expiring in 1971, $20 million in 1972 and $50 million expiring in 1973 would not be inspired by additional tax credits to purchase additional equipment. In order for the job development credit to be an effective stimulus for the carriers some means should be provided to preserve these previously generated credits.

We therefore recommend that the job development credit law include a provision that the investment credit generated in earlier years be utilized before the current year credit need be considered.

In addition the regulated transport industries, characterized by widely flucuating earnings, require a ten-year carryforward period for the credit in lieu of the seven-year period provided for in the old law.

H.R. 10947, "The Revenue Act of 1971", allows the utilization of pre-1971 credits before current credits as well as a 10-year carry-forward period for pre-1971 credits. It is our opinion that for the job development credit to have the desired stimulus in the airline industry, these provisions should apply also to post-1971 credits. The air transport industry over the past decades has established a cyclical earnings pattern and these modifications are necessary to adequately deal with this unique situation.

II. Lease Financing

The bleak earnings posture, the high debt-equity ratio and a shortage of capital has made it difficult for the airlines to arrange the necessary financing for their equipment. Common stock offerings are difficult during times of poor earnings record and prospects. Debt financing at reasonable rates is practically impossible to arrange. Airline debt/equity ratios are already too high at a 66 to 34 industry average, with some carriers even running above 80 to 20. Debt cannot be expanded measurably without increased equity.

The debt-burdened and unprofitable airline industry, therefore, has been searching for new sources of funds since traditional sources—i.e. internal funds, debt and equity—are virtually unavailable. Consequently, the carriers have turned increasingly to leasing. A major portion of the new equipment acquisition is now financed through leasing arrangements which are by their nature more costly than outright purchase.

The first major aircraft lease for $143 million was negotiated in 1965. The airlines now lease over $2.5 billion worth of airplanes. Lease obligations accounted for 9 percent of the total investment in aircraft being operated in 1967. Currently, about 25 percent of the investment in aircraft has been financed through leasing arrangements and this percentage will increase in the future with the acquisition of new, more expensive equipment.

The acquisition of equipment through lease arrangements, although not a new practice, is emerging as a major financing tool in other industries as well as the airlines. The public utilities, in an effort to increase their capacity, are leasing nuclear fuel cores and turbine generators. Even the U.S. Navy has announced recently that it would lease up to $150 million worth of tankers.

In most lease acquisition transactions the leasing institution buys the equipment and, in turn, leases it to a user at a rate designated to provide a fair return on the investment. The determination of the actual lease rate depends upon many factors including the life of the lease, the cost of the leased equipment, the credit-worthiness of the lessee, and the depreciation allowed under the tax law on the equipment to be leased. A principal inequity in negotiating aircraft leases is the lack of a definitive statement in the law specifying the depreciation life that may be used by the lessor for tax purposes.

For example, let us assume a company wishes a 15 year lease, or an aircraft worth $20 million. If, for tax purposes, the depreciation life is 15 years, an annual lease payment of $2,164,000 is required, in order for the leasing institution to make a 10 percent return on their investment. However, if the leasing institution could use the class life for aircraft, an annual lease payment of $1,903,000 will provide a reasonable return on the investment. This is a savings to the carrier of $261,000 per year on this lease. Therefore, we feel that the lessee should be assisted in reducing his financing costs by including a provision in the law that would allow the lessor to adopt the same class life for the equipment that would be available if the carrier owned the equipment.

Such a provision would allow the lessee to negotiate a financing arrangement on a more favorable basis. In a depressed industry such as the airlines, a reduction of 10 percent in rental expense on leased aircraft will have a significant impact. For example, the reduction is worth $3.2 million over the life of a fifteen-year lease on a Lockheed 1011 aircraft. When all leased industry equipment is considered, the savings would be about $15 million annually, which over a fifteen-year leasing period, represents some quarter of a billion dollars. Historically, such a reduction would mean direct benefit to our employees and the consumer.

House Report 92-533 which accompanies H.R. 10947 states that "a taxpayer which elects the class life system may with respect to property leased by it depreciate the property on the basis of the appropriate class life (without regard to the period of the lease)." We strongly support this much needed clarification and urge the committee to adopt this position.

Statement of Joseph H. Guttentag

Summary of Statement

This statement is restricted to Title V of H.R. 10947 dealing with the Domestic International Sales Corporation and more specifically to that portion which restricts DISC benefits to incremental export earnings.

1. No position is taken in this statement with respect to desirability of the enactment of the DISC legislation as proposed by the Treasury Department.
2. The DISC legislation should not, however, be enacted on an incremental basis as proposed in the legislation as passed by the House.
3. Granting of DISC benefits on an incremental basis results in such complexities and administrative burdens on taxpayers and the Treasury Department that it cannot serve as a useful export incentive.
4. The incremental proposal creates such inequities as between different classes of United States taxpayers that it should not be included in any DISC legislation.
5. The incremental basis fails to take into account the fact that maintaining or preserving an existing export market may be as difficult for a United States exporter as the creation of a new market. There can be as much justification for incentives to the exporter who is trying to maintain or preserve a market as to the exporter who develops new markets or increases sales in existing markets. The success or failure of each such exporter has the same effect on our balance of payments.
6. The incremental system could cause a disruption of normal export trade channels as United States taxpayers attempt to maximize the benefits of the DISC, so that the DISC, on a short-run at least, could have a negative impact on exports, which could result in serious balance of payments implications.
7. One of the reasons for the enactment of the DISC, as stated in the report accompanying the bill, is to remove discrimination against those who export through United States corporations. The incremental proposal only serves to reduce any such discrimination with respect to increased United States exports.

8. The legislative history of the DISC discloses serious gaps in our knowledge as to the impact of tax incentives both as to cost and effectiveness. The DISC proposal should be given the further study that legislation making such drastic changes in our tax system warrants.

STATEMENT

1. My name is Joseph H. Guttentag. I am a partner in the law firm of Surrey, Karasik and Greene, Washington, D. C. I submit this statement to the Committee with respect to one portion of the DISC legislation as it appears in the bill as passed by the House.

I do not take any position as to the merits of the DISC legislation as proposed by the Administration, but wish to limit my statement to the most significant change made in such proposal by the House. I refer to the provision of the House bill which limits the benefits of tax deferral as provided by the DISC legislation substantially to incremental export earnings.

Under the legislation as proposed by the Administration all export income earned by DISCs would have been subject to the tax deferral benefit. Under the legislation as passed by the House the tax deferral benefits of the DISC are limited to a portion of the DISC's income based on increases in export receipts of the DISC and related companies over 75% of the average export receipts for the base period 1968 through 1970. Income which does not qualify for deferral is deemed to be distributed to DISC shareholders.

2. This incremental provision should not be enacted as part of the DISC legislation if this Committee decides to enact the DISC legislation, for the reasons stated below. I have been unable to conceive of any incremental system which I believe satisfactorily resolves the difficulties which will describe. It is possible, however, that with the application of additional effort and time that such a system could be devised. While it is true that it appears that the incremental system was decided upon by the Ways & Means Committee at a rather late hour, the use of incremental systems for export incentives has been under consideration by the Government for a much longer period of time and it is assumed that the learnings of the Treasury Department, as well as those of the Committee staffs involved, were applied in the development of the pending legislation.

I have not set forth my objections to this proposal necessarily in the order of importance, but rather in the order in which they develop in connection with consideration of the legislation and in an order which makes my position more understandable, and for the sake of clarity.

3. My first objection to this proposal relates to the administrative difficulties imposed upon taxpayers and the Treasury in insuring an equitable and feasible application of the incremental rule.

The first step in the application of the incremental rule is the determination of what the bill refers to as "base period export gross receipts." For this purpose taxpayers will be required to resurrect financial records for the years 1968 through 1970, and determine the figure which represents 75% of the average of the gross receipts from the sale, lease or rental of property for use outside the United States (which was held primarily for sale, lease or rental, to customers in the ordinary course of trade or business) or for engineering or architectural services for construction projects located (or proposed for location) outside the United States.

These computations must be made not only for the taxpayer but for all members of a controlled group of which it is a part. For this purpose the definition of controlled group for consolidated return purposes is used, except that a 50% control test in lieu of an 80% test is applied. The basic difficulty in this connection is to make this determination for years in which such determinations were probably irrelevant for any tax or financial accounting purposes. The data may be exceedingly difficult to dredge up, or it may be impossible to make the determinations required by the statute with sufficient degree of accuracy either to satisfy an internal revenue agent upon subsequent audit, or even to enable a taxpayer to know what, if any, benefits he may derive from the deferral offered by the DISC election.

One of the reasons given by the opponents of an excess profits tax under our present economic conditions is the administrative complexities and inequities inherent in such tax. Yet we have here in the DISC the best (or worst) example of complexities generated by such a tax in the determination of base period receipts.

I must admit that a great deal of my difficulties with this proposal result from a visceral reaction to the use of this base period figure, and I have not had the time, in view of the recent availability of this proposal, to consider all of the possible administrative problems. Let me point out a couple of examples, however. Suppose a taxpayer and related companies were engaged in exports, but the exports consisted of goods which incorporated over 50% of imported parts. Under the bill, the taxpayer has an election to exclude such exports in computing base period gross receipts. Many taxpayers would find it impossible to make such computations for prior years. The bill also provides for carry-over of attributable base period receipts under the acquisition of assets by one company from another. If in 1975 one company were to acquire assets constituting a division of another company, the former would have to attempt to determine that portion of the latter's base period receipts attributable to such division. The regulations which the Secretary will have to promulgate to set forth these rules will be a long time coming and exceedingly complicated.

4. My major objection to the inclusion of an incremental test in the DISC is the inequity or potential inequity created between taxpayers currently engaged in export activities and those not so engaged or with only minimal export activities.

Taxpayers with a zero or low base for DISC purposes will be given the largest incentive in the proposed legislation as most or all of their tax liability will be deferred. On the other hand, those taxpayers whose exports have been diminished over the years by the factors described by the Administration in proposing this legislation will receive the smallest incentives.

On the one hand, therefore, we have the exporter with zero base period gross export receipts. Every dollar of income earned from export activities will carry with it tax deferral. Compare the taxpayer whose receipts from exports have been declining over the years. Assume an exporter whose export receipts during the base period 1968 through 1970 were $12, $10, and $8 respectively. This taxpayer's base period export gross receipts would be $7.50 which means that he gets no tax deferral on any income until his receipts exceed that figure. If the prior trend continues in the taxpayer's business he would have received only $6 of receipts in 1971 so he will have to increase his export receipts from $6 to $7.50 before he starts to receive any incentive under the legislation.

The pending DISC legislation is another example of the Government acting to the detriment of those who participate in so-called voluntary government programs. Beginning back in about 1965 businessmen were encouraged to bring back dollars from overseas, stop or slow down capital investment overseas, and borrow needed funds overseas for foreign expansion rather than transmitting them from the United States. When the Foreign Direct Investment Regulations were announced in 1968 it was those businesses which had cooperated to the greatest extent who suffered the most under the OFDI program. Now, with the DISC, the Congress is considering doing the same things to those exporters who cooperated with the various governmental and private agencies encouraging exports.

What this legislation does is tell those businesses which have won the Commerce Department's "E" award for export activity that they need only minimal incentives or none at all, and that the Government is now going to give tax dollars to other businessmen—their competitors: the amount of the tax dollars to be inversely proportional to the extent of cooperation with the voluntary export expansion program during the period 1968 to 1970. Well, of course this is facetious, but this is the result if not the reasoning behind the incremental proposal.

5. The incremental system also relies solely on the criteria of increased export receipts without giving any consideration to the problems of the exporter who has built up a market and then must fight to maintain it against competition. It may very well be as difficult if not more difficult, depending on the markets and products, to maintain an existing market as to open up new markets.

The already committed exporter finds that he gets minimal or no benefits out of the DISC to help him compete with foreign businesses. Now he finds that his

Government under the guise of encouraging exports has put him in a worse position, as other U.S. exporters will be competing in the same markets with the added advantage of the use of deferred tax dollars.

Even assuming the viability of an incremental system, which I doubt, the one proposed in the DISC is the most discriminating and inequitable that could be devised. The exporter who happened to have a high base period is stuck with that base forever and ever. Ten years from now he must still pay full U.S. tax currently to the extent of his base period export receipts, while on the other hand, his competitor who happened to have low or no base period receipts. never pays any current tax on export receipts even though he never increases them by so much as a dollar, from 1971. It is difficult to imagine why ten years from now, the taxation of export income should be dependent on exports during 1968 to 1970.

6. I have seen no reports and have heard no testimony other than the Secretary's as to how American businessmen will react to the DISC proposal in its present form. If it has the effect intended, there should be changes in existing trade patterns in order to enable taxpayers to maximize the benefits of the DISC. If there are no such changes or reactions to the DISC, then the DISC might not have been necessary. These changes that may take place could be very disruptive of normal trade patterns to the extent that in the short run at least there could be a drop in exports as new exporters begin learning their way attempting to cut into both foreign and other U.S. competition. The existence of the base period concept can be very disruptive of mergers and acquisitions by American businesses as the existence of a high base period will lower the value of a company and make it unattractive for acquisition when this might be just the type of company whose exports would be increased by new capital or management resulting from a merger or acquisition.

7. The DISC proposal as it was originally drafted was a most expensive type of tax incentive. It is understandable that the House balked at the cost of the DISC and tried to solve the problem by limiting the benefits. I suggest that the DISC requires further study in order to insure that maximum benefit is obtained for each tax dollar forgiven or deferred, and that the inequities described herein are eliminated. The bill is moving much too fast through the Congress to give these matters the attention they deserve. Accordingly, I suggest that the DISC be tabled for further consideration, particularly with respect to the incremental aspect and in order to give the Administration an opportunity to answer the questions raised herein and by others.

CITIZEN AMERICA CORP.,
Beverly Hills, Calif., October 8, 1971.

Hon. ALAN CRANSTON,
U.S. Senate,
Washington, D.C.

DEAR SENATOR CRANSTON: The President's investment tax credit proposal before the Senate Finance Committee has a provision which excludes its application when capital goods are of foreign manufacture.

It is my opinion that office machines should be excluded from this restrictive provision. Imported office machines, which would be classified as capital goods subject to this provision, represent a small portion of the total market but they help control inflation; they reduce the already too strong monopoly of the industry; and they provide many jobs to small independent businesses throughout the United States.

Prior to World War II, the manufacture and distribution of office machines was controlled by the prime manufacturers of business machines. These had direct company owned branches in most of the trading areas of the United States. During this period the independent office machine dealer had to earn a living by repairing machines and selling used equipment. He had almost no access to new business machines. Competition in business machines was limited to a very few giants whose company controlled distribution protected them from adverse competition.

After Europe began to reestablish its industry, products became available to market. Thousands of independent dealers from every corner of the United States now had an opportunity to purchase and distribute office machines. In the years hence a strong independent office machine industry has developed. The influx of these new machines forced modernization of domestic products and also made these domestic products lower in price. For example, electric adding machines which were selling for $450. were reduced in price to $250. There were no cost reductions for the manufacturers. The prices were inflated due to lack of competition.

There are over 10,000 independent office machine dealers in the United States. Almost all of these will be affected. These small dealers provide many jobs in all the small towns of America. For a moment look at the products affected. The office electric typewriter business is dominated by IBM. The independent dealer cannot buy new machines for resale from IBM, so he can only service his community with an imported typewriter. The photo copy business in again dominated by Xerox and a few others selling through company controlled distribution. To compete, the independent must sell an imported product. The same is true for the calculator market, the cash register market, the dictating market and the adding machine market. Measured against the total market, that portion supplied by foreign manufacturers is small. Yet this small portion is of great importance to the thousands of small independent dealers in the United States. They not only contribute to their own local economy but they help keep the giants honest. Without this competition there is little doubt that prices of office machines would be much higher and the inflation pressures much greater.

We are one of the large importers of adding machines and calculators manufactured in Japan and distributed through the independent office machine industry. These independent dealers have looked to companies such as ours to supply their needs since they are unable to get products from domestic manufacturers. These dealers are already penalized by the increase of surcharge and yen evaluation. The added differential will for all practical purposes destroy their hard earned market.

The benefits in cost savings from overseas are not entirely because of low labor. For instance, the giant calculator makers continued to sell obsolete mechanical rotary calculators at prices over $1,000. Japanese manufacturers began the trend toward electronic calculators. This technology was all here in the United States but was resisted by the three who held monopoly. When United States customers began to abandon the big three in favor of the new electronic calculators, the three closed down these old factories and are now concentrating on electronic calculators. The customer can now buy for $300. a machine that is superior in every way to one formerly selling for $1300.

To sumarize, the restriction of the investment tax credit against imported business machines will play directly into the hands of the giants; it will drastically affect small businesses and employees in every small town in America: and it will give the giants a chance to increase their prices with little concern when the freeze is over.

I strongly recommend that the office machine industry be exempt from the restrictive category as it pertains to imported office machines.

Respectfully yours,

THOMAS B. O'REILLY,
Executive Vice President.

SPECIAL INDUSTRIAL RADIO SERVICE ASSOCIATION, INC.,
Rosslyn, Va., October 14, 1971.

Hon. RUSSELL B. LONG,
Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: This Association represents some 25,000 small businessmen who use mobile radio equipment for a variety of purposes. Industries eligible to be licensed in the Special Industrial Radio Service are Agriculture, Fuel Delivery, Heavy Construction, Mining, Ready-Mixed Concrete and/or Hot Asphalt, and Specialized Services to the Petroleum Industry, activities that have a high degree of hazard to life and property. Two-way radio is not only essential to them, but also is usually the only means of communication. Telephone companies cannot provide this service because all of the equipment requiring it is mobile . . . "on the move."

In behalf of these licensees, this Association takes strong exception to a proposal being considered by your Committee which would reduce the 7% Investment Tax Credit, as provided in H.R. 10947, from the full 7% to 4%.

We think that this would be discriminatory. Why should an American businessman who wants to buy radio equipment to expand his business operation, be deprived of the full tax incentive that would apply to any other capital equipment purchase?

The essential nature of radio communication to the use of such capital equipment, and the personnel to operate it, is vital to the concept underlying the Tax Investment Credit. We respectfully request that your Committee will see to it that the 7% credit shall be maintained as provided in H.R. 10947.

Sincerely,

DENIS E. COGGIN,
Executive Vice-President.

STATEMENT BY PACIFIC CAR AND FOUNDRY COMPANY, SUBMITTED BY JOHN S. VOORHEES AND DONALD J. GAVIN OF HOWREY, SIMON, BAKER & MURCHISON, WASHINGTON, D.C.

WHY THE JOB DEVELOPMENT CREDIT SHOULD BE AVAILABLE FOR TRUCKS MANUFACTURED IN CANADA PURSUANT TO THE UNITED STATES-CANADA AUTOMOTIVE AGREEMENT OF 1965

INTRODUCTION

The Revenue Bill of 1971 recently adopted by the House of Representatives (H.R. 10947) restores the investment credit, now called the "job development investment credit", subject, however, to some major limitations. The most significant limitation is found in Section 103 of the House Bill which generally denies the credit to property completed abroad or domestic property which is predominantly of foreign origin. This prohibition applies to property (1) which is ordered before the termination date of the 10% surcharge,[1] or (2) which was completed outside the United States or completed domestically when less than 50% of its basis represents value added within this country. However, the foreign produced property exclusion clause can be waived by the President if he determines that its application to any article or class of articles "is not in the public interest."

Because the President's proposal of a job development tax credit (as adopted in a slightly modified form by the House of Representatives) contains a blanket prohibition for foreign produced goods so long as the import surcharge is in effect, the net result will be to inequitably deny the credit to trucks manufactured in Canada pursuant to the Automotive Products Agreement of 1965. For all practical purposes, the exclusion of foreign produced property from the credit will create non-tariff barriers and will effectively abrogate the Automotive Agreement insofar as it applies to capital items, such as heavy-duty trucks, eligible for the credit.

CANADIAN MADE TRUCKS SHOULD BE ELIGIBLE FOR THE TAX CREDIT

Large trucks and heavy-duty tractors, including those manufactured by Pacific Car and Foundry Company (PC&F) (which often cost more than $20,000 each) represent property eligible for the tax credit, and it can be expected that commercial purchasers in the United States will insist that the credit be available to them. However, any such tractors or trucks "completed" in Canada would not be eligible for the credit and accordingly would not be competitive in the U.S. market.

We submit that when the all-encompassing foreign produced property exclusion is considered in the context of trucks made in Canada, it is clear that the Bill in its present form is basically unfair. It imposes an unwarranted retroactive penalty on those American companies who in good faith have relied on the 1965 Automotive Agreement and have either (1) established substantial production facilities in Canada, or (2) purchased trucks some months ago without any legitimate concern as to whether the trucks would be completed here or in

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[1] This surcharge was imposed by Presidential Proclamation 4740 dated August 15, 1971.

Canada. Accordingly, the House bill should be modified so as to provide that items produced in Canada pursuant to the 1965 Automotive Agreement are eligible for the tax credit.

In the alternative, should it not appear feasible at this time to exempt outright from the bill such transactions, it is our recommendation that at the very least it be made clear that the provision for granting a waiver of the foreign produced property exclusion is specifically intended to cover heavy-duty trucks manufactured in Canada pursuant to the Automotive Agreement. Appropriate language should be inserted in the bill to the effect that a waiver may be granted in cases of hardship or inequity resulting from action taken by American companies in reliance on agreements made by the United States with Canada. Further, it should be specifically pointed out in the committee report accompanying the bill that a waiver could properly be granted for Canadian made trucks.

Because of the inequity which would result if any such waiver did not apply to trucks currently in the process of being made, the House of Representatives' Bill should be modified to allow such waivers to apply retroactively to items currently being made. The present bill limits the President's authority to grant a waiver solely for property ordered on or after the issuance of the Executive Order containing the waiver. Such a limitation would obviously be unfair to American purchasers of trucks currently in the process of being made in Canada at the time the waiver is issued. If these trucks were made in the United States, they would ordinarily be eligible for the credit and we know of no logical basis for reaching a different result if a waiver of the foreign produced property provision is granted for trucks made in Canada.

NATURE OF THE AUTOMOTIVE TRADE AGREEMENT AND THE PROBLEMS WHICH HAVE ARISEN THEREUNDER

The Automotive Agreement and the statutes implementing the Agreement (19 U.S.C.A. §§ 2001-2033) have resulted in the removal of duties by both countries on specified motor vehicles and other automotive equipment and parts. Basically the agreement has three objectives:

"1. the creation of a broader market for automotive products within which the full benefits of specialization and large-scale production can be achieved;

"2. the liberalization of United States and Canadian automotive trade in respect of tariff barriers and other factors tending to impede it, with a view to enabling the industries of both countries to participate on a fair and equitable basis in the expanding total market of the two countries; and

"3. the development of conditions in which market forces may operate effectively to attain the most economic pattern of investment, production, and trade." [2]

Despite problems which have arisen in the past six years many of these objectives are being met and in fact the Agreement has had a far-ranging effect on the combined United States-Canadian market for automotive products.

In the most recent report by the President to the Congress on the Agreement, its tremendous impact is described as follows:

"Total automotive trade between the United States and Canada, adjusted for transaction values, grew to $6.3 billion in 1969, an increase of 29 percent over 1968 and about 8 times the level in 1964, the year prior to the Agreement. United States automotive exports to Canada were $3,186 million and imports were $3,089 million in 1969. The rapid expansion of automotive trade is due primarily to the Agreement." [3]

In 1965 when the Automotive Agreement was reached, it was necessary to take into consideration the considerable disparity between the size of the automotive industries and the costs of production in the two countries. Accordingly, Canada requested special transitional arrangements which would allow its much smaller automotive industry to compete in the overall North American market.

In recognition of these needs of the smaller and higher cost Canadian industry to adjust to the overall United States-Canadian market, certain restrictive measures were set forth in Annex A to the Automotive Agreement:

1. Only bona fide Canadian vehicle manufacturers may import automotive products duty-free; and

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[2] Fourth Annual Report of the President to the Congress on the Operation of The Automotive Products Trade Act of 1965 dated November 10, 1970, at p. 1.

[3] *Id.* at p. 13.

2. Bona fide manufacturers are those which meet certain Canadian value added and Canadian production to Canadian-sales-ratio requirements (which means that a United States manufacturer who wishes to export automotive products into Canada must also manufacture substantial quantities of automotive products in Canada).

The practical effect of these transitional measures has been that United States companies which manufacture automotive products for the overall Canadian-United States market *must* maintain factories in both countries. Further, although substantial quantities of the component parts for the Canadian factories come from the United States, there are certain minimum requirements for obtaining Canadian-made parts. Consequently, in direct reliance on the agreement and pursuant to the applicable provisions of United States law (19 U.S.C.A. §§ 2001-2033), automotive manufacturers such as PC&F have established significant manufacturing operations in Canada.

If the proposed investment tax credit is not available to automotive products manufactured in Canada, the effect will be to abrogate the Automotive Agreement and the public laws implementing the agreement and to irrevocably injure PC&F and other manufacturers of large trucks, which would ordinarily be eligible for the credit. For all practical purposes non-tariff barriers will have been raised through the tax credit and the purpose and intent of the Automotive Agreement and the laws implementing the agreement will have been effectively abrogated and those who have relied thereon will be irrevocably injured.

PACIFIC CAR AND FOUNDRY

Pacific Car and Foundry Company has two Canadian truck manufacturing subsidiaries. One is Canadian Kenworth Ltd. in Burnaby, British Columbia, and the other is Sicard, Inc. at Ste. Therese, Quebec.

Since the enactment of the United States-Canadian Automotive Agreement of 1965, PC&F has transferred some of its production for the U.S. market to Canada in order to attain the full benefits of specialization and large-scale production for the overall North American market in accordance with the terms of the Agreement. Further, in order to be able to export its U.S. made trucks to the Canadian market, it was necessary under the transitional provisions of Annex A of the Agreement to establish *substantial* Canadian production.

It is important to note that unlike Japan or Western Europe, the cost of producing trucks in Canada is in fact greater for PC&F than the cost of manufacturing in this country. PC&F's intent in establishing a small part of its manufacturing operations in Canada was *not* to avail itself of low cost foreign labor to the detriment of the American labor force. Rather, this action was taken in full reliance on the Automotive Agreement and the provisions of the United States law which sought to encourage domestic manufacturers to participate to the fullest extent possible in creating an overall North American production and market for automotive products.

At the present time the Canadian Kenworth plant in British Columbia is manufacturing the bulk of PC&F's specialized off-highway vehicles for the timber and construction industries. The vast majority of Kenworth trucks are the normal highway type and are manufactured in Seattle and Kansas City. In addition, PC&F also manufactures Peterbilt trucks with manufacturing facilities at Nashville, Tennessee and Newark, California.

The Sicard plant in the Montreal area is used to manufacture a smaller highway vehicle of the Class 7 category which has a 26,000 to 33,000 pound capacity and a Class 8 cab-over truck which has over 33,000 pound capacity. PC&F is building the cab-over truck in Canada only because a lengthy strike at Kenworth's Kansas City plant created a tremendous backlog and the only available facility to eliminate this backlog was the Sicard plant.

PC&F has established these substantial manufacturing operations in Canada, even though it can produce the trucks more economically in this country. One of the primary reasons is that under the Automotive Agreement PC&F is prohibited from exporting into Canada more trucks than are imported into the United States from its manufacturing facilities in Canada. Therefore, in order for PC&F to take into Canada the vehicles which it can manufacture more economically in the United States, it must manufacture in Canada and bring to the United States at least an equivalent value.

There has been an increased emphasis by the Canadian authorities to meet a Canadian-value-added requirement, but PC&F has been unable to find a sufficient quantity or Canadian components necessary to produce a wholly Canadian truck. At the present time over 60% of the component parts in trucks manufactured in Canada come from the United States. Accordingly, while the trucks made at PC&F's two Canadian plants are rendered operational in Canada, in fact, a substantial part of each truck is actually composed of parts made in this country.

If the job development credit proposal is enacted into law in its present form, the "foreign produced property" exclusion will mean that trucks made by PC&F in Canada will be unfairly denied the tax credit. In our view this result will be extremely inequitable for PC&F and its customers (particularly if the credit is made retroactive to April 1971), and will be due to the fact that PC&F in good faith relied upon the Automotive Agreement and applicable statutes of the United States. As a result of any restriction of the tax credit to U.S. manufactured goods, PC&F will be forced to reconsider its production schedule and it will probably mean that substantial manufacturing facilities in Canada will be reduced or closed with the concomitant loss of many hundreds of jobs.

We understand from government officials in the Treasury Department and elsewhere as well as officials of the Canadian government that there is presently some misunderstanding regarding the need for continuance of the so-called transitional restrictions imposed by Canada at the outset of the Agreement. Some U.S. officials contend that there has resulted over the last few years a trade deficit to the United States because of these transitional restrictions imposed by the Canadian government and that the restrictions should be removed.

Conversely, other U.S. officials, as well as officials of the Canadian government, point to the fact that the trade imbalance in favor of the United States in 1965 was in excess of $704 million [4] and this situation was creating an intolerable drain on the Canadian balance of payments. No one seriously contends that we should return to the situation prevailing in 1965 when the United States occupied such a dominant position. Instead, the purpose of the agreement is to bring about a true integration of the automotive industries of the two countries and to encourage rationalization of production for the overall North American market. Therefore, it is not accurate to consider the difference between the original surplus of $704 million in favor of the United States in 1965 and the current surplus in favor of Canada as a true measure of any imbalance in the automotive trade.

We further understand that a negative United States automotive trade balance has resulted in recent years because of some rather unique developments and that in the long run the trade situation should be equalized between the two countries. In the early years of the Agreement in 1966 and 1967 the automobile companies invested literally hundreds of millions of dollars in new plants and equipment in Canada and naturally there resulted a tremendous increase in production from these factories. No longer did the car companies have specialized production for Canada alone. Instead, as the Automotive Agreement envisioned, these companies manufactured cars in Canada on a large-scale production line basis for the overall North Americn market and substantial quantities of cars were exported to the United States. On the other hand, because of the less than anticipated growth of North American type car sales in Canada, the demand for such automobiles was not as great as originally anticipated. It can be expected, though, that the Canadian market for North American made cars will ultimately become larger and that a balanced trade between the two countries will result.[5]

Because of the trade imbalance and dissatisfaction with the transitional safeguard measures imposed by the Canadian government, there may be some reluctance to recognize the inequities resulting to PC&F and other manufacturers of automotive equipment under the foreign product exclusion in the proposed Job Development Tax Credit. We submit, however, that this view is not justified nor supportable when viewed in the context of the specific facts involved here. Indeed, as shown in Attachment A hereto, PC&F has contributed over $50.5 million to the net United States credit in the last two and two-thirds years.

We do not know why the large trade imbalance has resulted in the last year or so under the Automotive Agreement, but it is clear from PC&F's own figures that its experience has been just the opposite. Apparently, the imbalance has resulted from the large-scale automobile production in Canada, but the foreign property exclusion in the President's proposal would have no effect on this, because the

[4] *Id.* at p. 8.

[5] We also understand that at present the automobile companies are more than meeting the transitional safeguard requirements imposed by Canada and that even if these safeguards are removed, there would be no effect on Canadian production by United States automobile manufacturers.

average automobile purchaser could not avail himself of the tax credit. Moreover, any trade imbalance or other problems which exist under the Automotive Agreement should be solved within the context of that Agreement. It is clearly improper to abrogate the Agreement as it applies to trucks made in Canada by the blanket prohibition for foreign produced items in the proposed Job Development Credit.

CONCLUSION

In conclusion, we respectfully submit that the prohibition for foreign produced articles in the Job Development Tax Credit proposal should be re-evaluated in light of the United States-Canadian Automotive Agreement, and automotive equipment manufactured in Canada should be eligible for the tax credit.

In the alternative, it should be made clear that the President may properly waive the foreign produced property exclusion in the case of heavy-duty trucks manufactured in Canada pursuant to the Automotive Agreement, and that appropriate language to this effect be inserted in the Bill as well as the accompanying Committee Report.

ATTACHMENT A

Because of the trade imbalance problem under the Automotive Agreement which has been called to our attention by officials of the U.S. Treasury Department, Pacific Car and Foundry examined its records to determine what its experience has been under the Automotive Agreement in terms of the balance of trade. As illustrated in the tables below, the actual experience of Pacific Car and Foundry in the years 1969, 1970 and the first 8 months of 1971 is that it has contributed in excess of $50.5 million to the United States side of the balance of payments ledger with Canada. In terms of actual figures, the value of United States manufactured trucks and component parts shipped to Canada during this period of time was $71,885,000 whereas the value of Canadian manufactured trucks and component parts was only $21,289,000. The actual data for each year is described in the tables below. (Figures expressed in millions of dollars).

CANADIAN MANUFACTURED TRUCKS SOLD IN CANADA

	Total value	(35 percent) U.S. content
1969	$42,271	$14,795
1970	40,071	14,025
First 8 months of 1971	27,551	9,643
Grand total	109,893	38,463

TOTAL CANADIAN TRUCK SALES (TRUCKS MANUFACTURED IN CANADA FOR UNITED STATES AND CANADIAN MARKETS PLUS TRUCKS MANUFACTURED IN THE UNITED STATES AND SOLD IN CANADA)

	Total value	Portion attributable to U.S. manufacture
1969	$58,540	$24,160
1970	60,066	27,344
First 8 months of 1971	45,998	20,381
Grand total	164,604	71,885

NET EXCESS OF U.S. ORIGIN OVER CANADIAN ORIGIN

	U.S. value	Canadian value	Net U.S. value
1969	$24,160	$6,904	$17,256
1970	27,344	6,676	20,668
First 8 months of 1971	20,381	7,709	12,672
Grand total	71,885	21,289	50,596

STATEMENT SUBMITTED BY GORDON R. COREY, ON BEHALF OF COMMONWEALTH EDISON COMPANY

MEMORANDUM TO THE SENATE COMMITTEE ON FINANCE WITH RESPECT TO THE PROPOSED TAX CREDIT

This memorandum addresses itself to two major questions: the amount of the credit to be applied to regulated industries and the normalization versus flow-through question.

1. THE AMOUNT OF THE CREDIT TO BE APPLIED TO REGULATED INDUSTRIES

The Job Development Credit made available to industry should be applied across-the-board. The regulated industries, particularly electric power, should not be treated as second-class citizens for the following reasons:

(i) It is unfair to discriminate against one kind of taxpayer, and particularly unwise from a social point of view to discriminate against the electric power industry in such a way as to discourage plant investment by that industry. Because it is an essential industry threatened with a serious possibility of not being able to finance required plant expansion to meet the nation's need for power, discrimination would appear to be short-sighted. The degree to which the electric power industry is faced with serious capital shortages is set forth in Tables I and II. The seriousness of the situation can be illustrated by the fact that ten years ago few if any could have expected that our nation's largest railway system would be bankrupt today. Yet, compared with the possible bankruptcy of a single carrier or type of carrier, or a single concern (like American Motors or Lockheed), the potential impact of possible financial distress of an *entire* essential industry such as the electric industry is serious indeed. To discourage necessary growth in this basic industry by discriminatory tax treatment would seem to be unwise as a matter of national policy.

(ii) Electric power companies must compete with other businesses.

One of the oldest and most prevalent forms of competition for the electric power industry is on-site electric generation. Many factories and some office buildings and shopping centers generate their own electricity. To grant such taxpayers a larger Job Development Credit for their generating equipment than is granted to the central station utility company is discriminatory and flies in the face of basic principles of fairness.

(iii) Failure to grant electric power companies the full development credit percentage allowance will neglect one of the most productive ways to stimulate economic growth.

It will be pointed out that electric plant expenditures are price elastic, and that some expenditures are being held back today by the shortage of capital. Yet the provision of abundant electric power is an essential part of the formula for general economic growth. This was recognized in the days of the New Deal, when the expansion of the electric generating capability of the Tennessee Valley Authority was selected in the 1930s as a basic way of stimulating economic growth in the Tennessee mountain area.

In short, if we are to stimulate general economic growth, it is important that the electric power industry not be denied the benefits of the full amount of the proposed Job Development Credit.

2. THE NORMALIZATION VERSUS FLOW-THROUGH QUESTION

The House Bill provides several options for regulated utilities to follow in accounting for the Job Development Credit—options similar to those provided for by the 1969 Tax Reform Act with respect to accelerated depreciation. Those options clearly imply a preference for normalization of the Job Development Credit for bookkeeping purposes and should be retained.

The plant investment decisions of the regulated electric power industry are significantly price elastic. I tried to point this out in my May 5, 1971 testimony on the matter of ADR before the IRS. At that time I presented an Exhibit (Table III attached hereto) showing that the effects of ADR were equivalent to a purchase discount of approximately 5%, and I testified that Commonwealth Edison estimates that its five year construction program will be increased by $75 million if it is granted the full benefits of ADR.

There is no doubt that any tax credit associated with the decision to install or replace plant facilities and equipment will stimulate the installation of such equipment. At first blush it would appear that the degree of stimulation is related solely to the reduction of carrying charges on the equipment—and hence is independent of the type of bookkeeping system used, whether flow-through or normalization. However, as I testified in the ADR matter, investment, replacement and modernization decisions are not made solely on the basis of cost analyses. They also depend upon the availability of cash to pay for the new facility. Today, more than at any other time perhaps, there are frequent instances where modernization plans, though justified economically, cannot be carried out simply because of a shortage of cash. This means that the Job Development Credit will tend to stimulate the most plant investment if accompanied by some measures to encourage the use of the added cash from the tax reduction to help pay for the added expenditures themselves. This is the real crux of the normalization versus flow-through matter.

In conclusion, the proposed Job Development Credit should be applied across-the-board to all industries without discrimination. In particular the full amount of the credit should be applied to the electric power industry in order to provide the full stimulative effects intended. For the same reason the accounting provisions of the House Bill should be retained because they encourage normalization of the benefits of the credit for accounting and rate making purposes.

TABLE I.—INVESTOR-OWNED ELECTRIC COMPANIES CONSTRUCTION EXPENDITURES AND NEW MONEY NEEDS, 1960-75

	Billions		New money needs as a percentage of electric construction expenditures	Interest coverage before Federal income taxes
	Electric construction expenditures [1]	New money needs [1]		
1960	$3.3	$1.8	54.5	5.2
1961	3.3	1.7	51.5	5.1
1962	3.2	1.5	46.9	5.2
1963	3.3	1.2	36.4	5.2
1964	3.6	1.5	41.7	5.2
1965	4.1	1.6	39.0	5.2
Total 1961-65	17.5	7.5	42.9	
1966	5.0	2.7	54.0	5.0
1967	6.1	3.5	57.6	4.6
1968	7.2	4.0	55.6	4.2
1969	8.3	4.6	55.4	3.7
1970	10.2	7.8	76.5	3.1
Total 1966-70	36.8	22.6	61.4	
1971	[2] 11.9	[2] 7.3	[2] 61.3	
1972	[2] 12.0	[2] 7.7	[2] 64.2	
1973, 1974, 1975	[2] 31.1	21.4	[2] 68.8	
Total 1971-75	[2] 55.0	[2] 36.4	[2] 66.2	
Percentage increase in annual amounts, 1960-75	215	294		

[1] Source: Edison Electric Institute.
[2] Estimated.

Note.—The total amount of new money financing needed has more than quadrupled since 1960. With future construction expenditures expected to increase sharply, new money needs will increase still more in the future.

TABLE II.—COMMONWEALTH EDISON CO., LAST 10 YEARS

[In millions]

	Construction expenditures [1]	New money [2]	Percent new money	Before-tax interest coverages
Year:				
1962	$123	[3] $4	3	7.1
1963	106	[3] 4	4	7.4
1964	137	[3] 5	4	7.8
1965	153	[3] 5	3	8.1
1966	200	129	65	8.2
1967	249	122	49	7.0
1968	352	204	58	6.0
1969	433	266	61	4.6
1970	498	364	73	3.5
1971	660	500	76	(4)

[1] Includes nuclear fuel, primarily initial core loadings.
[2] Includes minor amounts of refinancing moneys, primarily for sinking fund requirements.
[3] Primarily employee stock sales.
[4] 2.95 per latest prospectus, 12 months ended May 1971, computed on a pro forma basis reflecting the last bond issues Coverage similarly computed, but excluding interest capitalized as required by our bond indenture—2.6; the bond indenture does not allow additional bonds to be issued when the pro forma coverage so computed drops below 2.5.

TABLE III.—PRESENT VALUE OF FUTURE CARRYING CHARGES ON A $100 FOSSIL-FIRED ELECTRIC POWERPLANT INVESTMENT [1]

	Amount	Percent
Gross present value of future carrying charges—straight-line tax depreciation, pre-guidelines [2]	$166	
Reductions from:		
SYD depreciation (and minor related factors)	14	8½
28-year guideline life (with SYD)	4	2½
Proposed ADR rules permitting 22.4-year tax life (with SYD)	[3] 8	5
Total reductions	26	16
Net present value of future carrying charges after reductions	140	

[1] "Carrying charges" as used herein include cost of money, Federal and State of Illinois income taxes, and depreciation or amortization. They do not include ad valorem taxes, insurance, maintenance and the like.
[2] A 3.05-percent tax depreciation rate, equivalent to a 33-year tax life, applied (in our case) prior to adoption of the 28-year tax guideline life in 1962.
[3] Includes a reduction of up to $2 from the proposed change in the first year's depreciation which would add up to ½ year of early tax depreciation.

AMERICAN BANKERS ASSOCIATION,
Washington, D.C., October 15, 1971.

Senator RUSSELL B. LONG,
Chairman, Senate Finance Committee,
New Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: The American Bankers Association takes this opportunity to express its views on H.R. 10947, the House-passed version of the tax recommendations underlying the Administration's economic program. We recognize that there are other facets to the Administration's total economic package, and that a number of other proposals have been made by responsible sources, including members of your Committee, for inclusion in the overall economic program. However, at this time, we will confine our comments to the tax issues in H.R. 10947, the bill before your Committee.

The Association endorses H.R. 10947, although it departs to some extent from the proposals put forward by the President.

The tax proposals before your Committee include a balanced mix of consumer and business stimuli. They include: (1) reductions in individual income taxes through increased personal exemptions and increased standard deductions; (2) repeal of the 7 percent automobile and 10 percent light-duty truck excise taxes;

(3) establishment of a 7 percent investment credit, and (4) tax deferral on export income of Domestic International Sales Corporations (DISC's). In addition, the bill contains provisions relating to the taxation of trusts.

With unemployment averaging 6 percent during the past year, there is no doubt that our economy needs stimulation. However, any fiscal encouragement—whether in the individual or business area—must be carefully weighed. Overstimulation of the economy by excessive budget imbalance could undo much of the benefit of the present wage-price freeze and could weaken the post-freeze program announced by the President on October 7. The problems involved in shifting to more flexible anti-inflationary tools in mid-November are truly formidable and should not be compounded by unnecessary fiscal pressures. The best foundation for longer-term non-inflationary growth requires a relatively slow approach to induce higher levels of private spending. If at a later date additional measures are required, it would be far easier to provide further stimulation than to bring about a 180 degree change in direction toward restraining the economy once again.

The following comments concern specific proposals in H.R. 10947.

INCREASED PERSONAL EXEMPTIONS AND STANDARD DEDUCTIONS

The American Bankers Association would be concerned about any proposals that go beyond those in H.R. 10947 with regard to individual income taxation. The bill would accelerate the scheduled increase in personal exemptions to $750 in 1972, with an intermediate increase from $650 to $700, retroactive to July 1, 1971; increase the Low Income Allowance for 1972 and subsequent years from $1,000 to $1,300; eliminate the "phase-out" of the Low Income Allowance for 1971; and increase the percentage standard deduction from 13 percent to 15 percent with a $2,000 maximum.

These income tax provisions will augment the disposable income of individuals by approximately $1.6 billion in calendar 1971 and $3.2 billion in calendar 1972. The bulk of these amounts will go to the great majority of taxpayers whose incomes are subject to the lower tax brackets. As consumers, these people tend to spend all, or nearly all, of their after-tax income, and the bill's provisions will provide a substantial, but we would hope not an excessive, amount of fiscal stimulus.

REMOVAL OF AUTOMOBILE AND SMALL TRUCK EXCISE TAXES

The removal of the 7 percent manufacturers' excise tax applied to automobiles and the 10 percent excise tax on small trucks could play a significant part in stimulating consumer purchases and increasing production, thereby helping to reduce unemployment. Pick-up trucks are often used as a means of personal transportation or for recreation, or for farm or small business purposes. We believe the proposed repeal in both cases is logical and equitable.

The logic of the excise tax repeal rests on the pervasive effect of the automobile industry on the economy. Moreover, it is long overdue; if it were not for the escalation of the war in Southeast Asia, the 7 percent automobile excise tax would have been reduced to 1 percent after 1968.

The repeal of the auto and small truck excise taxes will provide needed stimulation to a wide segment of domestic industry. The secondary suppliers for auto production include industries which provide a large variety of products, steel, glass, rubber, textiles, copper, nickel, lead, aluminum, petroleum—as well as many services. While the auto industry is not ailing, some of these industries, particularly steel, are in immediate need of the added demand to be derived from a rapid increase in automobile production, with the resulting benefit of increased employment.

Although removal of these excises is likely to cost the Treasury $3.5 billion in revenue in the calendar years 1971 and 1972, the inflationary effect should be largely offset by the President's post-freeze program, together with the expenditure reductions included as part of the President's budget proposals.

INVESTMENT TAX CREDIT

The American Bankers Association supports the 7 percent investment tax credit as modified in the House-passed H.R. 10947. The bill also incorporates, in a modified form, the ADR depreciation system adopted by the Treasury Department last June.

This investment credit will stimulate the economy and create jobs, and we believe that reinstituting the credit is good policy now. The following are some reasons:

(1) Projected increases in business capital outlays have steadily deteriorated in 1971. The most recent Department of Commerce release shows that capital spending of U.S. business this year is expected to be only 2.2 percent greater than 1970. Seven months ago the projection was for a 4.3 percent increase over 1970. Despite current plant use statistics which show a relatively high rate of underutilization, the economy needs to have a continuing high rate of plant and equipment outlays. Such expenditures will improve productivity through plant modernization, necessary for effective competition with foreign producers, who have substantially modernized their industrial plants in the Post War II years.

(2) Concern about reducing employment through labor saving outlays is unfounded. Improved technology leads to more, rather than fewer, jobs overall. The investment tax credit, resulting in increased productivity, would accommodate wage increases in the future which would not be inflationary. Moreover, the added plant facilities would increase employment.

(3) In the process of increasing capital expenditures, the investment tax credit will reduce the relative need for external corporate financing. This would tend to reduce some of the pressure on credit markets generated by the anticipated expansion in capital spending.

The credit has generally proven successful in fostering business investment in productive equipment. If the credit is made available, and we strongly urge that it should be, we recommend it remain as a permanent measure. We believe this would encourage a steadier flow of business investment, avoiding some of the gyrations in business capital spending due, in part, to an on again, off again, policy.

DOMESTIC INTERNATIONAL SALES CORPORATIONS

The Administration has proposed the adoption of a provision for domestic international sales corporations, commonly referred to as DISC's. A similar program was proposed last year and was passed by the House, but not by the Senate.

Under the program, Domestic International Sales Corporations would be established and the profits from their sales would not be taxed until they are distributed to shareholders. To qualify for tax deferral, at least 95 percent of the gross receipts of the company must arise from export related transactions and 95 percent of its assets must also be so related.

The DISC program is a tool for improving our balance of payments and provides a positive complement to the more negative 10 percent import surcharge. In fact, if the DISC program is implemented promptly, it could, along with exchange rate adjustments, improve our balance of payments and therefore help to speed the removal of the 10 percent surtax on imports.

The DISC program would be consistent with international practice and would help to redress the competitive imbalance which U.S. companies face in international trade under prevailing tax laws.

While it is true that this would entail a short-run reduction in revenue, in the long run, the program could pay for itself through increased domestic economic activity producing added tax revenues.

U.S. firms have greatly increased their manufacturing capacity abroad over the past 20 years. In the long run, the DISC program may result in decisions to locate new investment facilities at home, rather than abroad. Thus, the passage of the DISC program would give both a psychological and a real boost to export business.

We are concerned, however, that the House has limited the tax deferral provision to increments of export sales above 75 percent of a base period (1968–1970) average, rather than applying the deferral to all DISC exports, as in the Administration proposal. While on first consideration this might appear to be a sound modification, we believe it would weaken the program. It would provide little, if any, incentive to many firms which have had a declining trend in their exports sales, and are now operating well under the 75 percent of base period floor. Moreover, it would discriminate against exporters who have made the greatest effort to increase exports during the past three years, in large part through the Commerce Department's voluntary export expansion programs.

PROVISIONS RELATING TO TRUSTS

Section 301 of the bill as it passed the House would add a new Section (280) to the Internal Revenue Code. This new section would provide that an individual receiving certain trust income is not to be able to use his personal exemption or the standard deduction to offset income received by him from the trust. The House report in discussing this section states:

"These provisions will also apply to income 'throwback' under the accumulation trust provisions (Section 665-669 of the Code) . . . These provisions require recomputation of the beneficiaries tax for one or more of his prior taxable years. If, in such prior taxable year, this provision wold have applied had the trust income been distributed currently, it will also apply to the recomputation under the throwback rules."

Subsection (a) of proposed section 280 is not in accord with this statement because it only applies to a year in which the beneficiary "is required under subchapter J to include in his gross income any amount of income of a trust." When a throwback is involed, the entire amount of the throwback attributable to prior years is, under section 668(a), included in the gross income of the beneficiary for the year of the accumulation distribution. The beneficiary then proceeds to recompute his tax for the current year as if he had received the income in the year it was earned and accumulated by the trust, but no actual inclusion in gross income under subchapter J for preceding years is involved. Accordingly, the denials provided for in section 280 would apply for the year of the accumulation distribution but would not effect the beneficiary's computation of tax for a prior year under the exact or short-cut method.

We suggest the most satisfactory and direct way to cure this problem would be to change the provisions of Subpart D of Subchapter J dealing with the computation of a beneficiary's tax for a prior year under both the exact and short-cut methods.

Section 306 of the bill would amend section 665-(g) of the Code to make it clear that for the purpose of the capital gains throwback rule a "capital gain distribution" for a taxable year includes the total undistributed capital gains for all years of the trust beginning after December 31, 1968 and ending before the year of distribution.

We do not object to this technical clarification of the capital gain throwback rule but we are concerned that it could be construed as a reaffirmation of Congressional approval of the capital gain throwback concept. When the 1969 Tax Reform Act was before the Senate an amendment was adopted which postponed the effective date of the unlimited throwback rule provisions, except in the case of multiple trusts, until January 1, 1972, in order to permit further study of the entire accumulation trust provisions. In Conference, this delay provision was limited to capital gain tthrowback rules only. The adoption of this delay provision contained in Section 331(d)(2)(C) is indicative of a Congressional intent to review the capital gain throwback provisions before they become effective. Although there have been discussions of these provisions with Treasury officials and with staff members of the Joint Committee on Internal Revenue Taxation, the Congress has not had an opportunity to review them. Because of the heavy Congressional program for the rest of the year it is unlikely that the capital gain throwback rules can be considered by Congress. Accordingly we urge that the effective date of the capital gain throwback rules be postponed one more year to December 31, 1972.

CONCLUSION

To sum up, with the above recommended changes in the trust provisions, The American Bankers Association supports the enactment of H.R. 10947.

The President's tax package, embodied for the most part in this bill, will foster consumer confidence and will make an important contribution to the modernization of our productive capacity. These steps will improve our balance of payments prospects and will help to spur our domestic economy. However, greater stimulation in the form of tax reduction, particularly in the personal income area, raises the danger of unleashing inflationary forces too strong for the Phase II program to overcome. Therefore, it would be wise to remain within the tax boundaries embodied in H.R. 10947. Those provisions, together with other actions the President has taken, will help to bring about the full range of economic results we all desire.

Sincerely,

CLIFFORD C. SOMMER, *President.*

AUSTRIAN TRADE DELEGATE IN THE UNITED STATES,[1]
Washington, D.C., October 15, 1971.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee
Washington, D.C.

DEAR MR. CHAIRMAN: This statement is submitted on behalf of The Austrian Trade Delegate in the United States*, 845 Third Avenue, New York, New York, to comment upon the Investment Tax Credit as contained in H.R. 10947 (Proposed Revenue Act of 1971), one of the tax proposals presented by the Secretary of the Treasury to this Committee at a hearing which commenced on October 7, 1971. Specifically, we wish to oppose limiting the proposed Job Development Credit (investment credit) to the purchase of domestic products. As the proposal now exists, no credit would be allowed for foreign produced capital goods as long as the temporary import surcharge is in effect, and upon removal of the surcharge, the credit would be allowed only for such foreign goods ordered after the removal. Under H.R. 10947, the President is afforded very limited powers to waive this "Buy American" provision.

We submit that this "Buy American" aspect of the investment credit is objectionable for many reasons, perhaps the most important of which is that, if enacted, this provision would be inconsistent with the treaties of Friendship, Commerce and Navigation or Consular Rights that this country has entered with many countries, as well as with Austria. This also raises serious questions under the General Agreement on Tariffs and Trade. At a time when the United States is actively seeking the removal, by other countries, of trade barriers to United States exports, it is incongruous that she should seek to erect a new non-tariff barrier of her own which could well lead to an adverse effect on mutual trade interests and thus hinder the American capital goods industry, a traditionally net exporting sector of United States business.

From a purely economic point of view the provision seems to be disputable. With the surcharge in effect and the dollar depreciating abroad, the United States capital goods industry is already being significantly stimulated. The investment credit, without the "Buy American" provision to which we are opposed, would be a further stimulus as it would create more United States jobs and promote further United States productivity. The investment credit provision enacted by Congress in 1962 proved this to be true as it provided substantial stimulation to the United States economy without such a "Buy American" provision and without the stimulation of the other competitive advantages, i.e. the surcharge and the dollar depreciation, that are present now by virtue of the President's new economic program.

If the Administration wishes, as it claims, to promote the modernization of American industry, it is only logical to facilitate that modernization by making available to American industry the most advanced equipment at the least possible cost, regardless of the country of manufacture of the equipment. To do otherwise, that is to discourage American producers from buying foreign machinery, and thereby hinder competition, is to create substantial inflationary pressures at the very time when the Administration is seeking to dampen such pressures.

Finally, in many sections of the United States capital goods industry there is insufficient capacity to meet demand. In such instances the effect of the "Buy American" provision would be twofold:

First, it would eliminate the incentive of United States industries who rely on foreign capital goods to invest in such goods at the present time, postponing their purchases until either domestic supplies become available or the import surcharge is removed. This would effectively postpone the increase in employment that would be created by the increased economic activity generated by the purchase of new machinery and thus would frustrate United States economic growth.

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[1] The Austrian Trade Delegate in the United States is a part of and represents The Austrian Federal Economic Chamber of Commerce, Vienna, Austria.

This material is prepared, edited, issued or circulated by Max N. Berry, 888 17th Street, N.W., Washington, D.C., who is registered under the Foreign Agents Registration Act of 1938, as amended, as an agent of The Austrian Trade Delegate in the United States, 845 Third Avenue, New York, New York. This material is filed with the Department of Justice where the required registration statement is available for public inspection. Registration does not indicate approval of this material by the United States Government.

Second, in cases where a limited domestic supply exists, the provision would create a competitive disparity between those who are able to obtain new machinery with the investment credit advantage and those who are not. Most of all, what is of particular concern to the Austrian machine industry is that it would most likely penalize custom-made Austrian machinery, tailored for a particular United States industry, which might not otherwise be available in the United States.

For the above reasons, we urge that the Committee eliminate the "Buy American" provision from the proposed Job Development Credit.

The Committee's consideration of these views is appreciated. We request that these comments be incorporated in the Committee's published hearings on H.R. 10947.

Sincerely yours,

MAX N BERRY, *Attorney at Law*.

MANUFACTURING CHEMISTS ASSOCIATION,
Washington, D.C., October 14, 1971.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: In your press release of October 4, 1971 you announced that the Committee on Finance would conduct hearings on H.R. 10947, the Revenue Act of 1971, at which public witnesses would have an opportunity to testify. On behalf of the Manufacturing Chemists Association, I wish to submit written comments to you on this legislative proposal. The Manufacturing Chemists Association is a nonprofit trade association of 166 United States company members representing more than 90 percent of the production capacity of basic industrial chemicals within this country. I respectfully request that this letter, setting forth the views of this Association, be made a part of the official record of the hearings of your Committee on H.R. 10947.

This Association strongly endorses the President's four-point tax program which would restore the investment tax credit, establish a domestic international sales corporation, accelerate certain tax cuts, and eliminate the auto excise tax. The President's proposals are substantially reflected in H.R. 10947 and, with certain modifications discussed below, the Manufacturing Chemists Association recommends enactment of this measure. We believe that early implementation of this program is esential to stimulate the economy, create more jobs for American workers, increase exports, and contribute to a more healthy balance of payments situation.

In a letter addressed to you dated July 21, 1971, this Association urged that your Committee give favorable consideration to the restoration of the 7 percent investment tax credit which was repealed in the Tax Reform Act of 1969. We pointed out in our letter that a tax credit would contribute to substantially higher employment levels in the United States, assist American companies to meet foreign competition, and insure the growth of national productivity and efficiency.

The "Job Development Credit" contained in Title I of H.R. 10947 is similar to our recommendation and is highly desirable. The enactment of this measure would encourage replacement of obsolete production machinery which entails a cost substantially in excess of depreciation reserves. Modernization of manufacturing facilities is urgently needed to raise the productivity and efficiency of our industrial complex, and to strengthen the competitive position of American industry at home and abroad. Continuing gains in productivity and constant modernization of our factories will encourage new economic activities, widen employment opportunities, and thereby reduce much of the present unemployment.

The most effective way to halt inflation is to increase the supply of available goods and services over and above demand, to modernize and replace obsolete plant and equipment, and thus to cut the unit costs of production. This would result in lower selling prices ensuing as a natural result of competition and, in addition, would permit industry to grant non-inflationary wage increases.

I 1969, during the tax reform hearings, this Association testified that the removal of the investment tax credit would place American companies at a disadvantage in international trade. It is our considered opinion that the repeal of this credit weakened the competitive position of American industry in the international marketplace with unfortunate consequences to our balance of payments. It also made U.S. industry less competitive against imports.

The investment credit is needed now more than ever to enable American industry to compete effectively with foreign manufacturers. Foreign producers have historically had the competitive advantage of cheap labor which we managed to counterbalance through more efficient machines and equipment. But foreign producers now have modern machines also, as well as low-wage labor, and their governments grant tax credits and other benefits to encourage the most up-to-date, efficient production facilities.

Early restoration of the investment tax credit as a permanent part of the tax structure should help remedy this situation and stimulate the economy by providing the necessary incentives for increased capital investment in production facilities. We stress "permanent" because we feel strongly that the investment credit should not be used as a temporary or stopgap measure to control economic fluctuations. In the capital-intensive and technologically sensitive chemical manufacturing industry, plant replacement, modernization, and expanison require continuous long-range planning which canot be effectively carried out if an on-again, off-again tax policy is pursued by the Federal Government.

We wish to suggest certain changes in Title I of H.R. 10947 in order to enhance the effectiveness of the investment tax credit.

We note the recommendation made to this Committee by the Secretary of the Treasury on October 7 that the investment credit be established at a 10 percent level for one year, to be followed by a permanent 7 percent credit. We heartily endorse this proposal and concur in the supporting reasoning given by the Secretary. However, in view of the long lead time required between commencement and completion of chemical facilities, we suggest that a "plant facility rule" similar in concept to the one provided for in existing investment credit provisions of the IRC be included as a part of the legislation. Otherwise, the temporary 10 percent credit would be of very limited value to the chemical industry.

Section 101 of the bill, which provides for the restoration of the investment credit, contains a transitional rule which states that: "In the case of property the construction, reconstruction, or erection of which is begun before April 1, 1971, and completed after August 15, 1971, there shall be taken into account only that portion of the basis which is properly attributable to construction, reconstruction, or erection after August 15, 1971." On the other hand, property acquired after March 31, 1971 pursuant to an order placed after that date qualifies in its entirety. We therefore recommend that this transitional rule be modified to provide that the credit be applicable to construction, reconstruction, or erection completed on or after April 1, 1971.

When the investment credit was first under consideration in 1961, the Administration at that time recommended that it apply to all property acquired in 1961 even though the proposal was made by the President for the first time on April 20 of that year. When the Revenue Act of 1962 was finally enacted on October 16, 1962, the investment credit covered the entire year 1962. Similarly, with respect to this proposal, we believe that a single overall date should be adopted and that it be April 1, 1971. This was the date publicly referred to by the Secretary of the Treasury, John B. Connally, and several Congressional leaders. Based upon this past practice, taxpayers reasonably assume that the promised April 1 date would be the date after which all property constructed would qualify.

We strongly endorse the incorporation of the provisions relating to the Asset Depreciation Range (ADR) System as a part of this legislation. We believe that both ADR and the investment credit are necessary in order to make American industry competitive with its foreign counterparts by bringing capital cost allowances in the U.S. more in line with those adopted in many industrialized countries of the world. This is clearly illustrated in Table I of Secretary Connally's statement.

We note with regret the elimination of the so-called three-quarter year convention from ADR. The effect of this action nullifies considerably the intended effect of the adoption of the investment credit by actually increasing the tax burden of business in Calendar year 1971. The elimination of this special one-year convention makes the adoption of the April 1 date, as discussed above, even more compelling as it would extend more equitable treatment to those taxpayers who accelerated their projects to take advantage of this convention.

We approve the action taken by the House Ways and Means Committee in not requiring a reduction in the basis of the property for the amoun tof the investment credit taken. As you know, this adjustment which was required by the 1962 Revenue Act, was repealed in 1964. Your Committee Report in 1964 pointed out that his basis adjustment severely restricted the incentive effect of the investment credit by converting the 7 percent to a 3½ percent credit. Additionally, the adjustment caused many record keeping problems for taxpayers, especially in the case of early retirement, and also severely complicated the statutory language of the investment credit provisions. We believe that those reasons are still as valid today as in 1964 and urge your Committee to refrain from adopting a provision requiring a reduction in the basis of property.

During the hearings conducted by your Committee on foreign trade legislation last year, the Manufacturing Chemists Association urged adoption of the Administration's Domestic International Sales Corporation (DISC) proposal.

There are substantial differences in taxation systems and practices among the major industrial nations. A significant effect of these differences is an economic trade advantage for those exports accorded relatively more favorable tax treatment. Economic studies and trade analyses conducted in the chemical industry have led us to the conclusion that foreign chemical exports, in comparison with United States chemical exports, currently enjoy a trade advantage arising from more favorable tax treatment. We believe that United States industrial products, in general, are similarly disadvantaged. This competitive disadvantage tends to discourage existing American exporters from increasing efforts to expand exports as well as to deter others from entering the export market. The DISC proposal has been designed to reduce this disadvantage and would, we believe, encourage export operations of American companies by providing for a deferral of Federal income tax on export profits of domestic manufacturers.

We expressed the opinion to your Committee at the trade hearings last year that the DISC proposal was desirable from the point of view that it would strengthen the U.S. export position at a time when U.S. exports were failing to grow apace with imports. This becomes even more pertinent today in view of the fact that the United States has now incurred an overall trade deficit for the first time in many years.

The DISC provision contained in H.R. 10947 differs from and restricts the Treasury proposal by applying an incremental concept which would permit deferral of export earnings only with respect to the taxable income attributable to export sales which exceed 75 percent of the average amount of export sales for a base period 1968 through 1970. We believe that this new concept would so reduce the DISC benefits that it would not relieve the unfavorable differences in taxation systems as between the U.S. and major industrial nations.

It might also be pointed out that, since the new proposal in H.R. 10947 applies primarily to increases in export sales, it favors those companies which have not heretofore been engaged in exporting over those companies which have continually marketed their goods abroad. We believe this result treats unfairly existing exporters. As Secretary Connally so clearly stated in his remarks to this Committee:

"The incremental approach gives rise to very serious inequities. It penalizes those corporations who made substantial efforts to maintain or boost their exports in the base period years, while favoring those who did not do so, thus creating disparities between companies directly competing with one another, some of which will get the benefits of tax deferral and some of which will not."

While DISC has been proposed primarily as an incentive for increasing exports, it is equally needed to prevent a reduction in the present level of exports. With increased competition in foreign markets from resurgent foreign industries which receive favorable tax treatment of export income, many U.S. companies are hard-pressed to retain their present level of exports.

For the foregoing reasons, we strongly recommend that the original concept embodied in the DISC proposal be adopted.

We sincerely appreciate the opportunity to inform your Committee of the Association's support for H.R. 10947 subject to the changes we have recommended. It is our firm belief that adoption of this package will strengthen the national economy, expand employment opportunities for American workers, and improve the competitive position of U.S. industry in world trade. Accordingly, we strongly recommend that your Committee take early and favorable action on these proposals.

Sincerely,

W. J. DRIVER.

AMERICAN GAS ASSOCIATION,
Arlington, Va., October 15, 1971.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

JOB DEVELOPMENT TAX CREDIT

DEAR MR. CHAIRMAN: These comments are submitted on behalf of the American Gas Association which is a non-profit trade association, representing natural gas companies which serve the gas requirements of about 92 percent of the ultimate gas consumers in this country. Gas is used for industrial and commercial purposes, as well as residential. It is an essential fuel for thousands of industrial processes, highly important and consistently preferred for many commercial uses and is a premium, economical, clean, safe fuel for major household uses. Gas powers 43 percent of industry in the United States, including some 28 percent of the nation's electric power. Gas presently serves more than 42,000,000 meters through 900,000 miles of pipelines in all 50 states. This national network of pipes and mains with a total investment of $46 billion serves some 150,000,000 of our population. The use of gas for space heating, water heating, and cooking, to mention only the more important residential uses, is vital to the comfort and health of most of these people.

The gas industry now employs some 210,000 people and the industry's ability to obtain adequate gas supplies and render vital services are very significant factors in contributing to the nation's economic expansion and the creation of new jobs—not only new jobs in the gas industry, but new jobs in all industries.

SUMMARY OF ASSOCIATION'S POSITION

(1) The Association supports the Job Development Tax Credit proposal.

(2) The general endorsement of the proposal should not, however, be construed as acceptance of any principle that members of the Association should not be given the same incentive to create and develop jobs as is given to other industries. The increase in H.R. 10947 to 4% over the 3% recommended by the Treasury is a step in the right direction; we urge your Committee to increase the investment credit for regulated utilities to the full 7% allowed all other sectors of the economy.

(3) The legislation should make unequivocally clear that the tax credit is not to be passed on to the consumer in the form of lower rates by the action of regulatory agencies. It should be clear that the credit is to be used to aid in financing the construction of job producing and service performing facilities. If the regulated industries are to create jobs, they must retain the entire benefit; otherwise the purpose of the Job Development Credit is frustrated.

(4) The legislation should give gas companies the incentive to construct non-conventional facilities for production of alternative gas supplies in order to meet an increasing demand for gas in the face of an increasingly tight supply situation. These investments, not being of the traditional utility type, should give rise to the full tax credit and the legislation should so provide.

(5) The Association supports the unified system of class lives which may be elected by taxpayers for assets placed in service after 1970 for the purpose of determining the reasonable allowance for depreciation and the repair allowance.

ENDORSEMENT OF JOB DEVELOPMENT TAX CREDIT

Along with the vast majority of the American people, member companies of this Association have committed themselves to carrying out the spirit, as well as the letter, of President Nixon's recent economic proposals for combating inflation.

Rapid and continuing inflation such as our nation has experienced in recent years is particularly difficult for utilities whose charges and rates of return are limited by federal and state regulatory agencies. Accordingly, the Association wholeheartedly endorses programs designed to promote real economic progress and to reduce the financial hardships borne by literally millions of citizens as a result of inflation.

American industry must continually modernize and expand in order to increase the productivity of the American worker, to create new jobs, and to permit our nation to compete in the world's markets. We understand that because of the

President's desire to create a strong incentive for industry to accomplish these goals as quickly as possible, he has recommended prompt enactment of the Job Development Credit which is similar to the Investment Tax Credit enacted by the Congress in 1962 and amended in 1964. Recognizing the need for prompt action, the Association endorses the program.

NEED FOR FULL INCENTIVE FOR GAS COMPANIES TO DEVELOP JOBS

Even though we recognize the need for prompt action, the Association would be remiss, however, if it failed to express disappointment and concern that there is a failure in H.R. 10947 as passed by the House of Representatives to recognize the substantially different situation confronting gas companies in 1971, as distinguished from 1962. This different situation fully justifies the same tax credit for gas companies as proposed for other segments of the business community.

In brief, some of the current factors calling for a full investment credit are:

(1) The tremendous increase in the demand for gas service to meet the accelerating needs of industry for gas, resulting from the increased emphasis on the use of clean energy by all segments of our people;

(2) The extensive capital investments required to satisfy such demands;

(3) The ever-escalating costs for construction and materials;

(4) The escalating cost of gas supply; and

(5) The emphasis on matters of ecology and public safety which has required additional expenditures of substantial amounts in excess of normal operating requirements—most of which expenditures will not contribute new revenue but will substantially increase capital costs.

Probably the most significant factor is the circumstances that in many areas of our country gas companies do not have sufficient gas at this time to meet the full demands of their market. Thus, more and more capital must be expended in the effort to correct this gas supply situation. The full tax credit would assist in this effort and result in developing jobs to help alleviate the gas supply crisis.

For these reasons the Association's support of the proposed Job Development Tax Credit should not be construed as acceptance of the principle that gas companies do not need the full amount of the credit as an incentive to develop jobs and to meet the gas supply crisis.

The Association earnestly requests the Committee on Finance to extend the full credit to gas companies.

NEED TO KEEP THE TAX CREDIT TO DEVELOP JOBS RATHER THAN USING THE TAX CREDIT TO REDUCE RATES

The legislation should make unequivocally clear that the Job Development Tax Credit is to be used to aid in financing the construction of job-producing facilities. Therefore, to the extent that the member companies of this Association have a Job Development Tax Credit available, it should be made clear that this tax credit is not to be passed on to the consumer in the form of lower rates but is to be available to the companies for financing job-producing facilities. Regulatory agencies, both federal and state, should not be allowed to defeat the objective of the legislation by converting the Job Development Tax Credit into a rate reduction for gas customers. Lower rates may be desirable to the consumer; however, they will create no jobs.

The Ways and Means Committee report at page 24 indicates that the Committee considered it "appropriate to divide the benefits of the credit between the customers of the regulated industries and the investors in the regulated industries". No reason is suggested why it is appropriate to treat regulated utilities in a manner different from unregulated industry. We believe that the critical shortage of natural gas is a compelling reason to give the regulated gas companies the full benefit of the credit in order to induce them to create jobs in the business of developing new sources of gas supply and insuring the earliest distribution of this clean fuel to the many industrial users who expect it to solve at least a part of their pollution problems.

NEED FOR FULL CREDIT TO DEVELOP NEW SUPPLY FACILITIES

As suggested above, new conditions are confronting the gas industry. With the present shortage of gas from historical or conventional sources, many companies are considering the construction of new types of facilities to augment their gas supply. These facilities include plants to liquefy natural gas for convenient storage during periods of low demand, plants to reform or synthesize streams of liquid hydrocarbons into synthetic natural gas, and plants to produce gas from coal. A reforming plant with a capacity of 250,000 Mcf per day will cost many millions of dollars and will create a substantial number of jobs. A coal gasification plant will cost some $200 million and will create more jobs. Plants of this kind would qualify for the full tax credit if undertaken by a non-utility with the sale of the synthetic natural gas to the utility. Logically, this type of plant, if constructed and operated by a gas company, should likewise qualify for the full tax credit. This is particularly true since some of these plants probably will be constructed by non-utility companies who will receive the full tax credit. The gas companies constructing such plants should not be put at a competitive disadvantage with respect to the tax credit. In addition to the job developing aspects, every reasonable incentive should be provided for meeting the sharply escalating enery needs so essential for economic expansion. Natural gas and synthetic gas serve as that form of energy most compatible with our growing environmental concerns.

The Association respectfully requests that your Committee make clear that investments in such facilities as these constructed by gas companies for storing gas and for producing synthetic gas should be allowed the full tax credit of 7% rather than the 4% now proposed.

ENDORSEMENT OF REVISION IN CODE PROVISIONS FOR REASONABLE ALLOWANCE FOR DEPRECIATION AND REPAIRS

The Association has noted with satisfaction that H.R. 10947, as passed by the House, seeks to put at rest the controversy that arose over the Treasury's authority to issue regulations providing for the Asset Depreciation Range System. This would be accomplished by establishing a new unified system of class lives and allowing the Treasury to permit taxpayers to use a useful life for one or more classes of property which varies from the class life by up to 20 percent. The proposal also establishes standards for the determination of the deduction allowable for repairs. The Association endorses these provisions of H.R. 10947 and urges your Committee to adopt them and to insure that the variation now in the proposal remains at 20 percent.

We would be pleased to answer any questions suggested by the foregoing at the convenience of the Committee or its Staff.

Very truly yours,

F. DONALD HART.

EMERGENCY COMMITTEE FOR AMERICAN TRADE,
Washington, D.C., October 15, 1971.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance, U.S. Senate, Old Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: We regret that your schedule did not allow an opportunity for the Emergency Committee for American Trade (ECAT) to appear before your Committee in its current hearing on H.R. 10947.

I am enclosing copies of the statement that ECAT submitted to Chairman Mills of the House Ways and Means Committee on the items of interest to ECAT contained in H.R. 10947. I respectfully request that a copy of our statement to Mr. Mills be included in the record of your Committee's present hearing.

Sincerely,

ROBERT L. MCNEILL,
Executive Vice Chairman.

EMERGENCY COMMITTEE FOR AMERICAN TRADE,
Washington, D.C., September 17, 1971.

Hon. WILBUR D. MILLS,
Chairman, Committee on Ways and Means, U.S. House of Representatives, Longworth House Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: When President Nixon announced his economic measures on August 15, the Emergency Committee for American Trade (ECAT) issued a statement on the import surcharge in response to queries from the press.

This statement, a copy of which is attached, recognized the need for the President's program and his objective of improving the competitiveness of American goods. It also emphasized the importance of early international consultation and coordination concerning the new economic measures so that the surcharge could be rescinded at an early date. This concern about early removal of the surcharge reflects the view of ECAT members that new restrictions on trade can get out of hand despite all good intentions and lead to spiralling retaliations, culminating in a world trade war that is in the interest of no one. It is part of the purpose of ECAT to help prevent that from happening.

We find in the legislative proposals of the Administration two matters that concern us greatly. They are the Domestic International Sales Corporation (DISC) and the so-called "Buy American" provisions of the Job Development Credit proposal.

The DISC recommendations receive our wholehearted support. ECAT has endorsed the concept embodied in DISC in its testimony of May 18, 1970 before your Committee. We said at the time: "We strongly recommend vigorous and even costly action to improve the export side of the trade equation." The arguments for and against the DISC export incentive plan have been put forward frequently in a number of forums, most notably in your Committee. We believe that in the present context in which nations may be prone to emphasize the import side of the equation, this recommendation addressed to the export side is more compelling than ever.

We are quite sure that action of this nature would be far more acceptable to our trading partners in GATT than the continuation of old trade restrictions or the imposition and continuation of new ones. It is quite clear that other nations employ methods similar in purpose to those embodied in the DISC proposals. Many European countries, for example, rebate internal indirect taxes on products that are exported.

Just as we firmly support the DISC as an export generating device, we have great reservations about the trade curtailment provisions embodied in the Administration's Job Development Credit recommendations. And we understand the proposed arrangement, imports would be excluded from the very broad range of capital equipment eligible for tax credit purposes as long as the import surcharge remained in effect. The economic wisdom of this proposed exclusion is most questionable, particularly as it would seem to derogate from the Job Development Credit's purposes of raising U.S. productivity and increasing U.S. competitiveness internationally. It seems further questionable to impose import restrictions on products when the official statistics of the United States on pages seven and eight, eleven and twelve, fourteen, fifteen, and sixteen of the enclosed United States Department of Commerce publication, "Overseas Business Report" (OBR 71-009) issued February, 1971 show enormous trade surpluses in capital equipment. The enclosed table lists by country and region where some of these balance of trade surpluses are earned.

It is easy to understand the Administration's desire to strengthen its hand in bringing about reform in international monetary matters, but we believe, particularly in light of our competitive advantages, that this proposal will have the effect of (1) being so distasteful to those trading nations which have treated American products fairly that we will lose much-needed goodwill and support in pursuit of our current international economic objectives and (2) the example set by this measure will be seized upon by trading nations whose proclivities are already protectionist as a rationale for locking in their own practices of discrimination in favor of domestic producers.

In this connection, we suggest that the constructive approaches to government procurement policies recommended by the President's Commission on International Trade and Investment and made public earlier this week would be made most difficult by even temporary restrictive actions by the United States.

Sincerely,

DONALD M. KENDALL, *Chairman.*

EMERGENCY COMMITTEE FOR AMERICAN TRADE,
Washington, D.C., August 16, 1971.

STATEMENT BY DONALD M. KENDALL, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, PEPSICO, INC., CHAIRMAN, EMERGENCY COMMITTEE FOR AMERICAN TRADE

ECAT regrets that the President has determined that conditions require a temporary ten percent surtax on imports.

Hopefully, the surtax will be short-lived and will meet the Administration's expectations of improving the competitive position of American goods.

ECAT further hopes that our trading partners will not retaliate or take other recriminatory actions because of the surtax. We urge the Administration and other governments to enter into immediate consultations using such institutions as GATT and the IMF to facilitate understanding and cooperation.

Although the tax is to be temporary, it can lead to inequities and undue burdens both to American consumers and to foreign suppliers. These should also be the subject of scrutiny and negotiation and action when necessary.

U.S. TRADE WITH MAJOR TRADING PARTNERS CAPITAL GOODS INCLUDING TRUCKS AND BUSES

[In millions of dollars]

	1966	1969	1970	Percent United States 1970 total
Australia:				
Exports	307.0	444.3	490.5	3
Imports	2.8	6.0	7.5	(*)
Canada:				
Exports	2,278.3	2,825.0	2,793.5	19
Imports	629.5	1,384.1	1,481.8	33
Belgium-Luxembourg:				
Exports	190.3	311.9	409.1	3
Imports	49.5	62.4	75.9	2
France:				
Exports	447.8	618.0	748.2	5
Imports	110.7	128.1	137.7	3
Germany (FDR):				
Exports	488.7	746.1	1,031.1	7
Imports	358.9	417.7	666.8	15
Italy:				
Exports	210.2	445.6	468.1	3
Imports	89.8	158.1	176.8	4
Netherlands:				
Exports	220.5	338.4	392.3	3
Imports	42.4	65.4	74.4	2
EEC total:				
Exports	(1,557.5)	(2,460.0)	(3,048.8)	(21)
Imports	(651.3)	(831.7)	(1,131.6)	(26)
United Kingdom:				
Exports	548.0	804.2	1,071.9	7
Imports	451.7	475.3	502.7	11
Japan:				
Exports	464.8	853.2	1,201.3	8
Imports	282.2	613.3	658.2	15
Total:				
Exports	5,155.6	7,386.7	8,606.0	58
Imports	2,017.5	3,310.4	3,781.8	85

Source: U.S. Department of Commerce "Overseas Business Report—July 1971."

TABLE 7.—U.S. EXPORTS OF SELECTED END-USE CATEGORIES

[Value in millions of dollars]

Commodity	1964	1965	1966	1967	1968	1969	1970
Exports, total	26,650	27,521	30,430	31,622	34,636	38,006	43,226
Foods, feeds, and beverages	4,849	4,928	5,489	4,998	4,813	4,688	5,826
Wheat and wheat flour	1,533	1,185	1,536	1,207	1,101	831	1,112
Rice	206	245	230	316	348	348	306
Other grains and preparations	1,137	1,471	1,738	1,474	1,373	1,337	1,640
Fruits, vegetables, and preparations	435	468	489	472	447	504	524
Soybeans	567	650	760	772	810	822	1,216
Other agricultural foods and beverages	906	837	651	667	653	733	904
Fish and other nonagricultural food and beverages	65	71	85	91	82	113	124
Industrial supplies and materials	9,185	8,917	9,613	9,971	11,004	11,756	13,767
Agricultural supplies and materials	1,564	1,377	1,473	1,476	1,500	1,364	1,476
Raw cotton, including linters	690	495	440	470	466	286	378
Unmanufactured tobacco	413	383	482	498	524	540	488
Other agricultural supplies and materials	461	499	551	508	510	538	610

TABLE 7.—U.S. EXPORTS OF SELECTED END-USE CATEGORIES—Continued

[Value in millions of dollars]

Commodity	1964	1965	1966	1967	1968	1969	1970
Fuels and lubricants	946	948	977	1,106	1,052	1,132	1,596
Iron ore, pig iron, and iron and steel scrap	333	283	270	324	275	371	547
Iron and steel	781	759	699	702	740	1,127	1,389
Nonferrous ores, metal, and scrap	822	767	876	844	1,164	1,240	1,444
Aluminum	192	174	190	207	196	316	352
Copper and alloys	280	338	332	262	398	326	494
Silver	141	51	111	96	247	157	49
Other nonferrous	209	204	243	279	323	441	549
Finished metal shapes	243	298	339	356	368	391	428
Logs, lumber, plywood, millwork, and copperage	257	298	330	402	499	566	645
Paper base stocks, paper, and products	597	594	666	722	828	906	1,137
Plastic and synthetic resin materials	366	392	433	437	545	545	604
Fertilizers and insecticides	328	358	486	534	628	529	502
Industrial chemicals, unfinished	909	869	911	959	1,129	1,214	1,410
Industrial chemicals, finished	387	330	370	383	462	453	542
Textile yarn, waste, and manmade fibers	281	248	249	227	242	288	307
Fabrics and other textile materials	371	328	345	335	314	349	366
Other nonagricultural supplies	998	1,070	1,188	1,163	1,258	1,281	1,373
Capital goods including trucks and buses	7,820	8,375	9,259	10,325	11,504	12,878	14,926
Machinery	6,399	6,796	7,527	8,115	8,642	9,992	11,564
Electrical machinery other than consumer type	1,179	1,144	1,279	1,426	1,557	1,856	2,078
Mining, drilling, and related processing equipment	247	285	302	334	368	409	488
Excavating and paving machinery	600	592	608	657	685	759	831
Non-farm tractors, parts, and attachments	408	431	425	404	473	512	584
Power generating machinery other than engines for aircraft and autos	369	430	469	474	524	582	614
Machine tools and metalworking machinery	522	440	458	463	468	485	572
Other specialized industrial machinery	628	634	677	673	709	795	931
Commercial air-conditioning, refrigerating, and central heating equipment	156	167	192	211	237	279	320

TABLE 8.—U.S. GENERAL IMPORTS OF SELECTED END-USE CATEGORIES

[Value in millions of dollars]

Commodity	1964	1965 [1]	1966	1967	1968	1969	1970
Imports, total	18,749	21,427	25,618	26,889	33,226	36,043	39,963
Foods, feeds, and beverages	3,915	3,946	4,499	4,586	5,271	5,238	6,158
Green coffee	1,197	1,062	1,067	963	1,140	894	1,160
Sugar	458	443	501	588	640	638	729
Meat products and poultry	424	445	617	662	765	885	1,037
Fish and shellfish	425	472	552	520	629	690	791
Fruits, nuts, and preparations	309	356	391	384	465	452	472
Whiskey and other alcoholic beverages	387	430	497	528	626	648	725
Other foods, feeds, and beverages	715	739	874	941	1,006	1,031	1,244

TABLE 8.—U.S. GENERAL IMPORTS OF SELECTED END-USE CATEGORIES—Continued

[Value in millions of dollars]

Commodity	1964	1965 [1]	1966	1967	1968	1969	1970
Industrial supplies and materials	9,563	11,024	12,162	11,856	14,159	14,159	15,117
Fuels and lubricants	2,015	2,212	2,247	2,233	2,509	2,777	3,053
Paper and paper base stocks	1,227	1,301	1,448	1,386	1,431	1,595	1,578
Materials for nondurable goods production, n.e.s	2,084	2,368	2,644	2,371	2,749	2,658	2,866
Textile fibers and yarns	468	517	553	394	472	366	429
Fabrics and twine	541	645	690	621	708	776	780
Hides, skins, and leather	247	273	310	233	281	264	210
Tobacco, unmanufactured	142	123	137	162	148	117	111
Industrial chemicals	231	295	399	399	506	527	600
Fertilizers, seed, and other farm materials	159	184	207	215	216	220	292
Other materials	293	332	349	346	417	388	444
Building materials other than metals	705	722	784	754	1,072	1,187	1,[illegible]6
Materials for durable goods production	3,533	4,421	5,048	5,112	6,398	5,942	6,603
Iron ore, scrap, and ferro-alloys	602	679	758	687	673	649	734
Iron and steel	825	1,273	1,312	1,422	2,123	1,914	2,093
Nonferrous ores, metal, and scrap	1,298	1,592	1,882	1,939	2,335	1,992	2,183
Aluminum	343	430	490	456	575	543	553
Copper	355	361	503	564	696	411	435
Lead	68	86	110	118	101	100	102
Nickel	181	226	206	244	276	279	403
Tin	113	174	165	175	188	186	202
Zinc	78	106	150	136	152	171	154
Silver	64	63	76	77	138	120	104
Other nonferrous	106	146	183	171	209	182	230
Finished metal shapes	164	215	347	320	399	368	464
Other materials	642	661	749	744	869	1,019	1,129
Capital goods including trucks and buses	1,063	1,502	2,310	2,683	3,259	3,934	4,512
Machinery	1,020	1,357	1,923	2,252	2,592	3,040	3,591
Electrical machinery other than consumer type	203	301	477	535	682	817	1,017
Metalworking machine tools	53	77	158	232	234	212	194
Other specialized industrial machinery	177	223	313	354	439	471	536
Other industrial machinery and components	204	283	357	443	498	641	775
Farm tractors and machinery	191	247	329	353	337	347	359
Business machines and computers	84	110	151	183	225	340	471
Scientific instruments; miscellaneous equipment	108	116	139	154	178	212	239
Civilian aircraft and all aircraft parts	20	102	212	129	188	177	191
Trucks, buses, and special vehicles:							
From Canada	8	24	158	277	448	675	667
From other countries	16	20	17	25	32	42	63

ILLINOIS COMMERCE COMMISSION,
Chicago, October 15, 1971.

Re: Proposed Job Development Investment Credit and Depreciation Revision.

SENATE FINANCE COMMITTEE,
New Senate Office Building,
Washington, D.C.

DEAR SIRS: This letter is sent to you in connection with certain aspects of the Job Development Investment Credit and Depreciation Revision on behalf of the National Association of Regulatory Utility Commissioners (NARUC), a quasi-governmental, non-profit organization of agencies concerned with the regulation of public utilities. It, in essence, updates my testimony on behalf of NARUC before the Ways and Means Committee of the House. The NARUC's principal objective is to serve the public interest by seeking to improve the quality and effectiveness of utility regulation. As the Job Development Tax Credit and Depreciation Revision will have an important bearing on these responsibilities, we submit our comments to you.

We do not here express views on matters of basic Federal tax and revenue policy, but do wish to let the Committee know of our views on matters which directly effect our responsibilities.

As the members of the Committee know, regulatory commissions in recent years have had a difficult time keeping up with the utility industries' needs for rate relief brought about by high costs of construction, tremendous new demands for environmental improvement and pollution control expenditures, and high interest rates. As these pressures underlying these needs for rate relief continue unabated, we regulators welcome any relief by way of income tax mitigation that will tend to assist these companies in the financing of their programs and relieve the pressure for increases in prices for utility services.

The Job Development Investment Credit and Depreciation Revision reported out of the House in H.R. 10947 will provide important measures of relief to regulated public utilities. On this basis we approve of the tax relief measures involved in H.R. 10947 to public utilities. And, further, we endorse the method and conditions under which these credits are made available to these companies with the exception of certain matters covered below. We, therefore, urge the Senate Committee to adopt in principle, although not in all specific details, the measures approved by the House of Representatives.

We do note, however, that the House Bill provides that regulated utilities effectively will receive a credit of 4% whereas all other taxpayers effectively will be entitled to a 7% credit. We regulators, from our perspective, see a compelling need for equality of treatment for public utility companies under the income tax law. We believe it is essential that public utility property should be treated on a parity with that of all other property.

We believe this parity of treatment under the income tax law is necessary because utilities are, contrary to the view of only a few years ago, highly competitive both in their sales and in their efforts to obtain capital in adequate quantities at low cost. Today, electric and gas companies receive extensive competition in the market from other energy forms such as coal and oil. Regulated telecommunications companies now face extensive competition from competitive microwave systems and data transmission facilities. They also compete against nonregulated companies which sell and install entire telecommunications systems within buildings and complexes. All these forms of competition, some direct and others that are subtle and indirect, have convinced us that parity of treatment under the income tax statutes is essential if the regulated industries are to maintain their ability to raise the huge quantities of capital that they need on terms which are not unfavorable. If they are treated as "second class citizens" under our income tax laws, their job and therefore ours, will become even more difficult in the future.

We, therefore, urge the Senate Finance Committee to adopt the substantive provisions of H.R. 10947 as it relates to public utilities, but that it provide parity of treatment of the Job Development Investment Credit for utilities so that they are not economically disadvantaged.

We do request that if the provisions in H.R. 10947 (Bill Sec. 106(e)(1)(A), and Bill Sec. 106(e)(2)(A)), which would establish certain ratemaking criteria as a prerequisite to the availability of the credit to regulated companies, are to be adopted, that they be expanded to require a corresponding treatment for accounting purposes. We favor the inclusion of requirements for correspondence of ratemaking and accounting treatment because, if left unclear, a disparity between the two can cause difficult regulatory problems. The favorable experience under the liberalized depreciation sections of the income tax law which require corresponding ratemaking and accounting treatments leads us to believe that the Job Development Investment Credit should be treated in the same manner.

Additionally, we believe the Committee should consider the advisability of a limitation on the time periods which can be effected by a regulatory order. Under H.R. 10947, a change in regulatory philosophy years after the realization of a Job Development Credit could apparently cause its recapture thus creating substantial uncertainty as to the ultimate realization of the credit. We believe that the impact of regulatory orders on the Job Development Investment Credit should be limited to the credits realized in the time periods to which the regulatory rate and accounting orders apply.

Five copies of this letter are enclosed. I respectfully request that this letter be included in the printed record of your proceedings.

Respectfully submitted,

DAVID H. ARMSTRONG, *Chairman.*

HOPKINS, SUTTER, OWEN, MULROY & DAVIS,
Chicago, October 16, 1791.

Re: Section 307 of the Revenue Act of 1971 (H.R. 10947), Retroactively Disqualifying Taxpayers from Western Hemisphere Trade Corporation Status because of Virgin Island-Source Income.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance, U.S. Senate,
Washington, D.C.

BACKGROUND

DEAR MR. CHAIRMAN: In 1921, Congress established the "mirror" system of income taxation for the Virgin Islands, making the United States income tax laws applicable in the Virgin Islands and allowing the Virgin Islands to collect the tax attributable to Virgin Island-source income. The purpose of the mirror system of taxation was to encourage the Virgin Islands to become financially self-sufficient by allowing the Virgin Islands to collect, for its own use, the same tax the United States would otherwise have collected on Virgin Islands-source income.

In 1954, the scheme was slightly altered by giving the Virgin Islands the right to collect all of the income tax due from its inhabitants (Virgin Islands corporations and individuals maintaining a permanent residence in the Virgin Islands) on all of their income regardless of source.

Since 1942, Congress has granted tax relief to Western Hemisphere trade corporations, i.e., "domestic" corporations doing business only in the Western Hemisphere which meet two qualifying source-of-income tests during the three years immediately preceding the close of the taxable year: (1) *Geographical source of income test*—95% of gross income must be from non-United States sources; and (2) *Nature of income test*—90% of gross income must be from the active conduct of a trade or business. This relief (currently a 14 percentage point tax reduction) was designed to encourage American corporations doing business in the Western Hemisphere (outside the United States) and to alleviate the competitive disadvantage they suffered vis-a-vis foreign corporations which, as a matter of tax policy were not taxed on income derived from sources outside their home countries.

THE CHICAGO BRIDGE & IRON CASE

The Virgin Islands Commissioner of Finance took the position that, for Virgin Islands income tax purposes, only a Virgin Islands corporation was a "domestic" corporation that could qualify for the Western Hemisphere trade corporation deduction and that a United States corporation which otherwise met all of the Western Hemisphere trade corporation qualifications—and was entitled to take the Western Hemisphere trade corporation deduction in computing its United States tax liability—was not entitled to the Western Hemisphere trade corporation deduction in computing its tax liability to the Virgin Islands on its Virgin Islands-source income. The Commissioner's theory was that only a "domestic" corporation can be a Western Hemisphere trade corporation (IRC § 921) and that a United States corporation was "foreign" to the Virgin Islands because Code § 7701(a)(4) defines a "domestic" corporation as one "created or organized in the United States" and the mirror system of taxation requires that "Virgin Islands" be substituted for "United States" in applying the Internal Revenue Code as the income tax law of the Virgin Islands.

In *Chicago Bridge & Iron Co., Ltd.* v. *Wheatley*, 430 F. 2d 973 (3d Cir. 1970), certiorari denied 401 U.S. 910 (1971), the Third Circuit rejected the Commissioner's interpretation because it would have distorted the Congressional policy behind both the mirror system of taxation and the Western Hemisphere trade corporation deduction: The Virgin Islands was trying to collect a larger tax than the United States would have collected on the same Virgin Islands-source income absent the mirror system; and, depending on whether or not a similar substitution of "Virgin Islands" for "United States" was made in the geographic source-of-income test of § 921, the Western Hemisphere trade corporation deduction would be available either to a Virgin Islands corporation doing all of its business in the Virgin Islands (thus discriminating against a United States corporation similarly situated) or to a Virgin Islands corporation doing all of its business in the United States (thus creating the spectre of all United States business incorporating in the Virgin Islands to obtain a 14 point tax reduction). The court felt that the policies of both the mirror system of taxation and the Western Hemisphere trade corporation deduction would be served by reading the Wesetrn Hemisphere trade corporation definition in § 921 literally and allowing a qualified United States Western Hemisphere trade corporation to take the deduction with respect to its Virgin Islands-source income as well as its other income.

THE VIRGIN ISLANDS FINANCE COMMISSIONER'S COMPLAINT

In a letter appended to his petition for certiorari in the Chicago Bridge & Iron case, the Virgin Islands Commissioner of Finance predicted that, if all Virgin Islands corporations doing business in the Virgin Islands re-incorporated in the United States in order to take advantage of the Western Hemisphere trade corporation deduction, the Virgin Islands would lose over $7,000,000 per year in corporate income taxes—30% of all corporate income taxes, 11% of all income taxes, and 9.6% of all taxes collected by the Virgin Islands. The accuracy of these statistics has not been established, but is accepted for the purpose of this letter.

THE HOUSE BILL'S RESPONSE TO THE VIRGIN ISLANDS COMMISSIONER'S COMPLAINT

Without any notice to the public or hearings, a provision was inserted in H.R. 10947 (§ 307) changing the three year 95% geographic source-of-income qualification in § 921 of the Code from "sources without the United States" to "sources without the United States and the Virgin Islands". The stated reason was to deny, for taxable years beginning after the date of enactment, the 14 point tax benefit both to United States corporations doing a "substantial volume" of business (presumably more than 5%) in the Virgin Islands and to Virgin Islands corporations with more than 5% of United States and Virgin Islands-source income. H. Rep. 92–533, pp. 49–50.

It is submitted that § 307 is neither appropriate to accomplish its stated purpose nor in accord with Congressional policy concerning the economic development of United States possessions and the taxation of possessions-source income.

THE RETROACTIVE IMPACT OF THE CHANGE IN THE QUALIFICATION TEST

Although the amendment to § 921 is made effective prospectively (for taxable years beginning after the date of enactment), it has a pernicious retroactive effect because the geographic source-of-income test spans a three year period: 95% of a Western Hemisphere trade corporation's income must be from qualifying sources for three years immediately preceding the close of the taxable year. Thus, under § 307 of the House Bill, as it now stands, a corporation which met the geographic source-of-income test in 1970 and 1971, relying on the fact that Virgin Islands source-of-income was permissible, would be denied Western Hemisphere trade corporation status in 1972 because of the amendment—and be powerless to restructure its affairs to avoid that result. It is one thing to provide that Virgin Islands-source income will no longer qualify; quite another to provide that it never did qualify. Surely, this retroactive impact on the qualification formula was unintentional: Western Hemisphere trade corporations which have qualified in the past should at least be given an opportunity to restructure their affairs to qualify in the future by placing their Virgin Islands operations in another corporation.

OVERKILL: THE IMPACT ON THE UNITED STATES TAX LIABILITY OF WHTC'S

The apparent impetus for the change in the qualification formula is the Virgin Islands complaint about the prospective loss of revenue. But the amendment affects not only the Virgin Islands income tax liability of an otherwise-qualified WHTC; it also applies to its United States tax liability on income from other sources. The only solution for a WHTC with more than 5% of its income from Virgin Islands sources will be to transfer its Virgin Islands operations to another corporation, which unnecessarily complicates the administrative structure of corporations designed to handle Western Hemisphere operations outside of the United States.

Even if it were desirable, as a matter of tax policy, to deny the WHTC deduction with respect to Virgin Islands-source income, there is no reason to force a structural change to avoid the impact on a WHTC's United States tax status. There are easier and more direct approaches to the problem. For example, it might simply be provided that the WHTC deduction provisions (§§ 921 & 922) shall not be a part of the Internal Revenue Code when applied as the income tax law of the Virgin Islands. This, indeed, was the approach adopted with respect to Guam: § 31(a) and (b) of the Organic Act of Guam establishes the mirror system of taxation for Guam by providing that the United States income tax law shall be the Guam Territorial income tax law, but § 31(d)(1) provides that § 931 of the Internal Revenue Code shall not be a part of the Guam income tax law. 48 U.S.C. § 1421 i (a), (b) and (d)(1). § 931 provides that a United States corporation doing most of its business in a possession is not taxable on any of its income except United States-source income. And if § 931 were a part of the Guam income tax law, it would enable a United States corporation doing all of its business in Guam to avoid income taxation both by the United States and by Guam, which would have defeated the whole purpose of the Guam income tax law. By simply reading § 931 out of the Guam Code, but retaining it in the United States Code, a United States "possessions" corporation pays tax to Guam on its Guam-source income and to the United States on its United States-source income, but retains its immunity to tax on its income from other sources, in accordance with the policy underlying § 931. At the very least this would seem to be a more reasonable approach to the Virgin Islands situation than requiring a Western Hemisphere trade corporation to form a separate corporation for its Virgin Islands activities.

STRAW MAN: A VIRGIN ISLANDS CORPORATION CANNOT BE A WHTC

One of the stated reasons for § 307 of the House Bill is that "It is also possible to interpret this 14-percentage-point tax benefit as applying to Virgin Islands corporations." H. Rep. 92–533, p. 49. This simply is not true: The Third Circuit specifically rejected the Virgin Islands Commissioner of Finance's proposal to substitute "Virgin Islands" for "United States" in § 921 because it might have led to granting WHTC status to Virgin Islands corporations. Under the court's ruling—fortified by the denial of certiorari by the Supreme Court—§ 921 is to be taken literally, which means that only a "domestic" corporation—one organized under the law of any "state or territory"—can qualify as a WHTC. (The Virgin Islands, being an unincorporated territory, does not qualify as a "territory" for this purpose.)

Indeed, instead of resolving any doubt there may have been as to whether a Virgin Islands corporation can be a WHTC, the House Bill actually engenders confusion. The Committee Report (p. 49) states that § 307 is intended to apply "with respect to a Virgin Islands corporation's Virgin Islands tax liability with respect to gross income derived from the United States (or the Virgin Islands)." This implies that a Virgin Islands corporation may qualify for WHTC treatment, under Virgin Islands income tax law, with respect to income from sources within the Western Hemisphere other than the United States and the Virgin Islands—a result precluded by existing law.

A SERIOUS POLICY CHANGE TOO LIGHTLY CONSIDERED

Bad as they are, the technical difficulties with the House provision are overshadowed by the stark change in Congress's fiscal and economic policy towards United States possessions.

For almost thirty years, there has been a tax incentive for United States corporations to do business in the Western Hemisphere outside the United States. Now, it is proposed to deny that incentive with respect to the Virgin Islands simply because the Virgin Islands is concerned with $7,000,000 a year in tax revenue. Is this a sufficient reason? Does this change square with expressed Congressional policy toward the economic development of United States possessions? These are questions that should be fully aired before making a change that appears primarily to be just a response to a tax collector's cry for money.

Congress has long been concerned with encouraging the economic development of United States possessions through tax incentives. § 931 of the Code expresses a fundamental policy of not taxing a United States corporation deriving most (80%) of its income from the active conduct of a trade or business (50%) within a possession on any of its income other than United States-source income. The Western Hemisphere trade corporation deduction has served essentially the same purpose with respect to the Virgin Islands. And Congress has recognized the need of the Virgin Islands to grant special tax incentives to encourage economic development in § 934 of the Code. The avowed purpose of these provisions, as reflected in this Committee's report on § 934, was "to encourage the development of the economic resources of the possessions by citizens of the United States or by U.S. corporations." S. Rep. No. 1767, 86th Cong., 2d Sess. (1960), p. 3. Now, under the guise of plugging a revenue loophole, the entire tax incentive policy is to be revised with respect to one United States possession--the Virgin Islands. We ask, rhetorically, is it really in the long-range interest of the Virgin Islands to discourage United States corporations from doing business there and, predictably, to divert business capital and effort to other Western Hemisphere countries?

Are there not other ways to supply the Virgin Islands' immediate revenue needs which better suit the ultimate goal of economic self-sufficiency than abolishing the WHTC deduction for Virgin Islands-source income?

For example, the Virgin Islands now grants extensive subsidies to certain types of business. In a letter appended to its petition for certiorari in the Chicago Bridge & Iron case, the Commissioner of Finance cited one Virgin Islands corporation that would have had an income tax liability of $8,430,370 but for a 75% subsidy. Denying that subsidy to that one corporation would almost compensate for the Commissioner's estimate of revenue loss from the WHTC deduction. Why should not the Virgin Islands review its own subsidy program in the light of its revenue needs, instead of asking Congress to abolish the WHTC deduction across the board? Also, the Virgin Islands has the power to levy taxes other than income taxes. Has it adequately explored these other sources of revenue?

At stake here is the conflict between the desire of the Virgin Islands Commissioner of Finance to solve his immediate financial problems and the long-range Congressional policy of encouraging the development of the total economic resources of possessions by United States corporations through tax incentives. This conflict should not be resolved in favor of the bare need for tax money without a careful consideration of the broader consequences and the possible alternatives.

Because § 307 was passed by the House without hearings and opportunity for public comment, these larger policy considerations have not been adequately explored. We submit that § 307 should be rejected by the Committee on Finance and that the entire subject should then be given the study it deserves.

Sincerely yours,

CHARLES W. DAVIS.

NATIONAL GRANGE.
Washington, D.C., October 7, 1971.

Hon. RUSSELL B. LONG,
Chairman, Finance Committee,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The National Grange applauded the President's bold action in announcing a change in the economic policies of his Administration. Most, if not all, of his recommendations have been advocated by many economists both inside and outside of government for several years. In addition, many Congressional leaders on both sides of the aisle have argued the logic of changing our economic direction.

The new economic policy will improve our foreign trade and monetary position throughout the world. The President's action has already stirred the industrialized nations to seek a more equitable, more flexible international monetary system—something which has been needed for a long, long time.

I think that it is well to remember that these new economic actions are interrelated parts of a total program, both at home and abroad, to keep our economy strong, competitive and dynamic. To lose any part or to have any of the program appreciably altered to placate any self-interest group—be it labor or management—will weaken the total program and place in serious jeopardy the anticipated results—inflation control and improvement of the U.S. balance of payments.

We cannot allow pettiness, greed or obstructionism to stand in the way of the battle against inflation or focusing the eyes of the industrialized nations of the world upon the fact that they have a responsibility toward world leadership and a world monetary system that is equal for all. We need a willingness on the part of all people to bring the new economic policies into full play for the good of all people and for peace in the world.

We believe the total package, if enacted, will work to the benefit of American farmers, labor and management, but making a Christmas tree out of the package can only result in further budget deficits, widen the economic gap between special interest groups, and further deteriorate our position in world markets.

We are pleased that you and many members of your Committee have, in the past, support such changes in our economic policy. Therefore, we are assured that you will continue to have the best interests of the nation foremost in your mind during the hearings on this vital and important matter. We urge you to use your influence and wise counsel to guide the Committee to conclusions that will fortify the President's economic policy.

Thank you for permitting us to make known the views of the National Grange. We respectifully request that this letter be made a part of the hearing record.

Sincerely,

JOHN W. SCOTT, *Master.*

ACME-CLEVELAND CORPORATION,
Cleveland, Ohio, October 7, 1971.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee, U.S. Senate, Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: We wish to put on record with you in the most positive terms we can muster our support of the proposed "Revenue Act of 1971" as passed by the House of Representatives which includes reinstatement of the 7% investment tax credit and approval of a new class life Depreciation System (the ADR system effected by Treasury Department regulations issued last June). Both are needed. Even with both, the United States will remain behind the other important nations of the world in allowances for faster recovery of capital.

It would be tragic, in our view, if the progress made in 1971 toward more realistic capital recovery allowances should be sacrificed in a trade-off to secure passage of the investment credit. The option provided by the ADR to choose equipment lives in a 20% range below the guidelines will be a substantial long-run help in augmenting the flow of capital funds. This badly needed liberalization of depreciation rules has been called a giveaway to business, but it is important to bear in mind that larger recoveries in the early years of the life of a piece of capital equipment do not result in the elimination of tax, only in its postponement. If a business does not continue to reinvest its larger cash flow in replacement equipment to start the cycle over (which action, most likely, broadens the tax base), its tax deductions from capital recovery dwindle away. After all, no one can recover more than 100% of the book value of a piece of equipment under any present system of allowances.

We are attaching a copy of two tables clipped from *The Wall Street Journal* issue of October 6, 1971, page 13, which show the annual rate of increase in productivity in recent years for a gruop of industrialized countries and capital investment as a percentage of GNP. They demonstrate the correlation between capital investment and productivity, and it is significant that the U.S. is at the bottom of both.

Sincerely yours,

HENRY R. HATCH III, *Secretary.*

Attachment.

[The Wall Street Journal, Oct. 6, 1971]

Output per man-hour Yearly Gain, 1965–70

	Percent
Japan	14.2
Netherlands	8.5
Sweden	7.9
France	6.6
Germany	5.3
Italy	5.1
United Kingdom	3.6
United States	2.1

1960–69 annual averages—Capital Investment as percent GNP

	Percent
Japan	27
Netherlands	20
Germany	20
Sweden	18
France	18
Italy	14
United Kingdom	14
United States	13

TRUCK TRAILER MANUFACTURERS ASSOCIATION,
Washington, D.C., September 3, 1971.

Hon. RUSSELL B. LONG,
U.S. Senate,
Washington, D.C.

DEAR SENATOR LONG: In his efforts to stimulate the economy and expand production and employment in the auto industry, President Nixon his requested Congress to repeal the 7 percent manufacturers excise tax on automobiles. Unfortunately, however, his recommendation does not include any consideration for the trailer manufacturing industry which has been involved in a severe economic struggle during the last year and a half.

When Congress studies the President's tax proposals, we strongly urge you to introduce legislation that would repeal the discriminatory 10 percent manufacturers excise tax on truck trailers. If the President's plan is to spur the economy, then our industry, too, could stand a shot in the arm as indicated by the following figures:

TRAILER INDUSTRY SHIPMENTS

	1969	1970	1st 6 months 1970	1st 6 months 1971
Number of units	171,679	131,847	74,972	53,371
Dollar value	808,335,000	647,835,000	357,830,000	283,471,000

We realize that the chief counter-argument for repealing the federal excise tax on commercial trailers is that these revenues have been 'dedicated' to the Highway Trust Fund since 1956. But we also recognize that there have been continuous attempts to divert these monies from their specified purpose and that other recommendations have been made to eliminate the Highway Trust Fund entirely in favor of a General Transportation Fund. A number of bills to this effect have been introduced in Congress and we feel that the Highway Trust Fund is about to lose its integrity and that *now* is the appropriate time for repealing the 10 percent tax on commercial trailers.

One of the objectives of opponents to the Highway Trust Fund is to obtain use of its monies to finance urban mass transit. We would like to point out, however, that the problems of urban mass transit were not created by truck trailers.

Consequently, it would seem more appropriate to use auto import revenues for this purpose rather than the excise taxes now levied on commercial vehicles. We believe that monies collected from this source would more than offset any loss to the Fund by elimination of the excise tax on truck trailers.

Our membership, in annual convention in April 1971, adopted a resolution suggesting that revenue to finance urban mass transit be provided through use of the duty on the hundreds of thousands of autos imported into this country each year. We feel it quite appropriate to repeat the suggestion at this time.

Another reason for advocating repeal of the excise tax is the sheer complexity of interpreting and applying the tax law and the regulations and rulings issued by the Internal Revenue Service. We would venture to say that the value of time and manpower expended by trailer manufacturers, tax attorneys, Government tax administrators, etc., in dealing with excise tax requirements and its very many ramifications possibly exceeds the dollar value contributed by these specific taxes themselves.

Attempting to interpret and comply with a law that was conceived for another industry and another distribution pattern (the automobile wholesale and retail sales method) has placed a very serious administrative and financial burden on the truck trailer manufacturing segment of the industry which does not have a wholesaler-to-dealer pattern but operates mainly on a manufacturer-to-user concept.

The Truck Trailer Manufacturers Association, therefore, urges your support in immediately enacting legislation that will achieve the following:

(1) Repeal the 10 percent excise tax on commercial truck trailers *without retaliatory increases in the present diesel fuel differential or highway use taxes* which by themselves inflict a tremendous financial burden on the trucking industry.

(2) Use of the 10% import duty on foreign cars for urban mass transportation purposes.

We make these recommendations so that one segment of the American transportation industry will not have to continue its economic struggle under undue hardship.

Sincerely yours,

CHARLES J. CALVIN,
Managing Director.

AEROSPACE INDUSTRIES ASSOCIATION OF AMERICA, INC.,
Washington, D.C., October 15, 1971.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance, U.S. Senate,
New Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: On behalf of the nation's leading manufacturers of aircraft, spacecraft, missiles and their components, the Aerospace Industries Association of America, Inc., urges passage of the job development investment credit and Domestic International Sales Corporation portions of H.R. 10947, with the following suggested changes.

Our industry, in particular, is acutely aware of the need to maintain an up-to-date, efficient productive capacity by utilizing the most modern research and production facilities and by producing capital goods of the most advanced types. The job development credit will facilitate technological progress and widespread benefits for our national economy by stimulating both of these areas.

However, there is one aspect of the tax credit portions of H.R. 10947 which we strongly urge the Finance Committee to change. In lieu of the partial credits for items having useful lives of 3–7 years, full tax credit for all eligible property having useful lives of four years or longer should be allowed, with recapture only for dispositions prior to the expiration of four years. This would reduce considerably the record-keeping and other administrative burdens associated with partial credit arrangements. More importantly, this change would encourage the prompt ordering of all types of eligible property whenever needed and would avoid penalizing those in highly technical industries where technological progress makes facilities obsolete before they are worn out. Prompt replacement of obsolescent items and those with useful lives of less than seven years requires additional investment and keeps the nation's tools of production modern and efficient. This should be encouraged rather than discouraged by the tax credit legislation.

Because aircraft and related equipment is the nation's single largest export commodity and is facing increasing foreign competition, the aerospace industry is keenly cognizant of the need for DISC to assist in creating domestic employment and keeping industry competitive, thus improving the balance of payments. While we strongly support this portion of the bill, our members feel that the provision limiting DISC benefits to the excess of exports over 75 percent of base period exports and the deemed distribution provision with respect to income from export sales up to 75 percent of base period sales will tend to negate the intended benefits of DISC and could even produce results contrary to the intent of the legislation.

The law should be designed to motivate the production of goods in this country for export, whether or not levels in excess of 75 percent of base period levels can be achieved. Extending benefits only to exports over the 75-percent level provides little motivation to maintain domestic production of goods for export unless it is clear that the 75-percent level will be exceeded substantially. Further, it provides none of the intended assistance in maintaining current levels of exports against the inroads of increasing foreign competition. The deemed distribution provision, moreover, may encourage rather than discourage further off-shore production, whether or not a taxpayer's exports can be expected to exceed the 75-percent level. In the interests of effecting overall improvements in the U.S. balance of payments, these two provisions should be deleted and DISC benefits accorded to all export sales which otherwise qualify.

We appreciate the Committee's taking time to consider these suggestions and we commend its swift action on this legislation.

Yours very truly,

KARL G. HARR, Jr.

STATEMENT OF CLAUDE E. HOBBS, ON BEHALF OF NATIONAL ELECTRIC MANUFACTURERS ASSOCIATION

The National Electrical Manufacturers Association (NEMA), 155 East 44th Street, New York, New York 10022, submits this statement in support of certain aspects of President Nixon's tax program, as announced on August 15 and more particularly explained by the Secretary of the Treasury before this Committee on October 7, 1971.

The 485 members of NEMA are the principal United States manufacturers of electrical and related products used in the generation, transmission, distribution, and utilization of electrical energy.

The President's economic program to encourage the creation of new jobs and to arrest inflation deserves the support of the Congress and the country. We will not repeat in detail what others have already said in support of the program, but we would like to comment particularly on two of the President's tax proposals:

1. enactment of the Job Development Credit, and
2. authorization of Domestic International Sales Corporations (DISC).

JOB DEVELOPMENT CREDIT

NEMA urges prompt enactment of the Job Development Credit for the following three reasons, as stated by Secretary Connally on September 8:

1. to increase U.S. jobs,
2. to improve U.S. productivity, and
3. to increase U.S. competitiveness in international trade.

We believe that if the investment tax credit is to achieve these desired objectives it must be at a rate high enough to provide an incentive to invest in equipment, and must be of sufficient duration to encourage orderly, long-term planning for new, productive capital equipment. Accordingly, NEMA associates itself with and endorses the recommendation of the National Association of Manufacturers made to this Committee with respect to the need for (a) a "permanent commitment" to an investment credit, and (b) the credit being retained "at *at least* a 5% rate after 1972." The 7% rate in H.R. 10,947, which you are now considering, fully meets such criteria. We urge that the 7% rate be permanently enacted.

Those NEMA members who produce heavy equipment for the generation and transmission of electric power—the turbine generators, power transformers and power circuit breakers which are at the very heart of this country's electric power systems—have a particular interest in one aspect of the proposed Job

Development Credit, i.e., the non-allowance of the credit to purchasers of foreign-produced equipment (which, as explained by Secretary Connally, means "property produced abroad" and "property produced in the United States if more than 50 percent of the value is attributable to imported materials or components.")

NEMA members who manufacture heavy electrical equipment in the U.S. have for many years faced unfair competition in the international trade of this equipment. As we have told this Committee and other Congressional committees as well as Executive Departments and agencies on several occasions over the past ten years, the trade of this equipment with the producer nations of Western Europe is a one-way street: foreign-made high-technology electrical equipment has come into the open U.S. market in substantial and steadily increasing quantities; but, conversely, similar U.S.-made equipment is excluded from European markets by the nationalistic procurement policies and practices of the government-owned or controlled electric utility systems of a number of European countries. There are also restrictions, not necessarily formal but highly effective, on the purchase of such equipment by Japanese utilities.

Foreign competitors, based on an array of protective and restrictive import devices in their home markets and a variety of export aids and incentives to penetrate the U.S. market in volume, should not have the benefit of U.S. tax credit designed explicitly to increase U.S. jobs, U.S. productivity and U.S. competitiveness. For this fundamental reason of competitve equity NEMA strongly recommends:

(a) That no investment credit should be allowed for foreign-produced equipment, now or, as proposed by Secretary Connally, beginning next year (at a rate of 5 percent), where unfair foreign competitive practices unreasonably burden U.S.-produced equipment;

(b) That the duration of the non-allowance of the investment credit with respect to foreign-produced equipment not be linked in any way to the duration of the import surcharge. We believe that the investment credit and the surcharge aim at two different targets for two necessarily different periods of time. The surcharge is admittedly "temporary", and its life is dependent on a number of future, perhaps short-term, developments in both the international trade and monetary arenas. The surcharge is not designed to increase U.S. productivity and U.S. competitiveness in export markets. Thus, to tie the deeply-rooted policies of foreign governments that give exclusive preference to their domestic manufacturers in certain basic industries—policies which may take years to eradicate—to the temporary (but necessary) expediency of the surcharge is unrealistic in terms of long-term solutions to an inequity that has already been allowed to endure too long.

DOMESTIC INTERNATIONAL SALES CORPORATIONS (DISC)

NEMA recommends prompt enactment of the DISC proposal substantially in the form submitted by the President, although individual member companies of NEMA may request certain amendments which they believe to be important. We believe the tax deferral principle requested with respect to exports from the United States will provide an important stimulus to increasing exports and improving our balance of payments.

We believe it will at least partially equalize the competitive advantages enjoyed by exporting nations with indirect tax systems. Corollary benefit to the domesitc economy should inhere by reason of inducement to U.S. firms to expand their operations and employment here rather than locate facilities offshore. We hope, moreover, that the high technology sector of the U.S. manufacturing-industrial base would be a particular beneficiary of the DISC program. U.S. competitiveness and export expansion lie for the long-term in continued U.S. technological leadership in world trade. To the extent that the tax inducements of DISC can help protect and enhance that leadership the United States will be allocating its resources to very good advantage.

Some of the member companies of NEMA have noted that the base period in H.R. 10947 [Sec. 995(e)(i)] for establishing Export Gross Receipts is specified as the years 1968, 1969 and 1970. We believe that flexibility should be permitted to avoid penalizing a company which happened to have an unusually large export volume in one or more of those years. Such flexibility could be achieved by permitting the taxpayer the option of substituting 1971 for 1968, or by some other method of modifying the categoric base period. We hope that flexibility of this type will be written into the bill.

In the light of these underlying objectives we hope the Congress will express its clear and unmistakable legislative intent, in the statutory language and in the committee reports, that the DISC program is not to be frustrated or inhibited by rigid or unduly narrow administrative regulations and interpretations. The statutory presumption should be in favor of expanded trade rather than restrictive eligibility requirements for qualification of a domestic international sales corporation.

STATEMENT OF ROBERT F. PUGLIESE, GENERAL TAX COUNSEL, WESTINGHOUSE ELECTRIC CORP.

Mr. Chairman and members of the committee: Westinghouse Electric Corporation endorses the recommendation of President Nixon for the enactment of legislation relating to Domestic International Sales Corporations (DISC). We urge this Committee and Congress to enact this proposal which we believe is important to maintaining and improving the volume of exports of industrial equipment and other products from the United States.

We urge the Finance Committee and the Senate to restore the DISC proposal to the form recommended by the President in order to accomplish the objective of providing incentive for increasing United States exports. If, however, it is decided to adhere to the concept of applying tax deferral only to incremental export sales, we urge a relaxing of the method of determination of the base period.

The Tax Reform Act of 1971 (H.R. 10947), as passed by the House, provides for a limited amount of tax deferral for export-related profits of a Domestic International Sales Corporation or a "DISC". The amount of the deferral is limited since the DISC provision applies on an incremental basis to export income in excess of a specified base. Specifically, the advantages of the DISC proposal are to be available only for export income attributable to sales in excess of 75 percent of the average export sales of the corporate group to which the DISC belongs for the year 1968, 1969 and 1970.

Historically, the major objection to incremental type provisions is that it is impossible to establish a base period which will fairly apply to all taxpayers. This objection can be met, in part, by: (1) using an average base period concept: and, (2) permitting the base period to be altered or adjusted if it contains a significant variation from normal experience. The House passed bill permits the averaging of the base period years experience but does not provide a basis upon which the base period can be adjusted if it contains a significant variation from normal experience which distorts the base period.

During one of the base period years one Westinghouse contract generated approximately 20 percent of that year's gross export sales. As a result of including that sale in the base period, the base period average for the three years is higher than the export experience in any of the three years with the exception of the distorted year.

There are a number of methods which could be adopted to permit modification of the base period so as to adjust it for significant distortions. One method would be to permit a taxpayer to use the year 1971 in lieu of the distortion year. It would appear that if the base period to be used was the most recent years, the use of 1971 would be consistent with that concept. We understand that the year 1971 was not chosen for the base period because of a concern that this might cause exporters to delay their sales until next year. That concern is not well-founded primarily because the advantage which might be gained is minimal and it would create major administrative problems.

The option to use 1971 in lieu of 1968 could be granted by the following changes in Section 995(e)(2) (page 89, line 1, of the bill):

"(2) *Elections With Respect to Export Gross Receipts*—

"(A) Notwithstanding paragraph (1), a taxpayer may elect (under rules prescribed by the Secretary or his delegate) to compute his base period export gross receipts by taking into account only those sales, leases, or rentals of property which would have been export property if held by a DISC.

"(B) For purposes of computing base period export gross receipts, under paragraph (1), a taxpayer may use taxable years 1969, 1970 and 1971 in lieu of taxable years 1968, 1969 and 1970."

INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA,
Washington, D.C., Oct. 15, 1971.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: I am writing on behalf of the Independent Natural Gas Association of America, often referred to as "INGAA", to express our concern about the provisions of section 106 of H.R. 10947, as adopted by the House of Representatives, that permit regulatory agencies to reduce the incentive value of the Job Development Investment Credit.

INGAA is a non-profit industry organization whose membership includes virtually all the major interstate natural gas pipeline companies in the United States. While our Association is primarily pipeline oriented, we also have producer and distributor company members.

Our pipeline member companies today serve all of the lower 48 states, with the exception of Vermont, through an underground pipeline network now totaling more than 200,000 miles. They account for 90 percent of the total interstate sales of natural gas and provide the vital transportation link between the gas producer at the wellhead and the distributor who makes final delivery of gas to the consumer.

As the country's major transporters of natural gas, we are acutely sensitive to the overall question of natural gas supply. Our customers now need and will require more gas than we can presently deliver. We, in turn, are expending every effort possible to guarantee future supply and development of new reserves.

The lack of energy is a crisis in the United States today. Without energy in growing amounts this nation inevitably will decline. The crisis is particularly serious with respect to natural gas which is in extremely short supply. With natural gas now providing over one-third of the nation's total energy requirements, there is a critical need for new gas supplies to meet unprecedented demand by residential, industrial, and commercial consumers. These facts are recognized by (1) the President of the United States; (2) all segments of the gas industry—producer, pipeline and distributor, and (3) spokesmen for the Interior Department, the Federal Power Commission, and State Regulatory agencies whose National Association of Regulatory Utility Commissioners on July 17, 1969, adopted a resolution acknowledging the existence of and need to solve the supply problem.

On June 4, 1971, the President issued a Message to Congress in which he outlined a large number of programs that are required to provide the energy required "to sustain healthy economic growth and improve the quality of our national life." While referring to the role of government in meeting the nation's expanding energy needs, the President emphasized that private industry "will still play the major role in providing our energy" and concluded that the success of the effort will depend in large part "on the willingness of industry to meet its responsibilities in serving customers and in making necessary capital investments to meet anticipated growth."

Recently the Federal Power Commission, in its Order No. 598 issued July 16, 1971, in Area Rate Proceeding, *et al.* (South Louisiana Area), Docket Nos. AR61-2, *et al.*, found ". . . a critical shortage of gas in the United States." And on September 8, 1971, the Commission announced that natural gas reserves available for shipment through interstate pipelines declined by 17.8 trillion cubic feet in 1970.[1]

If the pipeline industry is to assist in alleviating the critical gas supply shortage, it has to raise massive sums of capital to replace, supplement and expand our traditional sources of gas supply. For example, the July, 1971, Interim Report of the National Petroleum Council to the Secretary of the Interior on the United States Energy Outlook projects required capital expenditures for gas transportation alone of $21 billion, in 1970 dollars, during the period 1971 through 1985. Many billions of additional dollars will be required for the construction of plants to gasify coal, naphtha and other hydrocarbon feed stocks. Indeed, the Petroleum Council's Interim Report estimates that during this same 15-year period, capital requirements for the gasification of coal will be approximately

[1] FPC News Release No. 17749, issued September 8, 1971.

$8,700,000,000. Thus the pipeline industry, which has a gross plant of about $21 billion today, is faced with the necessity of raising approximately one and one-half times that amount of capital over the next 15 years in its efforts to meet our Nation's essential requirements for additional gas supplies.

The problem should not be considered solely in the context of future demand. It is an urgent problem today, as evidenced by the fact that several major pipelines must curtail deliveries below contract obligations during the 1971–72 winter. Major additions to supply are needed *now* to provide deliverability for even today's needs. As to tomorrow, the National Petroleum Council estimates that, assuming no gas supply limitations or changes in the energy pricing structure, demand for gas would create a supply shortfall of 7,848 trillion BTU's by 1975, 12,220 trillion BTU's by 1980 and 17,939 trillion BTU's by 1985.[2] It is clear that vigorous effort must be elicited as promptly as possible in order to start solving the problem for both the near-term and the long-term.

As evidenced by the magnitude of capital required in the future, the complete availability of the 7% investment credit to the pipeline industry still represents only a limited, but essential, source of the required funds. If H.R. 10947 permits a "flow-through" of this essential capital to consumers, there is at best only a minimal, wholly inadequate, source of funds to pipeline companies. In short, it is of far greater significance to consumers to have an adequate supply of energy available than it is to have a possible nominal reduction in their monthly bills. This is particularly true since possible reductions from flow-through may be fully offset by increased costs of borrowed capital that would be borne by customers.

Contrary to the situation which existed in 1962 when the prior investment credit was instituted, or in 1964, when it was amended, future growth in the national economy will be determined by the supply of energy available to support that growth. Thus, the economy cannot be expected to grow and to create additional jobs at the desired rate if the supply of energy adequate to support that rate of growth is not available.

As recognized by Congress in 1962 and 1964, pipelines are involved in substantial competition for supplies and markets, both between themselves and with non-regulated industries. Additionally, unlike utilities, pipelines have no "franchises" (therefore, no monopolies of service area) and are not legally required to expand their facilities. Notwithstanding the lack of obligation to expand, the pipeline industry has historically made every effort to satisfy the demand for gas and today stands ready and willing to continue that effort in the public interest. It is in the public interest to utilize the economic advantages of the existing network of pipelines and to provide the availability of gas to the greatest number of consumers by encouraging the pipelines to continue and to increase their efforts to supply additional energy.

Based on every indication of the future, non-utility characteristics of the pipelines will be increasing as they are required to go far afield geographically and technologically in their efforts to satisfy the demands for energy in gaseous form. This will put the pipelines in a position of competing more and more with non-regulated industry, both for supply sources and for the capital required to develop these sources. Since the challange of providing adequate energy for the future requires all resources available, the pipeline industry should not be placed under a competitive burden vis-a-vis the non-regulated sector of the economy, which will enjoy the full benefit of the credit. The nation's effort to provide an adequate and reliable energy supply for its present and future needs simply cannot be so handicapped.

Accordingly, it is respectfully requested that the Committee take such action as will assure that pipeline companies will be able to retain the full benefits of the investment tax credit.

Very truly yours,

WALTER E. ROGERS, *President.*

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[2] Volume one July 1971 Interim Report on U.S. Energy Outlook, p. 34.

STATEMENT OF THE UNITED STATES–JAPAN TRADE COUNCIL

The United States-Japan Trade Council, Inc., is a non-profit trade association with a membership of over 700 firms in the United States interested in fostering trade relations between the two countries. Because a substantial contributing member, the Japan Trade Promotion Office, 39 Broadway, New York, New York, is financed by the Japanese government, the Council is registered with the Department of Justice under provisions of 22 U.S.C. Sec. 611 et seq. as an agent of such foreign principal. Copies of the Council's registration statement are available for public inspection in Department of Justice files. Registration does not indicate approval of the contents of this communication by the United States Government.

The following statement is submitted in connection with this Committee's consideration of H.R. 10947, the Revenue Act of 1971. The United States-Japan Trade Council members in its membership approximately 900 firms in the United States which are interested in and concerned about trade between the United States and Japan. As this Committee knows, the Council is registered with the Department of Justice as an agent of a foreign principal. The views here expressed have been formulated by the staff of the Council in Washington as reflecting the interests and opinions of the Council's members in the United States.

We urge this Committee to use its influence with the Administration to limit the duration of the supplemental duty on imports and the *quid pro quo* for its removal. As many well qualified commentators have pointed out, the value of the surcharge will be lost, if it is allowed to remain in effect so long that it becomes a part of the American trade structure. Vested interests of United States industries that benefit will cluster around it. The net losers will be the American consumers and the momentum of the international trading community toward freer trade. Continuation of the surcharge will be used to justify restrictive practices of foreign countries, whether they be recent or well-established, and from this seed could grow new and even more strangling impediments to the free movement of goods.

The United States-Japan Trade Council believes that removal of the surcharge should be related only to the achievement of new relationships between the dollar and other world currencies, and that negotiations to this end should be given the highest priority. If these negotiations are to succeed, there will have to be considerable flexibility on all sides, including the United States. In the main, the Council believes that some action was necessary in both the domestic and international economic sectors. We believe that either the import surcharge or the severance of the gold-dollar link was advisable, but not both. As Treasury Secretary Connally said in his address to the IMF on September 30, the U.S. import surcharge may well prove to be a "disturbing influence" in the international effort to obtain an appropriate exchange rate realignment. By ending the import surcharge, the U.S. would not only demonstrate its commitment to building a new world trading system, but would also be encouraging a move toward the American goal of "clean" exchange rate floats, devoid of intervention and controls.

The present statement is addressed primarily to that novel feature of the investment credit which is directly aimed at the limitation of imports, namely, the preference for domestically produced goods. H.R. 10947, Sec. 103. An investment credit can be expected to have a favorable impact on the foreign trade of the United States if it leads to greater productivity and greater competitiveness. For this reason, the Council supports a non-discriminatory investment tax credit. Since American industry should be encouraged to purchase the most efficient available equipment, which may not in fact be a United States product, the Council opposes the provisions of the tax credit discriminating against foreign goods. Although the investment credit approved by the House ameliorates the strictly discriminatory proposals of the Administration, the bias against investment in foreign goods remains, and if enacted a new non-tariff barriers will be created.

The reasons given by Secretary of the Treasury Connally for the investment tax credit, in his testimony before this Committee on October 7, all support a non-discriminatory investment tax credit such as the one enacted in 1962. The merits of denying the credit to foreign equipment during the life of the supplemental duty were not stated, and, we suggest, cannot persuasively be articulated. Indeed, the House amendment authorizing the President to make the credit available for foreign made equipment when to do so would be "in the public interest" is a recognition of the place of foreign goods in the domestic production base.

As it now stands, the availability of the credit for foreign goods will depend upon a Presidential determination as to the "public interest". If this means the credit will be available according to informed business judgment with respect to the best buy in equipment, this provision will have little effect on purchasing patterns and should be omitted as useless language. If it does not mean this, then the power of the President to exempt articles from the discrimination will probably accomplish little or nothing to dilute the discrimination.

There have not been, to our knowledge, any estimates of the number of jobs the discriminatory investment tax provision in itself would create, nor has it been indicated how selective discrimination against foreign equipment will spur productivity gains in the domestic economy. Indeed, within the announced purposes of the proposed legislation, it is hard to discover a place for this discrimination. Productivity is not stimulated by denying a manufacturer an investment credit on a more efficient machine because it is made in another country. Moreover, the bill provides that the discriminatory investment provision will last only for the duration of the supplemental import duties. It is unrealistic to suppose that jobs are made by creating a tax preference for domestically made goods for the unknown duration of the supplemental duties.

Presumably, this aspect of the Administration's proposals, marching lockstep as it does with the supplemental duties, is intended to be an added incentive to other countries to realign their exchange rates with the dollar. If so, it is surely a tactic of marginal effectiveness or persuasiveness in view of the dollar's divorce from gold, the imposition of the supplemental duties, and the more positive tone of discussion at the recent IMF meeting. It is surely also an unnecessary irritant which obscures the validity of the basic position of the United States, just as it is inconsistent with the economic stimulus which the investment tax credit is intended to give.

The discrimination against foreign made goods discourages a buyer from purchasing the machinery or equipment best suited to his business purposes and hence most likely to stimulate productivity. If comparable but less efficient equipment is made in the United States, and if the 10 percent credit makes the foreign built machine marginally more expensive for income tax accounting purposes, then possibly a businessman might invest in the domestically made machine. But he might just as well defer the purchase of a machine until the supplemental duty is removed, and then buy a less expensive, comparable foreign made machine on which he can presumably then take the investment tax credit. If, on the other hand, comparable goods are not produced in the United States, then the buyer compelled to buy abroad must either seek a Presidential exemption (a burden both to himself and to the agencies of government), or he will be deprived of a tax benefit which others enjoy.

Given the uncertainty of the duration of the supplemental duties and of the likelihood of an eventual exemption by the President, new industries will not be created in the United States by denying foreign competition a tax credit, nor will inefficient industries be strengthened. Venture capital to embark on new production is likely to be attracted to areas of more-assured, long-term advantage. As for the weak and inefficient industry, adjustment assistance, training programs, etc., are more likely to be effective in stimulating efficiency, expanding production, and creating jobs.

Finally, the discriminatory investment credit provisions of the Administration's proposals would appear to be clearly incompatible with the "national treatment" provisions of the various treaties of friendship, commerce and navigation to which the United States is a party. Article XVI of that with Japan is typical.

"1. Products of either Party shall be accorded, within the territories of the other Party, national treatment and most-favored-nation treatment in all matters affecting internal taxation, sale, distribution, storage and use."

The Congress has the power to abrogate this country's treaty obligations through legislation enacted subsequent to the treaty. However, we very much doubt, and we urge this Committee seriously to weigh, whether the insubstantial, temporary, and uncertain benefits which the discriminatory provisions of the tax credit may achieve counterbalance the unilateral abrogation of mutually advantageous "national treatment" obligations of the United States and other nations.

Should this nation step away from its treaty obligations for the sake of gaining petty leverage to negotiate great questions? The wisdom or propriety of a government's "buy national" policies, such as those reflected in the Buy American Act, presents one order of questions in the field of non-tariff trade barriers. The proposal in H.R. 10947 would, given the size of this market, create a non-tariff trade barrier of much greater consequence.

The effective exchange rate differential resulting from the combination of the import surcharge and the discriminatory investment credit proposal is a clear case of economic overkill. For example, even without the enactment of the present bill, Japanese goods of all kinds are already at a price disadvantage of 19 percent in this market (supplemental duty plus the current appreciated value of the yen), as compared with their competitive position a month ago. Enactment of the discriminatory investment credit would result in an additional 10 percent potential price effect. Although these measures would establish the level of price disadvantage at 29 percent for equipment for which the credit would be available. No good reason, or reason of any kind, has been given or can be given for enacting legislation to establish such an artificial and inflationary price disadvantage.

It is respectfully submitted that this Committee should omit from any investment tax credit provisions which it may propose a discrimination against goods of foreign origin, whether or not alleviated by the possibility of a Presidential exemption from the discrimination.

NATIONAL MILK PRODUCERS FEDERATION,
Washington, D.C., Oct. 18, 1971.

Hon. RUSSELL B. LONG,
Chairman, Senate Committee on Finance,
New Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: The National Milk Producers Federation wishes to point out that it is in favor of the House version of the Revenue Act of 1971 with the modifications herein suggested.

In their efforts to supply the nation with a wholesome and plentiful supply of high quality dairy products, dairy farmers and dairy processing plants must keep pace with new technological developments. Keeping pace demands the acquisition of modern equipment and the purchase of new facilities. The investment credit was a helpful cost offset to dairy farmers, and the Federation is delighted that the House version of the Revenue Act of 1971 provides for a 7 percent investment credit. We do not feel that the three principal differences from the credit previously allowed would be detrimental to our nation's dairymen.

We are hopeful that the House conclusion that the eligibility of livestock for the investment credit will be continued. We do, however, question the treatment of livestock as not being "new property" when, for example, a cow is used for dairy purposes and later used for breeding. We cannot see the rationale for making the prior use the test for new property when, in fact, a breeding cow would be a new investment even though that cow was previously used for dairy purposes. We feel that the purpose of the buyer should control rather than prior use.

Farmers' cooperatives are taxed on the same general basis as partnerships and small corporations in the sense that one level of tax is collected from the partners, from the stockholders of small corporations, and from the members of cooperatives.

In the case of partnerships and small corporations, the benefit of the investment credit is passed through to the partners and the stockholders since they pay the tax. The same principle should be applied to farmers' cooperatives.

The farmers that own the cooperatives, and pay taxes on any net savings the cooperatives make for them, should likewise have the benefit of the investment credit passed through to them. In effect, the farmers are making the equipment investments in their own plants.

Sincerely,

PATRICK B. HEALY, *Secretary, National Milk Producers Federation.*

Washington, D.C., October 15, 1971.

Re Repeal of 20 Percent Limitation on Investment Credit Carryover.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: I would like to call your attention to a problem in the applicable dates in the provisions of H.R. 10947 that repealed the 20% limitation on investment credit carryovers. Suggestions are contained in this letter for the correction of this problem.

The Report of the Ways and Means Committee on Section 107(c) of H.R. 10947 explains the repeal of the 20% limitation on investment credit carryovers as follows:

> When the investment credit was repealed in 1969, an additional limitation was imposed on the use of carryovers of unused credits to reflect the fact that new credits would not generally arise in future years and, thus, in the absence of a limitation, there could be a substantially greater use of unused credit carryovers which would have significantly delayed the impact of the repeal. Generally, it was provided that the amount of unused credit carryovers which could be used in 1969 and later years could not exceed 20 percent of the aggregate amount of carryovers to 1969. * * *
>
> In view of the fact the allowance of a credit for newly acquired property will place a limit on the use of carryovers similar to that provided in prior law, your committee believes that the special 20 percent limitation should be removed in the case of carryovers to future years. As a result the bill provides that this special limitation is not to be applicable to carryovers to taxable years ending after December 31, 1971.

When the 20 percent limitation (contained in section 46(b)(5) of the Code) was imposed, it was, in the case of calendar year taxpayers, fully effective in the year of termination of the credit. This suggests that the repeal of the 20 percent limitation should also be fully effective in the year of reinstatement of the credit, or 1971. Additionally, it may be noted that the effective date for the removal of the 20% limit, as contained in the House bill, provides more favorable treatment for fiscal year taxpayers than for calendar year taxpayers. For example, the repeal of the limitation, as presently drafted, would not be effective for calendar year 1971, but would be fully effective for taxpayers with fiscal years ending January 31, 1972.

At a minimum the repeal of the limitation should be effective for periods after August 15, 1971, or, in the case of calendar year taxpayers, for ⅜ of 1971. This is because the reason for the existence of 20% limitation, as explained by the Committee Report, is applicable only during those periods when no new credits are being generated, and, under the Bill, new credits are generated after August 15, 1971.

An August 15, 1971 repeal date for the 20% limitation could be given effect by applying the 20 percent limitation (as well as the 50% limitation), in the case of a calendar year taxpayer, only with respect to ⅝ of the taxpayer's tax liability for the year of 1971, and applying the 50% limitation (but not the 20% limitation) to the remaining ⅜ of the tax liability for calendar year 1971.

I will appreciate the consideration of the above suggestions by your Committee. I have taken the liberty of enclosing a draft of a proposed amendment to Section 107 which incorporates the recommendation made above.

Sincerely,

F. CLEVELAND HEDRICK, Jr.

PROPOSED AMENDMENT TO SECTION 107 OF REVENUE ACT OF 1971 (H.R. 10947) TO REMOVE THE 20 PERCENT LIMITATION ON USE OF CARRYOVERS AND CARRYBACKS WITH RESPECT TO 1971

(A) by striking out the heading an inserting: "(5) CERTAIN TAXABLE YEARS ENDING IN 1969 or 1970.—", and

(B) by striking out "ending after April 18, 1969," and inserting in lieu thereof "ending after April 18, 1969, and before January 1, 1971,".

STATEMENT OF ROBERT S. MCFARLANE, PRESIDENT, NATIONAL FARM AND POWER EQUIPMENT DEALERS ASSOCIATION

SUMMARY

The Revenue Act of 1971—H.R. 10947)—restores the 7% Investment Tax Credit to depreciable equipment. The investment credit is not restored in the case of foreign produced equipment during the period of the application of the 10% additional duty imposed by the President at the time of the issuance of the freeze order. The 10% additional duty did not apply to items moving between the United States and other countries duty free which is the case with respect to farm equipment. Request is made that the 7% Investment Tax Credit be made available for duty free items by amendment to Section 103 of the Bill.

This statement is presented to the Committee on behalf of the members of the National Farm and Power Equipment Dealers Association by Robert S. McFarlane, President of the McFarlane Company, Sauk City, Wisconsin, and President of the National Farm and Power Equipment Dealers Association .

The National Farm and Power Equipment Dealers Association is composed of approximately 10,000 retail equipment dealers throughout the United States. A majority of these dealers sell equipment and provide parts and service to farmers and are a key link in the nation's agriculture. Also, many of the members sell equipment and service it to small contractors.

This statement is presented to the Committee in connection with the hearings and deliberations relating to the Revenue Act of 1971 as passed by the House of Representatives in its Bill H.R. 10947. We direct our comments to the restoration of the 7% investment tax credit (provided in Section 101 of the Bill and Sections 49 and 50 of the Code) and more particularly to the limitation of the credit to domestic products (Section 103 of the Bill and Section 48(a) of the Code).

The members of our Association are unanimous in believing that the restoration of the 7% investment tax credit will be most helpful to farmers who are operating today in a cost-price squeeze in many sections of the country. It will also be helpful to small contractors. It will boost the economy of all small rural communities and smaller cities by encouraging the purchase of new equipment by farmers and contractors.

The House passed Bill provides that the 7% investment tax credit is not to apply to any foreign produced property during the period that the 10% additional duty proclaimed by the President remains in effect. Practically all domestic farm equipment manufacturers have factories in Canada and certain other countries. Tractors, combines and other items of farm machinery move back and forth between the United States and these countries duty free.

The 10% additional duty imposed by the President does not apply to farm equipment on which there is no duty. In spite of the fact that tractors and other items of farm equipment move into the United States duty free and the additional 10% duty does not apply, the Bill restoring the 7% investment tax credit prohibits the use of the tax credit to foreign produced property, including duty free farm equipment.

Purchasers of machinery and equipment have the obligation of establishing for tax purposes that the property qualifies for the credit. Where there are any questions buyers can request warranties from the seller that the item was not foreign produced. If this is done, then where the tax is disallowed by the Internal Revenue Service because it is discovered that the item was foreign produced, the dealer will be required to reimburse the buyer in the amount of the tax disallowed.

Dealers have no way of telling in many cases whether an item, new or used, is foreign produced or made in this country. An impossible situation is thereby about to be created which will react to the detriment of farmers and dealers of farm equipment and will create an extreme hardship for both.

It is our belief that the House didn't intend to exclude equipment from the investment tax credit where the equipment moves duty free as in the case of farm equipment. This is indicated by the Bill tying the exclusion to the period of the 10% additional duty imposed by the President which does not apply to duty free items.

We, therefore, urge your Committee to revise Section 103 of the Bill to restore the 7% investment tax credit to those foreign produced items which move between the United States and other countries duty free.

REPORT OF THE NEW YORK STATE BAR ASSOCIATION TAX SECTION ON H.R. 10947

The following comments are a synthesis of comments developed by the Special Committees on Tax Incentives, Income Taxation of Estates and Trusts and Reorganization Problems:

SECTION 102(d)(3)—EFFECTIVE DATE OF RECAPTURE PROVISION WITH RESPECT TO FOREIGN USED AIRCRAFT

Section 102(c) of the Bill reduces to three and a half years the permissible amount of foreign use of aircraft leased for use outside the United States for purposes of the recapture provisions. Section 102(d)(3) of the Bill provides that this amendment shall apply to leases executed after April 18, 1969. It is believed that, in the case of property which qualified for credit under existing law, the amendment should apply only to leases executed after September 29, 1971 (or, if earlier, the date on which the Ways and Means Committee made public its decision with respect to such amendment). This modification is believed necessary to protect the lessor who entered into a lease of property which qualified for credit under existing law in reliance on the four year provision of Section 47(a)(6)(A) of the Code. For example, the lease might permit the lessee to use the leased property outside the United States for four years and the lessor would be helpless to comply with the new requirement.

SECTION 108(a)—CASUALTIES TREATED AS DISPOSITIONS

Section 108(a)(1) of the Bill repeals Sections 46(c)(4) and 47(a)(4) of the Code (dealing with exceptions to the recapture rules for casualties, thefts and other dispositions). Section 108(a)(2) provides that such repeals are applicable to casualties and thefts occurring after August 15, 1971.

It is believed that such repeals should not apply to property, eligible for investment credit under existing law, which was leased after April 18, 1969 and before September 29, 1971 (or, if earlier, the date on which the Ways and Means Committee made public its decision with respect to such repeals), if the casualty or theft occurs while the lease is binding on the lessor. Under amendments to the Code contained in the Tax Reform Act of 1969, there is no recapture of investment credit in the case of a casualty or theft occurring after April 18, 1969. In many cases, owners of property have entered into leases which do not provide for indemnity against recapture of investment credit in the case of a casualty or theft, in reliance on existing law (as amended by the Tax Reform Act).

SECTION 109—AVAILABILITY OF CREDIT TO CERTAIN LESSORS

Section 109 of the Bill denies the investment credit to non-corporate lessors except in certain limited circumstances. The Ways and Means Committee Report (on page 29) may be read as indicating that such denial should apply to a partnership as well as to the partners. Thus corporations which are members of a partnership would not qualify for the credit in circumstances where they would qualify had they made the investment directly.

There seems to be no reason for this inconsistency in treatment and it is strongly urged that it be made clear, either by statute or in the Finance Committee Report that partners which are corporations will be entitled to their allocable shares of the investment credit.

A similar problem existed with respect to an earlier version of Code Section 163(d) disallowing certain investment interest (added by the Tax Reform Act of 1969) and this problem was solved by the addition of Section 163(d)(4)(B), which made it clear that interest would not be disallowed to corporate partners.

New Section 46(d)(3)(B) adds the additional requirement for a corporate lessor to receive the investment credit that the term of the lease is less than 50 percent of the useful life of the property and that—

> "for the period consisting of the first 12 months after the date on which the property is transferred to the lessee the sum of the deductions with respect to such property which are allowable to the lessor solely by reason of Section 162 (other than rents and reimbursed amounts with respect to such property) exceeds 15 percent of the rental income produced by such property."

Since expenses of the lessor which are paid by a lessee either directly or through reimbursement may be considered additional rent for income tax purposes, it is recommended that such reimbursed expenses not be so considered for purposes of the 15 percent requirement. If such reimbursed expenses are to be excluded from the numerator of the fraction, they should also be excluded from the denominator in determining whether the 15 percent test has been met.

SECTION 301—STANDARD DEDUCTION AND PERSONAL EXEMPTION OF INDIVIDUAL RECEIVING CERTAIN TRUST INCOME

Section 301 is a provision which would add a new Section 280 to the Internal Revenue Code wholly or partially denying the standard deduction and personal exemption to individuals receiving income from reversionary trusts of which the grantor is related to the taxpayer. There may well be room for legislation to prevent use of multiple standard deductions and exemptions in the case of wealthy grantors of trusts for minor children where the income from the trusts may indirecly benefit the grantor in any case. Section 677, which is designed to deal with the problem of trusts whose income is used to discharge support and other obligations of the grantor, may not be precsie enough to forbid avoidance. The proposed legislation, however, seems to be a case of overkill.

Incme reversionary trusts are commonly used to provide an income for life to aged parents or collateral relations whose other income, age or health may not permit them to fully provide for themselves. The grantor in such cases may be moved by a sense of filial or family love rather than any state law obligations of support. His ability to provide income to such relations may require him to retain a reversionary interest so that he in turn may rely upon the income from the assets upon his own retirement or disablement. It would seem unwise for Congress to discourage the establishment of such trusts either by penalizing the grantor (unless he is discharging a support obligation within the meaning of Section 677(b)) or by imposing an increased tax burden on the impecunious income beneficiary.

At most the proposed Section 280 of the Code should be restricted to trust income received by a minor child or stepchild of the grantor, since this is the area in which the abuse which concerns the House really lies.

Even when restricted to the case of reversionary trusts for minor children, the proposal is still of doubtful soundness. The approach seems to be to increase the tax burden of the minor children. Presumably, the legislation means to strike at the grantor indirectly on the assumption that the beneficiary's tax will be paid by the grantor. While this assumption is probably more valid in the case of minor children of the grantor than the other relationships covered by the bill as it currently reads, it breaks down if the children are in the custody of a spouse divorced from the grantor.

The whole provision seems to be a piecemeal and rather arbitrary and incompletely thought-out attack on a much broader problem which is the taxation of the family as a unit. It is urged that the proposal be stricken from the bill entirely in the hope that the general study of the questions of capital gains at death and general revision of Subchapter J of the Code can encompass the problem to which Section 301 reacts—and do so in a more comprehensive and balanced manner.

SECTION 303—AMORTIZATION OF CERTAIN EXPENDITURES FOR ON-THE-JOB TRAINING AND CHILD CARE FACILITIES

Section 303 provides for a 60 month write-off of expenditures for a facility for on-the-job training of employees (or prospective employees) of the taxpayer or for child care primarily for children of employees of the taxpayer. Consideration should be given to extending the amortization provision to facilities which are jointly utilized by two or more employers. Also it would seem that the amortization provision should be applicable to property acquired or constructed by persons operating the facility for the specified purposes for one or more employers.

SECTION 302—LIMITATION ON CARRYOVERS OF UNUSED CREDITS AND CAPITAL LOSSES

Section 302(b) would add a new Section 383 to the Code which, under regulations prescribed by the Secretary or his delegate, would apply the rules of Section 382(a)(1) and Section 382(b)(1)(B) with respect to the disallowance of net operating loss carryovers to unused investment credit carryovers under Section 46(b), excess foreign tax credit carryovers under Section 904(d) and net capital loss carryovers under Section 1212.

It is recommended that this amendment be made by amending Section 382 instead of enacting a separate section, so that all the areas covered will be in one place and thereby will avoid the possibility of anyone being misled. This could be accomplished by adding references to the other carryovers immediately after the references to net operating loss carryovers in Section 382.

Furthermore, the broad delegation of authority to issue regulations is unnecessary and undesirable. The authority to issue normal interpretation regulations is adequately granted by Section 7805 and need not be specifically stated in the new section. To the extent that a specific authorization is interpreted as a grant of a wider discretion then that granted under Section 7805, it is undesirable. No such special delegation is contained in Section 382.

SECTION 304—DEFINITION OF NET LEASES

Section 304 provides that in determining whether expenses of a lessor exceed 15% of his rental income, expenses reimbursed by the lessee shall not be considered as part of the expenses of the lessor. Since expenses of the lessor which are paid by a lessee either directly or through reimbursement may be considered additional rental income for income tax purposes, it is recommended that it be made clear that they shall not be so considered for purposes of the 15% test. In other words, they should be excluded from the numerator and denominator in determining whether the 15% test has been met. A similar comment was made above with respect to Section 109.

Section 304(c) provides that the proposed amendments to the net lease definition are to be effective as to the minimum tax on tax preferences for taxable years beginning after December 31, 1969 on the theory that this result was originally intended by Congress. However, in view of the fact that a statutory amendment was deemed desirable, it is apparent that the prior law was possibly misleading. Accordingly, it is urged that the amendment be applicable to leases executed after September 29, 1971 (or, if earlier, the date on which the Ways and Means Committee made public its decision with respect to such amendment). With respect to leases entered into before this date, it should be indicated that no inference is intended to be drawn from the effective date as to the treatment of such prior leases, thus leaving it to the courts to decide whether the prior law had the same meaning.

SECTION 308—CAPITAL GAINS AND STOCK OPTIONS

Section 308 amends Section 58(g)(2) of the Code to provide that for purposes of the minimum tax on tax preferences, preferential treatment should be considered to be accorded to capital gains and stock option income attributable to sources within a foreign country if the foreign country imposes no significant amount of tax with respect to such items. Section 308(b) makes this amendment effective retroactive to the original effective date of Section 58(g)(2), namely to taxable years beginning after December 31, 1969. In view of the fact that proposed Treasury regulations took a contrary position (until they were amended), it is apparent that the prior law was not sufficiently clear for the present amendment to be deemed merely a clarification. Accordingly, it is suggested that the amendment be applied prospectively, again with a provision that no inference should be drawn thereform as to the treatment under prior law.

Also, since a small amount of tax imposed by the foreign country will not prevent the minimum tax from being applicable, consideration should be given to allowing that foreign tax as a credit against the minimum tax in the event it is not otherwise allowable to the taxpayer as a foreign tax credit against his income tax.

THE AMERICAN ASSOCIATION OF PORT AUTHORITIES,
New York, N.Y., Oct. 14, 1971.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The American Association of Port Authorities, whose members are responsible for developing and operating port and terminal facilities to accommodate the foreign commerce of the United States, appreciate this opportunity to comment further on the proposed Revenue Act of 1971 (H.R. 10947) presently under consideration by your Committee.

There are two provisions in that measure as approved by the U.S. House of Representatives that concern us greatly. These are the "Buy American" restriction in the Job Development Credit proposal and the amended Domestic International Sales Corporation (DISC) Plan to provide tax incentives to exporters.

The Administration has indicated that the purpose of the proposed investment credit is to stimulate spending on new productive equipment with concomitant creation of new jobs, increased productivity and improvement in the competitive position of U.S. industry and labor in an increasingly competitive world.

It is our conviction that the proposed restriction of this credit to the purchase of domestic products for the duration of the import surcharge may actually prove counter-productive to the Administration's stated goals. If the purpose of this legislation is to accelerate modernization of U.S. industry, it should facilitate procurement by American industry of the most modern equipment available and at the least possible cost. Certainly there are instances when foreign-made equipment is best suited to a particular industry's needs. Yet, by making it unattractive for firms to buy the best equipment available anywhere at the least cost, enactment of the "Buy American" restriction may actually spur the same inflationary pressures which our nation has committed itself to containing.

The adoption of the "Buy American" provision would also signal to the International trading community that the United States has erected a new and highly restrictive non-tariff barrier. Thus, we would invite retaliation with U.S. capital equipment exports, which have enjoyed healthy surpluses in the past, especially vlunerable to counteraction by other nations.

Recognizing that differences in tax systems between the United States and other major trading nations place U.S. exports at a competitive disadvantage, this Association has adopted a standing resolution favoring the enactment of tax legislation consistent with the rules governing trade between nations which would provide tax incentives to U.S. exporters as beneficial as those provided to their competitors by other countries. Consequently, we urge your Committee to restore the DISC proposal as amended by the Committee on Ways and Means to its original form as proposed by the Administration without the "incremental" feature. Certainly, granting relatively greater DISC benefits to manufacturers who exported less in the stipulated base period would result in inequities to others who actually may have contributed more in past years to empolyment and prosperity in the U.S. by exporting more.

While the U.S. ports have invested over $2 billion in terminal and cargo handling facilities since World II, a recent survey conducted by this Association demonstrates that the physical handling of cargo accounts for but a small portion of the total number of activities which must necessarily accompany a foreign trade transaction. Research shows that activities related to the financing, promotion, documentation and handling of foreign trade provide employment for at least 1,137,000 persons residing in port regions throughout the country. As ports tend to be the driving economic force in their hinterlands and as a great portion of U.S. industry and population is concentrated about ocean and lake ports, it is our conviction that the economic interests of the members of this Assoication in urging deletion of the "Buy American" provision in the Job Development Credit proposal and restoration of the DISC plan to its original form closely parallel the national interest.

The North Atlantic Ports Association, representing U.S. Atlantic Coast public and private port interests from Maine to Virginia, concurs in these comments and joins in requesting that the views of the U.S. ports on H.R. 10947 be included in the record of hearings on that measure.

Sincerely,

CLIFFORD B. O'HARA,
Chairman, Committee XI: Foreign Commerce.

AMERICAN IRON ORE ASSOCIATION,
Cleveland, Ohio, October 14, 1971.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR CHAIRMAN LONG: The American Iron Ore Association is a trade association representing companies which mine over 94 percent of the iron ore produced in the United States and Canada. The headquarters of the Association are located at 600 Bulkley Building, 1501 Euclid Avenue in Cleveland, Ohio.

The American Iron Ore Association has followed with much interest the hearings that you are conducting on H.R. 10947 and urge your Senate Finance Committee to approve this important piece of legislation for consideration of the Senate of the United States with the amendments proposed by the Administration on the first day of your hearings.

We believe the economy of 1971 is confronted with many similar situations and possibly even more serious ones than those that faced our country in 1962 when similar steps were recommended by your Committee.

If your Committee in its deliberations does decide to amend H.R. 10947, we urge you to adopt the job development investment credit of ten percent for the first year followed by the seven percent as provided by H.R. 10947 as approved by the House of Representatives. We believe this would be a strong inducement to providing more jobs quickly.

We appreciate this opportunity to submit these comments and urge your approval of H.R. 10947 amended as suggested by the Administration.

Sincerely,

JOHN R. GREENLEE,
Chairman, Tax Committee.

PATTON, BLOW, VERRILL, BRAND & BOGGS,
Washington, D.C., October 15, 1971.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
Old Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: As counsel to Machinery Dealers National Association (MDNA), we have been requested to write the members of the Senate Finance Committee to explain MDNA's position concerning the investment credit provisions of H.R. 10947. MDNA is composed of 300 members who supply small and medium sized metalworking firms with modern used machinery and equipment. There are 105,000 metalworking firms in the United States, 90,000 of which employ fewer than 100 persons. Such smaller firms operate 43% of the 2.8 million machine tools in use in the metalworking industry.

The 1962 investment credit provision permitted the credit for annual purchases of used property not exceeding $50,000 in value. H.R. 10947 increases the $50,000 limit to $65,000 to reflect increased price levels. Further, the House Bill annually "offsets" the amount of used property eligible for the credit by the amount of new investment credit property placed into service. The "offset" represents a dollar for dollar reduction such that if a taxpayer places $50,000 of new property into service only $15,000 of used property purchases in that year are credit eligible.

The reason for extending the credit to used property in the 1962 Revenue Act and H.R. 10947 was to make the credit available to small business which traditionally has relied on used machinery and equipment to upgrade its productive facilities and we fully endorse the reasoning behind making the credit available to used property. Nevertheless, we believe the "offset" concept will be detrimental to smaller businesses because there are many types of machinery which can only be purchased new; i.e., special purpose machinery, pollution control facilities, etc. In 1965, the last full year in which the credit was available and statistics have been made public, approximately 180,000 corporations with under $5 million in assets purchased 20.3% ($7.5 billion) of new credit eligible property and 89% of credit eligible used property—see Statistics of Income in 1965, Corporations Income Tax Returns, a U.S. Treasury publication.

We submit that the House's attempt to limit the availability of the investment credit through the use of "offset" concept, can better be achieved by making the investment credit available for used property purchases up to $65,000 for corporations which have less than $5 million in assets. Accordingly, we request that the "offset" concept contained in the House Bill be deleted and that the $65,000 limitation on used property be retained for corporations which have assets of less than $5 million. In this way, we feel that smaller businesses will be able to modernize and improve their productive facilities, consistent with the purposes of the credit and their own ability to finance purchases of new and used machinery and equipment.

MDNA is fully prepared to assist the Committee and its staff in attempting to arrive at a workable solution to the problems faced by smaller businesses in their attempt to modernize and improve their productive base.

Sincerely,

THOMAS HALE BOGGS, JR.

STATEMENT SUBMITTED ON BEHALF OF AMERICAN AIRLINES, INC., PAN AMERICAN WORLD AIRWAYS, INC., AND UNITED AIR LINES, INC., BY T. F. QUINN, JR., VICE PRESIDENT, TAXES AND INSURANCE, AMERICAN AIRLINES, INC.

NET OPERATING LOSS CARRYBACKS REGULATED AIR TRANSPORTATION COMPANIES

This statement directs attention to a proposal for inclusion in H.R. 10947 which would be an important step in affording some relief from the distressing financial situation of an important segment of the nation's certified airlines, and in stimulating the sector of the airline economy along the lines envisioned in H.R. 10947.

Under present law, airlines and other regulated transportation companies may spread operating losses over a period of ten taxable years, with a carryback of three years and a carry-forward of seven years. Because of the length of time between profit periods for airlines, the three-year carryback has proved inadequate as an income averaging device. It has left several airlines unable to carry back their heavy 1970 losses to the nearest unutilized profit years, 1965 and 1966.

The proposal would allow airlines to carry back a net operating loss for a period of five years preceding a loss year and then to carry forward any unused part of the loss for a period of five years. This 10-year period corresponds to the 10-year period for which airlines are now allowed to apply net operating losses, but the proposal would permit the carryback period to begin five, instead of three, years prior to the loss year, and would require the carryforward period to end five years instead of seven, after the loss year.

At the present time, net operating losses of regulated transportation corporations (including airlines) are first carried back and applied against income of the three years preceding the loss year and then carried over and applied against income of the seven years succeeding the loss year. In contrast, unregulated corporations generally are allowed a three-year carryback and a five-year carryforward of such losses. The longer period for application of losses allowed to regulated industries reflects their controlled profitability situation even in good years.

The refund allowed by a loss carryback, rather than subsequently reduced taxes allowed by a loss carryforward, is particularly appropriate as a means of placing funds in the hands of these regulated airlines at a time when they are incurring losses and in serious need of cash resources to continue operations. The airline profit and loss experience tends to be extremely cyclical in nature, so that even a relatively mild general business recession can cause a substantial drop in airline traffic and profitability, and can put great pressure on the cash resources of an airline at the lower points of the cycle. Moreover, the cycles are of long duration; the last period of general profitability approaching permitted rates of return having occurred more than three years prior to 1970, with no immediate prospect of regaining these levels of profitability now in sight. Finally, airline earnings have been extremely poor over the last decade, averaging well below the rate of return permitted by the Civil Aeronautics Board. Accordingly, when large losses are experienced, they can readily exceed the low earnings, if any, of the three years immediately preceding the loss year.

In addition to being, in many cases, more useful to the recipient than a carryover would be, the carryback is also desirable from a fiscal standpoint, since it tends to be countercyclical, paying out refunds in bad years when the airlines and the economy need stimulation, in contrast to the loss carryover, which has some tendency to accentuate the business cycle and increase inflationary pressure by decreasing taxes in good years.

The airline industry, like other sectors of the economy, should benefit from the economic stimulus to be expected from the President's New Economic Policy reflected in H.R. 10947, now before the Senate Finance Committee. However, the main aid to business in the President's program is the Job Department Credit. The credit, as provided in the House bill, will have a stimulating effect on the economy and create added jobs but will not cure the pressing current problems which certain airlines are facing. The credit will be of little use to those airlines whose 1971 earnings are minimal or nonexistent, and any 1972 or 1973 profits will be offset by carryovers of 1970 and 1971 losses unless the present proposal is enacted permitting these losses to be carried back to 1965 and 1966.

The need for this relief is demonstrated by the recent history of three major carriers. Based on published figures, their net income (or loss) is as follows—

[In millions]

	1969	1970	1971 [1]
Pan American World Airways	(25.9)	(47.9)	(39.5)
United Air Lines	44.6	(40.9)	(32.1)
American Airlines	38.5	(26.4)	(23.2)

[1] 6 months.

Unless the present proposal is enacted, these airlines will be unable to carry back 1970 and any ultimate 1971 losses to 1965 and 1966, and will have to carry them forward against the uncertain earnings prospects of future years.

At a time of depressed earnings or heavy losses, the dubious prospect of a carryforward provides no immediate cash relief to airlines faced with the problem of servicing their existing aircraft acquisition obligations as well as meeting commitments to acquire aircraft in the near future. A five year carryback, however, would greatly assist certain airlines to meet their current cash needs for equipment acquisitions and thereby contribute to the stimulation of the economy.

The proposal is limited to airlines, because other transportation corporations do not generally have the airlines' extremely cyclical profit and loss experience with each cycle extending over a long period of time. Surface transportation lines have, therefore, expressed no interest in having available the proposed five year carryback. Moreover, from the administrative point of view, an amendment limited to airlines will be far easier for the Internal Revenue Service to apply than one applicable to the much larger number of railroad and truck carriers.

Not all airlines have 1970 or 1971 losses that could advantageously be carried back into 1965 or 1966. However, our proposal would not deprive such carriers of any future benefits they might anticipate from the present three year carryback-seven year carryforward of losses already incurred.

Under the proposal, an airline would be permitted to continue to apply its losses on the three back and seven forward basis until—even after application of the seven-year carryforward of losses from prior years—the airline has had taxable income for two consecutive years. Losses incurred thereafter would be applied on the new five years back and five years forward basis. A regulated air carrier could, however, elect the new five and five treatment at any time, beginning with the year 1970. Once on a five and five basis, the airline would not be permitted to return to the three and seven years treatment. These rules are intended to avoid hardship during the transition period.

The revenue effect of the proposal is a current outflow of $64.8 million (based on current estimates of 1971 losses), but, in reality, this is merely a revenue deferral inasmuch as these losses would have been allowable in the future. It is respectfully submitted that this revenue deferral is not unreasonable in amount in the light of the goal sought to be achieved by the proposal. The stimulative effect of this proposal is entirely consistent with the policy underlying the changes in the tax structure now contained in H.R. 10947, and is indeed necessary if many of the nation's largest airlines are to derive the anticipated stimulative benefit from the depreciation and tax credit provisions of this measure.

A draft of an amendment to the Internal Revenue Code intended to carry out the proposal herein outlined is attached to this statement.

A BILL To amend the Internal Revenue Code of 1954 with respect to the treatment of net operating losses of regulated transportation corporations

Be it enacted by the Senate and House of Representatives of the United States of America in Congress Assembled, That (a) section 172(b)(1) of the Internal Revenue Code of 1954 (relating to net operating loss deduction) is amended—

(1) by striking out in subparagraph (A)(i) "subparagraphs (D)," and inserting in lieu thereof "subparagraphs (C), (D),"; and

(2) by revising subparagraph (C) to read as follows:

"(C) Except as provided in subsection (j), in the case of a taxpayer which is a regulated transportation corporation (as defined in subsection (j)(1)) a net operating loss for any taxable year shall be—

"(i) a net operating loss carryback to each of the 3 taxable years preceding the taxable year of such loss and a net operating loss carryover to each of the 7 taxable years following the taxable year of such loss; or

"(ii) in the case of a taxpayer to which subsection (j)(5) applies, a net operating loss carryback to each of the 5 taxable years preceding the taxable year of such loss and a net operating loss carryover to each of the 5 taxable years following the taxable year of such loss."

(b) Section 172(j) of such Code (relating to carryover of net operating loss for certain regulated transportation corporations) is amended—

(1) by striking out in the heading thereof "CARRYOVER" and inserting in lieu thereof "CARRYOVER AND CARRYBACK";

(2) by striking out paragraph (3) and inserting in lieu thereof the following:

"(3) LIMITATIONS.—

"(A) For purposes of subsection (b)(1)(C)(i)—

"(i) a net operating loss may not be a net operating loss carryover to the 6th taxable year following the loss year unless the taxpayer is a regulated transportation corporation for such 6th taxable year; and

"(ii) a net operating loss may not be a net operating loss carryover to the 7th taxable year following the loss year unless the taxpayer is a regulated transportation corporation for the 6th taxable year following the loss year and for such 7th taxable year.

"(B) For purposes of subsection (b)(1)(C)(ii)—

"(i) a net operating loss may not be a net operating loss carryback to the 4th taxable year preceding the loss year unless the taxpayer was a regulated air transportation corporation for such 4th taxable year; and

"(ii) a net operating loss may not be a net operating loss carryback to the 5th taxable year preceding the loss year unless the taxpayer was a regulated air transportation corporation for the 4th taxable year preceding the loss year and for such 5th taxable year."

(3) by adding at the end thereof the following:

"(5) REGULATED AIR TRANSPORTATION CORPORATIONS.—

"(A) Section 172(b)(1)(C)(ii) shall apply to a regulated air transportation corporation (as defined in subparagraph (B)) if the corporation—

"(i) elects (at such time and in such manner as the Secretary or his delegate by regulations prescribes) to have a net operating loss for any taxable year beginning after December 31, 1969, treated in the manner described therein; or

"(ii) has taxable income (determined without regard to any deductions under this section to the extent attributable to a carryback of a net operating loss) for the 2 consecutive taxable years beginning after December 31, 1970 immediately preceding the taxable year in which a net operating loss occurs.

If a taxpayer elects under clause (i) or is subject to clause (ii) for any taxable year, section 172b(1)(C)(ii) shall be applicable to all succeeding taxable years of the taxpayer.

"(B) For purposes of this subsection, a 'regulated air transportation corporation' is a corporation which satisfies the conditions of subsection (j)(1) without regard to subparagraphs (A), (C)(i), (F), (G) or (H) of section 7701 (a)(33)."

SEC. 2. (a) The amendments made by this Act shall apply with respect to net operating losses sustained in taxable years ending after December 31, 1969.

(b) Notwithstanding any law or rule of law, a tentative carryback adjustment under section 6411 attributable to the amendments made by this Act may be made or allowed if application therefor is filed within the period allowed by section 6411 or within 90 days after the enactment of this Act. No interest shall be allowed with respect to any refund or credit of any overpayment attributable to the amendments made by this Act.

STATEMENT OF JOHN E. MITCHELL, PRESIDENT, MASSEY-FERGUSON INC.

Certainly my company, and I am sure our dealers and customers, support restoration of the investment tax credit. I personally have no doubt whatsoever that passage of the bill, like its predecessor, will have an immediate, and substantial, favorable impact upon our domestic economy. I am concerned, however, that the impact of House Bill No. 10947 upon foreign produced, non-dutiable property, and in particular non-dutiable Canadian agricultural machinery, may not be fully appreciated.

While Massey-Ferguson is generally thought of as a company with strong Canadian ties it is truly a multi-national company with a significant commitment to the United States. Massey-Ferguson Inc., our United States company, has existed since 1928, as both a manufacturer and a distributor of agricultural machinery. Our company's North American headquarters are located in Des Moines, Iowa, and a major manufacturing facility is located in that city. Substantially all Massey-Ferguson agricultural tractors sold in North America are produced in Detroit, Michigan. In terms of the criteria customarily employed for such purposes, Massey-Ferguson's commitment to the United States, based upon 1970 data, is substantial:

Total U.S. assets	$322, 000, 000
Total U.S. sales	$222, 000, 000
Total exports of U.S. manufactured product	$45, 000, 000
Total salaries/wages paid	$47, 000, 000
Total U.S. dealers	1, 877
Total U.S. employment	4, 798

For nearly 30 years, a totally free market has existed between the United States and Canada in agricultural machinery. Given this long-standing common market, and in reliance upon its continuation, some manufacturers of agricultural machinery, and most particularly Massey-Ferguson, have located their manufacturing facilities within the two countries in order to achieve the most efficient total manufacturing system. Highly integrated manufacturing arrangements have developed whereby, for example, a prime power source such as a tractor may be manufactured in one country while the implements used with the power source are manufactured in the other country. The farmer has clearly benefited as a result of the economies derived from this manufacturing integration which could only have come about as a result of Canadian-United States free market. Under this system the trade balance between the United States and Canada in agricultural machinery has historically been favorable to the United States. It presumably has not been the intention of the Administration to disrupt this system since it did not choose to assess the import surcharge against non-dutiable agricultural machinery. I suggest that it is equally unlikely that the House has consciously intended to burden such machinery with tax credit disqualification and the disruptive consequences that would follow from that action.

The consequences of denial of the tax credit on agricultural machinery imported from Canada would be most severe. To the integrated manufacturer, such as Massey-Ferguson, denial of the tax credit would mean not only lost sales by Massey-Ferguson Inc. but also a serious impairment of its capacity to continue as an effective full-line competitor in the United States market. To the nearly 1500 independent agricultural machinery dealers of Massey-Ferguson in the United States, denial could result in an impairment of their capacity to continue in business as dealers in agricultural machinery. To the thousands of users of Massey-Ferguson products, denial of the tax credit would result not only in economic loss, but also ultimately in a narrowing of product availability.

Under the House bill, the President may relieve tax credit disqualification when in the national interest. While I would pursue such discretionary relief failing the legislative action that I request, this approach is clearly inadequate in view of the character and magnitude of the problem. Given the consistent coupling of tax credit disqualification with the existence of the surcharge, governmental assurances of retroactivity of the credit, and also the qualification of foreign property under prior law, many purchasers of Canadian farm machinery undoubtedly have assumed that the tax credit will be available. The long delays and uncertainties likely to be involved in seeking administrative relief would further aggravate this situation. Given continuation of this confused period in which purchases of farm machinery may continue to be made in ignorance of tax credit disqualification, the Administration must be given latitude to provide retroactive relief under the discretionary power.

I ask that the Committee consider the practicability of fully qualifying imported agricultural machinery for tax credit. Should this broader approach not be deemed appropriate, then I would ask that such qualification be extended to Canadian produced agricultural machinery. Failure to legislatively extend this narrower relief would seriously undermine the principle of free trade in such products and jeopardize the financial commitments of not only manufacturers, but countless dealers and farm customers who have relied upon continuation of that system.

Finally, if legislative relief is not granted, I ask that the Committee authorize retroactive Administrative relief from tax credit disqualification, and, further, that the Committee, in its report, specfically identify non-dutiable products as a class to which relief might be extended.

BITTEL LANGER BLASS & CORRIGAN,
Miami, Fla., October 11, 1971.

Senator RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: We wish to call your attention and that of the Committee on Finance to some problems in connection with *Section 307* of H.R. 10947 (the proposed Revenue Act of 1971) as enacted by the House of Representatives. Section 307 would add 4 words to Section 921 of the Internal Revenue Code. However, in doing so, it would create 4 new problems—one a policy question and the others of a technical nature.

The provision seeks to deprive U.S. corporations from Western Hemisphere Trade Corporation benefits if they engage in substantial business in the U.S. Virgin Islands. We have closely followed the progress of the recent court case referred to on page 49 of the House Ways and Means Committee Report (No. 92–533) through the courts, to and including the denial of certiorari by the United States Supreme Court.

The Western Hemisphere Trade Corporation provisions have been a part of the Internal Revenue Code for nearly 30 years. An Internal Revenue Service ruling issued in 1945 (I.T. 3748, 1945 C.B. 152) made it clear that the Virgin Islands and Puerto Rico were both eligible Western Hemisphere "countries". Notwithstanding the clear intent of Congress and the Internal Revenue Service ruling, the Tax Division of the U.S. Virgin Islands Department of Finance has taken the position that it was not possible to obtain Western Hemisphere Trade Corporation benefits in the Virgin Islands. The matter was litigated and the courts have held that Western Hemisphere Trade Corporation benefits are available in the Virgin Islands just as they are in Puerto Rico, the Canal Zone, and elsewhere throughout the Western Hemisphere.

The basic argument of the Virgin Islands Government to the courts (and presumably also to the Congress) appears to be that if the law is permitted to remain as it is, they will lose considerable revenue. It should be noted, however, that the revenue they claim to be losing is actually revenue to which they were never entitled in the first place. There appears to be no policy justification for singling out the Virgin Islands for elimination of Western Hemisphere Trade Corporation benefits.

Even if the Congress were to decide that there is economic justification for such an amendment, the provision as presently drafted is technically deficient for these reasons:

(a) Section 921 of the Code contains a 3-year test. Thus, a corporation seeking to qualify as a Western Hemisphere Trade Corporation during 1972 must meet the income requirements for the 1970–1972 period. There are a number of companies engaged in business throughout the Caribbean area, including the U.S. Virgin Islands. If the proposed provision is enacted, these companies might find it impossible to qualify as a Western Hemisphere Trade Corporation during 1972 and 1973, even if they did no business in the U.S. Virgin Islands during those years, simply because they had done such business during 1970 and 1971. This would probably be true, for example, in the case of a company which had done 10% of its business in the U.S. Virgin Islands during those years, simply because they had done such business during 1970 and 1971.

(b) The House Report indicates that the provision is directed toward those companies "doing a substantial volume" of business in the U.S. Virgin Islands. As drafted, the provision would deny Western Hemisphere Trade Corporation benefits to a company doing 6% of its business in the Virgin Islands. It would also deny such benefits to a company doing only 2% of its business in the Virgin Islands if such company did another 4% of its business elsewhere, either outside the Western Hemisphere or in the mainland United States. This could hardly be deemed "doing a substantial volume" of business in the Virgin Islands.

(c) Although the provision is apparently directed toward helping the Treasury of the "Government of the Virgin Islands of the United States," it talks about the "Virgin Islands," a term which is probably more accurately applies toward "The Virgin Islands," meaning the British Virgin Islands. We know of several U.S. companies being operated wholly or in part within the British Virgin Islands and there is certainly no policy reason why such companies should be denied Western Hemisphere Trade Corporation benefits. If the provision is enacted it should clearly apply only to the U.S. Virgin Islands.

We do not feel that there is a sufficient policy reason for changing Section 921 at all. If, however, the Committee disagrees and feels that it should be changed, then we suggest that the change be effected in a different manner so as to eliminate the technical deficiencies set forth above. This could be done by completely eliminating the change made by the House of Representatives and in lieu thereof adding a sentence to Section 921 of the Code reading substantially as follows:

"A corporation shall not qualify as a Western Hemisphere Trade Corporation for any taxable year during which more than 20% of its gross income is derived from sources within the Virgin Islands of the United States."

Yours sincerely,

MARSHALL J. LANGER.

FORD MOTOR CO.,
Washington, D.C., October 13, 1971.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Word has come to me that persons outside Ford Motor Company have alleged to members of the Senate Finance Committee that the enactment of the Job Development Investment Tax Credit would make no appreciable difference in Ford's investments.

In order to provide the Committee with the views of the Company on this issue, I am enclosing a copy of a statement which has been approved by Ford management for transmission to the members of the Senate Finance Committee.

I trust that this statement will serve to eliminate whatever misunderstandings may have resulted from the earlier allegations.

Sincerely,

RODNEY W. MARKLEY, Jr.

EFFECT OF INVESTMENT TAX CREDIT

General

The overall effect of an investment tax credit is to make *all* investments relatively more attractive. This effect acts as an investment stimulus in two ways—*directly*, by making previously marginal programs attractive enough for implementation, and *indirectly*, by making the basic business more attractive so that continued *reinvestment* is encouraged.

Direct Effects

The greatest direct impact of an investment credit would be in the "cost savings" category, with modest direct effects on the reinvestment categories (capacity, product, modernization, pollution control, etc.). From our experience with the previous credit, we would estimate that our expenditures could increase by about $25 million a year for this direct effect.

Indirect Effects

In the case of Ford (and most established businesses), the majority of our spending programs are related to *reinvestment* in our basic businesses, and the investment credit would have only a minor "direct" effect on these spending plans. Based on the present state of the industry, we are planning to spend over $500 million annually on capitalized facilities in the U.S. over the next several years, principally for reinvestment for capacity, product, and facilities modernization programs. For this reinvestment spending, the investment tax credit would represent a substantial *indirect* incentive by increasing the basic attractiveness of reinvestment in the economy. Specifically, the tax credit would be a small offset to tohse other factors (cost/price squeeze, imports, recent recession, etc.) that have severely depressed profit margins and returns in the auto industry and throughout most of the U.S. business community. Given the unattractive state of business profits, this *indirect* reinvestment stimulus could be of more value than the more visible direct effects that Mr. Woodcock and others seem to view as the only result of the proposed credit.

NATIONAL FOREIGN TRADE COUNCIL, INC.,
New York, N.Y., October 15, 1971.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: The National Foreign Trade Council strongly supports the Administration's original proposals for tax inducements contained in the President's statement announcing his new integrated economic policy on August 15th.

We look with favor upon the Administraton's proposal for the Job Development Tax Credit since we believe it will improve the country's capacity to export and to meet foreign competition abroad. We would be equally satisfied with the general principles of the Ways and Means Committee's version of the Job Development Tax Credit which was enacted by the House of Representatives. However, we do have several technical amendments to suggest which would be equally applicable to either version.

Our first suggestion relates to the fact the Job Development Tax Credit would not apply to section 38 property which is used abroad. The presumed reason for this rule is that Congress did not want to export those jobs involved in the utilization of this property to foreign areas. However, in certain cases there is no alternative to the use of the section 38 property in foreign areas (examples are offshore oil drilling equipment for use in the North Sea, West Africa, etc., and generating equipment ordered by American utilities operating abroad). In such cases the failure to provide the benefits of the Job Development Tax Credit could result in a decision to purchase the equipment from foreign manufacturers thus resulting in the loss of U.S. employment in the manufacture of such equipment with no offsetting benefit. Therefore, it is suggested that the Job Development Tax Credit should apply to section 38 property manufactured in the U.S. and used abroad in those cases where such property is used in an activity which is not in competition with U.S. situated business.

Our second recommended change pertains to the interplay of the Job Development Tax Credit and the Minimum Tax on Tax Preferences. As presently drafted it appears that the proposed Job Development Tax Credit will cause an increase in the minimum tax liability of many taxpayers subject to the Minimum Tax on Tax Preferences. It could be remedied by having the calculation of the Minimum Tax on Tax Preferences be made before investment credit, i.e. by eliminating section 56(a) (2) (A) (iii).

Under the present Minimum Tax on Tax Preferences (secs. 56–58 of the Code) the base for the minimum tax is the total of the taxpayer's preference income (over $30,000) *reduced* by his normal income tax liability after all credits, which would apparently include the Job Development Tax Credit. If this formula is retained the intended benefit from the Job Development Tax Credit will be diluted. As noted above, the reason for this is that the tax base for the "tax preference income", would be reduced by the taxpayer's normal income tax liability after reduction by the Job Development Tax Credit.

The Job Development Tax Credit (like the prior Income Tax Credit) contains a limitation of 50 percent of tax liability. The Minimum Tax on Tax Preferences should be included in this limitation base as the Internal Revenue Service considers it as an income tax. Treating the Minimum Tax on Tax Preferences in this manner would be consistent with the treatment of the recently expired tax surcharge in the calculation of the Investment Tax Credit.

Another point regarding the Job Development Tax Credit relates to pollution control facilities. We are convinced that an increasing problem for American exporters will be the added cost burden resulting from pollution control installations required by law in the United States but which are not required in the respective countries of their export competitors.

This general problem was given recognition in the Tax Reform Act of 1969 which included a provision for a special five-year amortization of pollution control facilities. However, the House-passed version of the Job Development Tax Credit denies the credit for those facilities for which a taxpayer elects the special five-year amortization. We believe this limitation is ill-advised for the reasons stated above and we urge your Committee to eliminate it.

It is our belief that the Administration's original DISC proposal could provide an effective means of increasing exports thereby helping to overcome the country's balance of payments difficulties. In contrast we are concerned that the DISC incremental approach passed by the House of Representatives might do little toward increasing export sales or even retaining the present level of exports. In addition, the use of a base period to measure incremental exports would be exceedingly difficult to administer and would discriminate in favor of new exporters at the expense of many of our member companies who have long been established in the export field. In order to bring about a reversal in the balance of payments situation it is as important to retain present export markets as it is to establish new export markets. Both objectives were provided for in the Administration's DISC proposal which we strongly urge be reinstated.

However, we have certain amendments to suggest which we believe would further the purpose of DISC by eliminating possible controversies between taxpayers and the Treasury over transfer prices between the manufacturing parent company and its DISC. The proposed amendments relate to Section 994 of the Internal Revenue Code and are as follows:

"SEC. 994. INTERCOMPANY PRICING AND RELATED RULES.

"(a) SALES OF PROPERTY.—In the case of a transfer of export property to a DISC by a person described in section 482, the price at which such property is transferred to a DISC shall be deemed to comply with the provisions of section 482 if the taxable income of such DISC realized upon its sale of such property does not exceed an amount which is the greatest of:

"(1) 4 percent of the qualified export receipts on the sale of such property by the DISC plus 10 percent of the export promotion expenses of such DISC attributable to such receipts.

"(2) 50 percent of the combined taxable income of such DISC and such person which is attributable to the qualified export receipts on such property derived as the result of a sale by the DISC plus 10 percent of the export promotion expenses of such DISC attributable to such receipts, or

"(3) taxable income based upon the sale price actually charged (but subject to the rules provided in section 482).

"(b) COMMISSION.—In the case of a sale of export property by a person related to a DISC as described in section 482 which, if such property had been transferred to a DISC and sold by the DISC, would have resulted in 'qualified export receipts' to the DISC, any commission payment made by such person to the DISC with respect to the sale of export property by such person shall be deemed to comply with the provisions of section 482 provided that such commission does not exceed the amount which is the greatest of:

"(1) 4 percent of the gross receipts from the sale of such property plus 10 percent of the export promotion expenses of such DISC attributable to such receipts,

"(2) 50 percent of the combined taxable income of such DISC and such person which is attributable to the qualified export receipts on such property derived as the result of the sale by such person plus 10 percent of the export promotion expenses of such DISC attributable to such receipts, or

"(3) the commission actually paid (but subject to the rules provided in section 482).

"(c) SERVICES.—Where services are performed in behalf of a DISC by a person described in section 482, the amount charged the DISC by such person as consideration for the services performed shall be deemed to comply with the provisions of section 482 provided that the amount charged is not greater than the amount determined to be an appropriate charge under section 482 without regard to the provisions of this subparagraph.

"(d) RENTALS AND MARGINAL COSTING.—The Secretary of his delegate shall prescribe regulations setting forth—

"(1) rules which are consistent with the rules set forth in subsection (a) and (b) for the application of this section in the case of rentals and other income, and

"(2) rules for the allocation of expenditures in computing combined taxable income under subsections (a)(2) and (b)(2) in those cases where a DISC is seeking to establish or maintain a market for export property.

"(e) EXPORT PROMOTION EXPENSES.—For purposes of this section, the term 'export promotion expenses' means those expenses incurred, either directly by a DISC or by a person described in section 482 in behalf of the DISC and charged to the DISC, to advance the distribution or sale of export property for use, consumption, or distribution outside of the United States, but does not include income taxes. Such expenses shall also include freight expenses to the extent of 50 percent of the cost of shipping export property aboard ships documented under the laws of the United States in those cases where law or regulations does not require that such property be shipped aboard such ships.

"(f) APPLICATION OF SECTIONS 61 AND 269.—The provisions of sections 61 and 269 shall not apply to a DISC or a person described in section 482 for the purposes of making any reallocations of income, expenses, deductions credit or other charges from a DISC to a person described in section 482."

Respectfully submitted,

MALCOLM ANDRESEN,
Director, Tax-Legal Division.

STATEMENT OF THE AMERICAN IMPORTERS ASSOCIATION, INC., SUBMITTED BY GERALD O'BRIEN, VICE PRESIDENT

JOB DEVELOPMENT CREDIT

American Importers Association, the national organization of importers, offers this statement to the Finance Committee of the U.S. Senate in connection with the Investment Tax (Job Development) Credit proposal described by Secretary of the Treasury Connally in his testimony before the Committee on October 7.

The proposed Investment Tax Credit could apply to a very wide range of imported goods. The FOB value in 1970 of imported articles of the types described in the tax credit proposal was over $17 billion dollars. (Publication F.T. 990, U.S. Dept. of Commerce.) When duty and other expenses are added, this figure easily reaches $20 billion dollars or more. Thus the credit proposed is of enormous significance to the American economy. The impact of the contemplated discrimination against imports therefore affects a very large number of importers, their U.S. customers, and their suppliers in foreign countries.

Machine tools are perhaps the most directly and seriously affected of all imports. The views of AIA's Machine Tool Group have been presented to the Committee separately in writing.

On behalf of *other* importers who will be adversely affected, the American Importers Association presents the following arguments against eliminating imports from the benefits of the Investment Tax Credit.

"Buy American"

The duty surcharge and the increase in costs because of currency revaluation are probably more than enough to accomplish the Administration's purpose of rearranging our foreign trade structure. It is hardly necessary to add an additional sanction, namely, discriminatory tax treatment of foreign-made goods. Since this discrimination is not really needed, this feature is nothing more than a blatant and hardly disguised "Buy American" proposal, a form of protectionism repudiated by this administration and every administration since 1932.

Discrimination Against Certain Importers

Importers of merchandise which could be eligible for the tax credit are subjected to a burden not applicable to any other group of importers. The import surcharge and the additional cost arising out of foreign currency revaluation, together, would normally come to 20% to 35%, depending on the ultimate extent of revaluation. To this extent, a disadvantage is shared by all importers. Importers of tax credit goods, however, are singled out for an additional burden, namely, a deprivation of a tax advantage given to domestic manufacturers. This discrimination has no justification and is without defensible economic reason.

Efficiency and Competition

Foreign equipment often is more efficient and more productive as well as somewhat cheaper. If such goods are for all practical purposes eliminated from our economy there will be a loss of effiicency, of productivity, and of incentive to be competitive.

Employment Loss

Under the proposed tax credit plan, some employment may be created for workers making tax credit goods; but workers engaged in importing such goods will lose their jobs also.

Nonimporters Hit

The proposed tax credit will affect not only the importer but domestic wholesalers and retailers not otherwise involved in importing.

Currency Revaluation

It is obvious that the discriminatory feature of the Investment Tax Credit Program is being used as a club to force our trading partners to agree to various adjustments in currency exchange rates and tariffs. We believe this is a misuse of our taxing program, unfair to our suppliers aboard and to our own importers, and to other American sellers of imported goods who are not importers.

Favorable Trade Balance

Tax credit goods are exported by the U.S. in much larger quantities than imported into the U.S. In such merchandise we have a large favorable balance of trade—an even larger balance would result if imports of goods made by foreign subsidiaries of U.S. companies were deducted. Discrimination against foreign tax credit goods would surely invite retaliation by foreign countries and a serious loss in this favorable balance—ultimately a serious blow to the Administration's program.

Delayed Results

There is serious reason to believe that domestic manufacturers will be unable in the near future to fill all orders for tax credit goods. Those whose orders are not filled will undoubtedly wait for delivery in order to get the tax credit. This in itself could delay the purpose of increasing productivity and creating new jobs.

Violation of GATT

The imposition of the duty surcharge is itself a violation of the General Agreement on Tariffs & Trade. The tax discrimination feature is still another violation of GATT and also a new non-tariff barrier—a type of hindrance to foreign trade which the administration has repeatedly said it wishes to abolish.

Violations of Treaties

The United States has treaties of Friendship, Commerce and Navigation with all our trading partners which prohibit different treatment for imported goods from that given domestic goods. The present proposal represents a distinct violation of these treaties.

Violation of Due Process

There is serious question as to whether such discrimination against importers is not in violation of the due process clause of the Constitution.

Added Inflation

It would surely not help the fight against inflation if reasonably priced and more efficient foreign goods were eliminated in favor of more expensive domestic made equipment. Faced with the same problem, neither Germany nor France made such a mistake.

American importers are certainly in favor of reasonably designed steps that would help our country to solve its serious economic problems. The import trade has even accepted *special burdens* which other elements of our economy escape. But importers see no justification for singling out a special group of importers for peculiar burdens which are unfair, unnecessary, possibly invalid, and in the long run self-defeating. AIA requests that the tax credit feature be revised to remove any and all discrimination against imports eligible for the Investment Tax Credit.

LAKE MILLS CHAMBER OF COMMERCE,
Lake Mills, Wis., October 14, 1971.

Senator RUSSELL B. LONG,
Chairman, Committee of Finance,
Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: Lake Mills, Wisconsin, is a small town of 3500 people located in rural Wisconsin, in the heart of America's dairyland. The merchants in our city depend heavily on agriculture for their livelihood and would benefit greatly from an increased investment tax credit should this be granted.

The City of Lake Mills and the Lake Mills Chamber of Commerce urges your support for Senator Pearson's amendment to the present 7% investment tax credit.

Thank you for your consideration.

Very truly yours,

STEVEN C. QUANDT,
Secretary-Treasurer.

INDEPENDENT BUSINESS ASSOCIATION OF WISCONSIN,
Milwaukee, Wis., October 14, 1971.

RUSSELL B. LONG,
Chairman, Committee of Finance,
Senate Office Building, Washington, D.C.

DEAR SENATOR: Regarding the 7% tax credit bill and the amendment to that bill introduced by Senator Pearson of Kansas.

We, as a rural business, Lake Mills Concrete Products Co., in the small town of Lake Mills, Wisconsin and a member of the Independent Business Association of Wisconsin would like to express our desire to see that 14% amendment as introduced by Senator Pearson go into effect.

We would like you to vote in favor of this amendment.

Sincerely,

KENNETH R. PERSSON,
Lake Mills Concrete Products Co.

CRETNEY BUILDINGS, INC.,
Lake Mills, Wis., October 15, 1971.

Senator RUSSELL B. LONG,
Chairman, Committee of Finance,
Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: Cretney Buildings, Inc. manufactures Pole Buildings in Lake Mills, and markets them throughout the State of Wisconsin for distribution to farmers.

As a young company whic his seriously affected by the amount of money farmers can invest in new feed handling equipment for their farms, we urge your support for Senator Pearson's amendment to the present 7% investment tax credit.

Thank you for your consideration.

Very truly yours,

ERNEST J. CRETNEY, *President.*

FIBERDOME INC.,
Lake Mills, Wis., October 14, 1971.

Senator RUSSELL B. LONG,
Chairman, Committe of Finance,
Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: Fiberdome, Inc. manufactures fiberglass silo roofs in Lake Mills, and markets them throughout the United States for distribution to farmers.

As a young company which is seriously affected by the amount of money farmers can invest in new feed handling equipment for their farms, we urge your support for Senator Pearson's amendment to the present 7% investment tax credit.

Thank you for your consideration.

Very truly yours,

STEVEN C. QUANDT,
Marketing Manager.

AMERICAN TEXTILE MANUFACTURERS INSTITUTE, INC.,
Washington, D.C., October 19, 1971.

Re H.R. 10947.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The American Textile Manufacturers Institute, Inc. has repeatedly urged the revision of our outmoded tax depreciation rules in order to bring capital cost recovery allowances in this country to a level comparable with that allowed by other major industrialized countries of the free world. ATMI welcomed the depreciation reform offered by the new ADR System, and we are encouraged by the recent action of the House in approving the basic core of the new ADR System. But even with ADR, the United States lags far behind the capital cost recovery permitted by countries such as Japan, Germany, the United Kingdom and Canada. Thus, the reinstatement of the investment credit, now being considered, should not be viewed as a substitute for ADR, but rather as an additional means of partially equalizing the tax write-off provisions of our law applicable to machinery and equipment with those available to our foreign competitors.

America desperately needs modern, efficient plants to compete in the world markets in the 1970's. Further, we believe that Secretary Connally made a most valid point in his testimony before the Committee when he brought out the fact that the overall effect of the 1969 Tax Reform Act, ADR, and H.R. 10947, as passed by the House, during the five-year period 1969–1973 is a reduction in individual taxes of $36.4 billion whereas corporation taxes in the same period will have increased by $3.2 billion.

ATMI urges that the basic core of the new ADR System—elimination of the reserve ratio test, the elective depreciable life range and special salvage and repair allowance rules—be retained. This relatively simple approach to capital cost recovery is needed in order to help eliminate time-consuming and wasteful depreciation controversies between taxpayers and the Internal Revenue Service. In addition, since the House has reduced significantly the benefits available to taxpayers under the ADR System, we believe that taxpayers should be given the option of having their depreciation allowance determined under either the old guideline rules or the new ADR System, at least for a limited transition period.

In this connection, H.R. 10947, as passed by the House, provides for a class life system to replace both ADR and the 1962 guideline life procedures for property placed in service after 1970 which falls within any class for which the Treasury has prescribed a class life. This merging of the two systems, while generally a commendable step toward simplification, will inadvertently injure substantial numbers of taxpayers who in the past have been able to justify shorter than ADR useful lives under the old guideline procedures.

Revenue Procedure 62–21, which initially established the guideline depreciation rules on July 12, 1962, contains an entire section detailing the conditions under which taxpayers can use depreciation lives which are shorter than the prescribed guideline life for the guideline class in which the assets fall.

Under these rules many taxpayers, particularly in the case of buildings, have used class lives which are considerably shorter than the lower limit permitted under the 20 percent range of the Bill.

Thus, for example, under the old guideline rules, factory buildings were assigned a guideline life of forty-five years. In numerous instances in the textile industry much shorter lives than this were allowed under old Bulletin F under the component method of depreciating building costs. Accordingly, the taxpayers involved were allowed to continue to use such shorter lives under the guideline rules. Part II, Sec. 3 of Rev. Proc. 62–21.

Under the proposed new unified class life system, taxpayers who have consistently written their industrial buildings off over periods ranging from twenty-five to thirty-five years under the old guideline rules will suddenly find that buildings placed in service after 1970 must be assigned a forty-five year life, with apparently little likelihood that the 20 percent reduction of this class life authorized by the Bill will be put into effect until the Treasury completes a study requested by Congress and the Congress has time to consider possible amendments to the Sec. 1250 recapture rules.

A similar problem arises in the case of "subsidiary assets" which were treated as a separate class under the old guideline rules, but which were merged into the various industry classes by the Treasury in Rev. Proc. 71–25 which prescribed class lives under the ADR System. This "merger" has resulted in much longer lives being assigned to subsidiary assets under ADR than were applicable under the guidelines.

It is believed that more study is urgently needed of the problems facing taxpayers whose class lives in the past have been shorter than those that can be authorized under the new unified class life system. Buildings and subsidiary assets are two classes of property where this situation clearly exists for large numbers of taxpayers.

As a solution to the problem in the case of buildings, it is suggested that for a limited transition period, say through 1974, taxpayers be permitted to use a class for buildings placed in service after December 31, 1970 which is no longer than the class life used by the taxpayer for buildings in the taxable year preceding the effective date of the new unified class life system.

In the case of assets such as jigs, dies, molds and patterns, it is understood that the new Office of Industrial Economics in the Internal Revenue Service is studying the establishment of subsidiary asset classes on an industry by industry basis, where data being compiled indicate such action is appropriate. Since no guideline class life was prescribed for subsidiary assets under the old rules, it is important that the Treasury Department make timely determinations in this area. Otherwise, for a short transition period, taxpayers should be permitted to establish separate "subsidiary asset" classes with the lives being based upon the taxpayer's own "facts and circumstances."

Respectfully submitted,

A. Ward Peacock,
Chairman, Tax Committee.

AMERICAN TELEPHONE AND TELEGRAPH CO.,
New York, N.Y., October 15, 1971.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This statement is respectfully submitted on behalf of the Bell System Telephone Companies with respect to the Job Development Investment Credit, as set forth in Title I of H.R. 10947.

The Report of the Committee on Ways and Means accompanying H.R. 10947 (H. Rep. No. 92-533) discusses the need for restoration of a tax credit under today's conditions. The Bell System favors the enactment of the tax credit, believing that it would have beneficial consequences for the economy and help the nation back to acceptable levels of economic strength. I will, accordingly, limit my comments to certain provisions of the House Bill that concerns us.

Our primary concern is that the Bill would limit the credit extended to certain types of public utilities, including telephone companies, to a 4 percent rate, compared to the higher 7 per cent rate proposed for other regulated industries and business generally. As discussed below, we believe this is improper and that all regulated utilities should receive the credit on the same basis as business generally. Additionally, we have a few limited proposals for modification of the House Bill to assure that the basic intent of Congress will be fulfilled, and we also urge that the U.S. Treasury Department's Asset Depreciation Range system be retained in the law. Our other comments are largely of a technical clarifying nature.

THE CREDIT SHOULD APPLY EQUALLY TO REGULATED AND NONREGULATED INDUSTRIES

When the investment tax credit was incorporated in the Revenue Act of 1962, Congress permitted only a credit or 3 per cent to certain utilities, including telephone companies, whereas the rate to other business was fixed at 7 per cent. This reduced credit was based at the time on the reasoning that the utilities which were granted the lower credit were not subject to substantial competition.

Since 1962, however, the situation has changed dramatically. The expressed Federal policy has been to expand competition in the communications field substantially, particularly in the business communications market which ordinarily provides about half of Bell System revenues. Federal Communications Commission policies have actively fostered and compelled interconnection and attachment to the telephone system of equipment supplied by outside suppliers. This means that business customers and agencies of government can acquire their own equipment and even build entire communications systems for their own purposes and have them attached to, or interconnected with, the communications systems of the companies subject to regulation.

Under this new policy in the last two years, the Bell System has lost over 1200 PBX systems and about 10,000 data sets to competition whose sales would qualify for the full 7 per cent credit.

Since the changes in the interconnection provisions of our tariffs less than three years ago, some 40,000 known connections of competitive equipment had occurred by June 30, 1971. This figure is expected to double by the end of the year, that is, in only a six months' period.

Moreover, the Federal Communications Commission recently has indicated that it favors competition in the offering of regulated communication services, regardless of possible duplication of facilities. The effect has been the filing of more than 1,900 applications for authority to construct common carrier microwave stations, to provide competing systems for private line, voice and data services, and public switched network data services.

These are but examples. Competition now strikes across the broad variety of service of the communications companies, from satellite communications to switching equipment, private lines, private branch exchanges, call directors and data sets. Almost half of the potential impact of competition will involve equipment used in local exchange services, which has been commonly considered entirely free from competition. The full thrust of the new competitive philosophy, indeed, has not yet been felt. In a recent statement by the Director of the Office of Telecommunications Policy of the White House, he said that it is his "*intention that Government give far greater consideration to policies which would permit and encourage a more competitive self-regulatory environment in the* *communications services industry.*" (Remarks before International Communications Association, June 2, 1971.)

The House itself observes that "regulated companies are encountering increased competition from other regulated companies and, in the case of many of their products, from unregulated companies as well." (H.R. Rep. No. 92-533, at p. 24). We urge most strongly that the House Bill does not adequately recognize the new competitive environment in which utilities must carry on their business. Utilities would be placed at an unfair disadvantage in meeting competition from companies which are free from governmental regulation if they are to receive a substantially lesser tax credit than that available to their competitors. Common fairness would indicate that the credit should be given to utilities at the same rate that it is given to their competitors.

There are additional reasons why the credit should be made available to all utilities on the same basis as that given to other businesses.

It is important not to overlook the fact that the capital oulays of uilities are far greater than those of other businesses. Annual capital outlays of utilities as a whole have tripled in the decade of the 60's. Utilities have unprecedented demands on them for new capital at a time when inflation, high interest rates, increased competition and other factors are seriously affecting their ability to raise required new capital. The utilities' increasing problems in raising required capital strongly indicate that, if the proposed law is to have its intended effect, it is as important to grant the full credit to utilities as to any other segment of the economy. The economy can function with maximum efficiency only if utility services of the highest order are promptly available as needed. Moreover, utility services must normally precede the growth of other industry which depends on those services.

Another compelling reasons why the credit should be available to utilities on the same basis as industry generally is that this would stimulate the construction of new and better communications plant which is critically needed by the nation. Regulated utilities have an obligation to provide communications services to meet the demands of the public. However, expenditures for modernization, which are responsible in large part for improving productivity and making innovations and improvements in quality of service, are to a considerable extent discretionary. Modernization projects could be accelerated with funds made available by the credit. As the economy expands, more sophisticated communications will be needed, particularly by industry.

THE CREDIT SHOULD APPLY EQUALLY TO COMPETITIVE PRODUCTS AND SERVICES

If the Congress decides that it cannot forego the tax revenues which equal treatment for public utilities would entail, it should not further penalize those utilities in their competition with other regulated or nonregulaed suppliers.

Under the House Bill, a customer can purchase many telecommunications products from unregulated manufacturers and obtain a full 7 per cent credit, whereas a public utility receives only a 4 per cent credit on similar purchases and must price its services on that basis. This places the utility at a direct economic disadvantage with those vendors who sell communications equipment in competition.

The purpose of the Job Development Investment Credit is to stimulate investment; it does not seek to favor any particular industrial group or to create glaring inequities in the tax burdens borne by competing industrial groups. Accordingly, we respectfully submit that, before the credit is enacted into law, the House Bill be modified to assure that in any such case of direct competitive products and services, the credit will apply without discrimination.

The Technical Supplement attached to this statement contains a form of proposed statutory language which we believe should serve to avoid what otherwise will be unfair discrimination between competitive businesses.

STATUTORY SAFEGUARDS RELATING TO REGULATORY TREATMENT OF THE CREDIT

Section 106(c) of the House Bill sets out specific limitations as to the availability of the credit in the case of certain regulated companies. We want to emphasize that limitations along the line provided in the House Bill are very necessary. The Bell System believes that these limiting provisions, in general, should fulfill their intended purpose to assure that the tax credit will be available in the case of regulated industry as an incentive for increased utility investment, and furthering job opportunities. The need for statutory provisions along this line both with respect to the investment tax credit and accelerated tax depreciation allowances has been recognized by the Congress in the past,[1] and is further discussed by the Committee on Ways and Means in its Report accompanying the House Bill presently before your Committee.

There are, however, three specific aspects of the safeguarding provisions as set forth in the House Bill that we respectfully submit should be modified prior to enactment into law:

1. NEED TO ELIMINATE TRANSITIONAL HIATUS TO MARCH 31, 1972

The House Bill provides that public utility property qualifies for the credit from the effective date of the Bill, generally April 1, 1971 or August 16, 1971. However, the safeguarding conditions apply only for any period after March 31, 1972. The House Ways and Means Committee Report states (H. Rept. No. 92–533 at p. 26), that the purpose in providing for this deferred effective date for the safeguarding conditions is to give state and local regulatory agencies time to evaluate and conform their practices to the conditions of the new law.

While we agree that adequate time for evaluation of these new rules—which are, by their very nature, technical and complex—is certainly appropriate, we respectfully submit that this purpose can be accomplished without the risks that are entailed in the House Bill.

Regulatory commissions, under the House Bill, would be free to "flow through" the entire credit related to property which qualifies after the effective dates of the credit but before April 1, 1972. This is contrary to the Bill's clear purpose to prevent flow-through for ratemaking purposes so that the credit will be available for investment in plant to promote job opportunities and improve productivity. It carries the risk of diluting the needed incentives for higher capital expenditures in the months immediately ahead, when stimulus to the economy is so vital.

Moreover, although commissions fix rates for the future, they normally determine a public utility's revenue requirements on the basis of an historical test year. If a commission were to determine revenue requirements on the basis of a test year ending March 31, 1972 (or any test year which included a period between the effective dates of the credit but before April 1, 1972), they might determine revenue requirements on the basis that credits were available to the public utility and could be flowed through to consumers. This would reduce the rates allowed for the future; since rate cases occur relatively infrequently, the impact of such an approach could be felt many years into the future. Currently, there are twenty-one (21) pending Bell System rate cases predicated on test periods which include a portion of the April 1, 1971–March 31, 1972 period.

We urge that the full purpose of the House Bill can be carried out better by eliminating the special March 31, 1972 provisions. In lieu thereof, we respectfully propose that provisions be included which establish a transitional presumption that the conditions of the Bill will be complied with. I attach, in the Technical Supplement appended to this statement, a form of proposed statutory provision to accomplish this purpose.

2. IMPACT OF DISQUALIFYING REGULATORY TREATMENT IS UNDULY SEVERE

If an agency takes regulatory action inconsistent with the safeguard standards, Section 106 of H.R. 10947 calls for a wide-ranging forfeiture of credits. The Bill uses terms to the effect that no credit shall be allowed with respect to any public utility property if the prescribed regulatory action is not followed with respect to any portion of the credit. We believe these forfeiture provisions are extreme and beyond what is required to achieve the Congressional purpose.

Under this language, agency action could be interpreted to deny credits relating to property not subject to its jurisdiction. Forfeiture of the credit as to such property is no incentive for a regulatory agency to comply with the qualifying ratemaking treatment since such a forfeiture would not affect cost of service subject to the agency's jurisdiction.

Public utility property may be subject to the jurisdiction of different public bodies. For example, a central office switching machine may be used to provide

[1] Safeguards for the investment tax credits were included in Section 203(e) of the Revenue Act of 1964 and for accelerated tax depreciation in Section 167(*e*) of the Internal Revenue Code added for the Tax Reform Act of 1969.

local exchange services, intrastate toll services and interstate toll services. Portions of the service may be subject to the regulation by a city government, a state commission and the FCC. Suppose a local public body should require initial year flow through of the credit as to that portion of the property subject to its jurisdiction. Arguably, the forfeiture provisions may apply to property or portions of property not subject to the regulatory agency's jurisdiction.

Similarly, some public utility property such as pole lines and cable are jointly owned by different companies. If one company loses the credit as to the portion of the property it owns, some may argue that the second taxpayer would lose the credit with respect to the portion of the property it owns. An adverse decision by one regulatory agency could contaminate property not subject to its jurisdiction and the impact may be felt on other property of the same and different taxpayers and in other jurisdictions.

Moreover, the forfeiture provisions affect more taxable years than is necessary to achieve the Congressional objective. The House Report says that inconsistent rate treatment will cause the utility to lose the credit "for that period and for any taxable periods that are open at the time the limitations of the applicable options are exceeded by the agency." (H. Rep. No. 92-533 at p. 26). We believe that this penalty exceeds what is necessary to achieve regulatory treatment consistent with the statutory objectives and could have extreme and undeserved effects on the utility.

Typically, a utility's tax returns may be open for a period of five or six years. During this period, tax credit reserves could accumulate to hundreds of millions of dollars. If a regulatory agency were to make a rate determination inconsistent with the safeguard standards, even inadvertently, the utility would become immediately liable for large deficiencies which it might have difficulty financing.

We believe that regulatory agencies will be sufficiently deterred from ratemaking inconsistencies with the statutory standards if the credits are foregone commencing with the date rates become effective which are fixed on the basis of inconsistent ratemaking treatment.

Moreover, under the statute, inconsistent ratemaking may forfeit credits indefinitely into the future. A regulatory agency may subsequently realize that such ratemaking penalizes the consumer and utility alike and reverse itself in future action. We believe commissions should be free to conform their practices to the statute at any time whereupon utilities should again qualify for the credits.

The Technical Supplement attached to this statement contains a form of proposed statutory language which we believe is consistent with the purposes of the House Bill but which would ameliorate the harsh consequences of the House Bill.

3. SAFEGUARDS SHOULD EXTEND TO ACCOUNTING AS WELL AS RATEMAKING TREATMENT

The safeguarding conditions in the House Bill, relating to the availability of the credit for public utilities, explicitly apply to treatment of the credit "for ratemaking purposes."

To assure that the Congressional purpose of encouraging investment will not be thwarted under the regulatory process, we believe it is important that the safeguarding conditions apply to the treatment of the credit for accounting purposes as well as for ratemaking purposes. This two-fold condition—explicitly covering regulatory treatment for both ratemaking and accounting purposes—was contained in the analogous provisions of the Tax Reform Act of 1969 covering the use of accelerated tax depreciation by public utilities, and we believe it should also apply in the case of the proposed Job Development Investment Credit.

The Technical Supplement attached to this statement contains a form of proposed statutory provision to avoid the possibly complicating problems that otherwise may develop under the regulatory process.

DEPRECIATION PROVISIONS OF H.R. 10947

The House Bill contains several provisions relating to depreciation allowances. Many of these provisions are designed to achieve significant simplification in the overall administration of the depreciation rules, by limiting areas in which disputes frequently arise solely because of marginally different facts in individual situations. The Treasury Department's Asset Depreciation Range System (the so-called "ADR" regulations), adopted earlier this year, similarly was designed in large part to provide helpful simplification for administration of technical and complex provisions in the tax law. This, for example, is an important consideration underlying the concept of "class lives" under which depreciation allowances can be determined based on a range of 20 per cent above or below class lives specified by the Treasury Department. Certainly, for this purpose, the House Bill—as well as the ADR regulations—are very constructive in their concept. We urge that these provisions be retained in the law.

The House Bill, however, would eliminate the so-called "three-quarter year convention," provided under the ADR system, which in effect provides an additional allowance in the year property is placed in service. The Committee on Ways and Means viewed this convention as an incentive to business investment and concluded it would not be appropriate to provide this incentive in addition to the proposed tax credit. The House Bill would repeal the convention retroactively to January 1, 1971.

Because of the lesser 4 per cent tax credit for utilities, the repeal of this convention would likely have a discriminatory impact on public utilities. Business generally will obtain an incentive at a 7 per cent rate under the House Bill, which should more than offset the loss of the benefit from the convention. In contrast, utilities which are granted only a 4 per cent credit under the Bill, probably will have an *increased* Federal tax liability in 1971, when the offsetting repeal of the convention is taken into account.

In the case of the Bell System, for example, the convention would have reduced the Bell System's 1971 tax liability by approximately $100 million, whereas a 4 per cent credit will result in only a $90 million reduction. Thus, in addition to penalizing the Bell System competitively, the substitution of a per cent credit for the convention will *increase* its 1971 Federal income taxes by about $10 million.

The combined effect works directly against the basic purpose of the legislation, which is to provide an incentive. We respectfully submit that if the convention is to be replaced, this in itself is justification for giving utilities the full 7 percent credit that is being given to business generally. In the alternative, we submit that the convention not be repealed for utilities that are to be given only the reduced 4 per cent credit.

In any event, we urge that there is no justification for retroactive repeal of the convention in the case of this limited class of utilities, and that repeal apply prospectively on or after January 1, 1972.

OTHER TECHNICAL CLARIFYING CHANGES

In the Technical Supplement attached hereto, we suggest several other modifications to the provisions in the House Bill that are needed to assure that the basic intent of the legislation will be fulfilled. Some merely involve the substitution of different words or terms that, to our mind, might clarify the purpose of Congress. Others are more essential to insure that the intent of Congress is not thwarted. The items pertaining to the clarification of services which are regulated and submarine cables fall into the latter category.

Respectfully,

A. L. STOLT,
Vice President and Comptroller.

TECHNICAL SUPPLEMENT TO STATEMENT OF A. L. STOTT

A. Proposed amendment to remove inequality in competitive products and services.

B. Proposed amendment to eliminate transitional hiatus to March 31, 1972, and to condition credit on accounting as well as ratemaking treatment.

C. Proposed amendment to establish a transitional presumption of compliance and to ameliorate the severe consequences of disqualifying regulatory treatment.

D. Other Modifications.

1. Definition of "useful life."
2. Description of rate base.
3. Application of Special Rule.
4. Clarification of services which are regulated.
5. Application to submarine cables.

A

Redefinition of "public utility property" to cover competitive products and services

Section 46(c)(3):

(B) For purposes of subparagraph (A), the term "public utility property" means—

(i) Property used predominantly in the trade or business of the furnishing or sale of electrical energy, water, sewage disposal services, gas through a local distribution system, telephone services, telegraph services, or other communication services, if the rates for such furnishing or sale, as the case may be, are subject to regulation by a *public body, such as* a State or political subdivision thereof, by an agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof, or

(ii) *Communications property of the type used by companies engaged in providing telephone, telegraph or other communication services at rates subject to regulation by a public body, as referred to in subparagraph (i) hereof, where such property is used by the taxpayer for communications purposes for himself or others.*

B

(e) LIMITATION IN CASE OF CERTAIN REGULATED COMPANIES.—

(1) GENERAL RULE.—Except as otherwise provided, no credit shall be allowed by Section 38 with respect to any *property described in Section 50 which is also* public utility property (as defined in paragraph (4)) of the taxpayer—

(A) COST OF SERVICE REDUCTION.—If the taxpayer's cost of service for ratemaking *or accounting* purposes [for any period after March 31, 1972], is reduced by reason of any portion of [the] *such* credit [allowable by section 38] (determined without regard to this subsection) *provided that, for accounting purposes, the taxpayer shall increase its non-operating income by an amount equal to a ratable portion of such credit;* or

(B) RATE BASE REDUCTION.—If the base [on] *to* which the taxpayer's rate of return for ratemaking purposes is [computed for any period after March 31, 1972,] *applied* is reduced by reason of any portion of [the] *such* credit [allowable by section 38] (determined without regard to this subsection) *unless the reduction in rate base is restored not less rapidly than ratably.*

[Subparagraph (B) shall not apply if the reduction in the rate base is restored not less rapidly than ratably.]

(2) SPECIAL RULE FOR RATABLE FLOW-THROUGH.—If a taxpayer makes an election under this paragraph within 90 days after the date of the enactment of this paragraph in the manner prescribed by the Secretary or his delegate, paragraph (1) shall not apply, but no credit shall be allowed by Section 38 with respect to any *property described in Section 50 which is also* public utility property (as defined in paragraph (4)) of the taxpayer—

(A) COST OF SERVICE REDUCTION.—If the taxpayer's cost of service for ratemaking *and accounting* purposes [for any period after March 31, 1973], is reduced by more than a ratable portion of such credit (*determined without regard to this subjection*), or

(B) RATE BASE REDUCTION.—If the base on *to* which the taxpayer's rate of return for ratemaking purposes is [computed for any period after March 31, 1972], *applied* is reduced by reason of any portion of the *such* credit [allowable by section 38] (determined without regard to this subsection).

PRESUMPTION CLAUSE

A taxpayer shall be deemed to have complied wtih the requirements of paragraphs (1) or (2) hereof, respectively, with respect to the allowance of the credit referred to in those paragraphs unless and until there is a final determination (after the date of enactment of this paragraph) with respect to the rates of such taxpayer by the public body referred to in Section 46(c)(3)(B), inconsistent with such requirements.

CLAUSE LIMITING IN TERROREM EFFECT

Provided that, in the event of such a final determination, the taxpayer shall be deemed not to have complied with such requirements only as to the credits with respect to property placed in service in the taxable years, or portions thereof commencing with the effective date of rates determined on a basis other than described in paragraphs (1) or (2) hereof, as appropriate, and terminating with the effective date of rates established after a final determination of such public body consistent with such requirements.

CLAUSE LIMITING IN TERROREM EFFECT TO JURISDICTIONAL PROPERTY

Provided further that any such final determination shall apply only to credits wtih respect to propert yor any portion thereof used by such public body in determining the revenue requirements of such taxpayer subject to its jurisdiction.

OTHER MODIFICATIONS

1. On page 5 of H.R. 10947, line 21, we suggest that the word "period" be substituted for the words "useful life." This change is recommended to avoid the use of the same term in defining the phrase "useful life."

2. In the determination of a utility's total revenue requirements, regulatory commissions allow a designated rate of return on the total plant (or rate base) of the utility. However, the rate of return is not determined from the rate base but, rather, is determined on the basis of earnings requirements. After having determined a fair rate of return, this is applied to the plant, or rate base, of the utility. Accordingly, we suggest that the word "on," as it appears in line 18 of page 12, and in line 12 of page 13, be changed to "to." Further, we suggest that the word "computed," as it appears in line 20 of page 12, and in line 14 of page 13, be changed to "applied."

3. In Section 106(c) of the Bill, both subparagraphs (A) and (B) of the new Section 46(e)(1), and subparagraph (B) of the new Section 46(e)(2), provide that credits are to be ("determined without regard to this section)"—see lines 16–17 and 22–23 on page 12, and lines 16–17 on page 13. As we understand the provisions in subparagraph (A) of the new Section 46(e)(2), that qualification also should be determined independently of the subsection. We suggest the addition of a similar parenthetical phrase following the word "credit" in line 11 of page 13.

4. The House Bill modifies the definition of public utility property in Section 46(c)(3)(B) in order to encompass firms that provide miscellaneous types of regulated communications services. Without such a provision, the 4% credit would apply only to telephone and telegraph companies. Even those competitors whose rates are subject to regulation would be eligible for the 7% credit. However, even though the modification is intended to encompass such firms, they might avoid the 4% limitation on the ground that their rates have not "been established or approved" by a regulatory agency. This could be argued persuasively where a company has merely filed tariffs with the appropriate regulatory commission covering the communications services it offers the public. To meet this situation, we suggest that Section 46(c)(3)(B) be further modified to substitute the words "are subject to regulation" for the words "have been established or approved by."

5. In Section 104 of the House Bill, clarifying provisions are made to except communications satellites from the rule for property used outside the United States. The Bell System utilizes both communications satellites and submarine cables in the provision of international communications services and respectfully requests a similar exception for submarine cable systems. We believe this is necessary to avoid any ambiguity arising out of this explicit clarifying language applicable to satellites, and suggest a change in Section 104(b)(2) of H.R. 10947 along the lines of that indicated on the following page.

SUGGESTED CHANGE IN SECTION (b)(2) OF H.R. 10947

"(2) Section 48(a)(2)(B) (relating to exceptions from rule for property used outside the United States) is amended by striking out "and" at the end of clause (vi), by striking out the period at the end of clause (vii) and inserting in lieu thereof a semicolon and by adding at the end thereof the following new clauses:

"(viii) any communications satellite (as defined in section 103(3) of the Communications Satellite Act of 1962, 47 U.S.C., sec. 702(3)), or any interest therein, of a United States person," and

"(ix) any submarine cable system, or any interest therein, of a United States person, which constitutes part of a communication link with the United States and which is subject to regulation by an agency or instrumentality of the United States."

RCA GLOBAL COMMUNICATIONS, INC.,
New York, N.Y., October 8, 1971.

Re The Need for Full Job Development Investment Credit for International Telegraph Companies.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee, Old Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: RCA Global Communications, Inc. ("RCA Globcom") wishes to take this opportunity to express its views with respect to the proposed job development investment credit.

RCA Globcom is an international communications common carrier engaged in the business of furnishing communications services by radio, cable and satellite facilities linking the continental United States directly with 78 other countries and overseas points. It does not provide domestic communication services in the continental United States.

Under the Revenue Act of 1962, only a three percent investment credit was provided for "public utility property" in contrast to the seven percent credit allowed for other property, including equipment used in international telegraph operations. As noted, by way of example, in Senate Report No. 1881 on the Revenue Act of 1962 (2 U.S. Cong. & Adm. News '62 3317, 3446), in the case of property which is used predominantly in international telegraph operations, the qualified investment is to be determined without reduction to the three percent level. The full seven percent credit was allowed for equipment used in international telegraph operations in recognition of the keen competition in this industry as compared to the monopoly situation which exists in the domestic telegraph and message telephone industries.

The Revenue Bill of 1971 (H.R. 10947) restoring the investment credit, would increase the credit for public utility property to four percent but also provides that property used predominantly in furnishing or selling of all telegraph services or other communications services is to receive the four percent credit. Thus, the 1971 Revenue Bill, as reported by the House, would upset the prior determination by Congress that the international telegraph industry would be allowed the full investment tax credit.

It is the position of RCA Globcom that international telegraph companies should be allowed the full credit for amounts invested in new facilities to provide improved communications services to users within the United States in any restoration of the investment tax credit. We believe this result is consistent with the policy underlying the offering of tax incentives to industry for modernization and expansion to stimulate the domestic economy and improve the position of domestic business in the world economic community—as well as with the prior law noted above which granted a full credit for otherwise qualified property used predominantly in international telegraph operations.

We submit there is a compelling basis for distinguishing between the international telegraph industry and domestic utilities which enjoy essentially monopoly positions. Unlike domestic telegraph service which is provided exclusively by Western Union and also message telephone service in the United States which is operated on a monopoly basis, international telegraph service is competitive. The three principal United States international carriers—ITT World Communications, Inc., Western Union International, Inc. and RCA Globcom—must perforce contend for a limited market both with each other and with foreign international communications entities.

It is accordingly a matter of economic necessity for an international telegraph carrier to constantly invest in new and innovative equipment and technology and to improve and extend its facilities in order to meet this dual competition. In this sense, the international telegraph field is more analogous to such regulated industries as the airline and railroad industries which receive the full credit than it is to a local power or telephone company. The international telegraph business is thus deserving of treatment similar to these regulated industries in a reenactment of the investment tax credit.

The function of the job development investment credit is to provide an incentive to industry to spur modernization and industrial growth to improve the United States' competitive position abroad and create additional employment and raise our standard of living at home. An extensive investment in communication facilities to furnish international communications is required to maintain the preeminent position of the American international telegraph industry. Extensive and complex foreign-owned communication facilities are under construction in addition to those already in existence. These facilities can be used to furnish competitive communications services to those provided by the American carriers.

In order for an American international carrier to compete effectively with foreign carriers, which are either directly or indirectly owned by their respective governments and can rely on governmental funds for the necessary capital requirements incident to expansion, its facilities must be at least equal with those of the foreign carriers. The failure to meet this foreign competition would have a negative effect on our balance of payments and would be contrary to the intent of the investment tax credit.

We respectfully submit that the foregoing reasons amply justify applying the job development investment credit in full to capital investment by the international telegraph industry.

We accordingly urge that the proposed amendment to Section 46(c)(3)(B) of the Internal Revenue Code of 1954, which broadens the definition of public utility property to include all communications services, be deleted and the original language of this section retained.

Very truly yours,

H. R. HAWKINS.

RE: JOB DEVELOPMENT INVESTMENT CREDIT FOR INTERNATIONAL TELEGRAPH COMPANIES

RCA Globcom is an international communications common carrier competitively engaged in the business of furnishing communications services by radio, cable and satellite facilities linking the continental United States directly with 78 other countries and overseas points. It does not provide domestic communication services in the continental United States.

We are concerned that the House version of H.R. 10947 does not continue the full 7% investment credit to the highly competitive U.S. overseans telegraph companies for property invested in the U.S. as under prior law.

Congress granted, under prior law the full 7% credit for U.S. equipment used in international telegraph operations in recognition of the keen competition in this industry as compared to the monopoly which exists in the domestic telegraph and message telephone industries which received the lesser credit of 3%.

The present version of H.R. 10947 restricts all telegraph services to the 4% credit thus upsetting the prior determination by Congress that competitive industry should receive the full 7% credit while monopolies such as domestic telegraph should receive the limited credit.

Overseas telegraph service must respond to a highly competitive market including several U.S. International companies and with foreign international communication entities, unlike domestic telegraph servce which is provided exclusively by Western Union and also message telephone service in the United States which is operated on a monopoly basis.

To meet this competition an international telegraph carrier needs to constantly invest in new innovative equipment and technology, and improve and extend its facilities. In this sense, the international telegraph field is more analogus to these regulated industries such as the airline and railroad industries which receive the full credit than it is to a noncompetitive domestic power or telephone company.

The purpose of the job development investment credit is to provide an incentive to industry to spur modernization and industrial growth to improve the United States' competitive position abroad and create additional employment and raise our standard of living at home.

An extensive investment in communication facilities to furnish international communications is required to maintain the preeminent position of the American international telegraph industry. Extensive and complex foreign-owned communication facilities are under construction in addition to those already in existence. These facilities can be used to furnish competitive communications services to those provided by the American carriers.

In order for an American international carrier to compete effectively with foreign carriers, which are either directly or indirectly owned by their respective governments and can rely on governmental funds for the necessary capital requirements incident to expansion, its facilities must be at least equal with those of the foreign carriers. The failure to meet this foreign competition would have a negative effect on our balance of payments and would be contrary to the intent of the investment tax credit.

We respectfully request that the full 7% job development investment credit be applied to the capital investment in the United States by the international telegraph industry.

STATEMENT OF HENRY A. CORREA, CHAIRMAN, RAILWAY PROGRESS INSTITUTE AND PRESIDENT, ACF INDUSTRIES, INC.

Mr. Chairman and Members of the Committee: On behalf of the Railway Progress Institute, the national trade association of railway suppliers, I welcome the opportunity to heartily endorse the job development tax credit proposal included in the President's dramatic program to strengthen the nation's economy.

No measure could be more beneficial to the general economic health of this country than that proposal, particularly in regard to its effect on rail freight transportation. For, as has been testified before your committee, some railroads are having financial trouble, a problem that holds serious implications for us all.

Most of the goods which we depend upon for our day to day survival, not to mention comfort, are shipped by trains. And as Secretary of Transportation John Volpe has reported, "85 percent of all freight traffic moving on the railroads just cannot be handled in any other way."

For several years, the lack of government guaranteed financial programs have been a major factor in preventing railroads from purchasing enough freight cars and locomotives to handle present shipping demands, much less those that have been projected for the future.

The Department of Transportation estimates that by 1980 the railroads will be called upon to carry one trillion, one hundred billion revenue ton miles of freight. This is approximately 44 percent more than they carried in 1970.

To satisfy this need, competent observers say, will require 100,000 new freight cars and 2,600 locomotives annually, goals that the railroads' current purchasing power are far from able to meet.

In 1969, freight car deliveries were only 69,000; in 1970, only 66,000. What's more, freight cars were being retired at an average of 88,000 per year over the past five years. The locomotive situation is equally disturbing. While new locomotive deliveries have averaged a little over 1,000 per year over the last four years, locomotives were being retired at a rate in excess of 1,300 per year during the same period.

To finance these requirements will cost at least $36 billion over the next 11 years, according to the America's Sound Transportation Review Organization. Yet in 1970 the railroads' return on investment hit a rock bottom 1.47 percent.

Restoring the investment tax credit would make a significant contribution toward helping the railroads make the equipment purchases so vitally needed. That these expectations can be realized was previously demonstrated when an investment credit was applied in 1962. That year the number of new locomotives jumped from 288 delivered in 1961 to 764, steadily growing until it reached a peak of 1,419 in 1966 before the credit was suspended, then revived and finally repealed in 1969. The number of new freight cars jumped from 31,501 in 1961 to 36,454 the following year, to 89,899 in 1966, as total spending for new equipment during those years rose from about 0.6 billion to almost 2 billion dollars.

RPI urges Congress to restore the tax credit so that railroads will be able to modernize their plant and equipment to meet the expanding transportation needs of our country. We vigorously support the eloquent testimony presented earlier by Frank E. Barnett, Chairman of the Board of Directors of the Union Pacific Railroad Company and Union Pacific Corporation, on behalf of the Association of American Railroads.

As Mr. Barnett stated so clearly, the key to the economic strength of the United States is capital investment, and one of the most effective long-range weapons against inflation is to increase industrial capacity. It is axiomatic that the incentives to capital investment now before this committee will, if enacted, provide our industry the wherewithal to reactivate its program of expansion and modernization which, out of economic necessity, we were forced to curtail upon repeal of the 7 percent investment credit in 1969. Such capital investment would, of course, help increase employment in the railway supply industry which is a prime objective of the President's proposal.

We support the excellent legislation for restoring the tax credit which was recently passed by the House of Representatives and earnestly hope your Committee will give favorable consideration to authorizing this type if investment incentive, not only for the good of the railroad industry, but for the economy as a whole.

NATIONAL COAL ASSOCIATION,
Washington, D.C., October 19, 1971.

Hon. RUSSELL B. LONG,
Chairman, Senate Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR CHAIRMAN LONG: The National Coal Association (NCA), which represents most of the major bituminous coal producers and coal sales companies in the United States, submits this statement on behalf of its membership in support of the Job Development Investment Credit and the proposal for Domestic International Sales Corporations.

JOB DEVELOPMENT INVESTMENT CREDIT (JDIC)

NCA strongly supports the proposal for reenacting an investment tax credit. In 1962 the Kennedy Administration proposed the investment tax credit in order to bolster a lagging economy. The coal producers were the first major segment of industry to lend their full support to the investment credit concept; and the credit accomplished the purpose for which it was intended. The circumstances which engendered the need for the credit in 1962 are again apparent. The economy has been slow to respond to normal stimuli: employment figures are below expectation, and investment in new equipment is falling off. The reinstatement of the investment tax credit will provide another stimulant to help correct this situation.

In the case of coal, the demand is high—so high that the coal industry is training to meet that demand, and the opening of new mines is essential if that objective is to be achieved. But the sophisticated and expensive equipment necessary today to initiate new large-scale deep-mining operations calls for huge sums of investment capital. This is especially true since the industry's equipment and mining methods require costly modification to comply witht the new federal health and safety legislation, which is still being interpreted. Moreover, the coal industry is committed to the reclamation of lands disturbed by surface mining and additional capital is required simply to maintain reclamation and production at the present high levels.

The traditional low profit margin of the coal industry, which has been further reduced by the decline in productivity resulting from new safety legislation, does not permit the generation of sufficient capital to maintain current production, much less to permit expansion at the same time. And the competitive nature of the industry combined with the high risks involved are not conducive to attracting outside investment capital.

NCA, therefore, in the interest of the coal industry and the public demand for more energy, supports the concept of the investment tax credit, whether a two-step credit as proposed by the President or preferably a single credit as provided in Section 101 of H R. 10947. The coal industry, as well as many others, requires long lead times for certain special order production equipment. It is common, for example, to face a two-year waiting period from the time of a firm and binding contract to the date a huge dragline or shovel can be placed in service. Similarly, underground locomotives must be ordered about two years prior to expected use. With a two-step credit as proposed, the benefits of the first step would not be realized on such equipment, even though the machine had been ordered and work had begun on it. This problem will be fully remedied with a simple one-step credit.

Another factor should be considered. Because of the interplay of the minimum tax, the impact of the JDIC could be diluted. Present tax law provides that the taxable base for minimum tax purposes is the sum of the taxpayer's tax preference items (in excess of $30,000) reduced by the taxpayer's regular income tax liability after credits. If this formula is applied to the JDIC, the intended benefit will be offset by an increase in minimum tax liability. This would occur because the JDIC would reduce the regular income tax liability and thereby increase the amount subject to the minimum tax. Different economic policy considerations prompted the enactment of the minimum tax and the current need for the JDIC. Therefore, the two concepts should be free from interaction. To fulfill the need for which it was proposed, the JDIC should not be restricted by the impact of the minimum tax.

Present tax law also excludes the minimum tax base to which is applied the 50 percent-of-tax limitation in determining the amount of the investment tax credit allowed in a year. Since the minimum tax is, in fact, an added tax, it would be inequitable to exclude it from the tax base in determining the JDIC percent limitation. To be fully effective, the income tax liability used in the minimum tax calculation should be applied before reduction by the JDIC. Further, the regular income tax and the minimum tax should be combined in applying the 50 percent-of-tax limitation.

There are those who maintain that the investment tax credit is unduly favorable to business, particularly in light of the recently adopted Asset Depreciation System (ADR). This reasoning cannot be defended. History indicates that the investment tax credit will accomplish for the economy what is intended; namely, an immediate stimulant at a point in time which will benefit the entire nation. If more machinery and equipment are constructed, additional labor will be required. The country's unemployed will certainly be direct beneficiaries.

The tax credit complements the ADR. Whereas the benefits to the nation from the tax credit will be immediate, the ADR effects will become apparent more slowly. It has gone far toward upgrading our obsolete depreciation system. In so doing, it will help make our nation's industrial complex more competitive with foreign industrial countries such as Japan, Italy and Germany.

Action by the House of Representatives has already removed a large share of the benefits under ADR as initially instituted by the Department of Treasury. If the ADR cannot be restored to the form conceived by Treasury, at the very least, no further dilution of this very worthwhile adjunct to our depreciation laws should take place in the Senate.

DOMESTIC INTERNATIONAL SALES CORPORATION (DISC)

NCA is also in favor of the proposal for DISC. A mining company transferring profits to a DISC, under certain circumstances, may suffer a loss of the depletion allowances, but those companies engaged in exporting coal believe the proposed treatment will operate to make available additional capital needed to expand mining capacity to produce export coal. Export coal today contributes about a billion dollars a year to our balance of trade.

The full effectiveness of the original proposal has been restricted by House action. Nevertheless, some incentive must be found to encourage exports to help relieve the nation's trade deficit. The DISC proposal, as amended by the House of Representatives, will be a small but affirmative step to that end.

CONCLUSION

The National Coal Association supports those provisions of H.R. 10947 as they affect the coal industry. Their adoption would benefit our membership, the labor force, and the general public.

We ask that this statement be included in the printed record of the hearings on H.R. 10947, the Revenue Act of 1971.

Sincerely,

CARL E. BAGGE.

ILLINOIS STATE CHAMBER OF COMMERCE,
Chicago, Ill., October 11, 1971.

Hon. RUSSELL LONG,
Chairman, Senate Finance Committee,
U.S. Senate, Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: In connection with the hearings scheduled to begin by your committee on HR 10947, the Illinois State Chamber of Commerce respectfully submits the following comments for your consideration:

1. JOB DEVELOPMENT INVESTMENT CREDIT

As a means of stimulating investment by businesses, we are generally in favor of the restoration of the job development investment credit. We believe that the credit will serve as a stimulus, particularly for small businesses which are more likely to make investment decisions on a short range basis. We believe that the credit should also be extended to equipment eligible for special five year amortization, especially since it provides impetus to industry to invest in additional pollution control facilities.

While the legislative language is necessarily complex because of the continuing effect of the carry-over provisions from the previous law, we believe that every effort should be made to correlate the various effective dates regarding such carry-overs. For example, Section 107 of the bill removes the 20% limitation with respect to taxable years ending after December 31, 1971. However, the changes in the order in which the credits are to be utilized and the 10 year carry-over for unused credits apply with respect to taxable years beginning after December 31, 1970.

2. CODIFICATION OF THE ASSET DEPRECIATION RANGE SYSTEM

We have always been, and continue to be in favor of stimulating capital investment by way of an adequate capital cost recovery allowance. We believe that the codification of the ADR system will act as such a stimulus and is a logical step toward a true capital cost allowance system.

3. DOMESTIC INTERNATIONAL SALES CORPORATION

We are in favor of the DISC concept as a means of promoting exports and providing additional employment and capital investment in the United States. However, we believe that the inclusion of a base period concept will deter rather than stimulate export sales and investment in equipment of export manufacturers. The base period concept penalizes those businesses which have done a good job in the past in the forign export area and could very well react unfavorably to them by making it more advantageous to move their operations overseas rather than expanding at home. In other words, the bill as presently drafted minimizes the incentive to retain, much less expand, investment in the United States for export purposes.

Furthermore, a base period concept tends to complicate the administration of DISC both from the taxpayers' and government's standpoint.

With the base period adjustment removed, we believe that DISC will accomplish the dual purpose of providing jobs at home for our own labor force and assisting in the struggle to restore a favorable balance of payments.

Respectfully yours,

LESTER W. BRANN, Jr., *President.*

CRAVATH, SWAINE, & MOORE,
New York, N.Y., October 13, 1971.

H.R. 10947.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: On behalf of certain of our clients, we would like to express our objection to Section 308 of H.R. 10947 as passed by the House of Representatives.

Section 308 of the Bill would amend Section 58(g)(2) of the Code to provide that foreign source capital gains and stock options would be subject to the preference tax imposed by Section 56 if they are attributable to a foreign country which imposes no "significant amount" of tax with respect to such items. The proposed amendment would be retroactive to taxable years beginning after December 31, 1969.

Section 58(g)(2) in its present form provides that foreign source capital gains and stock options are not subject to the preference tax if, under the tax laws of the foreign country or possession in which realized, preferential treatment is not accorded them. We think that the language makes it unequivocally clear that a capital gain (or stock option exercise) realized in a foreign country which has no income tax at all, such as the Bahamas, is not accorded preferential treatment under the laws of such foreign country (because all items of income are treated the same, i.e., are not taxed) and, therefore, is not subject to the preference tax. This interpretation was confirmed by the original proposed Regulations published in the Federal Register on December 30, 1970, which contained a specific example of a sale of a capital asset in the Bahamas and stated that the gain was not subject to the preference tax. On June 24, 1971, however, the Treasury Department revoked the original proposed Regulations and proposed new Regulations which took the position that a capital gain or stock option realized in a foreign country would be subject to the preference tax unless a "significant amount" of foreign tax was payable thereon, and the term "significant amount" was defined as a tax of at least 3%.

This firm filed objections to the new proposed Regulations on the ground that they could not be justified under the language of the statute. Moreover, we submitted that, in any event, taxpayers who relied on the original proposed Regulations and effected sales in a country such as the Bahamas (at not inconsiderable expense) should not have a tax imposed upon them retroactively. In this connection, we point out that the original proposed Regulations constituted an invitation to taxpayers to do just that.

The Treasury Department apparently has now concluded that the new proposed Regulations cannot be justified under the present statute and, therefore, is seeking legislation. We submit that the proposed change should not be retroactive. It has not been the policy of the Congress to enact retroactive tax legislation adversely affecting persons who relied on the language of existing law. The policy against non-retroactivity should be particularly applicable in a case such as this where the Treasury Department in its original proposed Regulations encouraged taxpayers to sell in a country such as the Bahamas. At the very least, if retroactive legislation is to be enacted, it should not apply to sales made prior to June 24, 1971, that being the first date that taxpayers were put on notice that the Treasury Department was no longer adhering to the original proposed Regulations.

Very truly yours,

CRAVATH, SWAINE & MOORE.

LAW OFFICES, SILVERSTEIN AND MULLENS,
Washington, D.C., October 14, 1971.

Re Section 105 of H.R. 10947.

Mr. THOMAS VAIL,
Chief Counsel, Committee on Finance,
New Senate Office Building,
Washington, D.C.

DEAR MR. VAIL: This letter is written on behalf of our client, GATX-Armco-Boothe, to call your attention to the problem concerning the application of section 109 of H.R. 10947, providing a limitation of the availability of the investment credit to certain lessors.

GATX-Armco-Boothe is a joint venture consisting of two corporations, GATX/Boothe Corporation and Armco/Boothe Corporation. The joint venture is engaged in the purchase and lease of aircraft and other major transportation equipment to airlines and other users.

Section 109 of the Bill imposes a limitation upon the availability of the investment credit to "a person which is not a corporation" with respect to property of which such person is the lessor. While the provision is thus not intended to apply to corporations, there is some question as to whether the provision would be applicable where the lessor is a joint venture, partnership or other entity owned entirely by one or more corporations.

I am herewith enclosing a brief memorandum indicating that the application of section 109 to a joint venture such as GATX-Armco-Boothe was not intended by the House and is not necessary to effectuate the purpose underlying such provision. It is therefore respectfully requested that the problem be eliminated by expressly providing, either in the statute or the Senate Finance Committee Report, that section 109 of the Bill will be inapplicable to a joint venture, partnership or other entity owned entirely by one or more corporations (other than subchapter S corporations and personal holding companies). Suggested language for a statutory resolution of this unintended problem is attached to the enclosed memorandum.

If there are any questions with respect to this matter, or if additional information is required with respect thereto, please do not hesitate to contact the undersigned.

Very truly yours,

SILVERSTEIN AND MULLENS,
ARTHUR H. SCHREIBER.

Enclosure.

MEMORANDUM

ELIMINATION OF ENTITIES OWNED BY CORPORATIONS FROM LIMITATION ON AVAILABILITY OF INVESTMENT CREDIT TO CERTAIN LESSORS

Section 109 of H.R. 10947 as passed by the House imposes a limitation upon the availability of the investment credit to "a person which is not a corporation" with respect to property of which such person is the lessor. While the provision is thus not intended to apply to corporations, such application could nevertheless result in a factual situation where the lessor is a joint venture, partnership or other entity owned entirely by one or more corporations.

The Report of the House Ways and Means Committee expressly indicates that in adopting section 109, the Committee was concerned "about the extent to which individuals (singly or as a group in a joint venture) are able to utilize the tax benefits of leasing transactions (the credit, and the depreciation and interest deductions) as a means to shelter from tax a substantial part of their other income." (Emphasis added). The Report further indicates that the Committee desired to prevent such result, which would otherwise occur by reason of the restoration of the investment credit, and thus felt it appropriate to limit the extent to which the investment credit will be available to such lessors.

The action by the House, as evidenced by the Report of the Ways and Means Committee, reflects a clear intention to exclude corporations (other than subchapter S corporations) from the limitation on the availability on the investment credit provided in section 109 of the Bill. Thus, a corporation engaged in the business of leasing section 38 property would be entitled to claim the investment credit with respect to such property without regard to the limitation provided in section 109 of the Bill. Where, however, a corporate lessor for business reasons joins with one or more other corporations in a joint venture, partnership or other entity to lease section 38 property, it is unclear whether the limitation provided in section 109 of the Bill would be applicable to such entity.

It is submitted that where the lessor is a joint venture, partnership or other entity which is owned entirely by one or more corporations (other than subchapter S corporations or personal holding companies), the limitation provided in section 109 of the Bill should be inapplicable in determining the availability of the investment credit with respect to such joint venture, partnership or other entity. It is clear that the House did not intend that such limitation would be applicable to a lease of section 38 property by a corporation, and there is no substantive basis for applying such limitation to a lease of section 38 property by a joint venture, partnership or other entity owned entirely by corporations. Since the corporate ventures would not be subject to such limitation if they leased section 38 property individually, the result should be the same where, for economic considerations, they join together in a joint venture, partnership or other entity to lease section 38 property. The situation sought to be prevented by the House in adopting section 109 of the Bill, i.e., the utilization by individual taxpayers of the tax benefits of leasing transactions, does not exist where section 38 property is leased by corporations either indirectly or through a joint venture could by them since in either event the tax benefits are claimed by corporate taxpayers.

Application of section 109 of the Bill to the joint venture in the factual situation in question would produce an anomalous result as to each corporate venturer in that each would be entitled to the investment credit for section 38 property leased directly by it in the conduct of its leasing business but would (assuming neither test provided in section 109 is satisfied) be denied the investment credit where it joins with other corporations in such joint venture to lease similar or identical section 38 property. Moreover, application of such limitation to a joint venture owned entirely by corporations could have an adverse economic effect by precluding the lease of section 38 property where the corporate venturers are unable or unwilling to undertake the financial commitments and responsibilities necessary to effect the lease of such property in their individual capacities. This is particularly true with respect to aircraft and other major transportation equipment which require the investment by the lessor of substantial funds to acquire such property.

The application of such limitation to the joint venture in the factual situation in question would also adversely affect the airline or other user which leases such equipment where it is unable to obtain the necessary financing to make the acquisition directly. The airline industry, for example, is dependent upon lease financing to satisfy equipment needs. The acquisition of new aircraft is necessary in order for the airline industry to keep pace with technological development and meet the demands of its passengers. The denial of the investment credit to the joint venture would have an inflationary effect by causing an increase in the cost to passengers and would be detrimental to the airline and shipping industries as well as to the economy.

In view of the foregoing, application of section 109 of the Bill to a joint venture, partnership or other entity owned entirely by corporations (other than subchapter S corporations and personal holding companies), which was not intended by the House, is not necessary to effectuate the purpose underlying such provision and would have a substantial adverse effect on the airline and shipping industries and on the economy. Adoption of the proposed amendment is therefore necessary to eliminate such unintended and undesirable result.

H.R. 10947, Section 109

AVAILABILITY OF INVESTMENT CREDIT TO CERTAIN LESSORS

1. On Page 18, Line 18 of the Bill, insert after "poration" the following:
"or an entity the entire beneficial interest in which is owned by one or more corporations"
2. On Page 19, Line 8 of the Bill, insert before "shall" the following:
"and a personal holding company (as defined in section 542)"

National Association of Business and Education Radio, Inc.,
Washington, D.C., October 14, 1971.

Hon. Russell B. Long,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

Dear Senator Long: The National Association of Business and Educational Radio, Inc. (NABER) is a non-profit association organized in 1965 to provide assistance to the 150,000 licensees in the Federal Communications Commission

Business Radio Service. The members of NABER, of which 90% are small business organizations throughout the country, are greatly concerned that the telephone companies are attempting to persuade your Committee to deprive them of the full 7% investment tax credit as recommended by the House of Representatives on purchases of private communications equipment.

In his testimony before your Committee, Mr. Theodore F. Brophy of the General Telephone & Electronics Company, representing the United States Independent Telephone Association, has attempted to make this irrational and unsupported point. There are certain things relating to this matter which you should be aware of:

1. Telephone companies have been granted monopoly franchises for their basic telephone business in the states in which they operate and are guaranteed by the Constitution to a fair rate of return on their investment. No other company can enter the basic central exchange telephone business in these franchised areas.

2. To suggest that private mobile radio competes with telephone companies is ridiculous. Telephone companies do not and cannot satisfy the mobile radio communications needs of our members. This proposition has always been recognized by the Congress and the Federal Communications Commission in the provisions for the grant of radio frequencies for industrial and public safety uses. NABER members need two-way, mobile radio to communicate in remote areas, and while in transit on the highways and streets across the Nation. Therefore to suggest that they can use a telephone for this purpose is totally unrealistic, and any implication that mobile radio communications are competitive with the telephone companies is wholly without foundation.

3. Often, the use of radio communications by a small businessman can mean the difference between a successful, competitive business operation, or a business failure. Successful businesses will mean the success of the basic "job development" purposes of the legislation. The telephone companies proposal will mean reduced credit to our members and will give less incentive to them to invest in new or improved communications equipment.

Business needs the 7% investment tax credit to permit expansion and communications will be indispensable in accomplishing this goal—to reduce the credit on private communications equipment will only thwart the purpose of the Bill by arbitrarily discouraging business from an investment urgently needed to help expand our economy.

Since private land mobile radio use by industrial and public safety entities can in no way be presumed to be competitive to the telephone companies, we hope your Committee will reject this proposal outright.

Very truly yours,

VAL J. WILLIAMS,
Executive Vice Presdient and General Manager.

COLUMBIA UNIVERSITY, DEPARTMENT OF ECONOMICS,
New York, N.Y., October 18, 1971.

Hon. RUSSELL LONG AND OTHER MEMBERS,
Committee on Finance, U.S. Senate, Washington, D.C.

GENTLEMEN: Your invitation this morning to submit additional material regarding the tax legislation you are considering prompts me to enclose a short article, "Capital and Taxation," and excerpts from a longer one, "The Adaptation of the Tax System to the Needs of Contemporary Societies."

The first includes some estimates which I made two years ago comparing the probable needs for capital with probable supplies of savings. Clearly, at least to me, the anti-capital bias of present tax laws conflicts with the deeply entrenched expectations of the American people. More solidly based estimates of the relation between capital needs and supplies may be available in the near future. The subject certainly deserves serious attention in the making of tax policy.

The second deals with basic issues of the role of business and the taxation of business. These, I trust, may be of help in your difficult task of molding tax policy to the best long-run interests of the public.

Respectfully yours,

C. LOWELL HARRISS, *Professor of Economics.*

[From the Tax Foundation's Tax Review, August 1969]

CAPITAL AND TAXATION

(By C. Lowell Harriss, Economic Consultant, Tax Foundation)

The Tax Reform Act of 1969 was not deliberately designed as an "anti-capital" measure. Yet many features could be so designated without serious misrepresentation—large increases in taxes on incomes where savings tend to be high (over $100,000), large reductions where savings are low (under $7,000), changes which add to the burdens on particular industries (oil and other natural resources, real estate, banking and thrift institutions), and repeal of the investment credit which affects all business. Even a biased search will have difficulty turning up a handful of changes which favor capital formation or business and for only two of them (rate reduction beginning in 1971 and amortization of anti-pollution facilities) will relief exceed $100 million a year.

Proponents of the bill focused on removal of favoritisms which have enabled some taxpayers to escape burdens equal to those borne by others with the same "income." References in the news media paid little or no attention to the probable effects on production and growth. Professional economists also concentrated on the equity aspects; if pressed, however, they would argue that removal of the special features would improve the efficiency of the economy through better allocation of productive resources, but hardly enough to be discernible.

The lack of attention to investment and the productive elements of our economy contrasts strikingly with the emphasis in 1961–62 which led to the investment credit and that in 1954 which brought a depreciation breakthrough. Taxation has become so complex that we cannot possibly keep all important issues before us in any one tax program. Thus there is a reason for overlooking some of the effects of legislation as major as that just passed by the House. Unfortunately, ignoring problems will not make them go away—and will certainly not solve them. One of these problems is America's need for capital in the years ahead.

As interest rates rose to new heights in 1968 and 1969, demand-supply factors got some attention, though scarcely enough. Disproportionate concern was devoted to the Federal Reserve's influence on interest rates and to "tight money". From week to week, it is true, the "Fed" can certainly influence interest rates. But its power to affect the level over longer periods will be slight. The general level and also the structure depend upon the forces of demand and supply.

Capital "Needs" Estimates of the amount of new capital "needed" to meet reasonable aspirations must lack precision. The goals themselves are flexible. Moreover, judgments about the productivity of capital differ considerably. For a broad view, however, simple estimating can give helpful perspective.

First, capital for jobs—(a) to equip workers entering the labor force and (b) to provide equipment to raise the incomes of present workers. Jobs in manufacturing often have $20,000 of capital per worker—really good jobs, often very much more. In retailing and construction the figures are lower, in utilities far greater. For finance, government, mining, agriculture, and services estimating the amounts presents many difficulties, such as allowing for the use of rented property which represents capital supplied by others. The amounts do range widely but frequently are less than in manufacturing. Over the whole economy, the new jobs which can come close to meeting the expectations of the new generation will require much more capital on the average than available today—more *real* capital bought at prices higher than in the past.

The labor force will grow by about 1,400,000 a year in the near future. An average of $15,000 capital per worker comes to $21 billion a year. An average of $20,000 involves $28 billion.

How much capital will be needed to improve the earnings of people already working? Their productivity on the average will rise from the accumulation of skills on the job. Longer vacations and other increases in leisure, however, will continue to reduce somewhat the inputs of manhours. In general, increases in annual real earnings of employees require additional capital per job. Let us assume that $1.50 of capital once added to production facilities will generally support, in addition to something for those who make the funds available, a rise of $1 a year in employee earning. Such an assumption is open to much debate. But let us see where it leads.

On the low side, we may think of employees getting $6,500 (about the present average) and expecting a 4 percent annual improvement—$260. Then capital additions each year would need to be $390 per employee. For a nongovernment employed labor force of 66,000,000 the annual capital needed would be about $26 billion. But if we think of average earnings of $8,000 (still somewhat in the future) and an expected increase of 5 percent a year (already perhaps rather low), the total swells—to $40 billion. Nothing in this total would add to the capital used by 12,000,000 nonmilitary employees of governments; but relatively more than is realistic is allowed for jobs with low ratios of capital to labor, e.g., household service.

BETTER HOUSING HIGH ON LIST

Another major need of a growing population whose aspirations are rising will be better housing. Assume a rate of family formation of 1,100,000 a year and $15,000 per housing unit. (Land cost, in effect, is excluded; the average puts heavy emphasis on apartments as distinguished from single family residences.) Total cost, $16.5 billion.

For upgrading the existing stock of 60,000,000 units, think of only $300 a year a unit for net improvement including the replacement of demolitions—almost ridiculously low at present construction costs. Yet the total comes to $18 billion.

The two housing amounts come to $34.5 billion—only about 8 percent above the present (1969) rate of expenditure on residential construction; and it is generally conceded to be inadequate. Therefore, this total would not really provide enough net improvement.

The lower range of figures add to around $80 billion. Raising sights only slightly at each stage would put us more than a little above $100 billion a year. No allowance is made for investment in durable consumer goods, which can absorb several billions of savings in some years, or for capital exports.

Capital Supply Outlook. If each of us, for his company, were asked to forecast the quantity of net new saving in the future, how many would wager much on the accuracy of our best estimate for any year? Uncertainty would prevail. Think how much depends upon the size of income itself!

The national income accounts show net saving—personal saving (including the growth of pension funds) plus undistributed corporate profits—of $65 billion for 1968 (no increase over the year ealier; estimates for 1969 to date show a decline). The governmental sector had a net deficit, a condition which has been true for most of the postwar period. If the low figure of $80 billion of investment "need" were to apply to, say, 1970, the normal growth of savings would not yield enough. The shortfall might not seem huge as such things go, but it would cause much disappointment. The amounts needed for more ambitious notions of net improvement would cost a lot more than our savings would finance.

Looking ahead, estimating net new saving for the whole economy must be done with much caution. The dollar amounts will finance a rising level of per capita income even for the population increase ahead. Yet complacency would be out of order.

Much depends on corporate earnings retention. How large will profits be before taxes? How much will repeal of the investment credit reduce after-tax earnings in the near future? With the present outlook for business taxes, a very good level of business activity, one without a serious "wage-profit squeeze," will be needed to raise retained earnings by $3 billion a year.

Personal savings out of disposable income, plus pension fund accumulations which do not appear in disposable income, are not high enough to be consistent with our implicit expectations about the rise of the standard of living plus population growth. As incomes go up, of course, so do savings. Yet will the increases be enough to finance the income growth which so many Americans expect?

One reason for doubt grows out of a belief that steeply graduated personal income tax rates create a bias against the growth of savings. Let us think of the more prosperous groups who supply much of total personal saving. As pretax income goes up from year to year, progressively more will be taken by Federal and state income taxes. This result is sometimes viewed as a relatively painless way to get more dollars for rising governmental expenditure programs. The channeling of more and more of rising income into governmental treasuries will tend, I suggest, to keep personal saving from rising by as much as we might expect. Moreover, many "reforms" of the 1969 act focus on upper income groups; per dollar of tax increase the substantial additions to be paid would probably reduce savings by much more than consumption. Fortunately, rate reductions scheduled for the 1970's will work in the opposite direction.

Inflation, if it continues, will expand the flow of income into government treasuries—partly at the expense of saving. This result of graduated scales of tax rates (personal income, estate, and gift taxes) which were set without respect for inflation was unpremeditated. But we have no excuse for ignoring it. One effect is a drift to relatively larger government. Another is some drop in the level of private saving and capital formation.

The weight of evidence indicates that net new saving will fail to pay for as much capital formation as our rising expectations lead us to hope for. The shortfall, I fear, can be great enough to aggravate by more than a little both social strains and personal disappointments.

INVESTMENT CREDIT SUPPORTS GROWTH

Role of Capital: Special Points. One special aspect of capital supply was emphasized (1961–62) by some supporters of the investment tax credit. Technological progress plays a crucial role in economic growth. Much of the contribution of advancing technology becomes available—e.e., appears or is transmitted—in new machinery, equipment, processes. New capital facilities embody the fruits of scientific research which cannot otherwise be put to use. Capital formation, therefore, brings advantages greater than the addition of more equipment. The new things tend to be of best quality. Savings invested in new capital facilities yield an extra "technological dividend."

Another point involves the role of the banking system. The Federal Reserve can alter the speed at which commercial banks by extending credit can add to the total of demand deposits. The new dollars which become available through such lending are just as good as any others for the borrower. When the economy has much unused productive capacity, there is merit in financing business expansion by an above-average growth of the stock of money (demand deposits). The effects, however, are quite different when, as at present, the economy is pushing at the limits of productive capacity. The notion that the banking system can substitute for new saving can be a source of trouble. Yet we hear this suggestion in proposals to "ease" financing, to help meet "credit needs" by Federal Reserve policy. And over the longer run not much of the capital funds required by an expanding economy can be met by money creation as distinguished from net saving.

Our economic welfare will depend heavily upon the efficiency with which businesses operate. Taxes are obstacles in the sense that they take from the taxpayer without directly giving him an equivalent. Taxes on business firms cannot help in the process of income creation. They can hurt. They can impede the productive mechanism, not, of course, because lawmakers want to hurt the process of production, but because an important side effect of taxation is the change in conditions which face taxpayers. Inevitably, taxes lead some businesses to act differently from what would otherwise be in their best interests. If tax rates are low, the sacrifice of what is essentially one's best interest to save tax will rarely be worthwhile. But when tax rates are in the range of 50 percent, purely tax considerations can be decisive. What is basically a less efficient alternative will sometimes seem best when taxes are taken into account. Capital investment flows to take account of taxes as well as of productivity. Taxes at high rates distort business decisions. Some loss of real income for society results.

Despite the importance of capital for progress, our system taxes heavily the returns to equity capital of corporations. This bias against capital results from actions over the years taken without much explicit regard for the realities of capital as a source of productivity and progress.

The personal income tax applies to the earnings of unincorporated businesses, enterprises which have no small role in our economy and its growth. With tax rate schedules as high and as steeply graduated as now scheduled, personal income taxes take a bite out of business earnings more often, and in bigger amounts, than the man in the street would probably expect. Capital accumulation out of the earnings of successful enterprises must suffer.

Among the capital needs pressing for high priority are those of cities. Huge amounts of new capital, more than really included in the estimates above, are needed to rebuild the older parts of U.S. cities. More than allowed for would also be required to keep the quality of physical facilities of cities abreast of the rising standards of a progressive civilization.

The obstacles we face are a combination which includes not only the amount of capital but also the conditions for use. The property tax needs basic restructuring. In an economic sense the tax on real property is not one but two taxes. One falls on land, the productive resource which in its basic sense is a "product of nature." The space in cities will not depart no matter how heavy the tax on land. Much of the value of urban land results from governmental spending and the general development of society, not from the efforts and land improvements of the owner.

The other part of the tax on real property falls on buildings. The amount invested in new structures will depend upon tax rates. Burdens at present levels of American cities put new construction at a competitive disadvantage in bidding for new capital.

Assuming that no loss of revenue is a realistic possibility for the immediate future, basic reform still is possible. The chief element would be a much higher tax rate on land than on improvements. The rate on land, on pure site value, might be three, four, or even a bigger multiple of that on improvements. Owners of land would be under far greater pressure to put it to most productive use. The tax rate on buildings would go down—such "detaxing" of improvements is a major purpose of the proposal. The attractiveness of investment in new urban structures would rise, drawing more capital. The logic is so convincing that this aspect of tax reform deserves serious debate, and promptly.

One reason for urgency stems from a feeling that our concern with urban problems will lead to special programs of aid, some outright subsidies, some special tax concessions. Yet programs of urban aid which direct funds into particular areas will tend to raise land prices. Will not much of the intended benefit then be incorporated into gains for landowners? To the extent that land prices absorb the worth of special aid, future residents and other users will get much less advantage from urban subsidies and aids than is intended. One project's success will add to the cost of others in the neighborhood by raising nearby property values.

To sum up, rising expectations of a growing population will require more capital formation than the probable flow of savings will finance. Modifications of the tax structure to encourage saving would involve issues not examined here. Modifications to encourage more productive use seem possible—and clearly desirable. And moderation in encouraging aspirations may be a requirement of statesmanship.

Excerpt From the Adaptation of the Tax System to the Needs of Contemporary Societies

By C. Lowell Harriss

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II. THE SUBSTANCE OF CONSTRUCTIVE ADAPTATION

Now let us look at some conditions and constituents of progress in taxation.

A. *A Fact to Remember: People Bear Taxes, All Taxes*

Too much talk about issues of tax policy suffers from failure to recognize a basic point: *Things* do not bear taxes; *people* do. Some taxes reach us indirectly as higher prices for what we buy, others as lower incomes from our efforts and our investment. The tax may also appear as a direct charge on our income and wealth after we get them. Whatever the form, however, every tax is paid by people.

For convenience, we often say that taxes fall on business, real estate, corporations, liquor, or value added. True, in one sense, but also seriously misleading — for the man in the street, the legislator, and all too many whose "shorthand" use of language does not have the background support of a solid basis of economic analysis. The important fact, however, is that whatever the first impact, every tax affects people: owners, consumers, employees. Although a corporation is in one sense a thing with its own existence, any taxes on it reduce the income of its owners or raise the price of its products or cut the payments to labor and suppliers (or some combination of these).

Voters, and the officials of government, cannot escape the problem of taxing human beings by pretending to tax things, such as business firms or real estate or beer. The distinction between *direct* and *indirect* taxation can guide attention to the difference between the first impacts of various taxes. But for most issues of significance we need to know how the tax is shifted, and to whom ultimately.

B. *High Tax Rates as a Source of Troubles*

High tax rates in themselves do more than hit some taxpayers hard. Differences in high rates abound and complicate matters. High and differential rates produce other effects, and, it seems to me, call for explicit attention in opening a discussion of the substance of tax modernisation.

What is "high"? Examples abound — 50 % on income, 10 % on an employee's wage bill, 200 % or more on cigarettes and liquor and some imports and consumer goods, 3 % a year on the capital value of property, 60 % on transfers at death; such are neither uncommon nor the peaks of their types in the modern world. Their existence will make efforts to escape tax worthwhile, perhaps the best way to use skill and time.

Individuals and businesses will take what would otherwise be a second, third, or fourth choice in their investment, production management, consumption, and general business decisions if by doing so they can save a heavy tax. Economic distortions result. "Excess burden" appears — or speaking more accurately, comes into existence but rarely appears because it is hidden. What is it? Loss to taxpayer and also to the economy is "excess burden", something not obtained that would otherwise have become available; it is something to the disadvantage of the taxpayer which is not matched by benefit to a governmental treasury. Adverse "third party", "spillover", "neighborhood", or "external" effects of high taxes can be very real even though neither measurable nor evident. They correspond on the unwelcome side to some of the external benefits which economists cite as justifications for government spending.

What determines the height of tax rates? The level of spending is obviously of prime importance, but the size of the tax base is also crucial. The broader the base, the lower the tax rate needed to produce any given volume or revenue. The broader the base, the greater the difficulty of manipulating it to save any substantial portion of the tax. Erosion of a tax base tends to make for higher rates and then new distortions.

Avoiding high tax rates, therefore, takes on importance as a goal of tax policy. Adapting a tax structure for better service in the years ahead ought to include a deliberate attack on the highest of tax rates. Not easy! Perhaps somewhat less difficult may be the prevention of rates which are already high from going higher.

C. *Fairness and Justice*

Adapting a tax structure to new conditions calls for thought about the concepts of fairness and justice and equity. They unquestionably, and properly, loom large in the writings with which I am familiar. Not everyone getting about the same services of government will pay the same tax. The differences in tax bills (open plus hidden) can be large. They result, not from free choice but from the decisions of rulers of the state. In taxation society employs coercion. We want it to be used justly and fairly.

1. Some Problems of Definition

Like love, beauty, humor, and perhaps even heaven, justice, vaguely conceived but earnestly sought, stands as one of man's great aspirations. It is one of the chief goals which men seek through government. Justice will be one goal in adapting the tax system to new conditions. But what does it mean? Are there generally accepted principles of tax "justice"? [3]

In appraising different possibilities of imposing tax, the criteria for judging will assign high priority to the feeling that any use of

[3] In the United States, "justice" is a word freely used, but ill defined. Translation to other languages presents great difficulties. The basic concept is the rendering to individuals or groups what they are *entitled to under predetermined standards*. On how standards come into existence, views can differ widely. One possibility is legalistic, to make the standards whatever statutory and judicial law provide. Another approach would derive the basic principles from absolute God-given or "natural" rights. A more pragmatic approach accepts the standards as set by the consensus of the time and place. Where tax-burden distribution is in question, the legalistic approach gives no help; taxes result from laws, and the inescapable conclusion would be that whatever burden distribution is produced by a tax law is *ipso facto* "just" — obviously not what we seek. Elsewhere, I have discussed 9 doctrinal bases which have been — and to varying extent still are — used. W. J. Shultz and C. Lowell Harriss, *American Public Finance*, 8th ed., Englewood Cliffs, N.J., 1965, Chapter IX.

compulsion should be governed extensively by consideration of fairness and equity and justice. Ethical and moral value judgments will be both explicit and implicit. The determination to make a tax system fair seems to me worthy of the best in mankind's traditions of humanity, of consideration for others as well as self.

As we come from different societies, what are the meanings of the terms corresponding to "fairness" which we try most seriously to put into practice? One thing which I hope this program will encourage is discussion of the thinking in many countries, including those where Marxian ideology exerts strong influence, about how the costs of government ought to be divided among people. Looking ahead, what kinds of tax changes would represent progress on this score?

To repeat: Some people will pay very much more than others toward the cost of government for all. They do so because of coercion by the "state", more realistically, by the people who make government decisions. What criteria, what sense of values, are dominant in the theoretical, analytical, and philosophical thinking? Or is there much concern about what "ought" to be, about what would be better? With costs of government to be as burdensome as seems inevitable, the importance of striving for ever greater fairness seems to me of high priority. Progress requires thinking about the constituents of tax justice.

Then additional considerations command attention. They take many forms — the imbalance of political power, the complexities of laws of property, the quality of administrative machinery, competition from other economies, and many others. [4]

[4] The history of the growth of government includes much in the search for justice through law. But there are other objectives. Increasingly, men try to use the process of government to get more things which are not necessarily associated with justice — economic growth, education, subsidy for particular groups, health, conservation of natural resources, recreation, equality, cleaner air, and so on. Some of these goals are often said to fall within the scope of "social justice" or "economic justice". Such usage of the term "justice", however, can be misleading. For example, it implies that the thing sought is like legal justice. Government using police and courts can give us legal justice (although the statutes may not seem right to everyone). Use of the term "economic justice" (or "tax equity") may lead the unwary — or the person whose wishes make him accept as achievable what he wants to believe — to feel that "justice" in such a sense is as definable, and as obtainable through government, as is legal justice.

2. Enforcement of Law

On one aspect of tax justice there ought to be a consensus: "Every taxpayer shall be treated according to legal rules which apply equally to all taxpayers in the same class." Is this not a goal to which the good society will aspire? Fairness requires that there be no prejudice, whether by accident or design, in the application or administration of the law. The higher the tax rate, the greater the practical significance of this point because more money hangs on each action. The adaptation of tax laws and practices to the requirements of the future should conform increasingly to what can and will be enforced. The achievement of more justice in this sense requires modification of law, of administration, and taxpayer compliance. Better enforcement of tax law deserves higher priority than it seems to get.

3. Gradualness

A different kind of principle distinguishing the equitable in taxation from the unfair, a principle which can help in making many important decisions, is associated with continuity and gradualness. Big changes, big breaks, large discontinuities in tax for relatively small changes in conditions, are more likely to be a source of injustice than of justice. Is it not unfair if slight inequalities in personal position create large inequalities in taxes?

Let me be clear: Justice *does* call for tax inequality. But it also requires that the inequalities be related in quality and quantity, to differences that have substance. A relatively small and insubstantial difference should not give rise to a substantial difference in tax. If getting on one rather than the other side of a line — a legal formality, the wording of a contract or a will or a trust, a year or two of age, a few units of some measure of an auto, a small change of location — makes a big difference in tax, the result seems more inequitable than equitable. Some discontinuities, of course, may be a reasonable price to pay for ease in administration or some other desirable objective. In general, however, slight differences in conditions ought not to lead to big differences in our compulsory payments for government.

4. Horizontal Equity

Two other concepts can help in solving problems about the sharing of the costs of government. *Horizontal equity* requires that "equals be treated equally". Everyone on the same income level, or consuming about the same things, or in essentially similar circumstances, shall bear the same portion of the expense of government. When their circumstances differ in *ways that are significant for the sharing of the costs of government* — size of family or wealth or total of charitable contributions, for example — fairness requires that tax loads differ.

This principle will elicit widespread agreement, and properly so. The equals-treated-equally guide can help in many cases. But many "nonequal" situations arise. Which of them involve elements that are relevant for dividing up the costs of government? This question leads to a companion concept.

5. Vertical Equity

Vertical equity requires that people whose circumstances differ in ways which are relevant for sharing the costs of government must pay different taxes. *How much* of *what* differences will warrant *how much* difference in tax? Little consensus will be found — except that the unequal treatment of taxpayers must rest on reasonable, not capricious, bases.

In sharing the expenses of government, is income a relevant factor? Place of residence, source of income, wealth, health, number of workers in a family, kind of property owned? Some as against other items of consumption? Effort made in getting income? Height or color of hair or age? Some technicality of a property contract? And so on. Many of these and other elements *always* appear in comparisons of people.

How must each thing we decide to take into account be weighted? For example, do we achieve vertical equity in taxing more heavily the $ 16,000 than the $ 15,000 income when the extra $ 1,000 resulted from the sacrifice of 200 hours of leisure and the input of 200 more working hours? Many more truly perplexing questions can be raised than can be answered to satisfaction. But the asking itself can perhaps help in clarifying issues and avoiding mistakes.

In the United States today a few types of income are taxed less heavily than others. Somewhat the same results may appear in other lands.

6. Ability to Pay

The notion that tax burdens should reflect "ability to pay" has wide acceptance — but lacks clarity. It almost defies our ability to define. Behind the concept one finds the principle (implicit in what has been said earlier) that government costs are incurred for the benefit of everyone and should be imposed on the individuals who compose the social unit in a manner which takes account of the hardship in paying and seeks to minimize the personal sacrifice, or at least to keep it "low".

What is the basis of "ability" as regards paying for government? Perhaps property (wealth) is the best criterion of taxpaying ability. More generally, today, income seems to be accepted as the major standard of taxpaying ability. Yet "ability" is also attributed to wealth, to inheritances and gifts, and to expenditures on consumption, in total or of some types, e.g., "luxuries". Is there any good reason to insist on a single base to measure ability? Of course not, quite the contrary. But try to set up principles for meshing together two different bases for ability to pay. Most of us would find easier the moving on to another aspect of this troublesome subject, as I do now.

Assume that we have agreed upon something as a *base* of ability. How can it be used as a measure? If one individual has twice as much property, or in the course of a year spends twice as much, or receives twice as much income, as a second individual, does the first person have exactly twice as much ability as the second? [5] Or is the proportion somewhat more than double, or somewhat less?

In one sense, however, there may be an *objective* application of the "ability" principle — a guide of practical significance. The amount needed to support a socially endorsed minimum standard of living can be calculated. Below this figure, it can be said, no taxpaying ability exists. [6]

[5] A business concern as such (as distinguished from its owners, employees, or customers) has no independent impersonal taxpaying ability, or so it seems to me. But the argument has been developed that business units do possess an impersonal taxpaying "ability" measured by net income or by the relation of net income to capital. This argument has been used to defend corporation income taxes. To me it seems mostly nonsense. To find defensible reasons for taxing corporation earnings, one must look elsewhere.

[6] Life requires government no less than some other elements of a minimum standard of living. In a strict sense, therefore, does not some payment for government, some tax belong in every budget? Not in principle, it seems to me. For the very poor, payment of costs of government by others seems much the same as payment of welfare and other aid which is provided on the basis of need.

7. Progression, Proportionality, Regression

The literature of public finance, and certainly popular feeling in my country and some others, generally accepts the view that the tax system should impose its burden progressively.[7] They believe that the amount of tax payable expressed as a percentage of income (or wealth or total consumption) ought to rise more rapidly than income (or wealth or consumption). In fact, however, the case for progression *is* an uneasy one.[8] What basis is there for deciding how much in taxes it is fair or economically wise to demand from the family with an income of $ 10,000 compared with the almost similarly situated family with $ 9,500 or $ 10,500? Ardent supporters of progression as a device for discriminating to achieve equity may disagree strongly on the fairness of a given set of tax rates. A scale of progressive rates may be so steep as to be unfair, perhaps starkly inequitable even in the eyes of someone who firmly believes in the justice of some progression. Or so lacking in differentiation as to be a sham. But when?

Intuitively, most of us are likely to resort at least a little to the "subjective sacrifice" doctrine in laying out and judging a set of discriminatory rates. We may *sense* that it leads to equity. Income, property savings, or any other measuring rod of taxpaying ability, it is said, has diminishing utility to its possessor. Consequently, a prosperous man's payment of a given sum in taxes entails less "sacrifice" than a poorer man's payment of an equal amount. (Other things being the same. But just when are they the same?)

The basic postulates of this doctrine find less than the firmest of support. Personal income, wealth, saving, and expenditure have values for more than one purpose — for example, as consumption and as instruments of economic creation and social status. Not all individuals have tastes and desires of approximately the same in-

[7] Since the term "progress" also has meanings of a very different sort, its use for taxation and tax rates should probably be supplanted by the term "graduation". The term "graduated" to apply when tax rates rise with the size of the base has at least one merit over "progressive". There is no implication that the rate differentiation has clear relation to progress as such. Some observers would argue that progressive tax rates can impede economic progress. Some people seem to believe so uncritically in the desirability of progression that any scale seems better than none. But if one steepness seems generally fair, others which are quite different must be inequitable.

[8] W. J. Blum and H. Kalven, Jr., *The Uneasy Case for Progressive Taxation*, Chicago 1953.

tensity. Each person's own patterns change as experience builds on experience. What reason do we have to believe that "sacrifice" can be related meaningfully to increments of personal income, wealth, or other measures for millions or tens of millions of people of all ages, education, place of residence, and so on?

To provide a guide to tax-burden adjustment in which we can have confidence, it would be necessary to establish a general formula for the diminishing utility of personal income, wealth, or other measures. Such is needed if *subjective* sacrifice is to be correlated with some *objective* measure. No general law on this matter has been established inductively. Nor can I see even a remote possibility of such an achievement. (Getting political acceptance would present still more problems.) Anyone who utilizes the "sacrifice" doctrine to attack or defend a tax system must assume some arbitrary formula for the diminishing utility of wealth or income that produces the conclusions he desires. [9]

Nevertheless, decisions must be made. But before saying more, another aspect needs to be brought into our examination.

8. Benefit from Government Spending

Thinking of equity or justice as "giving every man his due", one will find much appeal in the benefit *(quid pro quo)* doctrine. To some extent the cost of governmental services should be apportioned by taxation among individuals pro rata to the benefits derived. But what is a proper *measure* for apportioning the benefit of government services among individuals? The benefit doctrine in its most general form assumes that the benefits of government flow to identifiable recipients. Governments, however, perform functions of which the benefit is either entirely or largely collective so that it cannot be apportioned individually. How, then, can there be any measures of the value of government services by which the costs of such

[9] Three conflicting "sacrifice" objectives have been formulated: *equal, proportional,* and *minimum.* None so far as I know rests on a generally tested basis in psychology. Although much more can be said than is possible here, a few general conclusions may illustrate the complexities. According to the formula employed for diminishing utility of income or wealth, the "equal sacrifice" objective may be made to justify regressive, proportional, or progressive taxation. Either proportional or progressive taxation can be supported by the "proportional sacrifice" objective. The "minimum sacrifice" objective can lead to progressive taxation and possibly outright confiscation over a minimum figure.

services can be apportioned among individuals? Assume equal benefit for all? Many persons would not have money incomes large enough to meet the bill. Simple arithmetic rules out such a "solution".

Yet the benefit principle may have more possible applications than are generally used. Some government activities may produce measurable *individual* benefit along with collective benefit. In such case, the activity may be organized as a government enterprise financed in part by charges, tolls, or fees, imposed upon the individual beneficiaries. Charging also brings the advantages (and disadvantages) of restricting quantity demanded.[10]

A second application of the benefit theory occurs where the collective benefit of the government activity inures primarily to some *identifiable group.* A tax that rests exclusively upon this group can claim "benefit" justification. Motorists derive a special benefit from government expenditures on streets and highways. Hunters and fishermen can be compelled to pay special license taxes whose proceeds are spent for conservation. Social insurance presents possibilities of great magnitude and scope.

A third application of the benefit principle is *geographical.* (a) Local taxes for local benefits are fair, it seems to me, subject, of course, to various exceptions. (b) Nonresidents who are employed or possess property in a taxing area may derive benefits from the government there; this consideration provides support for nonresident income and estate taxes. (c) The benefit principle seems to me to provide an argument against financing government services of a local nature by a tax over a broad area. For example, does not the provision of funds out of *national* taxes for services in a few cities seem a bit hard to justify? Most of the collective benefit involved, let alone any supplementary individual benefits, will have no application to many taxpayers who are compelled to contribute the funds through national taxation.

The benefit principle deserves considerable respect as economies grow and develop. When it is used, the greater the value of the services which a person gets, the more his taxes — somewhat like

[10] Water, transit, electricity, sewer, and other products or services sometimes supplied by government can be priced. The issues of deciding on prices for optimum results can become very complex. One reason is that individual and group aspects cannot be disentangled readily. Sharing of fixed costs raises a range of difficult questions along with the opportunities for constructive discrimination.

market prices. [11] The constructive potentialities probably exceed the realizations to date.

D. *Some Thoughts on Progressive Taxation in the Years Ahead*

1. Sympathy for the Poor

The proper concern is with the total tax system. One or more elements must be progressive, but others can be proportional or even regressive and still be useful parts of a good revenue structure. The nature of the *overall* tax burden is what ought to command attention.[12] Conditions today and aspirations for the future will differ from one society to another and from person to person.

Humanitarian considerations alone, it seems to me, ought to be highly persuasive in any discussion of taxing the very lowest income groups. Is not an improvement in the conditions of the poor a mark of genuine social progress? And is not one sign of such progress a lowering, absolutely or relatively, of taxes on the (very) poor? Consumption, general business, and payroll taxes inevitably burden the poor. Therefore, a major tax which exempts this group has appeal, for me at least, on humanitarian grounds. The personal income tax and death taxes can do so.

This conclusion does not need to rest on considerations of fairness or justice, but of mercy and compassion. Whatever one may think about tax discriminations *against* those with high incomes — the "soak the rich", even vindictive, attitude on which some people base the arguments for graduation of tax rates — many of us will endorse the aspect of progression that affords tax relief for those at the bottom of the income scale. The personal exemption can do so. An income tax with an exemption will accomplish this end, and can do so with a flat rate — or even with regressive rates. [13]

[11] One difference, of course, can grow out of the element of compulsion that forces us to "buy" things through government which we would not purchase otherwise — in quality, in quantity and even in kind. For example, the tax on workers to pay for social insurance is levied partly according to eventual benefit; but we have almost no freedom to reject social insurance.

[12] The effects of government spending, of course, bear upon the total. Who gets the benefits of spending? A system with large emphasis on programs for the poor would presumably tolerate more regression in the tax system than if spending of government acts to spread benefits over the whole public more or less equally. One disadvantage of big government and big taxes is the resulting use of taxes which burden the poor heavily.

[13] From my paper, "Progression Reconsidered, *Tax Policy,* April—May 1964,

Intuitively, many of us may find that "ability" arguments do seem to provide appealing reasons for graduation of overall tax burdens. Personal — *not* business — income or wealth (as for death taxes) may be subject, at least to some extent, to principles of diminishing marginal utility. Taxes can be viewed as absorbing increments of income, starting from the top margin and working downward. Each higher income increment will be devoted to less vital spending than the one just below; hence it embodies less value for the recipient.

A proportional (not necessarily a progressive) tax will take much more from families with "high" than from those with "low" income. It would presumably absorb less valuable income from the higher income than from a lower one. Many of us may feel that proportional rates over fixed exemptions are not enough to satisfy our standards of fairness. In America one senses a general belief that only by taking progressively larger fractions of higher incomes can the burden per dollar of total revenue be kept from being needlessly high.

2. Caution: Moderation

Nevertheless, arguments *against* so framing a *tax* system that it results in progressive overall burden deserve attention. For one thing, rates may be unfairly steep. A rate scale from, say, 5 to 75 percent differs greatly from one of 20 to 50 or 40 percent (equal yield assumed). If one scale is generally equitable, the others must be inequitable. Larger incomes are to some degree due to more extensive and higher quality personal effort and greater contribution to the general economic benefit. Is it not wrong from the standpoints of both justice and economic efficiency to penalize such effort and contribution through discriminatingly heavier taxation?

Incentive aspects are interwoven with others. High tax rates and big differentials affect incentives to work, for thrift, and for efficiency in resource allocation. The steeper the progression, the stronger become the economic arguments, and to my personal way of feeling also those arguments which have social and ethical bases, against further sharpening the progressive elements at the high end of the scale.[14]

p. 4. Consumption taxes can exempt some, or many types of buying. To exclude entirely from the tax the very poorest families requires more complicated rebate arrangements.

[14] In the United States, I would argue, much inequity results from the steepness and the height of tax rates. Both vertical and horizontal inequities are greater

In some ways steep progression makes even crueler that "cruelest of all taxes", inflation. If income taxes do really "bite", then a rising price level makes the real burden heavier.

E. *The Wisdom — or Folly — of Taxing "Business"*

The United States, and many another country, could improve its economic future by deemphasizing tax burdens on business firms. Businesses are the organizations upon which noncommunist economies rely to produce most of their output. Of course, the efforts of teachers, judges, military personnel, and other employees of government — as well as the efforts of those who work for private non-profit organizations — yield valuable results. But most real income consists of what people accomplish through business firms. They are the public's major agency for organizing labor and capital to produce — and to produce more, rather than less, efficiently.

Let me state, too briefly, some general points, some fundamentals, to orient our thinking.

1. Role of Business

Businesses, whether or not incorporated, are *groups of people* seeking to benefit themselves by serving others. Such services, whether in producing and distributing things or in rendering *services directly,* are what people want. The process of serving consumers can be more or less efficient in terms of inputs per unit of output. How do we hope to get efficiency? Most societies rely primarily upon competition in markets to induce efficiency — and also to stimulate growth. For it is in business organizations that we find, not only the source of more of the old, but also most of the venturesomeness and innovations that contribute so much to rising living standards.

The wellbeing of the public as a whole calls for each business to: (1) turn out products or services which are wanted more than something else, as reflected (a) in freely made consumer decisions expressed in the market or (b) through government as the agent for making collective decisions. Part of this responsibility of business is to anticipate and to identify wants which will be satisfied by new

because of sharply differentiated income and death tax rates so high that "small" differences can mean much in absolute amounts. The standard of gradualness is often not met.

types of goods and services; (2) produce by the use of methods which economize on labor, materials, capital, and other "inputs" according to their relative scarcity and productivity.

The total accomplishment of people working as business organizations will depend upon many things: the training, inherent ability, and acquired skill of workers; their willingness to exert effort; the amount of capital — in the physical sense of buildings, equipment, and inventory, and also in the financial sense of money, without which transactions as we know them would rarely be possible; the intensity and vigor of competition; the state of technology and speed of scientific advance; the competence of management; and other things. Among these "other" things are some for which government is responsible. The system of law is one, enforcement is another. The tax structure is still another, and one of great importance.

2. Economic Disadvantages of Taxing Business

Taxes are obstacles. They take from the taxpayer without directly giving him an equivalent. Taxes do not help in performing the basic economic job of production. Taxes on corporations or other business firms do not improve the process by which consumers indicate the relative importance of their desires. Taxes on business income do not help indicate to managers the relative scarcities and productivities of inputs. But taxes do affect the alternatives which a business manager must consider — the incentive is to reduce taxes. In adopting methods which cut the tax bill, however, a business does not economize on the "input" of government nor does it reduce in any perceptible way government's use of resources. Reducing taxes does not really increase a company's output per unit of input.

A business, in fact, may wisely adopt methods which are inherently "second best" because the artificial factor of taxes makes such methods the best under the circumstances. Taxes thus give rise to an element of conflict between private and public interest as they induce the manager to redirect the firm's activities away from what is fundamentally most efficient. In this way taxes lead to results which are less than optimal when judged on the basis of economic productivity.

The distortion may be only trifling, or of some importance. Productive capacity is not allocated to the uses, and in the proportions, which are fundamentally best. Too much investment goes into forms with less burdensome tax consequences; too little will then go where taxes are high. The economy loses some real income. The loss is a burden — but one which is concealed, one which cannot be measured.

3. Reasons (Excuses) Given for Taxing Business Income

How, then, can one explain the heavy taxation of business? Each country's history will be somewhat unique. In the United States both accident and temporizing to meet emergencies — notably war — have, I submit, played a larger role than has the rational evaluation of alternatives. Practices of some businesses, especially large ones, have sometimes drawn sharp criticism from persuasive American writers, and "fighting reformers". Whatever the validity of the criticisms, school books, and writings of some persons who consider themselves "intellectuals", have perpetuated attitudes which contain no small hostility to business.

Strains of Marxist influence have exerted effects. Labor union attitudes of the employer as an adversary have extended into governmental policy debates. A deep-seated belief that "business" somehow has taxpaying capacity — business or corporations as distinguished from people as stockholders, consumers, or employees — such "shorthand" or "excuse for thinking" lives on with few challenges. The big corporation, seeming to be so impersonal, appears as an inviting target for the politician concerned about votes. Moreover, on the assumption that the shareholder bears the burden, and recognizing that the more prosperous members of society are share holders, advocates of corporate taxation defend it as progressive. [15]

High U.S. corporation tax rates went into effect during time of war and postwar boom when employees, owners, and government could all increase their "take" because total output was expanding markedly; at the same time rates of tax on personal income were rising and thus, it was argued (more persuasively than logically),

[15] Any resulting graduation can be only crude; it is not the type of progression which can be defended as leading to either vertical or horizontal equity. Furthermore, it is not true that a corporation income tax resting on shareholders imposes no burdens on low income groups. Some shares are held by people with low incomes. Large amounts are held by philanthropic, educational, medical, and other organizations whose activities serve even the very poor. Moreover, pension funds for employees of businesses, nonprofit organizations, and some state and local governments are acquiring substantial holdings of corporation stock .

justifying substantial increases in the rates on corporations. As the years have passed, justification for continuing the high rates has been found in the argument that taxes have been capitalized in the prices of shares and in a sense constitute little or no burden on present shareholders.

In the formative years of income taxation in the United States, some economists argued from theory. *Pure economic profit,* they said, is a true *surplus.* To tax it is not to burden the reward paid for productive "effort", and not an essential cost of production. Unfortunately, the income concept used for tax purposes is not the concept of pure profit. Tax laws impose definitions of "taxable income" which are much broader indeed than the notion of pure profit as a true surplus. [16]

Today's tax in the United States gets some support from another fact. The corporation income tax qualifies as an "automatic stabilizer" of considerable force, a feature which space limits will not permit me to discuss here.

So far, my discussion reveals no merit in reasons for high taxes on corporation income. But the story is not ended. To some extent corporations are separate from their owners and in ways which can have tax significance: (1) the comparative tax burden on incorporated and unincorporated activity; (2) the possibility of tax avoidance. First, a few words about the second.

Not all corporation profit is paid out in dividends. Those retained in the business are not subject to personal income tax. The owners are not so well off, presumably, as if they had received the income in cash, free of corporation tax; but at least those in control of the company must expect to make it better off than if they had gotten the earnings in cash and paid the personal income tax. The ownership interest in the business becomes more valuable because of the growth of assets. [17] Conversion into capital gains of what would

[16] Wartime attempts to tax excess profit have tried (to varying degree) to identify and reach that element of return to capital which is a pure surplus. The history of these efforts illuminates the tremendous difficulty of identifying pure profit.

[17] Accretion of economic power in this form free of personal income tax seems less than the ideal of fairness when other accretions, such as wages, are taxed. But disagreement with this conclusion is easily found. Any argument starting with questions of fairness will quickly move to other considerations, notably capital formation. Perhaps they deserve more weight than does justice or equity. But how can we balance all relevant considerations?

be dividends obviously has tax significance. Consequently, the existence of the corporation does make a difference in tax burdens.

Retained earnings do present a problem for tax policy. For logical solution, however, one will hardly look to a tax on all corporation earnings; for amounts which are paid out to shareholders get into their taxable income. (1) One solution is to tax (only) undistributed profit, but this practice has effects of some importance in themselves. (2) Another possibility is to require the shareholder eventually to make a complete accounting for tax purposes of net benefits from his share ownership. Needed for this result is an effective tax on net capital gains, including those embodied in transfers at death. (3) A third approach allows the dividend recipient a credit for tax paid by the corporation. Management decisions about business operations would still be influenced by the tax on the corporation. None of these approaches can be fully satisfactory. The guides of the market would not operate free from tax considerations to determine the amount of saving and the direction of investment.

4. Who Really "Pays" the Tax on Business Earnings?

Two points need to be distinguished. One inquires about shifting and incidence of the tax. The other looks farther to the effects which follow. And, of course, the results in the short run may differ significantly from those over the long run. Changes in the amount of tax on the profit of a company — whether resulting from fluctuations in pretax earnings or from a revision in the tax rate or in the definition of the tax base — are likely to be reflected, for a while, in what remains for stockholders. As time passes, however, adjustments take place.What is the process of responses to a change in the rate of tax on profit?

Supplying business with equity (ownership) capital as contrasted with debt costs something. The stockholder sacrifices the opportunity to use his wealth in some other way. This sacrifice is an economic cost. Although income tax law and traditional accounting do not recognize this as a deductible expense of doing business, consumers will not get equity capital to work *for* them — and employees will not get capital to work *with* — unless the people who are able to provide ownership capital firmly believe that the total net benefits for them will equal those obtainable elsewhere.

Suppliers of capital, whether in debt or equity (ownership) form, expect to be rewarded. What counts must be the reward *after tax.*

A normal return on equity capital is an *essential economic cost.* The net after-tax return which a supplier of equity capital will insist upon will be as high a yield (conceived broadly as total net benefit) as he could obtain from the best alternative use of his funds.

The equity capital already in a business, of course, is largely sunk, at least in the short run; it must remain for a time, regardless of actual returns. To get *new* capital, however, the business must offer attractions which are equal to those otherwise available to the suppliers of funds (debt in some cases, equity in others). Where can the company expect to get dollars (francs or pounds) to reward those who provide capital? From customers. If the corporation income tax rate is 50 % and if potential suppliers of new equity capital insist upon an *expected* return of 8 %, then the corporation must expect to get a price from customers which will yield 16 % before tax. Only those new projects which offer a gross return (above all other expenses) of 16 % will get equity financing.

The corporation will not succeed in selling new stock unless the prices which it expects from its customers will bring an adequate after-tax yield (retained earnings raise possibilities calling for special analysis). The expansion of output (in a growing economy) will lag until prices *are* high enough to give profits which satisfy investors. Over the long run, then, some or much of the corporation income tax will be shifted to consumers. The indirectness of the process conceals most of it; but the general result is a tax on consumption. This tax, however, falls capriciously, unevenly, and fails to conform to any concept of fairness familiar to me.

Corporations which are not growing and which do not seek new capital, will have much more difficulty in passing on to customers an increase in a tax rate.[18] A reduction in tax on corporation earnings will be followed by price reductions, but gradually rather than quickly, because of the time needed to enlarge output, and not uniformly.

The actual shifting to consumers has more complexities. Something depends upon what happens to the *total supply* of, and *total*

[18] Withdrawal of capital in the form of depreciation offers an opportunity to reduce productive capacity and output and thus creates conditions for a price rise. Throughout the discussion, of course, we assume other things being the same. If other revenue sources, such as personal income or sales taxes, were relied upon to raise revenue equivalent to that from a tax on corporations, demand and supply conditions for capital would be affected by many factors, not merely those of business taxation.

demand for, capital. The amount of capital available for new investment is not fixed — certainly not the amount available for equity investment in corporations.

Let us assume that a tax increase on corporation earnings reduces the prospective yield. The potential supply of equity capital (out of a given total of funds for investment) will decline. Meanwhile, as more of the total of savings seeks investment in debt form, the rate of return on debt will fall. Thus the tax on corporation income tends to reduce, not only the after-tax yield on equity capital (except as passed on to consumers) but also the yield for suppliers of debt capital. The corporate tax thus becomes a *more generalized burden on the suppliers of capital.* The amount and the distribution of this burden cannot be measured. Nor can they be compared with the amount passed on to consumers. And who will be able to learn how the amount of saving and the types of capital formation will change?

Any shifting operates in an environment in which conditions constantly change. Lags and frictions slow the process. No single set of forces has an opportunity to work itself out completely and fully. Some corporations will be more successful than others in getting a satisfactory after-tax return. Competitive factors differ widely. For example, businesses competing with others which are free from the tax — notably those operated by government — must expect considerable difficulty in passing the tax to consumers through the market process. Other factors affecting the relative position of company are foreign competition, the extent of production from firms with large proportions of debt finance, and special features of the tax law.

A major tax whose economic effects are so difficult to identify and measure — but some of which wise and good men would most certainly shun rather than seek — can hardly be the best that man can devise.

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STATEMENT OF THE AMERICAN ROAD BUILDERS' ASSOCIATION, SUBMITTED BY BURTON F. MILLER, EXECUTIVE VICE PRESIDENT

IN RE: H.R. 10947, REVENUE ACT OF 1971, EXCISE TAXES ON LIGHT TRUCKS

Mr. Chairman and Members of the Committee: The American Road Builders' Association is opposed to the immediate exemption of light trucks from the truck excise tax principally on the ground that the proposal has not been adequately studied.

The proposal was tied to the proposed repeal of the seven percent excise tax on automobiles in the House Ways and Means Committee. As we understand it, the case was made that light panel trucks and pickup trucks are used mainly for personal and farm use and that, therefore, it would be reasonable and logical to extend the tax relief granted to automobile users generally to the users of these light utility vehicles.

In our judgment, the exemption of light trucks has ramifications which have been overlooked or given little attention.

1. Unlike the automobile excise tax, the truck excise tax is one of the sources of revenue accruing to the Highway Trust Fund. The loss of revenue to the Highway Trust Fund will amount to almost $350 million in fiscal year 1973 and to approximately $2.2 billion over the statutory life of the Highway Trust Fund.

This loss of revenue can only result in a delay in the highway improvement program. The resulting increases in travel time, operating costs and highway hazards will be expensive to all highway users.

2. Adjustments in the tax legislation supporting the Highway Trust Fund should be made, when necessary, in the context of (a) highway needs and (b) an equitable distribution of the highway tax burden among all classes of users.

An exhaustive National Transportation Needs Study will be submitted to Congress early in 1972. It is apparent that the report will show that there are extensive and urgent needs for all modes of transportation, including highways. The matter of financing transportation construction programs will be one of the most serious problems confronting Congress next year.

The Administration has also recommended major changes in the manner in which Federal aid for transportation construction programs shall be administered.

In the light of major proposals pending and due to be supplemented in the next several months, the light truck exemption seems premature, at the very least.

3. Information regarding the proportions in which light trucks are used for business purposes and recreational purposes is scanty. Some of the pertinent questions which need to be answered are:

(*a*) To what extent will business purchasers of light trucks benefit from the proposed investment tax credit? The businessman who can charge off 7 percent of his vehicle investment in this way will enjoy a double tax benefit.

(*b*) Inasmuch as higher taxes on heavy trucks are justified because of the highway cost increment attributable to these trucks, should not recreational vehicles be treated similarly? The rapid increase in the use of truck campers, bus campers and recreational trailers has put heavy traffic pressure on roads serving recreational areas.

(*c*) Would farmers benefit more from a 10 percent reduction in the price of light trucks than they would from improved highway service? The tax saving to the farmer is somewhat illusory. He pays $250–$400 less for his pickup truck, depreciates it over a period of years, and hopefully increases his net income by an equivalent amount over that period. This increase in income is diminished, of course, by Federal and State income taxes.

In consideration of the foregoing, it is respectfully recommended that the proposed repeal of the Federal excise tax on light trucks (10,000 lbs, and under) be passed over pending further study.

AMERICAN INSTITUTE OF MERCHANT SHIPPING,
Washington, D.C., October 19, 1971.

Hon. RUSSELL P. LONG,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR LONG: The enactment of the 1970 Merchant Marine Act in which you played a vital role signaled the beginning of a new era of hope for the United States Merchant Marine. We in the industry anticipated an expanded program of ship construction which would put both the ship operating industry and the ship construction industry back in its rightful place as a vigorous arm of national defense and an essential commercial transportation link between the United States and the commerce of the world.

Unfortunately, ship construction under the new program has not proceeded at a very satisfying pace. There are several reasons for this, including the general state of the United States economy and the depressed state of international freight rates. One important obstacle, however, has been the difficulty of securing adequate financing for those vessel construction projects that are in an active state. The sheer size of the amount of capital required to launch successfully a new shipping venture has required prospective ship operators to scour the financial markets for the necessary capital.

When the President announced his new economic policy, which included as an essential element the reinstatement of the investment tax credit, the shipping industry was very much encouraged. We initially believed that the reinstatement of the investment credit would facilitate our financing efforts and make investment in U.S.-flag shipping more attractive.

It now appears, however, that the investment tax credit will not be available to many members of the ship construction and ship operating industry. As a result, the United States Merchant Marine will not receive the economic stimulation provided by the investment tax credit that the rest of United States industry will enjoy.

The investment tax credit embodied in the President's new economic policy will be of relatively little direct utility to a number of shipping concerns with limited income because of the current depressed state of the industry's earnings. These companies will have only a limited ability to absorb the credit generated by investment in new ships. Traditionally, this problem was avoided by passing the tax credit through to a financial institution which had sufficient income to make immediate use of the tax credit. The financial institution would own the vessel and lease it to the vessel operator. The financial institution, as owner of the vessel, would be entitled to the investment tax credit and the depreciation on the vessel.

The House Ways and Means Committee, in its report on the investment tax credit provisions of the Revenue Act of 1971 (H.R. 10947), approved this practice. It said:

"Your committee believes that making the [investment tax] credit available to the lessor is desirable, as a general rule, as a way of making the investment credit useful where the taxpayer has little if any tax liability. This is because the benefits of the credit normally are passed on, in large part, to the lessee in the form of reduced prices." p. 28.

In the past several months, a number of vessel construction projects under the Merchant Marine Act have experienced great difficulty in finding financial institutions willing to lease vessels to the prospective operator. The financial institutions are unwilling to advance funds in the form of a lease because of the operation of a little known provision of the ru'es relating to the foreign tax credit providing by the Internal Revenue Code of 1954.

Under the United States income tax laws, companies subject to United States taxation are taxed not only on income earned in the United States but also income earned through foreign operations. Income earned through foreign operations may also be subject to taxation under the laws of a foreign country. To mitigate the effect of double taxation by both the United States and a foreign country, the United States tax code provides a limited credit against United States income tax for taxes paid to foreign countries. Thus, under the proper circumstances, a company that pays tax to a foreign country on income derived from foreign operations may receive a credit against the taxes it owes the United States for the taxes paid to the foreign jurisdiction. This credit is limited, however, by a formula which provides that the amount of the credit may not exceed the proportionate share of total United States taxes payable by virtue of the foreign operation.

The formula limitation can be calculated either on a "country by country" basis or on a "worldwide" basis. If the limitation on the credit is calculated on the worldwide basis, income derived from providing a transportation service outside the territorial limits of the United States is treated, in large part, as foreign source income.

Because of these provisions, the lease by a financial institution of a United States flag ship, built in the United States, employing United States seamen and carrying goods between the United States and foreign countries reduces the foreign tax credit that would otherwise have been available to the financial institution.

The availability of the foreign tax credit is of great importance to these institutions. In recent years, the imposition of balance of payments controls on investment in foreign countries by United States companies and on loans to foreign operations by United States financial institutions has led the large money center banks greatly to expand the operations of their foreign branches and affiliates. The development of the Eurodollar financial market in which the London branches of United States banks have actively participated has meant that these banks have much greater amounts of foreign source income than they have ever had before. The participation in these markets by United States financial institutions has been encouraged by the United States balance of payments controls which impose limitations on investment by United States companies in foreign enterprises and on loans by United States banks to foreign enterprises. As a result, if the possibility exists that the lease of a U.S.-flag vessel will reduce the institutions' foreign tax credits, it will not enter into the transaction.

If this situation is not corrected, we are convinced that hundreds of millions of dollars of U.S.-flag ships will go unbuilt for want of adequate financing, and many jobs that would have been filled by American seamen will go to foreign seamen. At the present time, we are aware of ship construction projects involving more than half a billion dollars worth of vessels that will be, at the very least, made immensely more difficult by these provisions. Many of the these projects may be completely thwarted due to these tax code provisions. The number of jobs in the shipyard work force and among seafaring men represented by this dollar volume of construction is very considerable. The creation of new jobs and the maintenance of existing jobs represented by these ship construction projects would be a very significant contribution to the economic recovery that our country so anxiously awaits.

The correction of the tax code provision which cause the present difficulty would not result in any unfair advantage to either the financial institutions or the shipping industry. The financial institutions already have the benefit of the foreign tax credit provisions and will not forego the benefit of those provisions in order to act as lessors of U.S.-flag ships. Therefore, no revenue loss will be attributable to this change in law. The change will merely permit the financial institutions to provide financing for U.S.-flag ships without losing their existing foreign tax credit benefits.

We have taken the liberty of preparing an amendment that would eliminate this obstacle from the path of what promises to be encouraging developments in the United States shipbuilding program. This amendment is attached together with a technical explanation of the proposed amendment. We are also enclosing for your convenience a copy of the declaration of policy from the 1936 Merchant Marine Act as it was reaffirmed by the 1970 Merchant Marine Act.

The denial of the benefits of the investment tax credit to the maritime industry would not only be inconsistent with the national policy reaffirmed in the Merchant Marine Act of 1970, but it would also seriously inhibit the nation's attempts to stem the alarming decline of our merchant shipping. We therefore urge that the Senate Finance Committee take action to correct this serious problem during its consideration of the Revenue Act of 1971.

Sincerely,

JAMES J. REYNOLDS, *President.*

Enclosures.

Explanation of Amendment of Foreign Tax Credit Limitation To Permit Leasing of United States Vessels

The proposed amendment changes slightly the method of calculating the limitation imposed on the use of the foreign tax credit provisions by Section 904 of the 1954 Internal Revenue Code. It provides essentially that income from U.S. flag shipping, which is to be included in the foreign tax credit calculation, shall be calculated separately from other types of income reported by the taxpayer. The effect of this separation is to isolate the instance in which a loss is incurred on U.S. flag vessels. The separate calculation prevents the loss incurred in shipping (as would be the case of a leased vessel) from reducing other foreign source income used in the calculation of the foreign tax credit limitation.

The amendment applies to vessels under U.S. flag documentation and cargo containers. In order to be documented under the U.S. flag, a vessel must be owned by U.S. citizens and must employ a U.S. crew. The amendment provides that the separate treatment of U.S. flag shipping and container earnings may be elected at the option of the taxpayer. Both the operator and the lessor are given the opportunity to make the election provided for by the amendment. The election is to be made on a vessel-by-vessel basis. Once the election is made with respect to any vessel, it may not be changed for the remainder of the period that that vessel remains in the hands of the electing taxpayer. If the vessel is sold, the purchasing taxpayer should have the right to make the election once again.

If the election is made and the vessel is generating income, then a credit will be allowed only for foreign taxes actually imposed in respect of income from that U.S. flag vessel or container. In most cases, these foreign taxes will not exist because of tax treaties between the United States. In some instances where small amounts of tax are imposed by foreign countries, that tax can still be taken as a credit against U.S. income. Where the election is made with respect to a particular vessel, when that vessel ceases to lose money and becomes an income generator, the election could not be changed by the electing taxpayer unless the Secretary or his delegate consented to the change.

The election is effective only for taxable years beginning after December 31, 1970. This does not, however, mean that the election is available only with respect to those ships placed in service after that date. The election deals with the recording of income accrued from ships whenever built. Thus, existing vessels leased to financial institutions would qualify for this treatment if the financial institution so elected. Of course, the existence of the investment tax credit on such a vessel would be determined solely by the rules relating to the availability of the investment tax credit under those Internal Revenue Code sections dealing with the tax credit.

Proposed Section for Inclusion in Senate Version of H.R. 10947

Sec. ———

(a) The heading for section 904(f) relating to the separate calculation of the limitation on foreign tax credit is amended to read as follows:

"(f) APPLICATION OF SECTION IN CASE OF CERTAIN INCOME.—"

(b) Subsection 904(f) is amended—

(A) by amending subparagraph (1) to read as follows:

"(1) IN GENERAL.—The provisions of subsection (a), (c), (d), and (e) of this section shall be applied separately with respect to—

(A) the interest income described in paragraph (2),

(B) income other than the interest income described in paragraph (2) and in the case of a taxpayer who elects the separate treatment provided by subparagraph (C) of this subsection, income described in subparagraph (C), and

(C) in the case of a taxpayer who elects the limitation provided by paragraph (2) of subsection (a) and who further elects the separate treatment provided by this subparagraph (C), income from:

(*i*) the operation of any vessel documented under the laws of the United States;

(*ii*) rentals from any vessel documented under the laws of the United States;

(*iii*) the use of any container of a United States person which is used in the transportation of property to and from the United States; and

(*iv*) rentals from any container of a United States person which is used in the transportation of property to and from the United States."

(B) by adding after paragraph (4) the following new paragraph:

"(5) ELECTION FOR SEPARATE APPLICATION.—A taxpaper who elects the limitation provided by subsection (a)(2) may elect the separate treatment provided by paragraph (1)(C) for any taxable year beginning after December 31, 1970. The election shall be made separately with respect to each vessel or container owned or leased by such taxpayer. An election under this paragraph for any vessel or container for any taxable year shall remain in effect for all subsequent years except that it may be revoked with the consent of the Secretary or his delegate with respect to any taxable year."

COMPARATIVE TEXT SHOWING CHANGES MADE IN SECTION 904(F) OF THE INTERNAL REVENUE CODE (MATERIAL ADDED IN ITALICS AND OMITTED MATERIAL SHOWN IN [BRACKETS].)

(f) Application of section in case of certain [interest] income.—

(1) IN GENERAL.—The provisions of subsections (a), (c), (d), and (e) of this section shall be applied separately with respect to—

(A) the interest income described in paragraph (2), [and]

(B) income other than the interest income described in paragraph (2) *and in the case of a taxpayer who elects the separate treatment provided by subparagraph (C) of this subsection, income described in subparagraph (C), and*

(C) in the case of a taxpayer who elects the limitation provided by paragraph (2) of subsection (a) and who further elects the separate treatment provided by this subparagraph (C), income from:

(i) the operation of any vessel documented under the laws of the United States;

(ii) rentals from any vessel documented under the laws of the United States;

(iii) the use of any container of a United States person which is used in the transportation of property to and from the United States; and

(iv) rentals from any container of a United States person which is used in the transportation of property to and from the United States.

(5) ELECTION FOR SEPARATE APPLICATION.—A taxpayer who elects the limitation provided by subsection (a)(2) may elect the separate treatment provided by paragraph (1)(C) for any taxable year beginning after December 31, 1970. The election shall be made separately with respect to each vessel or container owned or leased by such taxpayer. An election under this paragraph for any vessel or container for any taxable year shall remain in effect for all subsequent years except that it may be revoked with the consent of the Secretary or his delegate with respect to any taxable year.

MERCHANT MARINE ACT, 1936

DECLARATION OF POLICY

Section 101. It is necessary for the national defense and development of its foreign and domestic commerce that the United States shall have a merchant marine (a) sufficient to carry its domestic water-borne commerce and a substantial portion of the water-borne export and import foreign commerce of the United States and to provide shipping service essential for maintaining the flow of such domestic and foreign water-borne commerce at all times, (b) capable of serving as a naval and military auxiliary in time of war or national emergency, (c) owned and operated under the United States flag by citizens of the United States insofar as may be practicable, (d) composed of the best-equipped, safest, and most suitable types of vessels, constructed in the United States and manned with a trained efficient citizen personnel, and (e) supplemented by efficient facilities for shipbuilding and ship repair. It is hereby declared to be the policy of the United States to foster the development and encourage the maintenance of such a merchant marine.

STATEMENT OF TRANS WORLD AIRLINES, INC., SUBMITTED BY F. L. SALIZZONI, VICE PRESIDENT AND TREASURER

There is much uncertainty under the present Federal income tax law as to how lessors of aircraft, ships and other transportation equipment must determine the source (U.S. or foreign) of rental income with respect to equipment which is used both within and without the United States and the source of related deductions for depreciation, interest and other expenses.

The American Institute of Merchant Shippers (AIMS) has proposed an amendment to Section 904(f) of the Internal Revenue Code, which is now before the Committee, to relieve the inequity caused by this uncertainty in the case of vessels documented under the laws of the United States. It is our contention that the proposed amendment, so far as it relates to income from rentals, should also be made applicable to aircraft registered with the Federal Aviation Agency. The manner in which this uncertainty is ultimately resolved will have a direct impact on the willingness of many of the largest financial institutions in the United States to continue providing capital to the transportation industry in the form of leased equipment.

The proposed amendment insofar as it relates to rental income, if applied to the airlines, would prevent the development of conditions which have diverted and will continue to divert a substantial percentage of available lease financing dollars from transportation equipment into other kinds of equipment or into activities other than leasing.

The problem facing potential lessors of vessels as well as aircraft is the possibility that the Internal Revenue Service will interpret existing tax laws as requiring lessors to allocate a portion of rentals and related deductions to foreign sources based on mileage travelled by the equipment outside the United States. Such allocation would adversely affect a lessor's foreign tax credit limitation because (1) the lease typically results in tax losses in the early years, and (2) to the extent that such losses were attritubed to sources outside the United States, the ratio of foreign taxable income to total taxable income would decline. Therefore, the ability of the lessor to absorb foreign tax credits would be diminished which in turn would prompt the lessor either to seek a compensating increase in rental rates of sufficient magnitude to destroy the economics of leasing for the user or else to avoid leasing transportation equipment which might travel outside the United States.

Leasing constitutes a significant source of capital for the airline industry. Leasing at competitive rental rates can reduce the cost to the user of financing new equipment (in part because of the availability to the lessor of the tax benefits of ownership). In the case of the airlines, the difference between the cost of borrowing to purchase their equipment and the implicit financing cost of leasing is customarily approximately 3–3.5 percentage points.

The loss of this important source of financing for the airline industry could have a twofold impact upon the industry and upon the travelling public. First, it could drive financing costs substantially higher, since the airline industry will have to return to its traditional source of debt financing on terms dictated by the present realities of the market place. TWA's recent financing experience is indictive of the trend in airline financing costs. TWA's current imbedded cost of long-term debt is approximately 5.8%, which represents the complete cost of all debt currently reflected in TWA's capital structure. Since this cost relates to debt contracted for during the 1960's, it approximates the average cost of debt to TWA for that period. However, earlier in 1971, TWA sold an issue of Guaranteed Loan Certificates (Secured obligations representing debt participation in a lease transaction) having a coupon rate of 11%. While this is not a typical secured bond in the traditional sense, it represents the most senior form of debt instrument issued by the airlines in recent years, and accurately reflects the marketability of TWA's senior securities in the public capital markets. Second, the loss of lease financing would eliminate one of the few sources of additional capital that is still open to the airlines. Private insurance company debt is no longer available to many airlines because of the inability of these airlines to meet required earnings tests. Additional equity sales must await tangible evidence that the airlines have returned to profitability. Public debt issues are prohibitively expensive—a result of the current financial plight of the airlines.

Without the leasing alternative, many airlines will be hard pressed to meet their equipment and service obligations in the future.

There have been instances in the last two years, in which major air carriers with routes outside the United States have had great difficuly persuading financial institutions to lease equipment to them on a satisfactory basis largely because of the fear on the part of the financial institutions that any tax loss generated might be treated by the Internal Revenue Service as foreign source losses in part, with an accompanying loss of foreign tax credit. Faced with this problem, many potential lessors have opted to avoid leases of equipment which may be used on routes outside the United States. Others have attempted to condition their participation on idemnification against the adverse effects of any allocation, although in most cases indemnification would subject the user to unacceptable cost factors.

If the separate treatment of rental income provided in the proposed amendment is made applicable to the airlines, all users who seek, and therefore compete for, lease financing would be placed on an equal footing from a tax standpoint.

If the airlines are not included, it is likely that lessors will discriminate against U.S. air carriers whose business includes routes to points outside the United States to any substantial degree. The tax laws should not make it more difficult or costly for a U.S. air carrier with, for example, 40% of its passenger miles logged on routes outside the United States to lease equipment from a U.S. lessor, although that situation seems to be developing under the existing statute.

Finally, the proposed amendment is not a tax relief provision, a subsidy or special incentive for lessors who are likely to invest in transportation equipment in any event. It is designed to prevent major lessors from being forced into investments other than transportation equipment by fear of adverse and unwarranted tax consequences. The amendment does no more than to place lessors who pay foreign taxes and therefore must be concerned about the foreign tax credit implications of transactions on an equal footing with lessors who do not pay foreign taxes. It is believed that this policy is in the best interests of the entire transportaion industry and the public which it serves.

TWA SUGGESTED CHANGES (ITALIC) TO PROPOSED LEGISLATION BY THE AMERICAN INSTITUTE OF MERCHANT SHIPPERS TO AMEND SECTION 904(F) OF THE INTERNAL REVENUE CODE

Secion 904(f) APPLICATION OF SECTION IN CASE OF CERTAIN (INTEREST) INCOME.—

(1) In general—The provisions of subsection (a), (c), (d), and (e) of this section shall be applied separately with respect to—

(A) the interest income described in paragraph (2), (and)

(B) income other than the interest income described in paragraph (2) and in the case of a taxpayer who elects the separate treatment provided by subparagraph (C) of this subsection, income described in subparagraph (C), and

(C) in the case of a taxpayer who elects the limitation provided by paragraph (2) of subsection (a) and who further elects the separate treatment provided by this subparagraph (C), income from:

(i) the operation of any vessel documented under the laws of the United States;

(ii) rentals from any vessel documented under the laws of the United States, *or from any aircraft which is registered by the Administrator of the Federal Aviation Agency;*

(iii) the use of any container of a United States person which is used in the transportation of property to and from the United States; and

(iv) rentals from any container of a United States person which is used in the transportation of property to and from the United States.

Election for Separate Application.—A taxpayer who elects the limitation provided by subsection (a)(2) may elect the separate treatment provided by paragraph (1)(C) for any taxable year beginning after December 31, 1970. The election shall be made separately with respect to each vessel, *aircraft*, or container owned or leased by such taxpayer. An election under this paragraph for any vessel, *aircraft* or container for any taxable year shall remain in effect for all subsequent years except that it may be revoked with the consent of the Secretary or his delegate with respect to any taxable year.

DEERE & CO.,
Moline, Ill., October 18, 1971.

HON. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Deere & Company is the leading manufacturer of farm equipment in the United States. My purpose in writing you on behalf of Deere is to express to you and the members of your Committee our strong support for reenactment of the investment credit as part of the tax legislation now under consideration (HR 10947).

At the present time farm equipment sales are depressed. Unemployment in the industry is abnormally high. Farmers, generally, are caught in a cost-price squeeze, their costs continuing to rise more rapidly than their income.

Enactment of the investment credit would contribute significantly to improving this situation. It would stimulate sales of farm equipment because it would operate to reduce the effective cost of such equipment to the farmer. This favorable effect on sales would translate into increased employment in the farm equipment industry. By easing the acquisition of new equipment it would aid the farmer in his continuing battle against rising costs. To win this battle the farmer must increase his efficiency and to do this he needs new and improved equipment.

For the above reasons we urge you to adopt a position in favor of the credit as a permanent part of the tax structure and at a rate of no less than 7%.

We appreciate having had the opportunity to present our views on this subject. We request that you give them careful consideration and that you include this letter in the record of the Committee's hearings on these matters.

Very truly yours,

R. W. WEEKS.

LAW OFFICES, ARENT, FOX, KINTNER, PLOTKIN & KAHN,
Washington, D.C., October 20, 1971.

In re Statement on application of Title IV of H.R. 10947 to Certain Livestock Trailers.

Mr. TOM VAIL,
Chief Counsel, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR MR. VAIL: This statement is submitted on behalf of Tidwell-Hale Manufacturing Company, West Monroe, Louisiana and Hale Trailer Sales, Inc., Sherman, Texas. These companies are manufacturers and sellers of horse, catt'e and other livestock trailers. Of the approximately 55,000 livestock trailers manufactured and sold annually in the United States, these companies account for approximately 20% of the industry and, consequently, are the persons most directly affected by the proposed excise tax changes. We are concerned over the application of certain excise tax reduction provisions now contained in H.R. 10947 and the unfair distinctions it makes in the taxation of trailers like ours used by farmers and ranchers.

I. PRESENT LAW

Present law provides, under IRC § 4061(a)(2), that a trailer which is suitable for use in connection wi'h a passenger automobile is subject to a 7% tax rate on the sale of the article. If the livestock trailer is not suitable for use with a passenger car, it is taxabe under the 10% rate provided for by present § 4061(a)(1). The Internal Revenue Service takes the position that one and two horse trailers are suitable for use with passenger automobiles and therefore taxable at the 7% rate. It takes the position, without justification we believe, that a trailer with a capacity of more than two horses (or cattle) is suitable for use wi'h a truck (rather than a car) and accordingly taxable at the 10% rate. These positions are described in detail in Rev. Rul. 68-584, Cum. Bull. 1968-2, 492, copy attached.

It has long been our view that three and four horse trailers, and even those capable of carrying up to six horses, can better be pulled by passenger cars than by light duty trucks because the cars transmission and gear ra lo facilitate towing better than the transmission of many of your light duty trucks. Because many farmers and ranchers own only a pick up truck (rather than a passenger car and pick up truck) and use the truck for both personal transportation as well as for farm and ranch chores, the Internal Revenue Service identifies the three and four horse trailers with these trucks and disregards the fact that passenger cars are better towing vehicles and do in fact tow these trailers where the farm or ranch family can afford both a passenger car and a pick up truck.

Most trailers which are not used for hauling livestock are used for personal hauling of household goods and other light moving and hauling. You are probably familiar with the many franchised trailer vehicles available for rent at service stations by families for personal moving and hauling chores. Because all these trailers are identified with passenger automobiles, the manufacturer pays only a 7% rate despite the fact that cubic capacity is essentially the same for both types of trailers. This means, of course, that a trailer we manufacture for livestock can be taxed at a 10% rate (hauled by pick up trucks) while the same size, weight and capacity trailer used for personal moving and hauling is taxed at a 7% rate. There is of course no justification for this distinction but we are able to compete because the 3% differential is not significant as to materially affect sales.

We believe the Internal Revenue Service has incorrectly construed § 4061 (a) (2) when it requires actual passenger car use by our customers rather than merely looking to see whether, in fact, the trailer can be hauled by a passenger car. The concept of "suitable for use" contained in present § 4061(a)(2) is a design test which should go only to whether or not the trailer is fit for the purpose and not, unlike the language in present §4061(a)(2), ordinarily or commonly used in connection with passenger cars. We believe the Internal Revenue Service takes the position that because most three or four (or more) livestock trailers are in fact hauled by pick up trucks, and owners using cars for such trailers are only an incidental number of the total users, these larger livestock trailers are not suitable for use in connection with passenger cars. Because most of your larger passenger automobiles have the horse power and transmission which can haul these trailers with the same or better facility than a pick up truck, such trailers are suitable for such car use though in fact the dominant use may be in connection with pick up trucks.

II. EFFECT OF H.R. 10947

Under the House version of the bill, trailers which are used with passenger automobiles will be free from all tax:

"Present law (section 4061(a)(2)) taxes passenger automobile trailers and semitrailers (i.e., small auto towed trailers 'suitable for use in connection with passenger automobiles') at the same rate of tax as passenger automobiles. The bill also repeals the tax on those articles.[1]"

Most of the references in this report to automobiles apply also to these small trailers.

See, H. Rep. 92–533, 92d Cong., 1st Sess. at pp. 51–52.

When the excise tax on these personal trailers is removed, the only light duty trailers subject to tax will be livestock trailers. All personal trailers and house trailers, including camping trailers, used on both passenger automobiles and pick up trucks will be tax free. The effect of this repeal is that livestock trailers which are the same size, weight and capacity as personal trailers will pay tax at the 10% rate while the identical trailer, sold to gas stations for U Haul services or the like in transporting personal goods, are free from tax. It won't take long before ranchers and farmers will realize that these personal trailers, with modifications can be converted into a livestock trailer thereby saving themselves the 10% tax.[1] Their 10% saving can put the present manufacturers of

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[1] If a farm family can afford both a passenger car and a pick up truck an anomalous situation can result when they desire to transport four cattle. If it buys two of the two-horse trailers, one for the car and one for the truck, and transports its livestock in that fashion, it will pay not one cent in federal excise tax under the proposed bill. But if the family can only afford a truck, and needs to transport the same four livestock in one trailer, it pays a full 10% tax on a four-horse trailer because of the rule promulgated by Revenue Ruling 68–584, cited above. Such an absurdity should not be in our tax laws.

livestock trailers out of business because they can't compete with one trailer paying tax while another doesn't.[2]

III. SUGGESTED REMEDY

Under the bill in its present form, new IRC § 4061(a)(2) will exempt bodies and chassis suitable for use in connection with a vehicle with a gross vehicle weight of 10 000 pounds or less. If the Finance Committee, at the bottom of this proposal, adds the words:

Truck and bus trailer and semitrailer chassis
Truck and bus trailer and semitrailer bodies

these livestock trailers will enjoy the same exemption from tax which personal hauling trailers will receive. Because we believe that livestock trailers are the only traiers used in connection with pick up trucks which would be subject to tax if the bill passes in its present form, we don't think that a condition limiting the trailer exemption suggested above to live stock trailers is necessary. We would not, however, object to such a limitation.

IV. CONCLUSION

Under the House version of H.R. 10947, pick up trucks were exempted because they provided comparable transportation to farm and rural families which the passenger car provides to urban and suburban families. It makes sense that farm families should not be penalized for their choice of transportation should they be unable to purchase a car for their transportation needs. It necessarily follows that if trailers pulled by these same urban and suburban families by their passenger cars are to be free from tax, that the livestock trailers pulled by the farm families pick up truck be free from tax.

We would appreciate any consideration you give this matter.

Very truly yours,

WILLIAM J. LEHRFELD.

"Tree movers," consisting of truck or semitrailer chassis upon which are mounted special machines designed to dig up and replant trees, are not subject to the tax on chassis and bodies or the tax on parts and accessories.

26 CFR 48.4061(a)-1: Imposition of tax. Rev. Rul. 68-570
(Also Section 4061; 48.4061(b)-2.)

A company manufactures and sells automotive articles designed to move trees. The completed units consist of either a truck chassis or a semitrailer chassis upon which is mounted a special machine designed to dig up and replant trees on development sites or other open areas, such as parks, golf courses, and nurseries. The chassis are constructed without springs, and the chassis frames are mounted directly on a rear axle assembly. The vehicles are equipped with off-highway traction tread tires, and any highway use of the vehicles is incidental to their jobsite function.

Held, since neither the described chassis nor the special machine mounted thereon is primarily designed for use in the transportation of persons or property over the highway, the chassis are not motor vehicle articles of a type enumerated in section 4061(a)(1) of the Internal Revenue Code of 1954, nor are the tree digging machines automotive parts or accessories, within the meaning of section 4061(b)(1). Accordingly, sales of the described "tree movers" by the manufacturer thereof are not subject to the manufacturers excise taxes imposed by these sections.

One-horse and two-horse trailers suitable for use with passenger automobiles are taxable under section 4061(a)(2) of the Code; whereas,

[2] The Internal Revenue Service could rule, of course, that the conversions from a personal trailer to a livestock trailer was an act of manufacturing by the farmer or rancher subject to the 10% tax. The technical truth of this fact does not, of course, reflect the realities that IRS could never administer such a position This is little solace to a manufacturer who is watching his market go down the drain to know that some of his competitors customers should be the excise taxpayers.

three-horse and four-horse trailers and stock trailers designed primarily as carriers of livestock are taxable under section 4061(a)(1); Revenue Ruling 59-358 superseded.

26 CFR 48.4061(a)-1: Imposition of tax. Rev. Rul. 68-584

Advice has been requested regarding application of the manufacturers excise tax imposed by section 4061(a) of the Internal Revenue Code of 1954 to sales by the manufacturer of the trailers described below.

Item (1). Stock trailers designed and manufactured primarily for use by farmers as carriers of livestock (such as cattle, hogs, sheep, horses, and goats) and other loads, including loose or sacked grain, baled hay, animal salt, or bundled feed. The trailers are used by farmers to transport livestock to a market place, from pasture to pasture, or to veterinarians. Some models are equipped with a conventional tongue and bolt-type hitch and others are equipped with a gooseneck-type hitch designed to place the towing point in the center of a pickup truck bed. Other equipment includes turn signals, stoplights, taillights, and such options as electric brakes and a top.

Item (*2*) One-horse, two-horse, three-horse, and four-horse trailers designed and sold for transporting horses over the highways. Some models of these trailers have such features as a dressing room, tack compartment, feed manger, or sleeping compartment. The one-horse and two-horse trailers are equipped with a conventional tongue and ball-type hitch. The three-horse and four-horse trailers are equipped with either a ball-type or a gooseneck-type hitch.

Section 4061(a)(1) of the Code imposes a tax upon the sale by the manufacturer, producer, or importer of certain enumerated articles including truck trailer and semitrailer chassis and bodies. Section 4061(a)(2) of the Code imposes a tax upon sales of chassis and bodies for trailers and semitrailers (other than house trailers) suitable for use in connection with passenger automobiles, including in each case parts and accessories therefor sold on or in connection therewith.

Section 48.4061(a)-1(e) of the Manufacturers and Retailers Excise Tax Regulations provides that a trailer or semitrailer chassis or body primarily designed for highway use in combination with a taxable truck, bus, or tractor is subject to the tax imposed by section 4061(a)(1) of the Code. That section further provides that trailers and semitrailers which are suitable for use in combination with passenger automobiles, but which are not house trailers, are subject to the tax imposed by section 4061(a)(2). The regulations also cite as an example of a vehicle which is not a trailer within the meaning of section 4061(a), a farm wagon primarily designed for use on farms, although it may be used on the highway.

As used in the foregoing statute and regulations, the term "suitable for use" means possessing actual and practical fitness for use in connection with passenger automobiles.

With respect to *Item (1)*, the facts indicate that the stock trailers are not farm wagons primarily designed for use on farms, within the meaning of section 48.4061(a)-1(e) of the regulations, but are trailers designed for various uses on the highway. Furthermore, they are primarily designed for use in combination with taxable trucks and do not have an actual and practical fitness for use in combination with passenger automobiles. Therefore, sales by the manufacturer of such trailers are subject to the manufacturers excise tax imposed by section 4061(a)(1) of the Code.

With respect to *Item (2)*, the one-horse and two-horse trailers are considered to be suitable for use in connection with passenger automobiles, inasmuch as they possess actual and practical fitness for such use. Accordingly, sales by the manufacturer of these trailers are subject to tax at the rate imposed by section 4061(a)(2) of the Code. However, horse trailers with a capacity for carrying more than two horses, such as the three-horse and four-horse trailers in the instant case, are not considered to possess actual and practical fitness for use in combination with passenger automobiles. Therefore, they are concluded to be primarily designed for highway use in combination with taxable trucks. Accordingly, sales by the manufacturer of such trailers are subject to tax at the rate imposed by section 4061(a)(1) of the Code.

Revenue Ruling 59-358, C.B. 1959-2, 254, holds that the sale by a manufacturer of a horse trailer designed to be attached to and pulled by passenger automobiles is subject to tax under section 4061(a)(2) of the Code. Since that conclusion is incorporated herein, Revenue Ruling 59-358 is hereby superseded.

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS,
New York, N.Y., October 18, 1971.

HON. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
Old Senate Office Building,
Washington, D.C.

DEAR MR. LONG: The Division of Federal Taxation of the American Institute of Certified Public Accountants has reviewed H.R. 10947, the "'Revenue Act of 1971," as passed by the House of Representatives. Based on our limited review, the following comments have been developed:

BILL SECTION 110(A)

The bill proposes to eliminate the three-quarter year convention in computing depreciation allowances for the year in which a depreciable asset is p'aced in service, under the Treasury Department's new ADR system. Instead, this proposed legislation wou'd limit any first-year convention to one that would not "provide greater depreciation allowances during the taxable year in which the assets are placed in service than would be permitted if all assets were placed in service ratably throughout the year if depreciation allowances were computed without regard to any convention."

It is suggested that the bill include a saving provision to prevent the assessment of any interest or penalty (under Code sections 6601, 6654, 6655, or otherwise) to the extent that such interest or penalty would be attributable to adjustments required to be made under the bill as a reflection of such a convention in a return already filed in good faith.

BILL SECTION 302

Where the ownership and business of a corporation are changed in the manner described in section 382(a)(1) or where there is a change of ownership in a reorganization, as described in section 382(b)(1)(B), then section 382 provides certain limitations on the carryover of net operating losses. Section 302 of H.R. 10947 would add a new code section 383 which would make the section 382 limitations also applicable to carryovers of unused investment credit, excess foreign tax credit and net capital loss.

Although we believe the language of proposed new Code section 383 would probab'y accomplish the congressional intent, we suggest that the references to sections 46(b), 904(d), and 1212 are erroneous and should be omitted. Unused investment credit, excess foreign tax credit and net capital losses may be carried over to a later year of the *same corporation* under the provisions of these three cited sections. However, a carryover of excess investment credit or net capital loss to a later year of a successor corporation (in a reorganization to which the limitation of section 382(b) would apply) would be accomplished under the provisions of section 381. There is no clear statutory provision for the carryover of foreign tax credit to a successor corporation, but the Internal Revenue Service has ruled that there is such a carryover in a statutory merger, subject to certain limitations. (See Rev. Rul. 68-350, 1968-2 CB 759).

For these reasons, we recommend that proposed Code section 383 be changed to read as follows:

"If—

"(1) the ownership and business of a corporation are changed in the manner described in section 382(a)(1), or

"(2) in the case of a reorganization specified in paragraph (2) of section 381(a), there is a change in ownership described in section 382(b)(1)(B), then the limitations provided in section 382 in such cases with respect to the carryover of net operating losses shall app'y in the same manner, as provided under regulations prescribed by the Secretary or his delegate, with respect to any unused investment credit, *any excess foreign tax credit, and any net capital loss of the corporation which can otherwise be carried forward.*

As noted above, it appears that sections 381 and 382(b) would not apply in the case of the carryover of excess foreign tax credit to a successor corporation in a reorganization. However, the provision in Rev. Rul. 68-350, which ties the use of the carried-over foreign tax credit to the "excess limitation" of the acquiring corporation that is attributable to the foreign taxable income resulting from the continuation of the premerger business of the transferor corporation, imposes a limitation much stricter than that of section 382(b). It prevents the credits from being taken against the foreign income of the acquiring corporation's business.

It should be noted that it is not at all clear that the Internal Revenue Service would follow Rev. Rul. 68-350 in a reorganization other than a statutory merger or consolidation. Accordingly, if it is not considered feasible to legislatively clarify the carryover status of excess foreign tax credit in a reorganization at this time, we recommend that the committee reports take cognizance of Rev. Rul. 68-350, and state a clear congressional policy regarding such a carryover that could be given effect in regulations to be prepared by the Treasury Department.

We hope these technical comments will be helpful to you and your committee in its consideration of the bill.

Sincerely,

ROBERT G. SKINNER.

COVINGTON & BURLING,
Washington, D.C., October 20, 1971.

Re: Revenue Act of 1971 (H.R. 10947) Job Development Credit—Production of Jobs Through Investment by Telephone Industry.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The discriminatory effect of the proposed Job Development Credit contained in H.R. 10947 against the telephone industry was explained in a written statement and oral testimony before the Senate Finance Committee by Mr. Theodore F. Brophy, Executive Vice President and General Counsel of General Telephone & Electronics Corporation, appearing on behalf of the United States Independent Telephone Association. Mr. Brophy has asked us to submit figures based on the actual experience of his company as a supplement to his written statement and testimony which demonstrate that telephone company investment, stimulated by a full Job Development Credit, will have a significant impact on increasing employment in the private sector of our economy.

At the beginning of 1965 there were approximately 4,600,000 main stations in the GTE telephone system as compared to 6,740,000 at the end of 1970, and investment in net telephone plant at the beginning of 1965 amounted to approximately $2.531 billion as compared to $5.755 billion at the end of 1970. During the same period of time, the number of employees in the GTE telephone system increased from approximately 55,500 to almost 100,000. For each 1000 main stations added to the system's plant during the period 1965 through 1970, an average of 16.70 employees has been added to the system's employment, as follows:

Number of employees added per 1,000 main stations added

Period:	
1965 thru 1967	16.31
1968 thru 1970	17.13
Six Year Total	16.70

The doubling of investment in the GTE telephone system during the six-year period 1965-1970 resulted in an increase of almost equal proportions in employment, with the addition of approximately 45,000 new jobs. Thus, the purpose of the Job Development Credit would clearly be well served by affording the telephone industry the same job development credit rate available to other industries.

Sincerely,

JOHN B. JONES, Jr.

cc: Hon. Clinton P. Anderson
Hon. Herman E. Talmadge
Hon. Vance Hartke
Hon. J. W. Fulbright
Hon. Abraham A. Ribicoff
Hon. Fred R. Harris
Hon. Harry F. Byrd, Jr.
Hon. Gaylord Nelson
Hon. Wallace F. Bennett
Hon. Carl T. Curtis
Hon. Jack Miller
Hon. Len B. Jordan
Hon. Paul J. Fannin
Hon. Clifford P. Hansen
Hon. Robert P. Griffin

READING COMPANY,
Philadelphia, Pa., October 15, 1971.

Hon. RUSSELL B. LONG,
Chairman of Senate Finance Committee, U.S. Senate, Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: It is my understanding that the House Bill reestablishing the 7% Investment Tax Credit restricts the use of the credit to corporations and that individual persons who are lessors to corporations will not be permitted use of the credit.

In the deliberations of your august Committee concerning this same legislation would you please consider the discriminatory effects of the House Bill as described below:

The Reading Company is a relatively small independent Class I railroad which has not earned a profit since 1966. Since that date the only practicable financing method available to a poor credit risk such as ourselves has been the lease financing method. By this method of financing we seek long term funds from institutional investors and equity capital from private investors to whom we have been permitted to extend the privilege of use of the tax investment credit or use of accelerated amortization for depreciation.

By this method we have been able to finance sorely needed equipment at relatively reasonable rates of interest.

If we are to be denied the ability to seek equity capital from private investors by our inability to pass on the investment tax credit, I am afraid that the Reading Company will be unable to continue the acquisition of rolling stock and motive power equipment sorely needed for its survival.

We would, therefore, appreciate earnest consideration by your Committee of the role of the private investor in supplying such needed funds and eliminate from the proposed legislation this very subtle form of discrimination against both the private investor and companies such as ourselves.

Very truly yours,

J. R. GREENE,
Vice President-Finance.

PREWITT-KING FARMS,
Lonoke, Ark., October 12, 1971.

Hon. RUSSELL B. LONG,
Chairman, Finance Committee, U.S. Senate, New Senate Office Building, Washington, D.C.

DEAR SENATOR: I understand that the Honorable James B. Pearson, United States Senator from Kansas, will offer an Amendment to the Revenue Act of 1971, H.R. 10947, which would double the investment tax credit for rural areas.

I am a small manufacturer located in a predominantly rural area and I feel this legislation would help stem the exodus of people from the rural community into the already over crowded metropolitan areas since I could enlarge my activities and employ more people.

I am sure that other small manufacturers who are in similar conditions would welcome the opportunities presented by this legislation.

I think this Amendment would improve the Bill and I hope your Committee will act favorably.

Yours very truly,

PREWITT-KING FARMS,
S. F. KING.

INTERNATIONAL EXECUTIVES ASSOCIATION, INC.,
New York, N.Y., October 18, 1971.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance, U.S. Senate, Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: Since 1917 the International Executives Association has been dedicated to furthering and strengthening America's export trade, and during those fifty-five years the members of our Association have, both collectively and individually, done much to raise our nation's export business to its present high level.

During its half century of service to those who are actively engaged in the export trade, the International Executives Association has maintained a strong but rather silent position in the world of international trade. These, however, are times when our nation's whole fabric of export trade is in danger of being ripped apart, and our Association feels that it can no longer remain quiet on the issues which currently face our industry. One such issue which our membership considers of vital importance is the proposed legislation concerning the Domestic International Sales Corporation.

Recently the International Executives Association conducted a poll of its 500 members relative to the measure which is now being considered by your Committee, and I sincerely feel that you, and the members of your Committee should be made aware of how strongly many of the leaders of our country's export trade feel about the bill. Two basic questions were asked of the members, (A) Are you in favor of the general provisions of the proposed DISC bill? and (B) Are you in favor of the President's proposal to make DISC fully effective by January 1st of next year? The response to the questionnaire left little doubt as to how the membership felt about the proposed legislation. In answer to the first question over 93% of the members indicated that they were in favor of DISC, and 92% favored the January 1st effective date.

Certainly none of those responding to our questionnaire are naive enough to believe that DISC represents any sort of legislative panacea for all, or even a significant percentage of our nation's export ills, but our members do feel that the measure in question might be at least a partial answer to some of the problems. In the almost 200 years of America's history no Congress has managed to devise a single piece of legislation which would provide the entire solution to any major issue, or which would please everyone concerned with that issue, but if the DISC proposal manages to eliminate just a few of the present tax inequities in the export trade, and promotes even a minor expansion of the industry, its passage could then be considered justified. In view of this, the International Executives Association respectfully requests your Committee's favorable consideration of the Domestic International Sales Corporation legislation, and urges that it be brought before the Senate as expeditiously as possible.

Very truly yours,

JOHN E. MARQUARDT,
Executive Director.

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION,
Madison, Wis.

Hon. RUSSELL LONG,
Chairman, Senate Finance Committee,
New Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: We have been following the progress of H.R. 10947, the administration's tax bill, and from the analysis and reports we have read on this legislation, it appears that it would create many new jobs without adding to the pressure of inflation, which is certainly a very desirable objective. Of course, there are many other proposals contained in this bill that are desirable, but we are most enthusiastic about the net effect on unemployment and relieving the pressures of inflation and we support this proposal in its present form.

We would appreciate it if you could have this letter made a part of the hearing record.

Sincerely,

DALE A. NORDEEN, *President.*

WISCONSIN SAVINGS AND LOAN LEAGUE,
Milwaukee, Wis.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
New Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: I understand your Committee is considering H.R. 10947, the Administration Tax Bill, which was passed by the House October 6. It appears to me that this bill has many good features and that it would create many new jobs without adding to the inflation problem. For these reasons I would respectfully urge that every effort be made to pass the bill in its present form. I would also like to request that my letter become part of the hearing record.

Thank you for your consideration.

Sincerely,

WILLIAM D. BROUSE,
Executive Vice President.

DIRECT SELLING ASSOCIATION,
Washington, D.C.

Hon. RUSSELL B. LONG,
Chairman, Finance Committee, U.S. Senate,
Old Senate Office Building, Washington, D.C.

DEAR SENATOR LONG: Over a million and a half people sell products made or distributed by members of the Direct Selling Association. Nearly all of those salespeople depend on the purchase and use of automobiles for their livelihood. The repeal of the 7 percent excise tax on automobiles is therefore of paramount importance to them. For this reason, and because there is a critical need to stop inflation and stabilize the dollar *now*, we urge that you act quickly and affirmatively on H.R. 10947.

We would also hope that members of your committee would not delay progress of the bill by engaging in time-consuming debates over proposed amendments. Rather, we hope that the national interest will override any special interests and re-ult in quick action on the House-passed measure.

I would appreciate having this letter made a part of the hearing record on H.R. 10947.

Thank you.

Sincerely yours,

J. ROBERT BROUSE.

NATIONAL AUTOMOBILE DEALERS ASSOCIATION,
Washington, D.C.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee, U.S. Senate,
Old Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: Consistent with our testimony before the Senate Finance Committee on October 12, we respectfully urge you to vigorously oppose any proposal to exclude imported automobiles from the repeal of the 7% excise tax approved in H.R. 10947.

Denial of excise tax relief to purchasers of import cars since August 16 would discriminate unfairly between purchasers of domestic and import cars. Purchasers of both domestic and import cars have been led to believe, as a result of President Nixon's recommendation, statements of other Administration spokesmen. Congressional leaders and action of the House of Representatives in H.R. 10947, that repeal of the tax would be extended to all new car passenger vehicles, domestic and imported.

Your support in resisting the exclusion of import cars from the benefits of excise tax relief will be most appreciated.

Sincerely,

WARREN J. MCELENEY.

RUBBER MANUFACTURERS ASSOCIATION,
Washington, D.C., October 20, 1971.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The Rubber Manufacturers Association is comprised of approximately 200 domestic manufacturers of rubber products who account for over 90% of the total rubber consumption in the United States. In behalf of our member companies throughout the nation, we submit this statement for the record of your committee's hearings on H.R. 10947, the proposed Revenue Act of 1971.

The RMA membership supports H.R. 10947 which it recognizes as a means of implementing the overall aims of the President's new economic policy contained in his statement of August 15, 1971. Although the rubber manufacturing industry firmly believes that the well-being of this nation's economy and the viability of American business in domestic and world markets are greatest with a minimum of government involvement, we nonetheless recognize the presence of economic pressures which led to the initial stabilization program adopted by the President.

In respect of this economic environment, we support the President's program as a needed remedy for the current ills in the nation's economy.

In implementing the President's program by statutory provision for certain of its tax aspects, H.R. 10947 will (1) lessen the burden of inflation on the low-income taxpayer through acceleration of presently-scheduled increases in individual exemptions and deductions, (2) heighten consumer demand in one of the major industrial influences on the nation's economy by repeal of the 7% auto excise tax on cars and the 10% tax applicable to small trucks, and (3) stimulate the current lag in capital investment levels through establi hment of the job development tax credit.

In recognizing the overall merit of H.R. 10947 as passed by the House of Representatives, we direct your committee's particular attention to those provisions of the bill concerning the job development tax credit for capital equipment purchases and the asset depreciation range system approved by the Treasury Department earlier this year.

As members of a capital-sensitive industry, domestic rubber manufacturing companies support the provision of H.R. 10947 to establish the job development tax credit. The report of the Ways and Means Committee itself—supporting of the credit—shows the decline in domestic machine tool orders occurring since 1960 during periods when the investment credit was not available to American business.

Stimulation of capital spending has multiple benefits to the economy, a primary one of which is "job development". Orders for new capital equipment are translated into jobs for workers to fill those orders and for workers to use the equipment once placed in service. The availability of modern production equipment to American business—particularly in the heavy capital equipment areas—will bring about greater efficiencies in production, providing a lower overall cost at which American goods may be sold. These net cost reductions will in turn stimulate greater consumer spending and will improve the competitiveness of American goods in world markets. "Job development" is thus a logical result of stimulation of capital spending.

Additionally, we favor—as is proposed in H.R. 10947—the single line rate of credit on a permanent basis rather than a two-tier credit as was contained in the President's August 15 statement. Uniformity in the available rate of the job development credit will provide a greater long-range capital spending incentive and will reduce the likelihood of immoderately heavy first-year outlays followed by a sustained reduction of capital spending levels.

We suggest to the Senate Finance Committee that establishment of the job development tax credit is an effective starting point in removing the discrimination against U.S. producers caused by the capital spending incentives granted by foreign governments to their producers, especially those for export purposes.

The Asset Depreciation Range System—adopted by the Department of Treasury on June 22. 1971 and proposed to be legislated by H.R. 10947—is a needed supplement to the job development tax credit to assure that outdated and inefficient production machinery is replaced as rapidly as possible. Critics of the A.D.R. system, who claim that its inclusion in H.R. 10947 causes an excessive tax benefit to business, ignore the fact that more realistic depreciation schedules are absolutely necessary for capital formation to effect replacement of capital goods.

This is particularly true in the tire manufacturing industry where constant improvements in manufacturing techniques necessitate the replacement of tire production equipment with each new era of technology. Particular evidence of this has been demonstrated in recent years during the gradual transition from the "bias ply" tire construction to the "belted-bias" type of construction. An even greater impact on production requipment replacement will come about as the radial ply tire comes more prominently into being.

Yet, whether American tire manufacturers have statutory tax incentives to purchase radial ply production equipment or not, market pressures may dictate such purchases as a matter of competitive necessity. Mass capital spending for radial ply production equipment without appropriate tax incentives (as certain foreign radial tire manufacturers appear to enjoy) could well hinder the competitiveness of the American radial tire in world markets.

We, therefore, support the A.D.R. system adopted by the Department of Treasury, including the three-quarter first year convention providing for substantial depreciation of assets during the first year of use. We suggest that H.R. 10947 be appropriately amended to contain the substance of the A.D.R. system as issued by the Department of Treasury on June 22.

In conclusion, the membership of the RMA expresses its support for the provisions of H.R. 10947 with the suggested amendment concerning the Asset Depreciation Range system and urges its enactment. Even beyond enactment of this bill, however, it is apparent that a properly balanced economic stabilization program as is sough by both the President's directive of August 15 and by H.R. 10947 cannot be fully realized without prudent controls over the level of federal spending. Few forces--if any—have such inflationary impact on the nation's economy as high levels of government spending. If the President's economic stabilization program calls upon business and the American public to accept temporary economic controls as a means of retarding inflation, then similar respect must be shown in the levels of government spending.

We, therefore, urge the Congress—along with enactment of H.R. 10947—to exercise restraint in its review and authorization of federal spending programs in the present and forthcoming fiscal years.

Sincerely,

W. J. SEARS,
Vice President.

AUTOMOBILE MANUFACTURERS ASSOCIATION, INC.,
1619 Massachusetts Avenue, NW., Washington, D.C.

Subject: Eligibility for Job Development Investment Credit of Products Not Subject to Import Surcharge (H.R. 10947).

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance, U.S. Senate, New Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: We wish to bring to your attention what we believe is an unintended result of the technical provisions of the Job Development Investment Credit as embodied in the bill passed by the House of Representatives. All cars and trucks produced in Canada, and imported into the U.S. under the U.S.-Canada Automotive Products Agreement, would be ineligible for the credit. This credit disallowance would have an extremely disrupting and unfair effect under the Agreement.

The House bill would exclude foreign-produced goods from the credit during the continuation of the import surcharge. Foreign-produced goods, which would not qualify or the tax credit, would include all goods imported in an operative condition.

It is respectfully submitted that this limitation would exclude, without any justifiable reason, various imports even though made primarily of U.S. materials and though free of the import surcharge or other duty when shipped into the United States. Since the disqualification of foreign-produced goods will apply under the bill only so long as the import surcharge is in effect, it is difficult to see why imports not subject to the surcharge should be disqualified. For example, farm equipment is usually not dutiable and, therefore, not subject to the import surcharge. Yet, farm equipment imported in operative form would be disqualified for the credit while the import surcharge is in effect. The same result would apply to all assembled cars and trucks imported from Canada.

The denial of the credit for vehicles imported from Canada would be particularly inequitable because these vehicles are assembled predominantly from materials manufactured in the United States and exported to Canada. In many cases, virtually all of the components of these vehicles are manufactured in the United States.

In an effort to meet the aims of the Automotive Products Agreement (to achieve industry efficiency, strengthen economic relations between the United States and Canada, and permit the free flow of automotive products between the two countries without duties or penalties), the industry has rationalized its facilities and is virtually unable to rearrange its production capabilities in the short-run and without enormous expense. Consequently, a denial of the credit would constitute a serious disruption of business and a harsh, inequitable penalty.

Further, the practicalities of the situation would produce administrative difficulties and inequities as among purchasers. It is common for United States dealerships to have an inventory of cars and trucks, some of which were produced in Canada and others in the United States. If a purchaser who may not be tax-alert orders a truck or car, he may receive a vehicle produced in Canada, totally unaware of the serious tax detriment involved. Another purchaser may specifically order a truck or car produced in the United States and the dealership may be able to accommodate him, although such accommodation may be wasteful in that it may involve shipping a vehicle from another distant dealership. The manufacturers, in seeking to acommodate their scheduling to this result, might have to incur substantial freight costs and rescheduling costs which, if feasible at all, would be extremely wasteful and serve no useful purpose. Some manufacturers would find such rescheduling at this time totally impracticable.

It is true that the House bill would authorize the President to exempt certain classes of articles from the disqualification provisions applying to foreign-produced goods. It is respectfully submitted, however, that reliance upon a possible future Presidential order for such exemption would not be a satisfactory solution to the present problem. Purchasers would be left wholly uncertain as to the possible exemption. Moreover, under the House bill the exemption could not apply to any period before the date of the Presidential order. It is clear that administrative problems would arise; manufacturers would be confronted with serious scheduling difficulties and the assurance of clear Treasury regulations would be hampered by the unforeseeable future periods of exemption or non-exemption.

It is also submitted that exactly the same reasons for making the tax credit available on a retroactive basis apply in the case of goods imported from Canada, in accordance with the Agreement, as in the case of any other goods eligible for the tax credit. The reason for applying the tax credit to goods ordered on or after April 1, 1971, although placed in service before August 15, 1971, was the assurance given by the Secretary of the Treasury, after discussions with Congressional tax-writing leaders, that any restored credit would be made retroactive to this extent. Purchasers in the United States of autos and trucks imported from Canada acted in reliance upon this assurance in the same manner as any other purchasers. They had no reason whatever to expect or foresee that the availability of the credit would be affected in any way by the domestic or foreign origin of the goods.

In view of the above considerations it is respectfully urged that the provisions of the Job Development Investment Credit under the House bill be so amended that imported products not subject to the surcharge, including products imported from Canada under the Automotive Products Trade Act of 1965, would be eligible for the tax credit. This eligibility should be made retroactive to include orders on or after April 1, 1971 in the same manner as in the case of properties produced in the United States.

We appreciate your consideration of this urgent problem, and if any additional information is desired, we shall, of course, give the matter our immediate attention.

We are taking the liberty of sending a copy of this communication to each member of the Committee.

Very truly yours,

C. B. HOWARD,
Chairman, Taxation Committee.

PEABODY, RIVLIN, GORE, CLADOUHOS & LAMBERT,
Washington, D.C.

THOMAS VAIL, Esq.,
Chief Counsel, Committee on Finance, U.S. Senate, New Senate Office Building, Washington, D.C.

DEAR MR. VAIL: Our firm is counsel for the National Tool, Die and Precision Machining Association, a small business organization representing some 8,000 metalworking firms in the United States. We understand that the Committee is now considering the basis for modification of H.R. 10947 to permit more liberal application of the investment tax credit to used machinery and equipment, and we wanted to reiterate our views on this very important matter. I enclose a copy of our earlier testimony in the House on this issue.

The credit, we feel, should apply fully to used equipment. Small businesses are quite adept at spreading their modest capital as far as possible to improve their productivity. "Modernization" is a good word, but to a small firm that point is to increase production, lower costs, and improve profits. That's really what modernization and the investment credit are all about, and the small firm really doesn't need the wise counsel of those who sell new equipment or the influence of Congress to force it to improve with one new machine if it knows it can get more out of two used machines for the same total price. We say let the businessman decide.

The $65,000 limit with the offset provision contained in the House bill is unnecessarily complex and restrictive. If Congress decides that some dollar limit on the credit for used equipment is needed for the sake of "modernization", then set a flat ceiling, and don't confound the small business with an intricate offset formula that bears no relation to his needs and abilities.

NDTPMA has not conducted any survey of how the proposed offset provision would work, but discussions with representative firms indicate that a flat maximum without the offset, even at a lower figure, might well produce more benefits for small business. But in any case, the offset as a concept makes no more sense than the total exclusion first proposed by the Nixon Administration. It rises from the premise that used equipment does not further the goals of the credit, and that premise negates the judgment and discretion that only the business itself can bring to the question of improving productivity.

We respectfully urge that the Committee either give full application of the credit to used equipment or at worst give a $100,000 ceiling on such purchases without any offset.

Sincerely yours,

WILLIAM C. BRASHARES.

STATEMENT OF WILLIAM HENZLER, ON BEHALF OF THE NATIONAL TOOL, DIE AND PRECISION MACHINING ASSOCIATION

My name is William Henzler. I am President of the Henzler Manufacturing Corporation of Toledo, Ohio, and I am appearing today on behalf of the National Tool, Die and Precision Machining Association ("NTDPMA") as Chairman of its Government Relations Committee. Appearing with me are William E. Hardman, Executive Vice-President of NTDPMA, and NTDPMA's General Counsel, William C. Brashares, a member of the Washington law firm of Peabody, Rivilin, Gore, Cladouhos & Lambert.

NTDPMA has a membership of some 1,700 companies throughout the nation but is the recognized national spokesman for a total of some 8,000 companies in the contract tool, die and precision machining field. These are small businesses, very often owned and managed by men who some years ago worked for other companies as skilled toolmakers or machinists. The tool and die shop of Detroit, Cleveland, Chicago and elsewhere has been a traditional source of most of the tools for mass production in the automotive, appliance and other industries. The machine shop of Los Angeles, Dallas and other cities has been the source of much of the high precision hardware of America's aerospace industry. Special machines for automation, die cast products and thousands of other things made of metal come from this small business industry. It has always been considered "the keystone of mass production" and a critical part of our national capability, both in peace and war.

Our industry represents over 250,000 highly skilled workers, men who in most cases have gone through four-year apprenticeships. Due to company failures and to work force reductions, many are unemployed today. For the past year the trade journals have been filled with auction notices, particularly in the mid-west areas where automotive business has been far below customary levels and on the West Coast where aerospace work has dropped significantly. In the country as a whole, employment in the industry as of June 1, 1971, was down about 25% and backlogs were down by over 30% from a base period of June 1. 1970.

The contract tool, die and precision machining industry is going through perhaps the most critical—and in some areas painful—adjustment in its history. The capital goods sector as a whole is down and, being an industry depending very largely on overflow demand, we are affected first by decline and last by recovery. Structurally we see our two largest traditional markets—automotive and aerospace—requiring less of our output. The automakers are making less frequent style changes, thus requiring less tooling. Aerospace, which is responsible for much of our industry's creation in the West, has fallen far below the public and fiscal priorities it had. On the other hand, we are encouraged by steady growth of our industry in the South and Southwest, seeking out new markets in developing regions. The biggest new market of all—the export market—is the subject of intensive effort by many of our member companies, which, despite their size, are confident they can have a hand in the tooling of new mass production facilities abroad.

Our only hope of maintaining our industry's capability and reaching out to these new markets is staying *ahead* in our skills and our equipment. This leadership created our industry and has sustained it. The investment tax credit is without question the greatest tool the Congress can provide to assist us in maintaining this leadership.

Much is said about the questionable value of incentives for new equipment purchases when throughout our country there is unused capacity. Our industry's situation should lay to rest those contentions. Volume of production is not the key to our success. We succeed or fail on the basis of quality and productivity. And nowhere is this truer than in our attempts to gain entry to export markets. We must outperform on competitors abroad with better equipment and better skills. Thus, companies with substantial idle machine time are constantly upgrading their equipment to improve productivity and lower costs. In most cases they do not have the backlog to justify it, but they know they must keep improving their equipment or they might as well close their doors.

The real down-to-earth question for the small businessman in our industry is how to find the dollars for constant upgrading of equipment. The sources are extremely limited. The greatest attraction of the investment tax credit to our industry was that it supplied a decisive form of financing assistance. The availability of the credit gave our industry of small businesses a significant added margin of capability to carry on this essential modernization process.

The stimulus of the tax credit has never been more needed. The machine tools our companies must purchase have become increasingly sophisticated and costly in the past decade. The advent of numerical controls has multiplied productivity in long machining runs, but also multiplied the prices our small companies must pay to stay abreast of this process. The transition to the metric system will noticeably accelerate the upgrading and replacement demands in our industry over the next five years, and the residual value of our older non-metric equipment can be expected to decline much faster than has been the pattern.

We would urge the Committee to take the following specific actions regarding the tax credit:

(1) Make it 10 percent and make it *permanent*. Write an ironclad commitment in the legislative history of this bill that henceforth the tax credit is not to be a political faucet turned off and on to appease any political faction.

(2) If there is a declining credit rate, eliminate any installation date requirement. The lead times on capital equipment differ greatly based on size, complexity and uniqueness, and there is no justification for penalizing the extended delivery items by an installation date cut-off as to the higher credit rate.

(3) Extend the credit to used equipment. Modernization is a major objective of the investment credit. But limitation of the credit to new equipment fails to

recognize the fact that a great deal of highly-advanced, recently-manufactured capital equipment is available on the used equipment market. I mentioned earlier the flood of auction notices in our industry. The recession of the past two years has put many millions of dollars worth of relatively new machine tools on the market. The purchase of a used machine tool by a small tool and die shop will frequently be—for that shop—a more radical modernization step than the purchase of brand new equipment by a larger company. Moreover, many companies simply will not be able to afford new equipment but could utilize the credit to modernize through the purchase of used equipment.

The exclusion of used equipment from the credit coverage, we feel, discriminates against smaller companies. It discriminates against new companies in our industry that are springing up around the country. Moreover, the immediate purpose of this tax credit is primarily to get the business sector moving again. That means getting large, medium and small businesses to expand production, increase employment, and increase purchases from other parts of the economy. The new equipment limitation is undesirable and unnecessary in these circumstances.

(4) The credit should not be limited to domestically manufactured equipment. Our companies have a strong loyalty to American-made capital equipment, even at higher prices and longer delivery dates in many cases. We have consistently argued for tariff adjustments to eliminate unfair competition from abroad based on substandard wages and working conditions, and we will continue to take this position. We support the President's temporary import surcharge in view of our serious balance of trade situation. We do not, however, feel that the tax credit should be used to reduce our options as to foreign equipment purchases. There is some equipment that as a practical matter can only be obtained from abroad. And where delivery or other terms for domestic products are impossible to accept, we need the option—without a tax penalty—to consider foreign products.

The tax credit is intended to stimulate spending, expansion, and new employment opportunities. It can be most effective if the individual business has maximum freedom to apply the credit in the manner of growth that fits his circumstances. The more unrelated policies that are incorporated in the credit, the less useful it will be to business and the less effective it will be to the economy.

We support the President's tax proposals enthusiastically. We hope your Committee will consider them promptly and favorably, although with the modifications we have suggested.

NATIONAL CRUSHED STONE ASSOCIATION,
Washington, D.C.

Subject: Investment Tax Credit, H.R. 10947—Revenue Act of 1971.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
U.S. Senate,
Washington, D.C.

DEAR SENATOR LONG: The purpose of this letter is to advise you of the National Crushed Stone Association's support of President Nixon's legislative proposal calling for the reinstatement of the investment tax credit ("Job Development Tax Credit") included as part of his economic program announced August 15, 1971, or along the lines of the 7% investment tax credit approved recently by the House of Representatives and applicable in the 1960's.

Following the initiation of the investment tax credit during President Kennedy's Administration, our economy received additional support through the encouragement given to business to take added risks by increased investment in production facilities. The resulting increase in employment, in improvement of our Nation's productive capacity and in our ability to produce goods at a competitively lower cost provided strength to our economy, expanded employment and had direct consumer benefits. In the long run, the health of our business sector provides the best possible opportunity for increased employment of our Nation's work force.

Thus, the experience during the 1960's, until the repeal of the investment credit in 1969, confirmed the ability of the investment tax credit to make a direct contribution to the strength of our Nation's economy. In reviewing the testimony presented to your Committee during your recent hearings on the President's economic program, reference has been made by some to both the investment tax credit and depreciation practices as being an out-right windfall to business. There is no question that such tax benefits encourage business to make additional investment, and such encouragement is an important factor in today's economy.

We encourage your Committee to give serious consideration to approving the reinstatement of the investment tax credit on a permanent basis.

We request that this letter be made a part of the record of your current hearings so that the position of our Association can receive full consideration in the Senate Finance Committee's deliberations on the President's economic program and the House approved bill.

Sincerely yours,

W. L. CARTER,
Executive Vice President.

WAUKESHA SAVINGS AND LOAN ASSOCIATION,
Waukesha, Wis.

Hon. RUSSELL B. LONG,
Chairman, Senate Finance Committee,
New Senate Office Building,
Washington, D.C.

DEAR SENATOR LONG: I understand your Committee is considering H.R. 10947, the Administration Tax Bill, which was passed by the House October 6. It appears to me that this bill has many good features and that it would create many new jobs without adding to the inflation problem. For these reasons I would respectfully urge that every effort be made to pass the bill in its present form. I would also like to request that my letter become part of the hearing record.

Thank you for your consideration.

Yours very truly,

R. R. STAVEN, *President.*

(The following resolution was forwarded to the Committee on Finance by Hon. John F. Seiberling, a U.S. Representative in Congress from the State of Ohio:)

RESOLUTION OF AKRON TIRE DEALERS ASSOCIATION

AKRON TIRE DEALERS ASSOCIATION,
714 Chitty Avenue, Akron, Ohio 44303.
Phone: 836-2454.

RESOLUTION

Whereas the membership of the Akron Tire Dealers Association asks that consideration be given to the repeal of the federal excise tax on all tires, tubes and tread rubber, be it resolved that every effort be made to do so.

Whereas we believe this tax not only imposes a hardship on the motoring public its repeal should be considered in line with the removal of the excise taxes on new automobiles.

Whereas this tax is not a burden to the rubber manufacturers with their company outlets, it represents a real hardship to the independent tire dealer who must pay the tax when the tires and tread rubber are purchased, not when the sale is made.

We, as an association, unanimously resolve that this tax be repealed, in the interests of President Nixon's economic program.

Passed this day, October 18, 1971, by the Officers, Directors and Members of the Akron Tire Dealers Association, Akron, Ohio.

DAN BINGHAM,
President.
JOHN MCMILLEN,
Vice President.
CECIL TEUSCHER,
Secretary.
GLENN COLEMAN,
Treasurer,
LEO KOTTE,
Director.
ROBERT TURNER,
Director.
JOSEPH SKINNER,
Director.
JERRY JOST,
Director.
JAMES H. HEISCHMAN,
Executive Secretary.

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