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BEFORE THE COMMITTEE

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EXECUTIVE SESSION

Wednesday, June 10, 1981

U. S. SENATE,

Committee on Finance,

Washington, D. C.

The committee met, pursuant to notice, at 10:00 a.m., in room 2221, Dirksen Senate Office Building, Hon. Robert J. Dole, (Chairman), presiding.

Present: Senators Dole, Packwood, Roth, Danforth, Chafee, Heinz, Wallop, Armstrong, Symms, Grassley, Long, Byrd, Bentsen, Boren and Bradley.

The Chairman. I might say at the outset, we are having the meeting this morning to discuss the President's proposal and specifically, the bill introduced yesterday, by Congressman Conable and Congressman Hance.

I would say that the bill on the Senate side has not yet been introduced. I thought it best to hear an explanation of precisely what the President's program was and then, at the appropriate time, a bill will be introduced on the Senate side. It may differ in minor ways with the House bill, but that is a judgment that has not yet been made.

I would like to include in the record, a statement and just read excerpts from it.

"Today we begin consideration of tax cut legislation with a technical explanation of the Administration's compromise tax cut proposal.

Much has been written over the past several weeks concerning the effort by the Administration and Republicans and Democrats, in the House and the Senate, to reach a bi-partisan agreement on a bill.

Typically, such discussions and meaningful attempts to consider the views of the maximum number of members did not occur until much later in the legislative process.

Now, I want to commend the Administration and all the others who were willing to move toward compromise and to do it at this time.

I believe the package that Mr. Chapoton will outline today stays true to the basic principles that the President has consistently stressed, while synthesizing some of the best tax proposals advanced by members of Congress in both parties.

Despite news reports, I hope the Democrats on the House Ways and Means Committee will not abandon across-the-board tax rate reductions for individuals.

The President has fashioned a tax proposal which will reduce the tax burden for all taxpayers. The impact of inflation and bracket creep is not limited to any one segment of our population and everyone should have a fair share of any tax cut.

The modified Reagan Administration proposals represent a major break through in tax policy. It is multi-year. It is across-the-board, for individuals. It encourages new business investment, additional savings and greater work effort.

These are the goals for tax policy that the Administration has endorsed. They are also goals on which most members of Congress, and particularly, members of the Senate Finance Committee can agree.

Generally, the revised proposal reduces tax rates by five percent, this year, rather than ten. It provides a somewhat simpler and more uniform system of accelerated depreciation, and provides for significant estate tax relief, expanding incentives for savings, relief from the marriage penalty and other changes that have been endorsed by many members of this committee, including, I might add, fairer treatment of small royalty owners under the so-called Windfall Profits Tax.

I would suggest, I have already heard that reported as relief for big oil companies. That was in one of the papers over the week-end. That is not a fact.

But, in any event, because most of these additional changes are phased in over a period of years, the net revenue loss is lower than under the Administration's proposal. It will be, between now and 1984, about $40 billion lower.

Frankly, I hope we can even do better before we finally report a bill out of this committee.

I know that many members would like to see additional changes, even in this proposal. There may be some small room for accommodation of some of those changes.

But, I would also suggest that the President has indicated privately that this, in effect, is what he supports

Now, if we can convince him that there should be some additions, that is fine. But, without that, it would be my hope we would wait for the second bill. There will be another package.

It just seems to me it is a bit too early to decorate the Christmas Tree, in June of this year.

So, I am pleased to have Mr. Chapoton here, members of the Joint Tax Committee, members of our own staff to go over the bill.

I will ask Senator Long if he has any comment.

Senator Long. Thank you, Mr. Chairman.

I would like to address myself to our present situation, Mr. Chairman.

It seems to me that what we have before us now, in terms of the President's recommendation is a far better proposal than what he sent up at the beginning of this session.

Now, why do I say that?

I want the Treasury to bring in the kind of studies that they have given to us when we worked on the Tax Reform Bill. The law requires it, but I haven't seen it. I want it up here, Mr. Chapoton, so we can look at it.

It still shows that among people who make over $200,000 a year, some of those people are paying 1 percent of their economic income or less, in taxes. Some are not paying anything.

Some of them may not even file a return, because, under the law, perhaps they are permitted not to; they don't owe us anything.

But, maybe we owe them something, even though they did make a lot of money. You are familiar with how that happens.

Now, on the other hand, we have some other people who also made the same amount of money, let us say $200,000 or over, who are paying as much as 65 percent of their economic income.

Now, a 10 percent, across-the-board reduction or 25 percent, in three years, if you simply do it by direct, across-the-board cutting, would cause this person who is paying you practically nothing to begin with, to have a percentage tax cut, when by rights he ought to be paying us a little something, a lot more than he is paying.

This person who is paying altogether too much is being crucified by these high tax rates, in relative terms, would get the same break as the other.

We have this problem with regard to the marriage penalty. How did we get into that trap? Well, we got there because we voted a tax advantage for single people beyond what they had any right to expect.

Half those people, since that time, have married and have now concluded it doesn't make any sense to begin with, the same ones who were campaigning for it.

Now, it would be a lot simpler to get back out of the trap from the same end you came in, because you have about four times as many people paying taxes as married taxpayers as you are as that single taxpayer.

To get out of it by giving the married taxpayers as much break as you gave the single taxpayers would cost four times as much as it did to give single taxpayers an additiona break to begin with.

Now, in trying to work these things out, it has to become more complex than a simple 10 percent across-the-board cut.

The answer is, it is fine to average out to a 10 percent a year cut, and that is fine as far as I am concerned. All I am saying is, within those parameters we ought to try to do more exact justice by one, taking this fellow who is not paying us anything and make him pay a little something, something within reason, I would hope.

Then, on the other hand, those who are really being crucified or being compelled to do all sorts of uneconomic things in order to keep from having all their income taxed away from them, to give them a better rate than they would receive otherwise.

So, I think we will have a better bill if we average out to whatever you want to average out to. So where we look to those who are not paying their fair share to begin with. and depart from the concept that they are guaranteed a 25 percent, across-the-board cut.

Those who are being taxed altogether too much, get them even more of a tax break.

Now, that adds a little more complexity. But, on the other hand, there are a lot of things about this law we can simplify. If we want to take the time to do it, we can move that 65 percent by using the standard deduction up to 75 percent or 80 percent, if you want to do some things that would bring that about.

I am just saying that in the context of what we are working with, this is in prospect of being the largest tax cut in history. We can do just a lot more uniform justice if we don't -- everybody, even if he is not paying his fair share to begin with, has to have a percentage cut of 10 percent, 25 percent or whatever amount.

I am going to be pointing to that fact as we go along and looking and marking this thing up.

If you want to provide a lot of incentives, fine; let's do it. But I think by the time you get through, I think we would do better to say we average out to whatever across-the-board cut you want, but we take enough time to look at this to try to provide more uniform justice. Indeed, it would be a better law if we do.

The Chairman. Thank you, Senator Long.

Senator Roth.

Senator Roth. First, Mr. Chairman, I would like to congratulate you and the splendid job you have done in helping to bring about a consensus in a compromise bill.

I think it is extraordinarily important that we adopt the President's proposal as rapidly as possible, because it is essential that this tax legislation begin to work on the economy.

Now, I will have to take exception with my distinguished former chairman. I happen to feel very strongly about the across-the-board tax cut.

I think it is important to point out that while this is a major tax cut, and may be the largest amount in the history of the country, the fact remains that the American people face a tax increase. We shouldn't lose sight of that.

Because of the actions of this Congress in the past, we have built the most mammoth tax increases probably in the history of the country.

So that I, for one, feel very strongly, as I know does the President, that the bottom line, as far as the individuals are concerned, is a 20 percent, across-the-board tax cut.

I would like to, just so the record is clear, point out that in 1981, the tax burden of the American people will increase by almost $23 billion over 1980 levels. That includes inflation creep and that includes Social Security Tax increases.

So that even with our original approach, the President's original approach, the net reduction for 1981 would have been $14.6 billion, and that would have left a tax increase of some $8.4 billion.

Now our new compromise proposal provides for only a 5 percent tax cut effective October 1, 1981. So that is equal to a 1.25 percent net cut for all of '81, or only some $3.7 billion.

This means the American taxpayer will be paying almost $20 billion more in taxes in '81, under the compromise.

Now, I support the compromise for the simple reason that I think it is essential that we enact the tax legislation and that we enact it early.

Mr. Chairman, I would just stress that I, for one, think the compromise is a good first step. I don't think it goes far enough. I think as far as the individual marginal rates, it is important to recognize that the President's proposal is the bottom line.

I again want to congratulate you for the leadership you have provided in working out this compromise.

The Chairman. I want to thank Senator Roth for his leadership over the years. It is now, hopefully about to bear fruit.

Are there others who want to make a comment at this time?

Senator Danforth.

Senator Danforth. Thank you Mr. Chairman.

Mr. Chairman, I would like to just add to what Senator Roth said. I think that the Administration and you, Mr. Chairman, have done a commendable job in working out a tax bill which I believe is a good one. I think the time has come to get on with it. I would hope that we could proceed with dispatch when the time comes for the Finance Committee to actually mark up a bill.

I think that the worst thing to do at this point is to worry this bill to death.

Having said that, however, I will make two points or raise two concerns which I would like to raise with Mr. Chapoton, either later today or at some other time.

The first relates to personal savings incentives.

Clearly, a major part of a supply side, so-called supply side tax bill is the encouragement of personal savings. This bill, for example, has provisions relating to the expansion of IRA's, Keoghs, also the extension of the $200 and $400 interest and dividend exclusion.

I would hope that as we proceed with the bill, there might be room to relook, take another look at some of those provisions, especially the $200 and $400 interest and dividend exclusion.

The savings and loans, in this country, are in an emergency situation. The housing industry is in an emergency situation. I would hope we would at least have the possibility of making some adjustment in the savings specific aspects of the bill which would provide specific incentives which would help out the thrift institutions.

I introduced something which was called The All Savers'

Bill. It is definitely specific to savings and loans. It has the support of those institutions. I would hope that maybe we could work out something along that line, perhaps as a trade off for the present $200 and $400 interest and dividend exclusion.

The second point has to do with research and development. The 25 percent incremental wages paid provision I think is important and is a step in the right direction; however, I think we should take a careful look at whether incremental wages is and should be the definition of what is included in this particular tax credit.

If the problem is a revenue loss problem, there may be a way to fashion a tax credit which is somewhat broader than just wages, but doesn't lose that much additional revenue.

I would like to find out from the Administration, at the appropriate time, the reason for including only incremental wages as opposed to other forms of spending for research and development and if some sort of accommodation would be possible with the Administration for working that out.

The Chairman. Senator Bentsen.

Senator Bentsen. Mr. Chairman, I too agree that I think this bill is a major improvement over the original bill that was proposed to the Congress.

I would like to buttress or reemphasis what we are talking about on savings. The dream of American home ownership is just evaporated. The average home in America today costs $84,000.

Three percent of American families can now afford a new home. When you talk about making a Christmas tree bill, I don't want to do that. But I sure would like to have a wedding present, maybe a delayed one, for a lot of young couples in this country. That means by trying to get savings up and interest rates down.

As the original author of the $200 and $400 that my friend from Missouri is talking about trading off, I am a little like Russell Long when he says, "I am against any combine I am not a part of."

(Laughter.)

Senator Bentsen. So, when we get to the trading, I want to be sure, if we do, that we trade it for something more meaningful in the way of savings.

I tried that one at $2,000, and $1,000 and they cut it to $400 and $200. That is obviously not enough. But when we have a rate of savings in this country of less than five percent and the Germans and French at 13, and you have the Japanese at 22. I don't want a quick fix for it.

I think we have something major that we have to do and it has to be something dramatic that will encourage savings in this country and help bring these interest rates down where people can afford homes again.

I want to anticipate in that. I want to do everything I can to try to get something like that in this piece of legislation.

The Chairman. Thank you Senator Bentsen.

Senator Grassley.

Senator Grassley. I want to thank the Administration for working so closely with us. I think there is a real chance for success. I think their open-minded approach to it is leading to that success.

Obviously the President's popularity is helping with that as well. I think that we need to be realistic, though, when we start talking about a second tax bill, because the extent to which we add additional things to this first bill, there is going to be less pressure for a second tax bill.

So, I think we have to realize that unless the Reagan Tax Program is obviously successful, I don't think there is any doubt about it going to be successful, but whether it is going to be obviously successful early enough on to invite a second tax bill, I am not sure.

So, I guess I am going into this deliberation feeling that this may be the only tax bill for this 97th Congress.

In one way of criticism, and then I have one thing I want to compliment the Administration on, that has developed in the last three or four days, one is the rejection, almost totally, in a first tax bill, even though they admit it can be a part of a second tax bill, is the context of the concept of indexing.

Now, the reason I say that I am not very happy with this, it is not the concept that has been rejected, because the President told us he supported it. Secretary Regan is now supporting it. But it is the way in which it is talked about that it is going to cost money.

The whole concept of indexing is nothing more than not having the automatic increase in tax rate. It is not going to cost anything these first three years. We are going to add it on in 1984, and then all it is saying is if we are going to have an increase in revenue, it is going to come when Congress makes a conscious effort to increase the revenue, not through the automatic increase.

I see it as an effort to bring fiscal discipline to the Congress. So, I think you are going to hear more of us talking about indexing, because we want to promote fiscal discipline within the Congress as much as anything.

Then, secondly, a compliment, because I guess I missed it on the first go around with the Secretary and President Reagan, that you had taken out the $250 for the spouse participating in the IRA. Since then you have agreed to put that $250 in.

Then, because of some interest we have shown in the concept of doing away with the female bias in IRA's because housewives who have no income can't qualify for their own IRAs. It has now been included at a lesser level than the LIRA.

Now, the extent to which you included that and that brings more women in under the umbrella of the IRA, I want to compliment you.

But, there is a principle that I am trying to get established here more so than just the dollar amount of the IRA, and that is the fact that women who work in the home, who get paid nothing cannot on their own initiative establish an IRA. I think we ought to do away with that sex bias in our tax code.

So, you will hear me promoting that concept more, not so much from the savings standpoint, not so much from the IRA standpoint, even though I support both of those goals of this tax bill, it is because I think it is one opportunity to do away with a bias against women in the Tax Code.

The Chairman. Thank you, Senator Grassley.

Senator Wallop.

Senator Wallop. Thank you, Mr. Chairman.

I want to add my compliments to you and others who have worked so diligently in trying to get some movement underway on this.

I happen to be one who is pleased you are contemplating some of the provisions to find inheritance tax relief in this legislation. I think when we are talking about capital creation, it isn't a bad idea with small business and small farms in this country who could use a little bit about capital retention.

In most respects, that serves more than one national purpose. It is odd we say we want to revitalize inner cities to avoid urban sprawl, and then tax people into sub-dividing property that try to maintain a little bit of a family farm or something.

I think it is politically wise, but I also think that it is a very sensible piece of relief that is overdue in this country. I hope that remains as part of the concept of this package as it goes through.

The Chairman. Senator Armstrong.

Senator Armstrong. Mr. Chairman, I share the general sense of euphoria to see what the Administration had laid before us. I compliment you and the others who have brought it forward. I think we should do something for the country that is important.

I note that it does not include out year indexing, and I am confident that the final bill which will be adopted by Congress will in fact include the provisions of S. 1, or some bill very similar to that which is sponsored I guess, by most of the members of this committee and whichwwas endorsed, as the Administration will recall, by the President, in his September remarks to the country, in which I believe, as Senator Grassley has said, he continues to support in principle.

I just think we are on the right track here. I have some minor questions to ask, and perhaps some minor amendments to the details of this proposal, but I think it is very good, very needed and with the addition of indexing of the rate structure and of possibly the capital gains basis as well, would be something of enormous importance to the country.

The Chairman. Thank you.

Senator Bradley. Do you want to co-sponsor now?

Senator Bradley. Mr. Chairman, I am tempted to make --

(Laughter.)

Senator Bradley. -- I am tempted to make an opening statement, but the camera angles aren't right.

(Laughter.)

Senator Bradley. So, I think I have a great many questions that I would like to ask Mr. Chapoton, when he explains the proposal. I will wait until the proposal is actually explained, to ask the questions.

The Chairman. Right. I didn't know you had any questions. But, I would be happy, because it is such a good proposal.

Senator Heinz.

Senator Heinz. Thank you, Mr. Chairman.

I think the committee has worked very, very hard to structure an approach that will meet the twin goals of providing tax relief, incentives for savings and investment and a tax bill that will allow us to reduce the deficit very, very substantially and on down to zero, just as quickly as possible.

The bill before us, as I understand it, represents a significant amount of change on the part of the President. He has tried to meet the Congress and its concerns about the size of the deficit, to a very considerable degree. I congratulate him on that.

I don't believe, just as one might expect, that any product of compromise is perfect. It necessarily is not so. It is my hope we can make some continued improvements in this bill that the President will accept.

One of those changes I would like to see is additional incentives for savings along the line that Senator Danforth has proposed, and also, some more in the way of incentives for our power plants to convert from imported oil to coal.

It makes no sense to this Senator, that we make it unnecessarily and unusually difficult for our utilities that used to burn coal, that we are told in the 70's to burn oil, and now want to burn coal again, but they have to make it

-- rather expensive investments to do so, to make it costly and difficult for them to do so.

So, I hope, Mr. Chairman, we will be able to make some modifications that the President will be supportive of, that he can live with, so that we can take every opportunity to make this bill just as strong as it possibly can be.

The Chairman. Thank you, Senator Heinz.

I appreciate your leadership in an area that you have been working on over the week-end.

Senator Boren.

Senator Boren. I'll pass for now. Thank you, Mr. Chairman.

The Chairman. We have one Senator visiting. He doesn't get to talk. Senator Boschwitz is here from the Budget Committee to keep an eye on us. Also, to hear Mr. Chapoton explain the tax bill.

Senator Byrd has just arrived. Maybe it would be timely -- we acted the other day to approve S. 955, introduced by Senator Harry Byrd. It is co-sponsored by Senator Packwood, which will allow the gift tax returns to be filed and gift tax paid annually rather than quarterly.

I guess we didn't have a quorum that day, Senator Byrd.

So, if there is no objection, I assume you would like to have that approved.

Senator Byrd. That would be fine, if the Committee is willing to act. The committee did approve it last year.

The Chairman. I know of no objection.

Senator Long. Do we have any bill to put it on, Mr. Chairman?

The Chairman. No. We are going to approve it and save it for the first thing that leaves the committee.

We have a couple of numbers. We would like to save those just in case the House doesn't move quickly on the tax proposal. We will have some porch to put something on.

We will do our best to accommodate the Senator from Virginia.

Senator Byrd. Thank you, Mr. Chairman.

The Chairman. Then move to report it.

Senator Long. I move we report it.

The Chairman. Without objection the bill will be approved.

Mr. Lighthizer. Mr. Chairman, that is the first vehicle other than the major tax bill that will leave the committee; is that correct?

The Chairman. More or less.

Well, Mr. Chapoton, I think in the last 40 minutes you have heard some of the concerns expressed.

Senator Byrd, do you want to make a brief statement before we proceed?

Senator Byrd. No, thank you.

The Chairman. Some of the real concerns members of this committee have -- I want to say again, we want to cooperate with the Administration and move very quickly.

I doubt that we can add Social Security to this Bill, but that is the thought that occurred to some of us. Make it a Master Package, one that would be long-remembered.

(Laughter.)

The Chairman. But, in any event, if you would proceed now to give us the highlights of the bill. We read about the proposal. Some of us discussed it with members of the Administration.

Now, I think we would like, and perhaps briefly, if you could just sort of run through the President's proposal as introduced by Hance and Conable, and then, maybe some changes were made, as I understand, over the week-end, and then we will open it up to questions on the -- based on the Early Bird Rule.

Mr. Chapoton.

Mr. Chapoton. Thank you, Mr. Chairman.

Let me say at the outset that we appreciate the comments of the Chairman and Senators in support of this compromise package.

We do think it is a package that achieves the stated goals of the President's original tax proposal and is a good, solid, economic recovery type tax proposal.

If I might, let me go through the original proposal that was introduced last February 18, very briefly, and then go through the bill, H. R. 3849 that was introduced in the House yesterday and show how that is changed.

As you know, the original proposal, on the individual side, was 10 percent a year, tax cuts, and marginal rates across-the-board, 10 percent a year, for three years, beginning July 1, 1981, and running through '84.

A 30 percent cut in marginal rates. That was the sum total of the individual tax changes in the original proposal.

On the business side, the original proposal was a modified 10-5-3 depreciation proposal where trucks and automobiles, research and development equipment would have been put in a three-year class.

All other equipment, other than long-lived utility property would have been put in a five-year class, long-life utility ~~property and owner-occupied buildings put in~~ a ten year class, and those three classes would have been -- the cost of those properties and those classes would have been recovered over an accelerated, basically 200 percent declining balance depreciation provision.

Leased real estate would have been put in a 15 year class, and housing leased, rental housing would have been in an 18 year class. Both were covered under straight line.

The new proposal, the H. R. 3849, which was introduced yesterday, on the individual side, changes the 30 percent across-the-board tax relief to 25 percent, commencing in October, this year, October 1, 1981.

You would have a 5 percent cut commencing then.

The second cut, 10 percent, July 1, 1982.

The third and final cut of an additional 10 percent, July 1, 1983, for a full 25 percent.

In addition, the ACRS, Accelerated Cost Recovery System, the original proposal would have been amended or would be amended in a number of -- actually, a number of technical respects, but let me list the more major of the changes which are quite few.

First of all, all structures would be put in a 15 year class, and recovered, depreciated over -- using a 200 percent accelerated method of depreciation.

Recapture would be at the 1245 rate for all structures which elect 200 percent declining balance depreciation, other than housing. Housing would -- cost recovery would be subject to recapture under the 1250 rule, which is recapture of depreciation in excess of straight line only.

The 1245 recapture is full recapture, is ordinary income of the entire cost recovery deductions claimed prior to the disposition.

So, you would have housing subject to 1250 recapture, if the 200 percent declining balance depreciation were elected. All other structures subject to a 1245 recapture if they elect 200 percent declining balance cost recovery.

But, all structures, all taxpayers would have the option of putting structures, of recovering costs over straight line so that you would have no recapture if they disposed of the property.

So, any taxpayer could avoid recapture by taking less generous depreciation on structures.

The second change in the ACRS proposal is to limit the 10-5 -- the depreciation of equipment which are in the 10-5-3 year classes. All equipment is in one of those three classes.

Limit the cost recovery to 150 percent declining balance cost recovery, down, less generous than the original 200 or approximately 200 percent declining balance in the original ACRS proposal, through 1984.

Then, beginning in 1985 and 1986, the cost recovery would move back, phase up to a full 200 percent cost recovery for equipment, so that in 1986, in future years, you would have the original 200 percent cost recovery.

In addition, relatively minor change, short-lived property, that is property that has an ADR life of four years or below under existing law would be moved from the five year class into the three year class.

In addition, the phase in, in the original ACRS proposal, as originally proposed in our February 18 bill, and the proponents of the 10-5-3 package, the last couple of years, have a five year phase in in the package, so that the full benefits under ACRS would not have been available for all taxpayers until five years out.

We would eliminate the phase in so that the ACRS proposal, as modified, would be effective immediately for equipment placed in service after January 1, of this year; after January 1, 1981.

Two other relatively -- compared to those two, other relatively minor changes.

One, we would eliminate the allowance of depreciation on qualified progress expenditures or allowed the investment tax credit under existing law for long construction period property. That is, general construction period of more than two years. The taxpayer may take the investment tax credit.

When payment is made for the property, the original ACRS would have allowed cost recovery to begin at that time.

We have removed that provision from this bill.

We have liberalized the leasing requirements, the restrictions on leasing of property, under existing law, to facilitate leasing among assets in the corporate sector, so that taxpayers, because they have losses or excess deductions or new taxpayers, new businesses starting up that cannot fully utilize the depreciation, the cost recovery and ITC deduction will be able to obtain most of the benefits entering into leasing transactions.

Those are the basic changes in the ACRS proposal. So that is the modification of the original, the President's original package.

The Chairman. In other words, these are the ACRS proposals introduced yesterday?

Mr. Chapoton. These are the ACRS proposals introduced yesterday and the individual rate cuts introduced yesterday.

The Chairman. I would assume that was put together in a rather hurried fashion. I guess there may be some modifications necessary. I haven't looked at them, except in a hurried fashion. I guess there may be some modifications necessary. I haven't had a chance to study the House Bill.

But, I would guess you have been working with the Joint Tax Committee and members and staff to try to hold down the number of errors, but there would probably be a few.

Mr. Chapoton. Well, we spent an awful lot of time on this, Mr. Chairman, and worked with your staff and the staff of the Joint Committee. We hope there are very few problems of that nature. But, of course, we want to make sure there are none.

In addition to those two changes there are what we might call the "add on items" that were that were not in the original proposal at all.

The Chairman. I think if you would just run down those quickly, because there is some misunderstanding. At least I read some misunderstanding about certain provisions. But, if you could do that very quickly.

I know Senator Boren, Senator Wallop and others have questions on the estate tax portions. Senator Bradley has some questions and some others.

Mr. Chapoton. I will go through it very briefly.

The first change would be an immediate reduction commencing January 1, 1982, in the top rate on unearned income from 70 percent to 50 percent. This, of course, will have the effect, also, of reducing the maximum tax on capital gains from the present law, 28 percent, to 20 percent and eradicating the present law distinction between earned income and unearned income.

The top rate on everything would be 50 percent, commencing January 1, of next year.

The marriage penalty relief is provided, phased in over two years. There would be a 10 percent exclusion of the earnings of the lower income spouse up to a maximum of $3,000. That would be phased in 5 percent in 1982, and the full 10 percent in 1983 and thereafter.

The unified estate and gift tax credit would be increased from the present law of $47,000, which is equivalent to an exclusion of $47,000 -- excuse me, $175,000. That would be raised to $192,000, equivalent to an exclusion of $600,000. That would be phased in over five years.

Also, the marital deduction on the estate, the estate tax marital deduction would be raised from the present law, 50 percent, to 100 percent. So that all gifts and bequests to a spouse would be free of transfer taxes commencing January 1, 1982.

Finally, and in the estate and gift tax area, the $3,000 annual exclusion on gifts would be raised to $10,000, commencing January 1, 1982.

In the individual retirement accounts, the IRA, the present $1,500 that can be contributed to an IRA would be raised to $2,000, continuing the spousal, that is, in present law of $250, so that a husband or non-working spouse could contribute a total of $2,250 to an IRA.

In addition, the IRA eligibility would be extended to persons who are covered by a qualified employer sponsored plan up to $1,000, plus the $250, plus $125 for the spouse or spousal, for a total of $1,125 for the husband and his working spouse and the non-working spouse, who, if the working spouse is covered by employer sponsored plan.

We would increase the Keogh plan limit from the present law of $7,500 to $15,000. We would make the interest and dividends, as we mentioned earlier, the $200-$400 interest and dividend exclusion which is due to expire under present law. That would be made permanent.

There would be an extension and an increase in the credit against windfall profit tax liability for royalty owners. The present law has a $1,000 exemption which was -- a $1,000 credit which was for 1980 only. That would be raised to $2,500, commencing January 1, of this year.

Then three additional business type items --

Senator Wallop. Mr. Chapoton, if I might, I would hope as you refer to that both here and in testimony that a few others of the Administration may give in the House, make it clear that the royalty owners that credit applies to or is targeted toward are not oil companies, but primarily retired people, former land owners or others that may have that as a source of retirement supplement or what have you.

But, it is not an oil company relief measure by any stretch of the imagination.

Mr. Chapoton. It is limited to royalty owners, and of course, the amount is relatively compared to the oil company income, it is relatively small.

The three additional items, the 25 percent incremental credit for direct wages paid for research and development, that would be a credit equal to 25 percent of such wages, direct wages, over a three year moving base period so the only increases in wages would qualify for the credit.

That would be effective July 1, of this year.

The section 911, the taxation of earned income of American's abroad would be liberalized considerably along the lines of Senator Chafee's proposal.

For a flat $50,000 of income earned abroad by an individual residing abroad would be excluded from tax, and an additional 50 percent of the next $50,000, for a total exclusion of $75,000 of income earned abroad, plus an exclusion of excess housing costs based upon the income level of a GS-14, which is basically 16 percent of that income level, which is basically housing in excess of $6,000 would be excluded.

Finally, an investment tax credit for rehabilitation expenditures. The present 10 percent credit would be -- on 20 year structures would be removed and replaced with a 15 percent credit.

On 30 year structures, a 20 percent credit.

On 40 year structures, 40 years and older, and a 25 percent credit for qualified historic structures.

So, Mr. Chairman, basically those are the add ons and that is the the entire package as introduced yesterday, in the House.

The Chairman. Did you mention the R & D credit?

Mr. Chapoton. Yes, sir.

The Chairman. Did you mention universities in connection with that?

Mr. Chapoton. No. This is a deduction -- I mean a credit, solely for business taxpayers who incur R & D direct wages in connection with research and development expenditures over a base period, incremental amount.

The Chairman. Senator Roth was the first Senator and he had to go to another hearing.

I will reserve my questions.

Senator Grassley was next and then Senator Long.

If we can limit our first round of questions to 5 minutes and then any others.

Mr. Chapoton. Mr. Chairman, let me amend one thing that was pointed out to me. On the universities. If the taxpayers, their company pays the university for research and development, then it would get the credit for such expenditures.

The Chairman. Senator Grassley.

Senator Grassley. Thank you, Mr. Chairman.

I would like to ask you about the IRA's. By the way, Senator Roth told me as he was leaving that he is very supportive of this whole IRA concept, and particularly taking care of the wives bias in it, as well.

But, does the Treasury have any objection to the creation of an individual retirement account for homemakers which would permit a homemaker to use her husband's income for the establishment of her own IRA?

Mr. Chapoton. Well, Senator, we have discussed IRA's increasing the IRA limits and the changes in the present IRA rules with a number of groups, staff here and interested groups on the House side. This represents what we think is a productive or desirable change in the rules.

It will greatly increase utilization of IRA's. We are not prepared, and if we do, as you commented earlier, put in the spousal IRA, so that a non-working spouse could, a non-working spouse would allow a small increase in the total amount.

But, at this time, we could not support going beyond that. We would like to see what effect this has.

Senator Grassley. Then, was I correct in my opening statement that the Administration has included in the LIRA, an opportunity for a maximum of $1,125, in the case of where people otherwise can't have individual retirement accounts, can now have individual retirement accounts and there would be credit for the spouse?

Mr. Chapoton. That's correct. The non-working spouse could utilize that.

Senator Grassley. That was the point I wanted to compliment you on for going at least that far in that.

Let me say, I welcome you coming to this committee, because when we had the estate tax hearings on the IRS Oversight Subcommittee, you announced some very good changes for the benefit of estate tax payers in this country.

So, I think the Administration is making some changes that are very realistic.

I want to ask you in regard to depreciation for buildings -- will what we refer to as a single-purpose agricultural structure be like hog confinement buildings be considered within the five year class for ACRS purposes?

Mr. Chapoton. No, it would not.

Senator Grassley. They would not be?

Mr. Chapoton. That structure would be in the fifteen year class.

Senator Grassley. Okay. Let me ask you --

Mr. Chapoton. Let me withdraw that. It would be in the ten year class.

Senator Grassley. They would be in the ten instead of the fifteen year?

Mr. Chapoton. Right.

Senator Grassley. Okay. So, that is some improvement over the existing law. Right?

Mr. Chapoton. Yes, definitely.

Senator Grassley. I am not going to comment in agreement or in opposition to that except that any improvement is good news.

Let me suggest to you that over a long period of time -- I think since 1972 -- we have had problems with special

Senator Long. Just give a lower rate structure for single people.

Now, how much would it cost us to eliminate the marriage penalty in the course that we take here where we tried to put the married couple in the same situation as the single people?

Mr. Chapoton. Senator, the cost of this proposal starts out in 1982 --

Senator Long. I mean in full operation.

Mr. Chapoton. Okay. In full operation, it would be $7 billion in 1984.

Senator Long. That's $7 billion. But, that only wipes out half the penalty, right?

Mr. Chapoton. It necessarily operates unevenly depending upon the relative income of the spouses. The penalty varies according to that.

Senator Long. But, now this is the same thing we had in last year's tax cut bill, isn't it? Basically, it is the same provision.

Mr. Chapoton. Yes sir.

Senator Long. Now, if that is the case, then that only takes care of half the penalty, right?

Mr. Chapoton. It takes care of variants. At some income levels and some distributions, it takes care of all of it and at some levels it takes care of half of it.

Senator Long. But, on the average, this will take care of half the marriage penalty. Isn't that about the size of it? That is about what we were doing last year.

Mr. Chapoton. A little less than that.

Senator Long. What's that?

Mr. Chapoton. Just a little less than that.

Senator Long. A little less than half, so that if you are going to eliminate the marriage penalty entirely it would cost twice that -- at least $14 billion, right?

Mr. Chapoton. Right.

Senator Long. All right. Now, by contrast, suppose we just wiped out the marriage penalty by undoing what we did to begin with. Just taking away the advantage we gave to single people to begin with. What would that cost? I mean cost the Treasury. What would the revenue loss to the Treasury be if we got rid of it by just eliminating the advantage we gave to single people to begin with?

Mr. Chapoton. You would raise money by doing that.

Senator Long. It would actually raise money for the Treasury. How much would it raise?

Mr. Chapoton. I am not sure we have that. Well, it would vary.

Senator Long. Mark probably knows that. Does the Joint Committee know that?

Mr. McConaghy. It will raise money essentially somewhere equivalent to I guess about the $10 to $12 billion, but we will get a figure for you.

Senator Long. How much?

Mr. Chapoton. Around $10 billion, Senator.

Senator Long. Well, I was led to believe that you are benefitting about one person -- you have about four times as many people file as married people as single and I was led to believe that you have about one-quarter as many beneficiaries on the single end as you do on the married end and therefore, it wouldn't cost near as much in terms of the increase on one end as it would to cut on the other.

Could you tell me about that?

Mr. McConaghy. Well, Senator Long, the $14 billion to correct the marriage penalty would also, in effect, have an amount that goes to people who now have a marriage bonus, so if you corrected it by raising the rates on singles you would raise about $10 billion out of that $14.

Senator Long. On those who are getting a marriage bonus, you might say.

Mr. McConaghy. Yes. You wouldn't use the money that is now going to those who get a marriage bonus.

Senator Long. All right. But, here is the thing I am thinking about.

What we have here would eliminate about the half the marriage penalty, cost $7 billion in revenue to the Treasury.

If you wanted to wipe it all out, it would cost $14 billion to the Treasury.

On the other hand, if you take the approach that Larry Woodruff wanted to take -- he has a job somewhat similar to yours, Mr. Chapoton and he used to be head of that Joint Committee staff on which Mr. McConaghy is sitting. His attitude was that well, that in future tax cuts you ought to try to get rid of that marriage penalty by simply not cutting the single people or those who are getting a marriage bonus as much as you would provide a tax cut for the married people.

By doing that you could cushion the cost of getting out of this trap. What we are talking about here is that to guarantee all those who are getting the marriage bonus and those who are have what now appears to be a doubtful advantage for single people, to let them have all the same tax cut as the others and then put the marriage penalty on top runs the cost of it way up -- $14 billion to rid of the whole thing.

The question is why don't we consider trying to do a little of both. Say we will give some advantage to married people, but we won't cut the rate quite as much. And that being the case we can move toward a solution where it won't cost $14 billion to get out of that trap.

We may make a little something for the Treasury while we are losing something for the Treasury.

Mr. Chapoton. Well, Senator, we have studied this marriage penalty thing in depth and we have worked with the Joint Committee staff on it at length.

There are ways you can move and it obviously, as you well know, a very complicated problem in the way it affects different taxpayers at different levels of income and the mix between spouses affects it.

But, you can move in the direction of adjusting entirely the rate schedules. It would make a flater rate schedule. The Joint Committee has looked at it. We have looked at it. But, we have come down on the side of across-the-board marginal rate cuts as a cornerstone of this tax package and given that constraint, if you will, the marriage penalty relief simply has to be on top of whatever across-the-board rate relief we propose.

Senator Long. But, now you see here is where you stand. You start out with a proposal of 10-10-10 and then it always seemed to me as though if you going to restructure this tax code to make it a much better law -- make it more just, more fair, more equitable, more uniform to all taxpayers -- you have to zero in on these areas where the injustice is the greatest, where the unfairness is the greatest, where the economic disparity is the greatest, and to pass a bill like that you have to have a bill that can stand a big revenue loss.

It is a lot easier to vote for a tax cut than it is a tax increase. That being the case, you need a big revenue bill like this if you are ever going to take care of a lot of things that are wrong with this code.

Now, a marriage penalty is one of these items. You have this section about the employees abroad. That is another one.

I applaud you. I think it is great that you are coming in and trying to do something about this. But, when we seek to do some of this, if you are going to do it, it is going to cost some revenue to the Treasury. Apparently, you find the revenue to do this by saying well, we will have a 5-10-10 rather than a 10-10-10.

I guess that is where you are finding a lot of the money to cover the cost of what are some very good provisions. My thought is that we ought to look in terms of what it is going to take to do some more things that need to be done. It would just make all the sense in the world.

I guess my time has expired for now. I will come back and talk about some more of this later on.

Thank you.

The Chairman. Senator Danforth and then Senator Bentsen.

Senator Danforth. Mr. Chapoton, the original version of the R&D credit bill would have provided 25 percent credit for incremental spending for research and development.

This bill provides the tax credit equal to 25 percent of incremental wages paid directly for research and development.

What was the reasoning behind the change?

Mr. Chapoton. It was a couple of factors, Senator. One, we are, of course, giving very significant tax benefits to any investment in equipment, including equipment used in research and development expenditures, through the basic ACRS proposal.

So, you have some benefit flowing that way through equipment. We put it in the three year class. As you know, we put the equipment used in research and development expenditures in the three year class. Originally under this modification, all short-lived equipment would be in the three year class so that is not an individual item any longer.

But, it still is major benefit for R&D equipment as well as other.

In addition, the allocation of the use of equipment between R&D and other uses gave us very difficult technical type problems in trying to fashion a provision and we determined that the benefits were already large enough for equipment so we just cover direct wages.

Senator Danforth. What would be the revenue difference, the revenue loss difference between the original bill and this?

Mr. Chapoton. If you added equipment, then you have to take into account the factor that these estimates because of the allocation problems.

Excuse me, Senator.

We don°t have with equipment at this point. I will have to supply that for you. You have before you, I believe, the cost of this provision -- $400 million in 82, $600 in 83 and $700 million in 84.

Well, I am advised I need to supply you that. I am advised it would be substantially more if we added equipment. Probably twice as much.

Senator Danforth. Let me just raise this possibility. If the bill were to specify wages, that would be saying to businesses we encourage you to spend more money for research and development providing that you spend the money for wages. You spend it the way we want you to spend it.

Wouldn°t it be better and accomplish the same result if you provided the credit for research and development spending and then accepted from the credit equipment or whatever other specifics you wanted to accept. Do you follow me?

Mr. Chapoton. No, I don't think I do.

Senator Danforth. Okay. I am told, for example, that spending for research and development includes things other than equipment. It includes various lab costs. It includes support services, utility costs, repairs, maintenance, things that aren't included in equipment, outside projects of one kind or another and that there are various experimental costs that are not necessarily included in wages.

It would seem to allow more freedom for the business involved if you were to say, you spend the money for research and development. We would like to accept from the tax credit equipment or whatever else you want to specify.

It would seem to me that it would allow more freedom in the business and be less manipulative of precisely how they spend their R&D money.

Mr. Chapoton. I suspect there would be, if you exclude equipment, very little that we have not covered and except, I guess the basic difference would be overhead or allocation of basic overhead.

Senator Danforth. Well, what I would like to do is to just leave the door open at this point if we could work this out between Treasury and staff as to precisely how this is framed.

I would prefer to do it in a way other than just specifying wages if we could.

Mr. Chapoton. We would be happy to go over the details of that.

Senator Danforth. Okay. Thank you very much.

that would do it.

Well, I reiterate my hope that within this general thrust with which I totally agree with, that the Administration is after, we could take a look at the details as we move along.

Mr. Chapoton. We would be happy to do it. Of couse, we have been examining savings proposals in detail already and to reiterate a point we have made often, very often, is we think the marginal rate cuts will have a tremendous effect on the savings rate in this country.

Senator Danforth. Thank you.

The Chairman. Senator Bentsen.

Senator Bentsen. Thank you very much Mr. Chairman. I thank my friend from Missouri for his generous remarks and will look forward to working with him as we try to do things to create more savings.

I don't share the optimism as to that amount of the marginal rate cut going into savings because we have a library full of empirical studies saying that that doesn't happen to the extent you would get with a targeted savings incentive.

I would like to comment concerning the royalty owners and say that again that is not, as some people seem to think, just a very small group. In my own state, that is 650,000 people and they are paying a tax rate that is the same as the major oil companies and in 80 percent of the cases that 650,000 people have earnings from royalty payments of less than $100 a month.

In many of those cases, that is the elderly people and that is very important supplement to their income, so I congratulate the Administration in what I think is a very forward and progressive step in trying to correct that injustice and I am delighted to have worked with my friends Senator Dole and Senator Long, Boren and the others in urging that.

Now, you have one situation there, Mr. Chapoton, where you talk about investment income being cut from 70 to 50 percent to be on a parity with earned income on January first. I can understand that because of the problem of loss of revenue to Treasury.

But, I don't think you can wait until then to do your capital gains part of it. It seems to me that you have to have an effective date on capital gains prior to January 1 of 1982.

The Administration, I think, very wisely said you go back on your depreciation schedules so you are sure that you in no way have delayed the purchase of equipment. But, we in the past and in the last tax cut on capital gains made an early effective date so there was no problem in stopping sales.

I think that you are going to find, if you are cutting from 28 to 20 percent in the capital gains rate, that is approximately a 23 percent cut. I think you are going to have a lot people who will not go ahead and consummate a sale until January of next year and I don't believe you are going to lose the kind of revenue by having an effective date July 1.

If you look at the feedback in the situation, we are running into the same kind of arguments that we ran into with the previous Administration when we tried to cut back from 49 to 28 and they said we were going to have a big loss in revenue. We didn't have that loss of revenue and particularly you won't have that loss in revenue in this situation, I believe, but you will have a delay in transactions and sales that should not happen.

You will stall a great deal of economic activity that is important to accomplish the objectives you are trying to accomplish for the economy if you delay the effective date of that capital gains cut until January 1.

Mr. Chapoton. Well, Senator, we reviewed that and we recognize that argument has been presented. There is certainly a matter of concern if there is delay. Keep in mind that the method by which capital gains are reduced under this proposal is a reduction in the ordinary income rates.

Senator Bentsen. I understand that. But, that doesn't mean that we can't find a way to bring about capital gains as a separate situation for that six months.

Mr. Chapoton. That is correct and you can do as was done in 1969, you can do it on transactions after a certain date. Now, we have not proposed that. We, basically, have not decided that the delay will occur and of course, it depends on when this legislation is passed. We are hopeful that it will be passed mid-year or at the end of July.

Senator Bentsen. Mr. Chapoton, any time I go before a group and open it up to questions and I talked tax to them and we talk about trying to get the capital gains cut, there is always somebody who stands up and wants to know what is the effective date. You know what is going on, what they are thinking about.

They are thinking about staling a deal, not making a trade.

There is another one I would like to ask you about and this is a more technical situation. You are talking about the limitation of the investment tax credit to the at risk side. Now, as you do that and I can understand some of the reasons in that because you are getting at the limited partner deals where the fellow really isn't liable or the major part of the investment, but you turn around on the other side and you say for the company that is not making money and cannot utilize the investment tax credit and the depreciation that you are going to liberalize the leasing provisions.

I think I understand what you are getting at there. You are trying to get away from a refundable tax credit and I congratulate you on that. But, don't you have a paradox there?

Mr. Chapoton. Let me explain. It is not a paradox as it would appear.

First of all, on the at risk rule as applied to the credit under this proposal as modified -- I didn't explain this -- that rule is liberalized to some extent. It still remains in the bill but it does not apply to debt. It originally applied to any non-course debt. It does now not apply if the debt is from a traditional financial institution.

Senator Bentsen. If it what now?

Mr. Chapoton. From a traditional financial institution.

Senator Bentsen. I see. I understand what you are trying to do.

Mr. Chapoton. But, secondly, the leasing provision, the liberalized leasing provision, is aimed at the corporate sector, not at the individual sector.

Senator Bentsen. I understood that.

Mr. Chapoton. So the at risk rule is limited to individuals so the two are not inconsistent. You see the leasing provisions, lessor corporations, and the at risk rule limits will apply only to individuals to who are lessors or investors.

Senator Bentsen. No, I understood that, but I still question if in the economic philosophy in what you are trying to accomplish that there isn't actually some conflict in the objectives there. I will explore that further with you.

I know my five minutes have expired.

The Chairman. Senator Armstrong and Senator Bradley.

Senator Armstrong. Thank you, Mr. Chairman. Mr. Chapoton, I understand that there have been a number of adjustments and accomodations and so on in the package in the last several days and I wonder if you could help me understand the Administration's proposal with respect to the method by which depreciation is computed.

I have before me a handout and I am not clear. Is this a handout that you have supplied entitled, "Summary of H.R. 3849"?

Mr. Chapoton. Yes sir.

Senator Armstrong. Well, this recites and I take it that this is now the revised proposal --

Mr. Chapoton. That is correct.

Senator Armstrong. This recites that equipment placed into service between now and 1985 would be depreciated on

150 percent declining balance and thereafter that would be increased to 175 and 200 percent declining balance beginning in 1985.

My question is this. Is it your view that the higher percentage is an important tax incentive? Is this something that is really meaningful? Is 200 percent a lot more important than 150?

Mr. Chapoton. Well, the business community certainly feels it is significant. The 200 percent, of course, was in the original proposal with the phase in.

The original proposal did have a phase in of the entire cost recovery system. We put in effect immediately at the 150 percent rate and we think it is important that the encouragement for investment be there and long-range, it seems to be very important to business that the full benefits of this system be there. So, we provided the full benefits after 1984.

Senator Armstrong. In my concern, I am inclined to agree that this is an important incentive. From my own experience and also from talking to people who are large buyers of equipment, I gained the impression that this is a very, very important incentive indeed.

Now, my question is this. If I am otherwise planning to put some equipment into service, say in February or March of 1984, am I given a strong incentive to postpone putting it into service until January of 1985?

Mr. Chapoton. That same question came up when the original proposal had a phase in and if you put the numbers down and you assume an income from the investment which you of course must assume, we think the deferral will not result.

That is why that factor made us phase in the increase to 200 percent over 2 years instead of going directly to 200 percent in 1985.

Senator Armstrong. Have you looked at the possibility of simply permitting all property to be depreciated on the basis of 200 percent declining balance after a certain date such as January 1, 1985 even though it was placed in service some time before that?

Mr. Chapoton. No, we have -- I guess it is not correct to say we haven't looked at it, but we think that adds a great degree of complexity and it certainly adds to the cost that year and we think we will get sufficient investment in the early years, which is what such investment would be under this proposal.

Senator Armstrong. You just don't see it as a problem that 1984 equipment would be postponed?

Mr. Chapton. No, we do not.

Senator Armstrong. Let me turn for a moment to the real estate. I am not as familiar as I would like to be even with the present law, but it is my understanding at the present time that commercial real estate if depreciated the rule if that you recapture in a sale and are taxed as ordinary income that portion of the sale price that exceeds the depreciation.

It is not clear to me where we are going in this proposal, but as I understand it, we are creating two rules in the Administration°s proposal. One, that there is no recapture if it is straight line, but that there is a recapture of the full amount of depreciation if it is an accelerated declining balance depreciation. Is that correct?

Mr. Chapoton. That is correct.

Senator Armstrong. In other words, you are not recapturing just the part that brings you back down to straight line, but recapturing the whole amount even that portion that would have been depreciated under a straight line --

Mr. Chapoton. That is correct on everything except housing and that is the provision that was applied to owner-occupied structures in the original.

Senator Armstrong. Have you computed what the probable tax consequences, revenue consequences are if you simply recapture the portion that brought you back down to the straight line method?

Mr. Chapoton. That is section 1250 recapture. I am not sure, Senator, we might have to supply that to you.

percent going into effect in October 1 and 10 percent going into effect in July of 1982 and another 10 percent in July of 1983. Is that correct?

Mr. Chapoton. That is correct.

Senator Bradley. The withholding rates -- could you tell me when will the withholding rates -- is it 10 percent effective January 1, 1982?

Mr. Chapoton. No. Senator, let me review the details of that because I think it will be helpful.

When we say a 5 percent cut October 1 of 1981 we mean we do not change the rate tables mid-year. We cannot do that. So, what that means is liability is reduced by 1.25 percent for the entire year so that in 81 it is although the tax cut goes into effect in October at a 5 percent rate it is really a 1.25 percent tax cut for the entire year, but withholding drops by a full 5 percent commencing October 1 and thereafter.

Senator Bradley. So, that an individual would have 5 percent more takehome pay out of his withholding?

Mr. Chapoton. That is correct.

Senator Bradley. Going for 1982. How is 1982 started?

Mr. Chapoton. In 1982 the withholding change is 5 percent withholding that commences October 1981 continues through the first half of 1982 and then the additional 10 percent comes in so that after July 1 and for the rest of

[redacted]

a three-stage phased in tax cut and this is one system of doing it. You can do it any number of ways.

If you have the 5 percent cut in withholding on October 1 and then the next cut in withholding say to the full 10 percent on January 1, 1982, it costs additional money to the Treasury -- about $3 billion.

Senator Bradley. So, you are saving $3 billion in fiscal 82, but won't it have an effect in 83 then?

Mr. Chapoton. You will have the same deferral. You are saving money each year when you defer withholding.

Senator Bradley. What is the economic rationale for that? If you are just deferring to another year, sometime you have to pay the piper, right?

Mr. Chapoton. Well, as in everything in the budget process, the deferral is very significant.

Senator Bradley. So, if the deficit was actually a little higher than you thought in 83 or 84, you would actually have an additional $3 billion in deficit that you had not suspected or hadn't planned on.

Mr. Chapoton. Well, it is, of course, in the numbers. The higher numbers in the out-years are in the projections.

Senator Bradley. So that to take advantage of a mid-year up in withholding cuts you are taking a chance that in the out-years you will have $3 billion more on the deficit?

Mr. Chapoton. Senator, when we make a change like this it is reflected in the 82 numbers and the impact on the 83 numbers is reflected. It is not a surprise. We know what is going to happen out there.

Senator Bradley. Is that in the budget assumptions then?

Mr. Chapoton. Yes, that is correct. It is in the budget assumptions.

Senator Bradley. For 83 and 84?

Mr. Chapoton. That is correct.

Senator Bradley. Thank you.

The Chairman. Senator Boren.

Senator Boren. Thank you, Mr. Chairman.

First of all I want to join with the others who have commended the Administration for this package. I think it is an excellent package and certainly I support the major thrusts of it. I think it is going to do a lot to rejuvenate the economy and keep the country from living off inventory and start rebuilding our industrial base.

I also want to echo what Senator Bentsen has said about the proposal to assist the small royalty owners. I think there has been a great misconception about that provision in the press.

As it has been pointed out, it is not help for the oil companies. It is help for individuals, most of them who are lower and middle income individuals.

We found that in a survey in our state that approximately half of them were retired persons living on social security in the lower income brackets. It is going to be of very significant help to them.

I commend the Administration for including it.

Let me add to the comment that Senator Bentsen made earlier. I hope that some consideration -- I realize you said that it already has been discussed in the Administration, but I hope you will discuss it additionally and that is the problem of effective date on the capital gains reduction.

I sincerely agree with Senator Bentsen that there is going to be simply the postponement of a lot of transactions if there is anticipation that the capital tax will be reduced and the effective is put off as late as January 1.

I hope there will, again, be renewed consideration of this point.

I wanted to ask you specifically about the provisions on the estate and gift tax. It is my understanding in discussing this matter with the Secretary and with the President and others that there might be some flexibility to the members of this Committee who have been interested in this particular field, to refine the provisions of that particular proposal so long as we stayed within the same dollar limits that have been set forth in this original proposal and I would specifically mention there are two or three elements that we thought were to be included.

In the bill that Senator Wallop and I introduced we had also adjusted the brackets, the rates across-the-board, so that when you exceed the $600,000 exemption which would eventually be phased in that you would not then jump in immediately at a very high rate on estates above that level.

I think that it is important for us to consider that. Also we had a provision and Chairman Dole has worked on this in the past and Senator Byrd and others, in regard to agricultural use valuation, simplifying that procedure and making it workable and several of us have also been interested the small business valuation. The valuation that would be applied to closely-held businesses.

I wonder if it is accurate to say that there is some flexibility on that matter. That is what I had been told for some of on the Committee to work with you and others at the Department on this matter so long as we stayed within the financial targets here in terms of impact on the budget.

Mr. Chapoton. Well, Senator, we have looked at other alternatives, particularly in the rate structure. On these constraints you don't have a lot of room to work on the rate structure, but I can assure if the President said we would work within these constraints we would.

Senator Boren. Well, I would hope and I have discussed this with the Chairman and I think if we can probably put together a little informal working group, we might be able to do it. There are several options that we could consider in terms of, for example, the schedule of phasing in all the changes that might be expanded slightly in order to make sure that we get these other provisions in.

I know Senator Symms has worked very hard as well. Many of us on the Committee were fearful that if we missed this opportunity to write a truly comprehensive reform of the estate tax law, we might have difficulty in getting some of these changes made later and so that is the reason we want to try to get as many of these provisions included as we possibly can.

Mr. Chapoton. Okay. We will, of course, be happy to work with you. I think it is a significant constraint under which we are working though, Senator.

Senator Boren. I understand the budgetary restraint and I certainly commend, again, the Administration for going as far as it has. I think that the provisions that are included are excellent ones and I am certainly not speaking against any of the provisions that you have outlined or that are in the draft proposal for all of them. I hope we may be able to refine it and make some tradeoffs maybe on time schedules to include some of these other factors.

Senator Byrd. Now, everyone seems to recognize the equity of reducing the 70 percent income tax rate from 70 to 50. I am wondering whether you feel that that same fairness or principal ought to apply to the estate tax.

Mr. Chapoton. Well, Senator, I think there are very different considerations in the estate tax, but let me say that we do not consider this the final act in estate and gift taxes and we do need to look at the entire area.

This is sort of a one shot very significant relief in the estate tax burden and improvement through the increased marital deduction.

There are a lot of other problems in the estate area. The generation skipping across, the rules for marital deduction, a lot of complexity and indeed, Senator Boren was eluding to the cliff, if you will, where the rate structure kicks in, now, at the $600,000 a very heavy rate structure immediately and running up to 70 percent.

We would like to look at all these things, but we simply did not have the time to do it at this point.

Senator Byrd. Do you happen to have a figure available as to what the revenue loss would be if you reduce the maximum rate from 70 to 50?

Mr. Chapoton. Senator, I think we better supply that to you. We have done that, but we don°t have it with us.

Senator Byrd. Thank you.

In regard to IRAs, would Government employees be able to set up an IRA under the Administration°s proposal?

Mr. Chapoton. Yes, they would.

Senator Byrd. I hope the Congress will act quickly on this tax bill. It seems to me the quicker that Congress can act, the better off the country will be.

In that connection, I want to express a view similar to that expressed by Senator Boren and Senator Bentsen in regard to capital gains. As a matter of fact, it seems to me that the Congress would be wise to set the effective date right away because if you set it any time in the future it seems to be is almost bound to reduce transactions and slow up momentum in regard to any transactions.

I don't believe the cost -- I don°t know whether you indicated the cost or not, but there couldn°t be much cost involved.

Mr. Chapoton. I do not think there would be much cost involved. We shall take a look at that, yes sir.

Senator Byrd. Thank you. Thank you, Mr. Chairman.

The Chairman. I might say in that regard, I think in view of Senator Byrd's comments, Senator Bentsen°s and others, I might just informally ask the Committee is there general agreement that the effective date should not be later than July 1?

Senator Long. It seems to me, Mr. Chairman, that the effective date ought to be immediately.

The Chairman. Capital gains --

Senator Long. It seems to me that anybody if he had any choice about it is going to postpone any capital gains transaction waiting for the rates to come down. All kinds of people are going to do that. Isn't that right, Mr. Chapoton? You were practicing law just a short time ago, wouldn't you advise your clients to either draft to pay for it slowly so it would be effective subsequently or to wait until the Congress acts?

Mr. Chapoton. There are a lot of factors that enter into a decision to make a sale if you look at the stock market. You have to worry about the stock going down. On land I think there would be more of a tendancy to think that it would not retreat so that you might be willing to hold. In the stock market, a little bad news could wipe out the gain that you were waiting for.

The Chairman. We are just talking about capping the capital gains, not lowering that from 70 to 50 effective July 1.

Mr. Chapoton. It could be done, certainly.

The Chairman. Do you have any strong objection to that?

Mr. Chapoton. I, off-hand, do not see any strong objection to that, Senator, no.

The Chairman. Does anybody on the Committee have any objection to that?

Senator Byrd. Why not make it today?

Senator Long. I would suggest we make it today. Any transaction should start now, at 11:45 or 11:46 on the 10th of June.

Senator Packwood. Bob, I want to offer only this caveat. You and I have been in conferences before where we made assurances in this Committee and then we went to conference and that wasn't the day that we ended up with and you can say that, but if anybody in this audience goes out and investment at 11:48 today thinking that it is going to be retroactive at that time they may be acting on assurances that we are able to deliver.

Senator Long. Well, make it any transaction as of the ninth of June then. That would take care of anything that done.

Senator Packwood. What I am saying is we may not be able to deliver on that.

The Chairman. We hope maybe the Ways and Means Committee in a meeting later today might agree this would be a good idea.

Senator Long. It was suggested in the beginning that the date ought to be January 1. Now, let's just be frank about it. Mr. Rostenkowski at that point was not ready to commit himself and so the matter was more or less held in abeyance, but you have all sorts of decisions that ought to be made.

I have sat right beside in restaurants and heard a man advise his son, wait until you see what the capital gains tax base is going to be.

Those dates would oftentimes be proposed as a date the Administration sent the recommendation up to the Treasury. Isn't that right, Mr. Chapoton?

Mr. Chapoton. That is often the case, yes sir.

Senator Long. My thought is it ought to be the date that -- when House Committee sets a date they act. I think why don't we make it the date they introduced the bill and I think that at a minimum we could say it shouldn't any date after that, starting right now, starting today. Let's make any transaction on the 10th of June covered by the new rule.

The Chairman. We had not planned on making any decision today, but I am not opposed to making a decision. If there is no objection, I think we could at least indicate to the Treasury what our feeling is on this Committee.

Mr. Chapoton. This, of course, is the problem that has existed. As soon as rate reduction was proposed, as Senator Long, has pointed out, capital gain rates are coming down. People know that. There may be more or less deferral now. I don't think it is a new problem created by yesterday's action. It may well be a problem as the Senators are saying. I am not sure it is a precipitous problem.

Senator Long. Anybody who has a big transaction is going to wait until he sees what the date is going to be, but it seems to me as though that both the House and the Senate Committees ought to commit themselves as soon as they focus on it.

In years gone by, I believe, you just get the two Committee chairman and sometimes the two ranking members to sign up and say we think it ought to be the date as of now, at the time the proposal came up.

I would think that this Committee could say it ought to be now and frankly, I think, if we set it now, set it right today, and move on that basis, by the time the bill gets to conference there will be so much pressure built up to stay with this date that it will prevail. I would be willing to bet you on that.

(Laughter)

The Chairman. It has been suggested we ought to make the estate tax effective today so that people can go ahead and pass on, but I don't --

(Laughter)

The Chairman. I would try to keep our priorities straight.

Why don't we just indicate, without objection, that is the consensus of this Committee and it probably will be in the bill that we pass.

Senator Packwood?

Senator Packwood. Mr. Chapoton, is the Treasury using static estimates in their revenue losses?

Mr. Chapoton. Senator Packwood, the estimates are static in the sense that they come off of the projections of the economy and to the extent the economy is built into it, the assumption of a tax cut of changes in depreciation --

Senator Packwood. Slow down, you are going farther than I want to ask.

The Treasury has always used static statistics before, static estimates.

Mr. Chapoton. The answer is yes.

Senator Packwood. Thank you. Now, in 1984, your static estimate of the loss under the new bill, the Economic Recovery Act of 1981, is $149.6 billion rounded off to $150 and under the original Administration bill it is $151.5 billion, rounded off for the moment to $150.

Am I okay so far?

Mr. Chapoton. Yes sir.

Senator Packwood. All right. Now, what is the original bill? Is that 10-10-10 as of January 1, 1981 or July 1, 1981?

Mr. Chapoton. July 1, 1981.

Senator Packwood. Okay. So, by fiscal 84, we have roughly the same static losses and what you have simply done is slip your 5 percent to October 1, gone ahead with your 10 percent and your 10 percent and then put in a whole variety of, perhaps, justifiable little do-dads, like the estate tax that Senator Grassley is interested in and the $200-400 in interest that Senator Bentsen is interested in and the overseas income that Senator Chafee is interested in and the research and development that Senator Danforth is interested in and the royalty owners that Senators Boren and Dole are interested in and come out with roughly the same loss that you had initially.

Mr. Chapoton. In the out-years that is correct, yes sir. In 1984, it is roughly the same amount, right.

Senator Packwood. Can you give me your estimated deficits for 81, 82, 83 and 84?

Mr. Chapoton. In 84 it is a slight surplus.

Senator Packwood. How much?

Mr. Chapoton. $2 billion.

Senator Packwood. $2 billion. Well, now what about for the previous three years?

Mr. Chapoton. Excuse me just a minute. Let me get that. Let me give you first the change, -- scratch the $2 billion figure because it is going to be about $6 billion surplus in 1984.

Senator Packwood. $6 billion surplus in 84.

Mr. Chapoton. The decrease in the deficit or the increase in the surplus under this bill as contrasted with the original --

Senator Packwood. I don't want that.

Mr. Chapoton. Well, okay.

Senator Packwood. I just want to know under this bill the estimated deficits and surpluses.

Mr. Chapoton. Let me give you the figures under the first budget resolution. The deficit in fiscal 81 would be $51.25 billion.

Senator Packwood. We are already at 58 for this year. We are likely to be at 62 or 63.

Mr. Chapoton. I am giving you under the budget resolution.

Senator Packwood. I understand that. We are at 58 in our estimates now.

Mr. Chapoton. Well, we are at 58 but that was based on the original tax proposal so you have a reduction in the last.

Senator Packwood. All right. Your new tax proposal for fiscal 81, what is the deficit?

Mr. Chapoton. The deficit would be 51.25.

Senator Packwood. Okay.

Mr. Chapoton. In fiscal 82, the deficit would be 21.15.

In fiscal 83, 11.05 --

Senator Packwood. And then $6 billion surplus in 84.

Mr. Chapoton. Well, let me correct that because it is 4.65 in fiscal 84.

Senator Packwood. Let's call it 5, round it off.

Mr. Chapoton. Okay.

Senator Long. What's that figure for 84? I didn't get.

Senator Packwood. $5 billion surplus.

Mr. Chapoton. $4.65, $5 billion.

Senator Packwood. And you were presuming that the difference between your static loss of $150 billion in the $5 billion surplus is going to come about totally through reduced spending and reflows because of the energized economy?

Mr. Chapoton. That is correct.

Senator Packwood. Now, next question. Do you have any evidence that the $200-$400 savings incentive has induced more savings?

Mr. Chapoton. No, we do not have any evidence of that. It is very difficult to determine that. You can analyze it in various ways, but we don't have any direct evidence.

Senator Packwood. Well, let me ask you this. Isn't the evidence pretty much the other way? It has not induced any new savings.

Mr. Chapoton. I just don't think there is any evidence one way or the other except it clearly does not have any increased savings for someone who already has saved an amount that produces capital income --

Senator Packwood. What is the point of putting it in if it doesn't increase savings?

Mr. Chapoton. Well, I think there are a number of points. One, it is certainly a symbolic matter that the policy of the Federal Government encourages savings. It does keep the pool of savings that you already have that people that are affected, that is at the margin, that do say do have $400 of interest and dividends. They would be affected if you remove it.

And in addition, it does have a major simplicity affect. People that have small amounts of capital income, of whom there are a lot, do not have to report these small amounts.

Senator Packwood. Don't mistake me, I have no objection to encouraging savings. I wish we had some reduced dividend exclusion, increased dividend exclusion here too. All I am saying is to reach a reasonable revenue loss and I have asked the Congressional Budget Office, the Library of Congress and Treasury and I cannot get any evidence that, indeed, it induces any savings.

Mr. Chapoton. We look at the overall savings rates and a lot of things go into that mix. The treatment of interest on the other side. The deductability of interest is a major factor, as you well know.

It is difficult to isolate what happens from any particular change in the tax law.

Senator Packwood. I have no other questions.

The Chairman. Senator Symms.

Senator Symms. Thank you, Mr. Chairman.

Just to pursue that line of questioning a little bit, that Senator Packwood started with you. What would be wrong in the area of savings exclusions, to approach it from a percentage. Whatever we are going to do, start in a direction of hopefully our goal would be at the end of five years, there would be no taxes on savings and dividends and start heading in that direction.

Would you look favorably on that?

Mr. Chapoton. Well, that, of course, is a very major concern --

Senator Symms. If we want to do something to help this economy, I think that would do it overnight.

Mr. Chapoton. Well, you have to -- a percentage -- I think you have to deal with all capital income, not savings and dividends if you are talking about something that major; if you are talking about encouraging savings.

You have to do something on the interest side so you simply don't have a borrowing to invest, the interest deduction side, so you don't simply have borrowing where there is an investment in capital.

Senator Symms. Well, you know, Senator Schmitt has a bill which I support, which starts off with a 5 percent exclusion on savings and dividends and works its way to 25 percent and removes the tax deduction for consumer debt.

It seems to me like that would be a very health thing to do. I guess you look at it favorably, but you don't want to get it in the first tax bill?

Mr. Chapoton. Well, I can't say that we look at it favorably at this point, Senator.

I will repeat that we think that savings will receive a big boost from this package. We will see a significant increase in the personal savings rate.

We have studied that savings incentive, along with all others. That, of course, as you well know, is very, very expensive.

So, we have not gone forward with that or any other savings incentive of that magnitude at this time.

Senator Symms. Well, I guess all I was trying to say is that in order to make these things simple and understandable, it would appear to me whatever we are going to do, if we just start in a direction and say we can only afford to do this much, this year. It would be a healthy way to go about it, to start a general trend which would encourage it.

If people knew that they were going to get a bigger savings exclusion in the future or earned income from interest, I would think they would start saving money now so that they would be able to participate in a bigger way later if they knew it was coming down the line. It might be something to consider.

Back to the estate tax that Senator Byrd and Senator Boren were asking you about. In view of the fact that we have raised no revenue from the generation-skipping tax up to date, and they project we may raise as much as $40 million or $100 million over the next 40 years, and in view of the fact that it costs absolutely hundreds and hundreds of thousands of dollars of wasted man-hours to try to calculate this thing out for the generation skipping ideas that people come up with, why not just include abolishing this in this package? It would be almost minimal on revenue loss.

Mr. Chapoton. Well, this package, of course, is not totally constructed on the revenue losses.

As I mentioned earlier, we do want to take a look at the overall estate and gift tax field. That is very near the top of the things that should be examined, generation skipping tax.

But, we are going on one single area this time. That is really all we are prepared to do at this time, Senator. There are a lot of problems in the estate tax laws and gift tax laws that should be examined.

Senator Symms. Well, I think that from my discussions with the President himself, that he shares my view on the estate and gift tax, the death tax, as it is commonly referred to.

That the only fair, proper, equitable answer to it is to completely get rid of it. How you get from where we are now to there.

So, if we put in this section in the bill that you suggested, do we have the assurance from Treasury that in the second tax bill we can make further reforms?

Mr. Chapoton. We have assurance that we are studying the matter for the future tax bill; yes, sir.

Senator Symms. The other day when we met with Secretary Regan, I asked a question about how much it would cost to phase this thing out. I see, according to your figures, you have by 1984, it would be a $3 billion revenue loss to Treasury.

What is it -- a $6 billion revenue -- $6.5 billion now?

Mr. Chapoton. I think that is close to present levels. Of course, the estate tax receipts will go up in the out years.

This is roughly -- eliminates half the estate tax, receipts from the estate tax.

Senator Symms. That is over a three-year period. That is through 1984.

Mr. Chapoton. Right.

Senator Symms. Well, would it be simpler to, if we are considering that is the direction we are going, just to compute the tax, based on the present statute and not change the statute, but just say that next year we will reduce the tax that you would have to pay by 25 percent of what it would have been this year and the next year reduce it by 50 percent.

Mr. Chapoton. Well, one of the real benefits of this change is you exclude a lot of the states, a great number of the states from having to file estate tax returns at all.

So, you achieve a real simplification.

Senator Symms. Well, I think -- I mean, I personally think this is a real healthy start in the right direction. I just don't want to have us think that for some reason, if we are going to have a continuation of printing press money, well then, we are going to have a continuation of declining values of money, of the dollar, so the estates are going to get bigger numerically, although they are not more valuable.

Would you look favorably upon indexing those estates -- that $600,000 number so that every year it goes up, whatever the general rate of inflation is?

Mr. Chapoton. I think I would put that off, Senator, until we see what we are going to do with estate and gift tax laws permanently.

Senator Symms. Very well.

Thank you, Mr. Chairman.

The Chairman. Senator Chafee.

Senator Chafee. Thank you, Mr. Chairman.

Mr. Chapoton, I would like to thank you for the support on the 911. I appreciate that. I am delighted it is going to be in the bill.

I would like to turn to the savings, if I might, again.

I know it has been discussed here, but I would like to pursue the IRA business. It seems to me that this legislation is very slim on encouraging savings. I know you have the $200 and $400, but we have that anyway. So, that is not a step ahead.

Now, on the IRA's, true, you have gone up $500, without the percentage limitation in there. But, the legislation I was interested in permitted two things.

One, it permitted the IRA's, all of them, to go to $2,000. But, of equal importance, it also permitted the withdrawal for education and for first payment of a home.

Now, IRA's haven't caught on very well. I think primarily, one may be the percentage factor. But, the other is for young people, there is no real inducement to go into them.

I think we need an incentive for the young people to get into them.

Could you address that? The losses in savings, it seems -- the losses in revenue would seem to me, to be very modest.

Now, I am sure you have heard that about every presentation of any item. But, if the objective is to increase savings, and also, this ties in with the perils of the Social Security, people depending more and more on a fund that has its own difficulties, an objective to try and make that fund a supplement rather than a main reliant. It seems to me something like expansion of the IRA's is very important.

Mr. Chapoton. Of course, we came to that conclusion. I must say, we looked at the IRA expansion as a significant factor in taking some of the pressure off Social Security.

To the extent there is utilization, it will relieve some of the pressure.

To the extent you -- the benefit for retirement, you delete the benefit of the IRA on retirement, or taking the pressure off Social Security. If you allow withdrawls for housing or for education, you dilute that benefit.

You do, of course, make young couples, much easier for them to go in to utilize an IRA. If they are going to have these expenses, they can see these expenses coming and they are not willing to put aside money that they cannot get to for those purposes.

So, we have discussed those concerns with a lot of people.

We have come down on the side, that, to the extent the IRA is a savings incentive, and it is that to an extent.

Equally important, perhaps more importance is the Social Security aspect of it. We would not want to dilute that by the allowing of early withdrawal for whatever purpose.

Then, you have to decide what is the desirable purpose. Is it a medical emergency? Housing? Education? Which housing qualifies? Casualty Loss?

You raise a lot of problems what this money was put in there for the first place.

Senator Chafee. Yes. I can see your rationale on maybe opening the door and everybody wanting to come in for some type of specialized saving purpose.

But, those two that I mentioned and that we have in our legislation, Congressman Moore, as you know, in the House, is co-sponsor.

It seems to me that are items we are all going to confront, and particularly act, as I say, as an inducement for the younger people to get into it. Because the objective of the exercise isn't solely the supplements of the Social

Security. That is an objective.

Another objective is to have increased pool of savings out there available for the good of the Nation. If the young people won't go into them, then we are cutting off a very substantial number of our potential savers.

Mr. Chapoton. Of course, a lot of that savings we know is going on now, because young people do save for housing. They do save for the education of their children without the tax benefits.

So, there is a good amount of savings that is already occurring for those two purposes. You wouldn't have a net increase if you gave a tax deduction.

Senator Chafee. Except the amount of withdrawals we permitted was limited to $10,000. So you are not going to go very far with that.

Mr. Chapoton. No, I mean independently of any specialized savings incentives, young couples save for houses.

Senator Chafee. Oh, I appreciate that. But I think this would be an added -- I don't think it would be in lieu thereof. I think it would be a plus.

But why did you have the limitation of the $1,000 for the person in a qualified plan?

Mr. Chapoton. We have to be very careful in giving tax benefits to persons for IRA in a qualified plan or we undermine the integrity of the employer-sponsored plan system, which is the major thing that takes the pressure off of Social Security. If it is too beneficial, if you can do it independently, then we will not have the pressure to have employer-sponsored plans, and that would be a serious blow to the private pension system.

Senator Chafee. It does seem a little unfair that the person, the self-employed, gets $15,000 on the Keogh, and the person without a qualified plan can only go to $2,000.

Now, is the incentive there, you are afraid to make it too attractive for fear that the incentive to have a qualified plan will be lost?

Mr. Chapoton. That's correct.

You make a good point on the comparison of the Keogh. Of course, the Keogh plan, the self-employed person does have to cover his employees.

So, to the extent he has a number of employees, we achieve our purpose of broadening the base of the private retirement system.

To the extent he doesn't have a number of employees, it doesn't have that effect.

But there is just a give and take between the regular corporate plans, the Keogh plans and then the IRA's at the lower end.

Senator Chafee. Well, Mr. Chairman, my time is up. Did someone else want to go?

The Chairman. I had a couple of questions.

Senator Chafee. I wonder if I could ask?

The Chairman. Yes.

Senator Chafee. Well, my principal thrust is on the IRA's. I would hope, as we get into the mark-up, we could give some more thought on that.

If you have any revenue loss figures on what it cost to go to the $2,000, I would be interested in.

The next point is on the small business. Now, as I see this, we haven't done anything for small business. Did you do anything about increasing the corporate surtax exemption to $200,000?

Mr. Chapoton. No, we did not.

Senator Chafee. What is in it for small business?

Mr. Chapoton. Senator, that question arises again and again. But, small business gets a lot out of this proposal.

Number one, the individual rate reduction --

Senator Chafee. Yes. I don't buy that, though. Because, most small businesses that employ any number of employees up beyond ten, I suspect are incorporated.

Mr. Chapoton. The statistics show that well over half are not incorporated. Now, in terms of dollars, obviously the larger ones are incorporated.

Senator Chafee. I interrupted you, go ahead.

Senator Symms. Excuse me. How much is that revenue loss? I think your suggestion is a good suggestion.

Senator Chafee. We always had -- we had it last year. We must have the figures. You are talking of exempting the $200,000?

Mr. Chapoton. Approximately $2 billion.

Senator Chafee. $2 billion?

Mr. Chapoton. Yes.

Senator Chafee. Okay. Go ahead. Mr. Chapoton, you were listing some of the benefits for small business.

Mr. Chapoton. The small business benefits like the individual deduction, they benefit in the depreciation proposals, certainly, significantly.

Like all other taxpayers, they benefit more or less in the other provisions, along with other taxpayers, the other changes in the law, but particularly -- the other proposals, but particularly small business, number one or two on the small business list is estate and gift tax relief.

So, we do consider that a major benefit for small business.

Senator Chafee. Did you do anything about the investment tax credit on used machinery?

Mr. Chapoton. No, we did not.

Senator Chafee. Thank you, Mr. Chairman.

The Chairman. I might say to Senator Chafee that others have expressed that same concern. Though I can't suggest anything other than what the President has suggested, there may be ways to accommodate a couple of those concerns, hopefully.

I want to ask just a couple of questions. Senator Bradley has some other questions. I think first, if there is any doubt about what we did earlier here on the vote, without objection, was to somehow cap that capital gain, made effective as of today.

There wouldn't be any question in the minds of anyone.

Hopefully, the House might take similar action. I don't want to make the House nervous if we are over here marking up the bill. That just happened to occur to us in the process of this discussion. We thought it best to deal with it.

So, if anybody in the House is listening, why we are not in a race to see who can mark up the bill first, but neither are we in a race to see who can make up the bill last. That will depend on what happens on the House side.

Is there some area -- you know, we have a number of these provisions are phased in. There are a number of members of Congress in both parties, concerned about the deficit in the out years. That has been expressed here this morning.

There are also members on this committee and others, who are concerned about adding more provisions to this bill which would really have an impact on deficits in out years.

One way to accommodate some of that would be to stretch out the phase in of some of these provisions. I am not asking you to comment on that. But that may be one area, one thing we may look at in this committee, whether it would be the marriage penalty or the estate tax or whatever, if in fact there is some way to accommodate some of the other concerns without having a Christmas Tree approach.

So, I just say, as a matter of information, that has been discussion. Now, whether or not the President would buy that, I can't say.

Mr. Chapoton. Mr. Chairman, let me just comment that these additional items, I know it is the President's wish that this bill be restricted to the extent possible, that these items and these changes do represent a compromise.

He would hope that we would not have a number of additional items added.

The Chairman. Right. I understand that. I think one way to make certain that happens is some strong statement from the Administration, very soon, that there will be a second bill and that it will be supported by the Administration and there will be some way to pay for the things we do.

One area that has been suggested, and we will be meeting tomorrow morning, in Executive Session, at 10:15, to look at some of the sanitized returns on the straddle question. That could find its way into this proposal or some provision on straddles. There is some interest in that on both sides.

Secondly, and maybe again, just to indicate, we certainly commend the estate tax provision, for example. Take that as an example.

There may be some flexibility, as I understand it, in talking with certain people within the Administration, as long as we stay within the dollar limits, if in fact we can put together a better package, that might be acceptable to the Administration.

Would that be a fair statement?

Mr. Chapoton. Yes, sir. That would be correct.

Senator Chafee. Mr. Chairman, you meant overall? You are not talking just on the estate?

The Chairman. I am just talking about --

Senator Chafee. The total bill?

The Chairman. Right.

Senator Chafee. The total bill?

The Chairman. No, just the estate.

Senator Chafee. Just the estate.

The Chairman. That might also apply to the interest that you have in IRA's and others. We have informally just designated a little task force on the estate tax provision, a bi-partisan group, to see if there isn't -- we may find there is no better way to do it.

We will be consulting with our staff and the Joint Tax Committee and Treasury as we proceed on that.

Mr. Chapoton. Good. That is fine.

The Chairman. I don't want to lead anybody to believe we can change it and then someone will say we can't change it.

But, I would say that I think we made progress this morning. You have had a chance to hear some of the concerns expressed by members on both sides.

I would guess we could move very quickly on the Senate side, at the appropriate time.

We appreciate very much your presence this morning.

Senator Bradley has some additional questions. If other Senators have additional questions, if not, I will give Bill all the time he needs.

Senator Bradley.

Senator Bradley. Thank you, Mr. Chairman.

I would like to just clear up a couple of points. The last series we talking about the withholding rates and when they would go into effect.

The result being that the real impact of the tax cut would be felt in July, 1982. I remain dubious as to whether the economic rationale for that is as clear or as justified as the political rationale.

But, I would like to move on from that question to one that deals with depreciation. Last week, Secretary Regan told us in several meetings, that he did not want the depreciation changed that was more generous than expensing.

Now, have you changed the depreciation proposal from last week to this week?

Mr. Chapoton. The change -- this entire package contains the change that goes to the point that you are making.

In '85 and '86, we would move back to the original rate of recovery in this equipment class to 200 percent declining balance.

As you know, it would be 150 percent, starting this year and goes through 1984; 175, in '85, and 200, in '86.

Senator Bradley. Why have you chosen to offer a depreciation plan that is more generous than expensing?

Mr. Chapoton. Well, the expensing question is wholly dependent upon the assumptions of the discount rates, as you know.

Senator Bradley. What is your assumption?

Mr. Chapoton. Well, if you use a 12 percent discount rate --

Senator Bradley. What is your assumption on the inflation rate?

Mr. Chapoton. The inflation rate is built in to whatever discount rate.

Senator Bradley. That is right. What is your assumption?

Mr. Chapoton. Just a minute.

(Pause.)

Mr. Chapoton. The deflater would be 9.9, in '81; 8.3, in '82; 7, in '83 and 6, in '84.

Senator Bradley. That is what you figured into your discount rate?

Mr. Chapoton. Well, Senator, you arrive at an appropriate discount rate taking into account what you think inflation is going to be.

Senator Bradley. With that, what is the effective tax rate on various categories of assets?

Mr. Chapoton. At a 12 percent discount rate, the effective tax rate is right at 46 percent.

Senator Bradley. Is that true for all categories of asset? I would like to ask the Joint Tax Committee if they can tell us what is the effective tax rate for each category of asset?

Mr. McConaghy. Senator Bradley, if, using different discount rates, the proposal would be more generous than expensing, and then there wouldn't be a positive effective tax rate.

There would not be a positive effective tax rate. If, on the other hand, it wasn't as generous --

Senator Bradley. Could you start again, Mark? I didn't hear.

Mr. McConaghy. Sure.

If the proposal were more generous than expensing, then there would not be a positive effective tax rate. Pure expensing would mean in effect, a zero tax rate.

If it were less generous than expensing, then it would be a positive effective tax rate.

Senator Bradley. What is your analysis, the Joint Tax Committee's analysis of whether the Administration's depreciation proposals result in a negative effective tax rate for any category of asset?

Mr. Chapoton. Senator, if I might interject one thing. The 46 percent rate, that is incorrect. It would be approximately a zero percent rate.

Forty-six percent would be the present value benefits of the deduction. It would be approximately zero percent, a zero tax rate, at a 12 percent discount rate.

Senator Bradley. Is that the Joint Tax Committee? Do you agree with that?

Mr. McConaghy. Through 1984, we would agree.

Senator Bradley. What about '85 and '86?

Mr. McConaghy. Then it would be more generous than expensing.

Senator Bradley. Then it would be a negative effective tax rate, more generous than expensing?

Mr. McConaghy. If you use the discount rates of 12 and 46 percent rate, yes.

Senator Bradley. That isn't what I understood the proposal to be last week, when Secretary Regan explained it to the Senators.

I was curious. What happened?

Mr. Chapoton. The proposal has been adjusted to move back to the original proposal as I have explained. So, it is an adjustment. It is closer to the original proposal of 200 percent or is the original proposal, 200 percent in the out years.

Senator Bradley. So that basically what the Administration has done is to back track on the commitment to make depreciation no more generous than expensing?

Mr. Chapoton. Senator, let me say again, it all depends on the discount rate assumption that would be applicable in 1985 and 1986.

The more generous depreciation would apply to property placed in service after 1984. You would have to look at the appropriate discount rate at that time, to make that determination.

Senator Bradley. What would be inflation rate or discount rate have to be then, for it to be no negative tax?

Mr. Chapoton. About at 17.5, 18 percent.

Senator Bradley. At 18 percent inflation?

Mr. Chapoton. Yes. Some companies argue -- no, not inflation. Excuse me. The discount rate. That is real rate of return, plus inflation.

Senator Bradley. Right.

Mr. Chapoton. Some companies argue that their internal rate of return is in that range now. So that indeed, it is not faster than expensing.

Senator Bradley. So that you need an inflation rate of 6 percent in order for that to happen?

Mr. Chapoton. You would need an inflation rate of higher, approximately 12 percent, I would say.

Senator Bradley. A 12 percent inflation rate?

Mr. Chapoton. Something like that.

Senator Bradley. By 1984?

Mr. Chapoton. Whenever you are making the --

Senator Bradley. Well the Budget's assumptions for the inflation rate in 1984 is 6 percent, not 12 percent. So, you know, you can't have it both ways.

Mr. Chapoton. Well, Senator, I --

Senator Bradley. You would have to concede an inflation that is going to be much higher than the budget has assumed or that you are going to have a negative effective tax rate.

Mr. Chapoton. There will be ample time between now and 1985, if it is decided that cost recovery is too generous.

Indeed, the point we are trying tomake here is that we want business to plan on making the capital investment. That is the point of this whole program.

There is a lot of argument about whether the discount rate should be anything below 18 percent now.

Senator Bradley. You know, there are some people that say your enthusiasm for the proposal that Secretary Regan conveyed to the Senate last week is in inverse proportion to the number of Lear Jets that landed at the National Airport.

Mr. Chapoton. I --

Senator Bradley. Is there any truth to that?

Mr. Chapoton. I don't believe there is any truth in that.

The Chairman. They weren't all Lears.

(Laughter.)

Senator Bradley. They weren't all Lears?

(Laughter.)

The Chairman. No.

(Laughter.)

Mr. Chapoton. Senator, this -- the encouragement of capital investment in this country is the major thrust of this program. So, you want business to be very upbeat about it. You want the activity that we expect out of this bill so it is a proper consideration that business be happy.

Business is what creates the jobs. We are trying to get capital investment moving ahead again in this country.

Senator Bradley. Well, I think there are many things in this bill that I think we should do for business.

I think removing the tax of 70 percent on investment income down to 50 is a very important incentive.

I also think we have to do something about depreciation. But I would like to do it so that you are not more generous than expensing. That was my impression that the Administration was on line about that, and suddenly, over the week-end, on a Sunday talk show, we had Administration officials saying, no, they were going to back away from the commitment that they made to the Senate last week, and they would provide in the out years, what will amount to a negative effective tax rate more generous than expensing.

You know, the rationale -- I mean, I would assume that when the Administration arrived at the proposal that the Secretary of the Treasury conveyed to us last week, that they had thought about what they needed to encourage business to make investment.

It is -- well, it is not too hard, but it is -- the change over the week-end raises some questions I think about whether the depreciation component of this bill is in the best interest of everyone.

As the Chairman knows, you can't really say, as we have in this committee, that many people who have traditionally been entitled to certain program benefits, can't have those benefits.

And, on the other hand, say we are going to be more generous to other segments of our economy. That is a troubling aspect. I wanted to confirm that indeed, you have adopted the negative effective tax rate.

Mr. Chapoton. I think that overstates it. You have to wait and see what the appropriate discount rate is in 1985 to determine.

Senator Bradley. Well, if you haven't adopted a negative effective tax rate, you are saying the Administration's assumptions about inflation are all wrong and you have to get a 12 percent inflation rate.

I mean, the budget assumes a 6 percent inflation rate.

Mr. Chapoton. Correct.

Senator Bradley. If you have a 6 percent inflation rate, there is no way that under this proposal, that you are going to be able to prevent a negative effective tax rate.

Mr. Chapoton. That is undoubtedly the case. If that occurs, at that time, then that would be something this committee might want to consider.

It is important, however, that this depreciation provision work. That is to have business encouraged about it, to have business making the investment. It is the whole point of the exercise.

Senator Bradley. So, you are saying that if indeed, it turns out in '84 or '85 that there will be a negative effective tax rate, the Administration will come back in here at that point and tell us that is not what we intended here?

Mr. Chapoton. No. Senator, I am not saying that. I am simply saying you have a lot of time to look at it between now and 1985, and indeed, to examine the question which is relatively new I think before this committee, on what is the appropriate discount rate to use.

Because the argument is made with a lot of validity, that you should split out the investment tax credit. That indeed, when the investment tax credit came in, with the appropriate discount at that time, it was more beneficial than expensing.

Senator Bradley. Fine. We won't continue on that line.

Let me ask you one other thing. It is late. Is there any reason why you haven't provided for, under your IRA and LIRA proposal, deductions for pension plan contribution?

Mr. Chapoton. Yes, we have examined that. There are two aspects. You can talk about voluntary contributions or mandatory contributions.

In both cases, as you know, there are severe restrictions, in both cases tremendous complexity, because there are severe restrictions on contributions to IRA's; that is, you can't withdraw it before age 59, none of which would apply to normal, most of which would not apply to normal pension plans.

You somehow have to segregate the amount that is in the pension plan. We think it is much easier to have it put in a separate account that is, can be administered separately.

Indeed, if the employer wants to sponsor an IRA, he can do that as well, can facilitate contributions to IRA's for his employees.

Senator Bradley. Well, you know, the Chairman and Senator Chafee have also heard from a great number of people who feel it is really a kind of bias away from plans that have been kind of thoughtful and have been fully funded.

Is that something the Administration is absolutely committed down the line to, or is that one of these areas where we are going to be able to have some negotiation?

Mr. Chapoton. Are you talking about the voluntary contributions or mandatory contributions?

Senator Bradley. Mandatory.

Mr. Chapoton. I think in mandatory contributions we have a lot of problems with, because for one thing, you are giving deductions for contributions that are already required to be made. So a significant amount of the revenue loss does not increase savings.

Senator Bradley. What is the revenue loss?

(Pause.)

Mr. Chapoton. Oh, it is in -- in the -- these figures were run sometime ago, Senator, but in the range of $2 billion.

Senator Bradley. $2 billion.

Mr. Chapoton. Yes, sir.

Senator Bradley. $2 billion, if you allowed mandatory plans to deduct employee pension contributions?

Mr. Chapoton. Up to $1,000; correct.

Senator Bradley. Well, it is something we ought to look at.

Mr. Chairman, I do have a number of further questions, but I am a half hour late now for a meeting.

I wonder if there is any chance we could have Mr. Chapoton back up sometime?

The Chairman. Yes, he will be here for eight years, at least.

(Laughter.)

Senator Bradley. Mr. Chairman, I am not sure his wife will agree.

(Laughter.)

The Chairman. I think his son is President. If not, we will have Mr. Chapoton back, and his son is President, right, or was.

Senator Bradley. Right.

The Chairman. Speaking of talk shows, I remember hearing some fellow, I don't remember his name, on Sunday. He was talking about somehow all these amendments are all stolen from the Democrats.

Have you been out doing any of that?

(Laughter.)

Mr. Chapoton. No, Senator. We thought we developed these proposals with the help of the Republican members of this committee and the Republican members of the Ways and Means Committee.

The Chairman. Plus, I think there were a lot of Democrats, a lot of bi-partisan --

Mr. Chapoton. Well, certainly, these proposals, most of them were very popular on both sides of the aisle, unquestionable. We talked to Democrats on both committees, as Senator Bradley knows, and as you know, and to the Republicans, at length, on both committees.

The Chairman. I think at best it was petty larceny, but I think the point is there is a great deal of interest, bi-partisan interest in this proposal, as you have seen evidence of this morning.

There is a strong base of support in this committee and in the Senate for the President's Program. We do hope there is some, in some small way we might make some adjustments.

I just indicated to Senator Chafee that maybe in the IRA's, Keogh's, LIRA's, the $200 to $400 exclusion on interest and divident income, we might even make some suggestions in that area, as long as we don't violate the sort of informal dollar limit that has been set by the President.

Mr. Chapoton. Yes, sir. I will state again, I think we would like to stay as close to this package as we can.

The Chairman. Senator Chafee.

Senator Chafee. Thank you, Mr. Chairman.

Mr. Chapoton, a couple of points. First, I have had indications on the mandatory contributions that what people will do will be to change their pension plans.

First of all, defining the difference between voluntary and mandatory is extremely difficult, apparently.

Mr. Chapoton. It is difficult, correct.

Senator Chafee. Secondly, apparently many will make a change in their pension plan to fall within the voluntary contributions.

So, you may lose that money anyway.

Mr. Chapoton. Senator, in this proposal we do not allow deductibility of voluntary contributions to an existing plan, because the complexity is just overwhelming. We think it can be facilitated by an employer-sponsored IRA for his employees, that wish to contribute.

Senator Chafee. Let me move on to something else, briefly.

I now want to discuss the depreciation of buildings in

15 years.

Now, it seems to me that if the thrust of this program, as I understand it is to renew the industrial competitiveness of the United States, to increase savings, to encourage greater capital investment and make us more competitive, industrially, as I have mentioned.

I have trouble getting very enthusiastic about the early depreciation of buildings. Machinery and equipment, yes, and buildings you brought to 15 years.

Could you discuss your rationale? Why not go to 20 years?

Mr. Chapoton. Well --

Senator Chafee. I think that will get the attention of a lot of people in this audience if we discuss this.

(Laughter.)

Mr. Chapoton. Keep in mind that under component depreciation it varies all over the lot where the present life, present depreciation life of a building is.

But in many cases, through component depreciation, the life is quite short under existing law, perhaps as 21, 22 years, particularly.

Senator Chafee. Well, certainly many buildings are at 40 years.

Mr. Chapoton. Well, that is correct. That is the shell is at 40 years and then what you add to it is less. But a lot of buildings, you are correct, particularly industrial structures are at substantially longer lives.

They have all long made the argument, however, with a good degree of validity, that their investment in productivity is their investment in plant and equipment and there is no reason to distinguish between the plant and the equipment.

Indeed, why doesn't the credit apply to the plant as well as to the equipment.

The argument is hard to dismiss.

Senator Chafee. Are you talking manufacturing establishments, now?

Mr. Chapoton. Manufacturing and retail distribution type facilities, definitely.

When you get into the office buildings, the argument probably is not it doesn't hold true as well, but in that case is where we know the component depreciation lives are very short, already.

Senator Chafee. Well, we obviously recognize that there can be an argument made in favor of any of these depreciation schedules. That they should be more paid. What we really ought to do is go to expensing. But, we are working within a limited amount of money here and it just seems to me that I would prefer to encourage industrial productivity, savings, by making cuts in those areas and cutting back on the rapid depreciation, what I consider to be pretty rapid depreciation of buildings and equipment, which I don't think will affect the industrial capacity of the Nation to a significant degree.

I mean, if you took these buildings back to -- well, let us take 20 years, would we pick up much revenue?

Mr. Chapoton. You do not pick up a lot of revenue. Let me see if we have that figure immediately available.

Senator Chafee. Because as you recognize, in these depreciation schedules, we have a group that probably you heard from already~~, which are those, the utilities who are~~ put in the 10, who are in a competitive situation with non-regulated utilities, with non-regulated industries, that are at the 5.

Is that not so?

Mr. Chapoton. There is a limited area of that, Senator I think it is quite limited. I think that is not a significant problem.

Senator Chafee. Now, I am not saying that we could solve that problem with what we pick up by the buildings going to 20, but I have trouble understanding the rationale for certainly the buildings at 10 and 15 is better. But, I can't see much harm in going to 20, if we could pick up some revenue and use it better elsewhere.

(Pause.)

I know the retail arguments. I have heard those presentations made.

What is the answer? Do we pick up much?

Mr. Chapoton. The answer is in a $1 billion, $2 billion range. We have a good figure on that.

Senator Chafee. You mean overall?

Or Annually?

Mr. Chapoton. Annually. About the third year out, 1983, approximately. But, let me give you a good figure.

Senator Chafee. Could you do that?

Mr. Chapoton. Yes, sir.

Senator Chafee. I would appreciate that. That would be helpful as we try and consider some of these other items if you could give us what we pick up by putting the buildings at 20.

Mr. Chapoton. Would you include commercial and industrial, or housing as well?

Senator Chafee. Well, let's take them all and then maybe you could segregate out the low income housing and give us a separate figure on that.

Mr. Chapoton. Yes, sir.

Senator Chafee. But all the rest, commercial, industrial, all of them at 20.

Mr. Chapoton. A 20 year, 200 percent declining balance. Of course, now --

Senator Chafee. You have 150. Haven't you 150?

Mr. Chapoton. No, it is 200 percent now.

Senator Chafee. Oh, you changed that.

Mr. Chapoton. Yes, sir; it is 200 percent.

Senator Chafee. Since this was printed, this material?

Mr. Chapoton. No, what you have before you should say 200 percent on the buildings.

The equipment is 150 percent.

Senator Chafee. Well, I have all structures at 15 years, under 150 percent declining balance, low income rental housing at 15 years under 200 percent.

Is this outdated?

The Chairman. Is that today's?

Mr. Chapoton. That was a prior one.

The Chairman. I think that is before the modification.

Senator Chafee. Well, okay, stick with your 200 percent.

Mr. Chapoton. Yes, sir.

Senator Chafee. Just tick it out another five years. See what happens.

Mr. Chapoton. Yes, sir.

Senator Chafee. See what happens.

Mr. Chapoton. Okay. We will do.

Senator Chafee. Thank you.

Thank you, Mr. Chairman.

(Material to be submitted.)

The Chairman. I want to thank you, Mr. Chapoton, and your staff for an excellent job. I think it has been very helpful to the members of the committee and the Joint Tax Committee, members of our staff. We appreciate your efforts.

We meet again tomorrow, at 10:00 o'clock for nominations and then at 10:15, in executive session, on straddles.

We will be meeting soon to mark up this legislation.

In the meantime, we will be working with the Administration in some of the areas that have been mentioned this morning.

Thank you, again.

Mr. Chapoton. Thank you, Mr. Chairman.

(Whereupon, at 12:40 p.m., the Executive Session adjourned, subject to the Call of the Chair.)
