

ORIGINAL

UNITED STATES SENATE

HEARINGS

BEFORE THE COMMITTEE

on
FINANCE

EXECUTIVE SESSION

Tuesday, June 23, 1981

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EXECUTIVE SESSION

Tuesday, June 23, 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, Danforth, Chafee, Heinz,
Wallop, Durenberger, Armstrong, Symms, Grassley, Long, Byrd,
Bentsen, Matsunaga, Moynihan, Baucus and Bradley.

1 The Chairman. I indicated yesterday that we would
2 take up IRA's, retirement savings for self-employed, incen-
3 tive stock options, incentive credit for -- investment credit
4 for use property.

5 I wonder if we might move to number 14, on the index,
6 investment credit for use property.

7 Mr. Chapoton can explain that provision. I don't
8 think there is any controversy. It is something that small
9 business in particular had a great interest in.

10 We -- the Administration was persuaded to include
11 it. I hope it is fair to say the Administration has no
12 objection to that provision.

13 Mr. Chapoton. That's correct, Mr. Chairman.

14 The provision, as we understand it, would allow a
15 full --

16 The Chairman. If we could have order in the hearing
17 room.

18 Thank you.

19 Mr. Chapoton. -- full investment tax credit for the
20 cost, purchase price of used property, at the same time the
21 seller of that property would be required to recapture a
22 like amount, the investment credit he had claimed on the
23 property when he originally purchased it.

24 So it would -- but it would allow full investment
25 tax credit on the purchase of used property.

1 The Chairman. Do we have figures from the joint
2 committee or the staff on the cost of that proposal?

3 Mr. McConaghy. We think, Chairman Dole, that it
4 would be fairly revenue neutral. We don't have any specific
5 number, but it would not gain or lose a great deal of
6 revenue.

7 It is intended to provide some ease of -- take the
8 cap off used property for the smaller businesses.

9 The Chairman. That is one of the items that we had
10 a number of task forces, that included members on both
11 sides and their staff.

12 I think Senator Durenberger, that was one of the
13 matters discussed in the small business task force.

14 Is this provision satisfactory with the members?

15 Senator Durenberger. Yes, Mr. Chairman. As you point
16 out, we considered this issue last August and included it
17 in that bill.

18 It is one of the issues that helps a very large
19 proportion of small business. It is essentially revenue
20 neutral, since it has a recapture provision on the ITC on
21 behalf of the seller, but it is just awfully important to a
22 lot of small business people, particularly now, who can't
23 afford the purchase of new equipment.

24 Yes, it is satisfactory to bi-partisan members.

25 The Chairman. Is there any objection to that

1 provision?

2 (No response.)

3 The Chairman. If not, we can agree to it on a
4 tentative basis. If someone finds some need to address
5 it further, we will be happy to do that.

6 I wonder if we might move to number 10, on that page,
7 the crude oil windfall tax royalty owners credit and have
8 that explained.

9 I know Senator Bentsen has maybe separate amendments.
10 I don't think you have any amendments to this provision.

11 Senator Bentsen. The Chairman is correct. I am
12 running some more numbers. If it does not create undue
13 delay, I think I would like to bring mine up tomorrow, after
14 I can give you numbers that I know you are going to ask
15 anyway.

16 Mr. DeArment. Mr. Chairman, under this proposal,
17 we would expand and extend the provision that this Committee
18 added in the reconciliation bill last year.

19 As you recall, last year we allowed a \$1,000 credit
20 against windfall profits tax liability for calendar year
21 1980. So that royalty owners were able to recoup the
22 windfall profit tax in 1980.

23 Now, in 1981, there is no similar provision. What
24 is proposed here is that that \$1,000 refund provision be
25 expanded to \$2,500, and made permanent.

1 It is also proposed that the Secretary of Treasury
2 would be directed to provide by regulations, procedures so
3 that royalty owners whose windfall profit tax does not
4 exceed \$2,500, in any year, would not have windfall profit
5 tax withheld.

6 That would solve the cash flow that many of the
7 small royalty owners experience where it may be 18 months
8 between the time that the windfall profits tax is withheld
9 and they get the refund of the tax.

10 The Chairman. Does the Joint Committee have numbers
11 on this proposal?

12 Mr. DeArment. I think it is about \$800 million,
13 in 1982, and then it drops down in subsequent years to
14 about \$600,000 million.

15 The Chairman. Maybe we could hear from Treasury on
16 this proposal.

17 Mr. Chapoton. Mr. Chairman, we have supported this
18 amendment. So, we have no objection. We do support it.

19 The Chairman. I think this is an instance where I
20 think there is strong bi-partisan support.

21 Senator Baucus has an interest in this amendment,
22 Senator Long, Senator Bentsen and myself, Senator Wallop.
23 I hope other Republicans and Democrats. But it does --
24 has anybody computed, we are not talking about oil
25 companies or people who get a great deal of royalty income.

1 As I understand, based on the base price and the
2 windfall profits tax, if you had royalty income in excess
3 of \$7,500, you would be -- that may be a ball park figure.

4 Mr. DeArment. That is correct, and indeed, for
5 certain other tiers, it may be royalty income less than
6 that.

7 The Chairman. Do you have any specific figures on
8 that?

9 Mr. McConaghy. We would show \$800 million going
10 down to \$500 million in 1985 and 1986.

11 The Chairman. But you agree with Mr. DeArment on
12 who it would apply to?

13 Mr. McConaghy. We think it would apply to people
14 as low as \$6,000, and as high as \$18,000, depending on the
15 mix of the oil.

16 Senator Bentsen. Mr. Chairman, let me congratulate
17 you on your work on this. I assure you it certainly is
18 bi-partisan. A number of us feel very strongly about it.
19 We have been pleased to work with you on it.

20 As you know, I called a meeting of royalty owners
21 down in Texas, for a Subcommittee hearing and we had over
22 3,600 of them turn out.

23 Most of those people are retired people. This is a
24 major part of what they live on. It is a substantial
25 supplement necessary one to their retirement.

1 The Chairman. Senator Boren and I had hearings in
2 Oklahoma and my state of Kansas and we had the same reaction.
3 I think there were just a number of royalty owners in
4 particular, land owners, most of whom in our audience were
5 retired land owners, who didn't realize they were going to
6 be taxed under the windfall profit tax.

7 They had heard a lot of statements made about big
8 oil. They didn't consider themselves in that category and
9 didn't worry much about it. Nobody back here -- some of
10 us on the Committee were worried about it. I know some of
11 us were, but they didn't have an organized effort.

12 So, in my view, this would address a real problem.
13 Senator Boren certainly had an interest in this also.

14 I hope we can pass it without objection.

15 Senator Long.

16 Senator Long. Let me just make this -- read this
17 sentence here, Mr. Chairman, so there can't be any misunder-
18 standing.

19 "The credit is available only to individuals,
20 estates and family farm corporations and not to other
21 corporations or trusts."

22 So this tax credit is not available to the oil
23 companies, generally speaking. They do not get it.

24 Mr. DeArment. That's correct.

25 The Chairman. Is there any objection to this

1 provision?

2 Mr. McConaghy.

3 Mr. McConaghy. We think that it might be desirable
4 to facilitate that rule on withholding to amend the Income
5 Tax Rules on estimated tax and withholding provisions to
6 permit facilitation of maybe reflecting it in both income
7 tax estimated and withholding.

8 Without that change, I don't think they can do it
9 on windfall.

10 Mr. DeArment. That would help those people who
11 might have slightly more than \$2,500 that might not be
12 affected by this change in direct withholding. They
13 could adjust their income tax withholding to take this --

14 The Chairman. It is a change we should make.

15 Unless there is some objection, we will do that.

16 This section will be tentatively agreed to, unless
17 again, someone at a later time would like to modify it
18 in some way.

19 Maybe we can move to -- Senator Packwood has a
20 direct interest in incentive stock options.

21 What about foreign earned income. We have Senator
22 Chafee here and Senator Bentsen. They both have an interest
23 in this. Could we take that up?

24 We could hear from Treasury first and then Senators
25 Bentsen and Chafee.

1 Mr. Chapoton. Mr. Chairman, we have proposed relieving
2 the burden on the earned income of individuals, Americans
3 working abroad along the lines of Senator Chafee's bill,
4 that is, an exclusion of the first \$50,000 of income earned
5 abroad, plus 50 percent of the next \$50,000, for a total
6 exclusion of up to \$75,000, plus a housing allowance.

7 The housing allowance we have proposed would be
8 the amount of housing in excess of 16 percent of GS-14,
9 grade 1, which is about \$6,000 now.

10 So, a housing allowance of \$6,000. That would go up
11 as the pay scale of that type of civil servant went up.

12 Basically, we think this would exclude a great
13 percentage, I have the percentage, I believe I have it
14 with me, of the income of Americans working abroad from
15 tax.

16 It would tremendously simplify the rules from the
17 present law which provides specific deductions in four
18 categories, for four categories of expenses, housing, trips
19 home, education and hardship pay or incentive pay, and has
20 caused a great deal of complication, unnecessary compli-
21 cation.

22 We think this would be a tremendous simplification,
23 and yet it would, for the higher income taxpayers living
24 abroad, would still pay tax on a portion of their income
25 above the \$50,000 range.

1 The Chairman. Senator Chafee.

2 Senator Chafee. Mr. Chairman, thank you.

3 This has been an absolute disaster, the foreign
4 earned income tax. I have held meetings with Americans
5 abroad on this, as I know Senator Bentsen has.

6 This bill will go a long ways toward solving the
7 problem.

8 Obviously, many would like us to go to the total
9 exemption of earned income abroad, such as is done in other
10 countries.

11 I think it is very important to point out we are
12 only talking about earned income. We are not talking
13 retirement income. We are not talking anything like that.

14 I think this will relieve about 75 percent of the
15 Americans abroad, of taxes. Then the 50 percent of the
16 income above \$50,000 would also be exempt to the extent
17 of a total of 50 percent of \$50,000.

18 The actors we passed in 1978, has caused a loss of
19 jobs of Americans abroad. But just as importantly, the
20 lost orders that come from not having Americans in those
21 crucial jobs.

22 So, I believe this will reverse that trend and
23 hopefully will start up again in the Americans that are
24 hired abroad.

25 Thank you, Mr. Chairman.

1 The Chairman. Senator Bentsen.

2 Senator Bentsen. Mr. Chairman, this one again,
3 could certainly be called bi-partisan. Because, as
4 Senator Chafee said, he held hearings on this. I held
5 hearings in the Far East. We looked at tax returns of
6 American nationals abroad.

7 We looked at the actual cost of hiring an American
8 national abroad and hiring a third country national.

9 Then we looked at the net result. It was costing
10 at least 50 percent more to hire an American national
11 and keep him abroad.

12 So what American companies were doing they were
13 replacing them with third country nationals.

14 Then that third country national, who is familiar
15 with the products of his own country, he would buy products
16 and sell products from the company he represented. But
17 when it came to all the supplementary things that were
18 needed to go with that, he turned around and bought from
19 his own country and recommend those. That is understand-
20 able.

21 So what was happening, we were losing substantial
22 exports abroad, and we were seeing American nationals
23 being returned to their home country because American
24 companies could not afford them.

25 We are seeing a situation where other countries

1 could not tax that income, of their nationals abroad.

2 I certainly agree with Senator Chafee that you
3 certainly have some kind of a cap on this. You can't have
4 a situation where an actor might go abroad for a relatively
5 short period of time and earn millions of dollars and be
6 totally excluded from tax.

7 So I think this is a reasonable compromise. I am
8 pleased to see the 16 percent put in there on housing
9 allowance. It is one of the things I have been espousing
10 for a long time.

11 I think this is a great step forward and I am
12 delighted to support it.

13 The Chairman. Would anyone else like to comment?

14 Mr. Chapoton. Mr. Chairman, let me mention one
15 thing that we -- it may be advisable and I would like to
16 work with the staff on this, to put some type of upper
17 limit on the housing cap. We haven't developed that yet.
18 Where you have a very high income, we would allow a very
19 high housing allowance because we have a floor but no cap.

20 It might be advisable to consider some type of cap.
21 But we haven't been able to come up with one.

22 I don't think a dollar limit, maybe some type of
23 percentage of income would be advisable.

24 The Chairman. Could you work that out with Senator
25 Bentsen and Senator Chafee?

1 Senator Chafee. I see no particular objection to
2 that. It is very hard to come up with some rule, what is
3 a fair price on housing in Saudi Arabia is going to be
4 hard to figure.

5 I think probably the limitation that is imposed is
6 by the corporations themselves who just aren't in theory
7 going to squander money on some housing.

8 Mr. Chapoton. No, I really wouldn't be worried
9 about the employer situation. You would be worried about
10 a person --

11 Senator Chafee. Self-employed?

12 Mr. Chapoton. Self-employed, living in the Middle
13 East and a country such as that, housing is very, very
14 expensive. But you are right, that is self-policing, the
15 employer is paying it.

16 I think we might be concerned about an apartment
17 in Paris, and that type of situation.

18 Senator Chafee. I am open to suggestions. I would
19 be delighted to work on it.

20 Senator Bentsen. I think the Secretary is making
21 a good point. I would be delighted to work with him on it.

22 The Chairman. Does the Joint Tax Committee have
23 any comments on this provision? You looked at it?

24 Any objection to this provision?

25 (No response.)

1 The Chairman. If not, we will tentatively approve
2 that provision and move to incentives for research and
3 experimentation.

4 That is one that I think Senator Danforth and
5 Senator Bentsen and Senator Bradley had an interest in.

6 Since two of the three are here -- could we hear
7 from Treasury first on that proposal?

8 Mr. Chapoton. Mr. Chairman, this proposal would
9 allow a 25 percent incremental credit for direct wages
10 incurred in research and development.

11 The incremental portion would be the increase in
12 direct wages incurred in R & D work over the average for
13 the three years preceding the year in question.

14 We have tied this to direct wages because it does
15 hold the cost of the provision down and it does make it
16 considerably easier to administer since we can determine
17 with much easier, the direct wages related to research
18 and development and do not have to become involved in
19 allocating the cost of equipment and allocating overhead
20 and items such as that.

21 So, we think it is as simple an approach as you
22 can have to this problem. It will be a significant
23 benefit to research and development activities.

24 The Chairman. Mr. McConaghy, I discussed this
25 proposal with you. You were of the opinion limiting it to

1 wages was maybe the best route to follow.

2 Is that an accurate statement?

3 Mr. McConaghy. That will solve a number of adminis-
4 trative problems from the standpoint of allocations of
5 equipment and allocations of overhead and so forth.

6 The Chairman. Is there a provision that affects
7 universities in this?

8 Mr. McConaghy. Part of this.

9 The Chairman. Will you explain that provision?

10 Mr. McConaghy. Part of this would allow the credit
11 where the taxpayer reimburses another person such as a
12 university for performing research and development on behalf
13 of that taxpayer.

14 So, it would be extended. If I would have a university,
15 someone do research for me. Payment to that university
16 would be eligible.

17 The Chairman. That is a matter that I think Senator
18 Bradley had a specific interest in. I don't think it goes
19 as far as his proposal would have gone, but it does address
20 his concern, in part.

21 Is that right, Mr. DeArment?

22 Mr. DeArment. That's correct.

23 The Chairman. Senator Danforth.

24 Senator Danforth. Thank you, Mr. Chairman.

25 I think it is pretty well recognized that any discussion

1 of what supply side economics means or supply side tax cuts
2 means, very quickly raises the issue of what we are doing
3 in this country with respect to encouraging research,
4 development, new technology.

5 When Senator Bentsen was Chairman of the Joint Economic
6 Committee, the very interesting reports that that Committee
7 put out, having to do with tax policy, specifically stated
8 the importance of research and development.

9 Therefore, there has been some thinking that has been
10 going on over a period of years as to what we could do in
11 a tax bill which would provide greater incentives for the
12 conduct of research and development.

13 This particular proposal I think was first introduced
14 a year or two ago. It was somewhat broader than the present
15 form. It applied to more than wages.

16 However, I think this is a very reasonable first step.
17 I am cognizant of Treasury's concern about revenue effects
18 and also, about administration of any tax credits for R & D.

19 So, I think that this is a very reasonable and very
20 helpful step in the direction of encouraging our country to
21 do more in the way of research and development.

22 Senator Bentsen. Mr. Chairman, I am very supportive of
23 what the objective is here.

24 I am concerned that when we limit it to wages and
25 salaries that you have substantially reduced the overall

1 incentive and you have developed a wage based credit that
2 is biased in favor of personnel oriented R & D activities,
3 and against R & D activities that require major expenditures
4 for supply and materials and other operating costs.

5 When we talk about increasing productivity in this
6 country, it is not something that is done overnight. You
7 grind it out decimal point at a time.

8 But you do get some major technological breakthroughs
9 from time to time. That is where you make some quantum
10 jumps in improving productivity in this country.

11 If I was to err in this situation, I would rather err
12 on the side of trying to really emphasize substantial R & D.
13 We have been dropping behind in R & D in this country. I
14 don't know what kind of support there would be for trying to
15 expand it. I am not interested in tilting windmills, but
16 I would like to see if there is any support for trying to
17 just exclude the depreciation for plant and equipment and
18 the allocation of indirect costs, i.e., general and adminis-
19 trative expenses.

20 I know that increases the costs some. I think that
21 would get you up to 65 percent. Where are we now, at about
22 45 percent.

23 I would like to hear what Treasury has to say, of
24 course.

25 Mr. Chapoton. Well, our principal -- we have looked at

1 the possibility of adding everything but equipment to the
2 proposal. We think that would add another \$300 million to
3 the cost. It would give us some problems on administration.

4 For those reasons, two reasons, we would prefer that
5 not be the case. When you limit it to direct wages it
6 clearly cuts back to some extent the benefit here, but it
7 is a tremendous, significant benefit anyway. We are talking
8 about a 25 tax credit.

9 We think, as a first step, that is going quite far.

10 The Chairman. Senator Wallop will be recognized.

11 Senator Wallop. Thank you, Mr. Chairman.

12 Mr. Chairman, I thank you. I wonder if Senator
13 Bentsen might be interested in a proposal I have. I would
14 like to have Treasury's comment on it, which would amend
15 Sections 861 and 862 of the Internal Revenue Code to
16 provide that R & D expenditures made in the U. S. should be
17 allocated to U. S. source income rather than being allocated
18 in part to foreign source income.

19 Under the present regulation, and it is an interpreta-
20 tion of law that hasn't been challenged, but it is causing
21 us some problems. Regulation 861 requires that R & D
22 expenditures be allocated between domestic source income
23 and foreign source income, regardless of where the actual
24 expenditures were made.

25 Thus, when a firm has a foreign income, only a portion

1 of domestic R & D can be taken as a business deduction on
2 its U. S. tax return.

3 In addition, the remaining expenses cannot be used to
4 offset foreign taxes, since foreign tax laws allow no
5 deductions for expenditures made in the U. S.

6 Another problem created by that is that the U. S. Tax
7 Law permits no credit for foreign taxes paid in excess of
8 the applicable U. S. Tax rate.

9 In effect, it makes the foreign tax rate higher, since
10 a portion of domestic R & D expenses are deducted from
11 foreign income before that foreign tax credit is computed.

12 Every R & D dollar spent in the United States which is
13 allocated to foreign source income, carries the tax penalty
14 of reducing the foreign tax credit.

15 The present law theoretically creates an incentive for
16 corporations to transfer their R & D operations abroad.

17 The situation is further exacerbated by liberal tax
18 incentives in many foreign countries, for U. S. firms, in
19 order to attract their R & D operations.

20 The Treasury Department itself has admitted that the
21 present law can create a double tax on corporate income.

22 Treasury's Office of Tax Analysis states, in its OTA
23 paper, and I quote, "By denying U. S. corporations a full
24 deduction for domestic R & D expenses against domestic
25 income, and by assigning some portion to foreign source

1 income where it often is not allowed as a deduction by
2 foreign tax authorities, the portion engaging extensively
3 in international business or in the production of technology
4 intensive products may, in some cases, be subject to a
5 significantly higher overall tax on their world-wide income.

6 That is Treasury's own assessment of their own
7 regulations.

8 The third point I would like to make is that there is
9 no other country in the world that requires its taxpayers
10 to allocate expenses incurred at home, to foreign source
11 income.

12 Hence, foreign companies, unlike American companies
13 are not subject to comparable double taxation and gives them
14 a significant competitive advantage over U. S. companies.

15 I think the most important part of it, though, is the
16 fact that it encourages our companies to do their R & D
17 overseas.

18 Ultimately we end up having our own technological
19 expertise franchised back to us by foreign governments or
20 foreign corporate subsidiaries.

21 This is not so expensive as it were, as yours, the
22 revenue effects would be \$108 million, in 1982 and \$136
23 million, by '85.

24 But, it would tend to encourage R & D in this country.
25 Mr. Chapoton. Senator, I don't think we would agree it

1 would cause R & D to be carried out abroad.

2 It is true that we allocate under our Treasury
3 regulation, under Regulation 861, we allocate expenses to
4 income wherever it is earned here or abroad. R & D expenses
5 are dealt with specifically in those regulations.

6 Other expenses that have benefits with respect to
7 income earned abroad or relate to income earned abroad are
8 also allocated abroad.

9 Those regulations were issued several years ago, two
10 or three or four years ago. I am not quite sure. They
11 were much discussed at that time. There was a hearing on
12 the regulations and meetings with affected groups, and as
13 a result, the regulations were significantly amended and
14 by and large, there was general agreement that the regula-
15 tions we thought at the time, operated basically correctly.

16 That is, we tax world-wide income, subject to a foreign
17 tax credit. We must allocate expenses that relate to that
18 income, to the income earned abroad.

19 Now, I think in some cases, depending on how the foreign
20 tax credit works, that allocation, as well as other factors,
21 can cause not a lack of a full offset for taxes paid abroad.

22 But that question exists. It exists under current law.
23 It is going to continue to exist.

24 This provision is increasing an expense or a benefit
25 that is related to an activity carried on here, but to the

1 extent that activity relates to income abroad, earned
2 abroad, it would simply be allocated to that income earned
3 abroad, as would any other such expense.

4 The increase of this expense should not or this benefit
5 because this would be a credit, should not -- I think if
6 that rule, it either correct or it is not correct. I don't
7 think this would affect that question.

8 As I say, it has been a much-discussed rule. By and
9 large, through negotiation and meeting with groups, the rule,
10 while maybe not to the satisfaction of all affected taxpayers,
11 has worked rather well, we think, over the last several
12 years.

13 Senator Wallop. It is my understanding, at least from
14 some companies, it has worked rather well for them to
15 transfer their R & D activities overseas.

16 Mr. Chapoton. If they tax --

17 Senator Wallop. There is no direct relationship
18 between that expense and other income, none established,
19 none required to be established.

20 Mr. Chapoton. There is no direct relationship, that is
21 correct. It is an allocation process. But, clearly, if
22 you conduct R & D in the U. S. and then your world-wide
23 income goes up as a result of developments from that
24 activity, a portion of that activity is obviously related to
25 income earned abroad.

1 Senator Wallop. But Treasury's own paper, in discuss-
2 ing it, suggests that it results in significantly higher
3 taxation, in effect, a double taxation that no other
4 country in the world assesses.

5 It is American jobs and American R & D here, primarily,
6 that this would seek to do something about.

7 Mr.Chapoton. Senator, the paper to which you refer, I
8 am not saying it is right or wrong, it is a Treasury study
9 that was performed. It is not an official Treasury position.
10 It is a study we release from time-to-time by the Office
11 of Tax Analysis. It is not adopted or rejected by the
12 Treasury.

13 Senator Wallop. It obviously wasn't adopted. It must
14 have been rejected.

15 It just seems that if part of this whole process is to
16 attract R & D expenditures in this country, and to maintain
17 and develop jobs in this country, that we would not create
18 a tax situation which in effect transfers R & D expenditures
19 of a company to some foreign country where their jobs are
20 the ones, their workers are the ones who benefit from the
21 jobs created.

22 Senator Bentsen. Would the Senator yield? I think he
23 has made a good agrument. It is a matter that concerns me
24 too.

25 Senator Wallop. Yes.

1 Senator Bentsen. Is it correct, Mr. Secretary, that
2 in effect these companies are not given their tax credit in
3 those foreign countries and therefore, they don't get the
4 full charge off?

5 Mr. Chapoton. No, they would get their full tax credit
6 under the mechanical rules applicable to taxes paid in
7 foreign countries.

8 But if you allocate a part of a deduction for any
9 expense incurred here, to income earned abroad, then your
10 foreign source income is reduced, and therefore, the fraction
11 means that a smaller portion of your foreign tax is going
12 to be creditable.

13 Senator Bentsen. Well, is the net result that they
14 would be better off tax-wise if they did that part of it
15 abroad?

16 Mr. Chapoton. It would depend upon their foreign tax
17 situation. Obviously, if they did it abroad they would
18 have no deduction against U. S. taxes.

19 So, they would have to be in a high tax country, and
20 like any other overhead expense, I guess in certain
21 situations, it might be more beneficial if that expense
22 were incurred abroad.

23 But, I think that would be an unusual case.

24 Senator Wallop. My understanding is it is not so
25 unusual that certain companies that have operations here and

1 in Canada, have those R & D jobs established in Canada and
2 not in the United States.

3 Mr. Chapoton. Well, Senator, I must concede I did not
4 know this was coming up today. I would be happy to look
5 at that. We could review that section 861 regulations
6 further and come back to the Committee.

7 Senator Bentsen. Mr. Chairman, I started out with an
8 amendment here. I ran up that flag to see if anyone
9 saluted. So far, I haven't heard any comment on it.

10 I would like to offer it, if it has any possibility of
11 passage, but I don't want to delay the Committee.

12 The Chairman. I happened to be here the day we had
13 witnesses, some indicating they needed R & D and some
14 indicating otherwise.

15 I had a visit with Mr. McConaghy, on the Joint Tax
16 Committee, to see if we could work out some proposal that
17 would be not too costly and still address some of the
18 concerns.

19 Then I believe that Treasury felt that since wages
20 are clearly defined in the Code, and they are easily
21 allocated, and it would reduce revenue loss, we ought to
22 proceed in this way.

23 I don't have any strong feelings. But I think there
24 was some indication that this would satisfy those three
25 requirements. You already have equipment benefited by ACRS.

1 I know Senator Danforth's and I think your original
2 proposal was broader than the final package. It is our hope
3 we might accept this compromise and see how it operates and
4 if it is necessary to make any additional changes.

5 Senator Danforth. Mr. Chairman, I am very much in
6 sympathy with Senator Bentsen's point. That was the
7 original proposal.

8 However, I am also a realist in recognizing that
9 working at any tax bill, particularly within the constraints
10 that I think we very wisely imposed on ourselves last
11 Friday, we can't have everything that we would otherwise
12 like in this bill.

13 Therefore, I think an agreement where 25 percent is
14 available for wages is an important first step.

15 My hope is that it will prove very successful and that
16 as we move down this road, we can expand it in the future.

17 One of the things that we discussed and our staff, I
18 think with Treasury, was the possibility of perhaps reducing
19 the percentage and expanding the coverage.

20 But, again, Treasury's view was that let's make sure
21 the thing works for the easiest part of it to administer.

22 My view, frankly, is that if 25 percent is a good idea,
23 let's keep the 25 percent and leave open the future possibil-
24 ity of expanding the coverage.

25 So, I would -- I salute the idea that Senator Bentsen

1 has proposed, but I think in the context of this bill, and
2 the limitations of this bill, it is best to take the offer.

3 Senator Bentsen. Mr. Chairman, with what the Treasury
4 said in opposition, and what my distinguished friend from
5 Missouri stated, I see no reason to offer the amendment.

6 The Chairman. Senator Durenberger.

7 Senator Durenberger. It seems to me what is important
8 here is not the 25 percent, but what we are trying to do to
9 help research and development, I think particularly the
10 development of technology.

11 I have assessed the impact of Senator Danforth's
12 original bill on my state which is heavily oriented towards
13 high technology industry.

14 I have a great deal of sympathy to the issue that is
15 raised by Senator Bentsen.

16 I have a great deal of sympathy in my state to the
17 issue that was raised by Senator Wallop. But I have even
18 more sympathy and more impact in my state on high technology
19 on a portion of that Danforth bill that is not in this
20 compromise.

21 That is the provision of a tax credit on top of the
22 contribution deduction, for contributions to research grants
23 contributions to colleges and universities.

24 In our state, the University of Minnesota's Institute
25 of Technology, for example, has, thanks to primarily to

1 corporate contributions and Federal grants, spent a lot
2 of high technology company spin off and now a lot of that
3 is new industry in Minnesota.

4 I have asked the specific question of some of these
5 people. Of all of the things that the Danforth bill, which
6 would do the most for in the short run, for the development
7 of new high technology industries. They say it is the tax
8 credit on contributions to colleges and universities.

9 So, I think we ought to think about this not in terms
10 of the 25 percent, but the broad spectrum of technology
11 developments in this country, given the different mix we
12 have in the different states.

13 If it means backing down from 25 to 20 percent, to
14 accommodate what we did last Friday, I think that is going
15 to have a lot more impact than just taking a few industries
16 and giving them a 25 percent wage credit.

17 I would like to hear Treasury's reaction in terms of
18 the dollars involved.

19 The Chairman. They get a benefit if the corporation
20 has a contract with a university.

21 Senator Bradley. Mr. Chairman.

22 The Chairman. Can we have Treasury respond to his
23 question.

24 Mr. Chapoton. Senator Durenberger, we would have to
25 look at that. We have heard a proposal. We have not had a

1 specific proposal presented to us on that. It would be a
2 credit on top of the charitable deduction? I am not sure.

3 Senator Durenberger. Yes. I think Senator Danforth's
4 original bill had a 25 percent credit without the contri-
5 bution.

6 We backed this off to 20 percent or something or we
7 can settle for a 20 percent credit on top of the contri-
8 bution.

9 The important thing here is the universities. I mean,
10 right now, they are in effect living, a lot of them, on
11 Federal grants.

12 Bill Proxmire has made that difficult to do. We have
13 all helped in one way or another.

14 We are in the process of cutting it even more.

15 It seems to me in the long run, the important thing
16 to universities is the talent they attract, the kind of
17 faculty they can keep there from year to year.

18 If we are going to go up and down like this in our
19 Federal largesse to universities, the good ones are not
20 going to be able to hang on to the good people in the
21 communities in which they are working with business.

22 If it is the business community, the technology oriented
23 people, who are making the contributions to the good univer-
24 sities and the ones who are producing something in high
25 technology and research and so forth, I think you are going

1 to get that steady stream through university faculties that
2 really is important to technology.

3 That is why this becomes an important policy.

4 The Chairman. Senator Bradley.

5 Senator Bradley. Mr. Chairman, I would like to strongly
6 support what Senator Durenberger has just said. I think if
7 the purpose is to promote research and development, then you
8 want to maximize where the research and development is
9 actually done, as opposed to simply creating a kind of in-
10 house subsidy that a creative accountant might describe as
11 being research and development oriented.

12 Now, I am willing to take the chance on the wage based
13 research and development tax credit, because I think it is
14 important we get research and development moving.

15 I would also like to see us expand that tax credit to
16 some of the things that Lloyd Bentsen talked about which is
17 equipment primarily related to research and development.

18 But I think that by far the most important thing we can
19 do is to allow university research and development to be
20 counted in the tax credit.

21 There are two ways we could do that. One of the ways
22 was suggested by Senator Durenberger which is to say allow
23 for a corporate contribution to a university, to be counted
24 as research and development eligible for this tax credit.

25 One of the things we want to assure though, is that it

1 is not simply the corporation buying six professors' time
2 which is the contract aspect of the bill, as I understand
3 it.

4 But that we also provide that the tax credit can be
5 taken for basic research grants. I think that is really
6 what Senator Durenberger is talking about. Because he is
7 not just talking about a corporation buying a couple of
8 professors' time, but at a time when the Federal Government
9 has decreased its contributions to universities for basic
10 research, encouraging the private sector to assume some
11 of that responsibility and giving them the incentive to do
12 that by allowing this tax credit to apply to grants from
13 corporations to universities.

14 The second way we could at least help in this is to
15 exclude from the rolling base that is embodied in the bill,
16 the three-year rolling base, any contributions to univer-
17 sities.

18 So that a corporations rolling base, for the purpose
19 of tabulating the tax credit is not determined by its total
20 research and development expenditures today, if a portion
21 of that expenditure goes to a university.

22 So, I would like to see us address both of those. I
23 would argue that if we want to increase productivity, if
24 we want to get the country moving again, so to speak, this
25 is the best way to do it.

1 Unless you are going to have the major break through.
2 There are a large number of economists who argue that the
3 present allocation of resource and capital is such that you
4 are not going to get a marked improvement in productivity
5 unless you have that break through.

6 It seems to me that we are being penny-wise and pound
7 foolish here, if we say we are going to limit it or put all
8 our money into getting companies to buy existing equipment
9 instead of encouraging companies to invest in research and
10 development themselves, as we have done in part with this
11 wage approach.

12 But, unless we broaden it to the equipment, and unless
13 we include the universities, we are not going to get the
14 kind of payoff we want and it is going to be a kind of very
15 small gesture.

16 I understand the argument that Senator Danforth has
17 made in this respect. The cars are on this train and it
18 is going down the track and we can't get more on the load.

19 Well, I would argue we should reconsider.

20 Senator Danforth. Well, Mr. Chairman.

21 The Chairman. Could I just say a word here? I think,
22 as I indicated before Senator Bradley arrived, I was here
23 for the testimony. We had some outstanding witnesses. They
24 were split right down the middle whether we even needed this
25 provision in any shape or form.

1 There has also been a concern expressed, I am advised,
2 by small colleges, who fear that if you do this in the way
3 that either Senator Durenberger or Senator Bradley indicate,
4 it may be helpful to the big universities with strong science
5 programs, but they are concerned about a lot of the contri-
6 butions they receive in small liberal arts colleges.

7 So, I think that is another concern. But, having said
8 that, I am not certain I understand the second option you
9 suggested, whether or not Treasury would have any comment,
10 if there is any way to accommodate the desires of probably
11 a number on this Committee, without creating problems,
12 maybe not only revenue wise, but administratively and from
13 the standpoint of parity among colleges and universities.

14 Mr. Chapoton. Well, Mr. Chairman, I think this would
15 be an ideal item for the second tax bill. There are a lot
16 of problems when you deal with specific encouragement on
17 charitable giving.

18 This is a form of charitable giving, as I understand,
19 but it would be directly targeted to research and develop-
20 ment activity, carried on at colleges and universities.

21 I think you are right, there would be concern among
22 colleges and universities who do not carry on that type of
23 activity.

24 In addition, we would have to set up some procedure
25 I take it for reporting back to the granting corporation,

1 which can be done. We have procedures under existing law
2 where that is possible.

3 But, I do not have a revenue figure on it. We would
4 prefer that this not be done at this time, that we take only
5 the step of allowing credit for business research, and
6 including business research carried on by college or
7 university by a contract and that the encouragement of a
8 charitable type grant to colleges and universities just be
9 considered further.

10 We have frankly, not considered it in any detail.

11 The Chairman. Senator Danforth.

12 Senator Danforth. Mr. Chairman, I thought it might be
13 useful to just explain what the proposal was. There are a
14 couple of them. One was Senator Bradley's; one was mine.
15 It was a tax credit of 25 percent over and above the
16 charitable deduction available to businesses for contri-
17 butions to colleges, universities and other basic research
18 organizations for the purpose of basic research.

19 One of the two bills was an incremental increase in
20 contributions for this purpose. One of the arguments for
21 putting it on an incremental basis was so it wouldn't just
22 be an offset for what the business would otherwise be doing
23 for basic support for say the college or university of its
24 choice.

25 So that there would be less of an offset. Less of an

1 effect on normal charitable giving, that is, a reduction of
2 it, if you provided for the incremental increase.

3 The revenue cost, as I recall, and I think the bill was
4 S. 1065, in 1979, but I might be wrong on that. I think the
5 revenue cost was about \$100 million.

6 Mr. Chapoton. It obviously would have the effect of
7 channeling, tending to channel some significant -- I mean
8 this would be a very significant benefit and some significant
9 corporate contributions toward this end.

10 Senator Danforth. Again, it would be incremental over
11 a moving base. So that if they wanted to take advantage of
12 it, they would have to keep increasing their contributions.

13 Senator Bradley. It would be specifically at a time
14 when research grants from the Federal Government is on the
15 decline.

16 If you can make the rationale that the university
17 corporate relationship should qualify on a contract basis.
18 I think you can make the same argument that basic research
19 grants should qualify.

20 You know, I have talked to a lot of corporations about
21 this. Some, as we heard in our testimony, are skeptical
22 about whether this kind of tax credit is really needed, on
23 the business side.

24 But, a lot of those same corporations, big and small,
25 electronics industry, as well as pharmaceutical, as well as

1 chemical say that the university component of this is very
2 important, more important in fact, than the business compon-
3 ent because they say you reduce the top rate from 70 to 50
4 and you extend patent length for a couple of years. That
5 will take care of us, meaning the corporation in research
6 and development, because they plan ahead.

7 What it does is, it doesn't take care of the univer-
8 sities where there is a very clear need for the kind of same
9 commitment to basic research and development that has been
10 in the past and we need increasingly in the future.

11 Senator Durenberger. Mr. Chairman, and Mr. Chapoton,
12 you have to keep in mind too, when you look at this as a
13 philanthropy issue, the whole idea of the R & D tax credit
14 and this portion of it is not just to create new technology,
15 it is really to create new companies. That is what happens
16 in this area.

17 You create new companies, new jobs, new profit. You
18 are generating more tax, more profit which can get the
19 benefit of the charitable deduction.

20 That is what happens in real life. I think that is
21 the answer to the so-called small colleges or other --

22 The Chairman. Could we -- we have a basic agreement
23 on the provision before us. Now if someone would want to
24 offer an amendment, we would be happy to vote on it.

25 If not, maybe there is something that Treasury could

1 do to accommodate the views or at least in part, expressed
2 by Senators Bradley and Durenberger.

3 I would like to adopt the provision we had before us.

4 If someone wants to offer an amendment at this time,
5 we would be happy to consider an amendment or discuss it
6 with Treasury.

7 Let's move on it. We have been on this for some time.

8 Senator Bradley. Mr. Chairman, we have been on it for
9 what, 15 minutes?

10 The Chairman. About 45.

11 Senator Bradley. I think unless we have some information
12 from the Treasury that they will be able or willing to
13 accommodate what we have been talking about which is the
14 basic grant, in addition to the contract, then we don't
15 have any option but to offer an amendment.

16 Mr. Chapoton. Senator Bradley, I will just have to
17 beg for some time to go back and look at this.

18 The Chairman. You don't even have any idea what it
19 might cost?

20 Mr. Chapoton. No, we do not have.

21 The Chairman. Does the Joint Committee have any
22 estimates on cost?

23 Mr. McConaghy. No, we don't.

24 Senator Durenberger. Mr. Chairman, my problem is that
25 I want to support you. I realize this is taking time, and I

1 realize we haven't discussed this a lot.

2 My only concern with supporting it now is the issues
3 raised by Senator Bentsen, Senator Wallop, as it relates to
4 25 percent, and the last Friday vote.

5 I mean, I could propose an amendment at a 20 percent
6 tax credit, instead of 25 that would accommodate all of
7 these and we could dispose of it that way. You could vote
8 me down and try something else.

9 The Chairman. We looked at 15 percent, 16 percent,
10 trying to figure out how to get more things into the
11 package.

12 I think it was finally decided that this was the best
13 way to proceed. I didn't make that decision.

14 Senator Long. Mr. Chairman, it seems to me that we
15 -- the way we have been doing business, I assume we are
16 still doing business that way, we can agree to what has
17 been proposed here, what is in this paper.

18 Anyone can offer an amendment at any point between now
19 and the time that we report the bill and make some change
20 that would make it a more desirable proposal from his point
21 of view.

22 In view of the fact we can vote without prejudice on
23 these matters, I would hope we could go ahead and vote on
24 what is here.

25 Then, if someone wants to bring in a suggested

1 alternative, they have from now until the time we report
2 the bill. I would hope that even after we vote to report
3 that you would consider having another meeting before we
4 call the bill up so that if the Committee wants to make
5 some further changes, we can make it, and as a spokesman
6 for the Committee, you can still modify the bill before the
7 Committee.

8 The Chairman. That thought has occurred to me, not
9 knowing for certain what the House might do, we might want
10 one more meeting after we report the bill out.

11 But, if we could ask the Joint Tax Committee to get
12 the numbers for Senators Durenberger and Bradley.

13 Senator Bradley. Mr. Chairman, I think that would be
14 very important. But I think the second thing I suggested
15 doesn't really have a revenue impact.

16 I mean, the second thing I suggested is, if corporation
17 X is spending 100 X on research and development and 25 X
18 goes to a university on a grant, that the base upon which
19 incremental research and development will be considered is
20 75 X and not 100 X.

21 Mr. Chapoton. Senator Bradley, would you say that if
22 it is making the payment to the college under contract, for
23 specific research or are you limiting your remark to where
24 it is a grant unrelated to specific research for that
25 company?

1 Senator Bradley. No, I am saying if it is related to
2 contract research or basic research.

3 Mr. Chapoton. If it is contract research, I think we
4 would have trouble distinguishing that from research
5 carried on in house or by non-university type contracts.

6 If it is incremental it is, the idea is that it should
7 be incremental over a base of the same type of research it
8 did in prior years.

9 If it is a grant, I would agree, it should be excluded
10 from the base.

11 Senator Bradley. You say a grant should be excluded
12 from the base?

13 Mr. Chapoton. Yes.

14 The Chairman. We are already making progress.

15 Senator Bradley. We are making progress, Mr. Chairman.

16 Senator Bentsen. Mr. Chairman.

17 Senator Bradley. This is more progress than I expected.

18 The Chairman. Senator Bentsen.

19 Senator Bentsen. Mr. Chairman, I would like to go
20 ahead and propose my amendment then. I would ask for a
21 show of hands, if we could, and that is that we expand the
22 incremental R & D tax credit by making eligible for the
23 credit, all R & D expenditures, except depreciation of plant
24 and equipment, allocation of indirect costs, i. e., general
25 and administrative expenses.

1 My concern is that you don't give sufficient credit
2 here for those companies that are not labor intensive, but
3 have to spend substantial amounts of money in things like
4 developing a new computer system.

5 I would ask for a vote by a show of hands, if that is
6 satisfactory.

7 The Chairman. Would you state the amendment.

8 Senator Bentsen. The amendment would be that we would
9 expand the incremental R & D tax credit by making eligible
10 for the credit, all R & D expenditures except depreciation
11 for plant and equipment, the allocation of indirect costs,
12 i. e., general administrative expenses.

13 Senator Danforth. Mr. Chairman, could I speak for 30
14 seconds?

15 The Chairman. Yes.

16 Senator Danforth. Mr. Chairman, one of the points that
17 you have made over the last few weeks, and I think it is a
18 very important point, we are going to come together, agree
19 on the tax bill that is reasonably satisfactory, to the
20 Senate Finance Committee and the Administration, some of us
21 are going to have to give up on some of our pet projects.
22 This is one of my pet projects; in fact, it is my bill.

23 I am going to vote against it.

24 The Chairman. All in favor of the amendment, signify
25 by raising either hand.

1 (Showing of hands.)

2 The Chairman. All opposed?

3 (Showing of hands.)

4 The Chairman. I have three proxies.

5 Senator Bentsen. I don't think you need them.

6 The Chairman. Could we agree then on what we had before
7 us and hopefully, you can maybe accommodate Senator Bradley's
8 -- part of his concern, the same with Senator Durenberger.

9 Senator Bradley. Mr. Chairman, what Mr. Chapoton has
10 already said on my second point goes a long way toward
11 meeting it, which is that as I understand what you said,
12 grants for basic research would not be included in the base
13 from which the company determines its incremental research
14 and development.

15 Mr. Chapoton. That is correct.

16 Senator Bradley, I would have to say, those grants
17 would not qualify for the credit either, you understand that.

18 Senator Bradley. I understand.

19 Mr. Chapoton. They would be excluded from the base,
20 that is correct.

21 Senator Bradley. The only remaining question then is
22 whether at a later point in our deliberations, I would make
23 an amendment to allow the basic research grant to be
24 included for the tax credit treatment.

25 The Chairman. Right. That right would be preserved.

1 Senator Wallop. And as well, I would like to have him
2 look at the effects on jobs on the proposal I made.

3 The Chairman. Right.

4 I think he has indicated he will do that.

5 Mr. Chapoton. Yes.

6 The Chairman. Without objection, we will agree to that
7 provision.

8 Let's take up number 5, retirement savings for self-
9 employed. That is not the IRA, the Keogh, there are a
10 number of discussions going on on IRA's I think, on both
11 sides, to see if we can make some accommodations.

12 I don't know of any problem with number 5, which appears
13 on page 13.

14 Then we would like to take the investment credit for
15 rehabilitated buildings and maybe the incentive stock
16 options.

17 Mr. Chapoton, do you want to address the --

18 Mr. Chapoton. Very basically, Mr. Chairman, this
19 proposal would increase from the present limit of \$7,500
20 on the amount a self-employed person, under a so-called
21 Keogh plan or H. R. 10 plan, may contribute toward his own
22 retirement, on a tax deductible basis.

23 Present law -- increase that \$7,500 to \$15,000. As
24 you know, present law does provide special rules, detailed
25 special rules for retirement plans which cover self-employed

1 persons.

2 There have been more severe limits, traditionally,
3 under these plans than are applicable to normal corporate
4 plans, that is, plans benefiting employees of corporations.

5 There have been a number of complaints that the limits
6 have been kept too low over the years. One of the results
7 we are seeing is a tendency for professionals to incorporate
8 to obtain the benefits of the retirement benefits under
9 corporate plans.

10 This answers that complaint to a degree, by increasing
11 from \$7,500 to \$15,000, the amount that a self-employed
12 person may contribute to his own retirement.

13 These people, of course, have to cover all other
14 employees, all common law employees that they have for the
15 partnership or sole proprietorship.

16 The Chairman. Senator Chafee.

17 Senator Chafee. Mr. Chairman, I think this is a good
18 provision, but I think it is important to point out that
19 this doesn't do much for the lower income person.

20 In other words, this helps those who are making more
21 than \$50,000, but the person who is making \$30,000 isn't
22 helped at all by this proposal.

23 Mr. Chapoton. That's correct.

24 Senator Chafee. That is why I think it is important to
25 get on with the IRA's, because under our proposal a

1 self-employed would be able to use an IRA. So he would get
2 a little something out of it, anyway, that he is not getting.

3 The Chairman. Senator Durenberger.

4 Senator Durenberger. Yes.

5 The Chairman. We are going to take up IRA's hopefully
6 this afternoon. I think Senator Chafee and others have
7 some things on IRA's.

8 Is there any objection to this provision?

9 Senator Bradley. This is as it was proposed, 7 to 15.

10 The Chairman. Right; \$7,500.

11 Without any objection, we will approve that on a
12 tentative basis.

13 Could we move to rehabilitated; investment credits for
14 rehabilitated buildings?

15 Mr. Chapoton.

16 Mr. Chapoton. Mr. Chairman, the proposal would modify
17 existing law which does allow a 10 percent investment tax
18 credit for the rehabilitation of a structure which is at
19 least 20 years old.

20 This proposal would delete that provision from the
21 law and replace it with a provision allowing a 15 percent
22 in credit if the structure for the rehabilitation expenses
23 incurred in connection with the structure is at least 30
24 years old.

25 A 20 percent credit if the structure is 40 years old,

1 and a 25 percent credit if the structure qualifies as an
2 historic structure and is certified as such.

3 There was a concern at one point that there was not
4 enough distinction between the 40 year old structure and
5 historic structures, because the intent, the feeling of
6 the National Trust for Historic Preservation was that there
7 should be a significant distinction there.

8 We have reviewed that and determined that there is
9 more distinctions under this proposal than exists under
10 existing law.

11 So, we think that the proposal addresses that problem
12 and certainly will be of benefit in some of the older parts
13 of the country where there is concern about --

14 The Chairman. Is there any demand for this provision
15 anywhere? I haven't detected any groundswell.

16 Mr. Chapoton. We have heard a great deal from parts of
17 the country that have argued without such a provision our
18 ACRS proposal will cause a flight to the Sun Belt, that is,
19 if the incentive to build a new plant, in a new part of
20 the country, cause relocations.

21 This is a partial answer to that, that it will be
22 more beneficial to rehabilitate existing structures.

23 The Chairman. Senator Bentsen.

24 Senator Bentsen. Mr. Chairman, if I might on that bill
25 last fall, that was the very point that was brought up. If

1 I didn't originate this, I at least was one of the early
2 participants.

3 The Chairman. That was in the bill last year.

4 Senator Bentsen. That is right. We put it in because
5 the argument was made that we were going to have everybody
6 moving to the sun belt. Frankly, we don't want everybody
7 down there. We have about all we can handle.

8 All you have to do is go down some of our freeways
9 and see some of our crowded schools. We like you all fine,
10 but you come visit. Please don't all of you stay.

11 We would like to see the ill factories, to the extent
12 they can be rehabilitated, rehabilitated. I think it is
13 not just the economic loss to that particular community
14 when all of a sudden you have utility lines that are stubs
15 and don't service the people, when all of a sudden a mass
16 transit system that is built no longer serves the people,
17 when you have a deteriorating tax base.

18 It is not just the problem of that community. It is
19 the problem of the entire Nation.

20 So, I was urging last year, along with some others,
21 that we put this in to try to encourage a modernization of
22 some of these old plants where you don't have the uprooting
23 of families and sending them all down there to crowd our
24 schools and our freeways.

25 The Chairman. Senator Bradley.

1 Senator Bradley. Mr. Chairman, I think this is a good
2 proposal. It clearly is aimed at older industrial areas.
3 I think it remains to be seen whether it will work, but I
4 think it certainly is an effort to recognize our particular
5 problems.

6 I think that -- I have talked to a number of business
7 people who have told me as a result of this, that they are
8 actually looking at the possibility of rehabilitating
9 structures in older urban areas, instead of moving either
10 to the suburbs or to the south.

11 So, I think it is a good amendment.

12 Senator Bentsen. Mr. Chairman, the nice thing about
13 this one is if it doesn't work, it doesn't cost you
14 anything.

15 The Chairman. That is true.

16 Senator Chafee.

17 Senator Chafee. Mr. Chairman, I think this is a very
18 worthy provision. There is nothing more tragic, it seems
19 to me, than to see downtown buildings remain vacant, except
20 perhaps for the ground floor where there are some stores
21 and up above is home for pigeons.

22 Meanwhile, we go on with suburban sprawl where we
23 have to build new sewage lines, new water lines, consume
24 valuable open space and all that.

25 So, I think this is good.

1 I would point out one thing, Mr. Chairman. I would
2 ask Treasury whether this was inadvertant.

3 When you changed the language about the 60 months
4 depreciation that you have in the current law, there was
5 also some language in the current law that says if somebody
6 destroys a building in a historic section, and in our parts
7 of the country we have complete sections of town labelled
8 historic, that -- and you replace it with another building,
9 you could only take straight line depreciation on that
10 replacement building.

11 You couldn't take accelerated depreciation.

12 Now, it would seem to me that that -- there is some
13 wisdom to that law. That discourages people from going in
14 to historic districts and tearing buildings down and
15 replacing them and getting accelerated depreciation.

16 Did you change that rule for a reason?

17 Mr. Chapoton. Senator, I think it was done knowingly,
18 but I would like to study that.

19 Senator Chafee. Very well.

20 Mr. Chairman, I think -- I am all for this language.
21 What I would like to do is to go ahead and approve this
22 with the reservation that we could insert that language
23 about denying anything more than straight line depreciation
24 for replacement structure in a historic area.

25 Senator Matsunaga. Mr. Chairman.

1 The Chairman. Senator Matsunaga.

2 Senator Matsunaga. Is there any -- I support the
3 proposal wholeheartedly, but is there any reason, Mr.
4 Chapoton, for limiting the 15 to 20 percent credits to
5 non-residential, industrial and commercial structures?

6 Mr. Chapoton. Yes, that was -- the concern related to
7 commercial and industrial. We did not -- the people we
8 talked to and the concerns that were raised were limited
9 to those.

10 We thought if you apply it to residential, you expand
11 the cost considerably and you may cover some situations you
12 may not want to cover.

13 You may not want to necessarily keep old apartment
14 buildings, make it more beneficial to have old apartment
15 buildings rehabilitated than build new ones.

16 There are, of course, substantial benefits throughout
17 this -- well, there are more benefits for residential,
18 under this bill, in any event.

19 Senator Matsunaga. Would that be contrary to the move
20 now to rehabilitate downtown areas and to keep downtown
21 businesses open in the evenings by rehabilitating residential
22 units so that the customers for those businesses will be
23 right in town.

24 I know that many of the cities are trying to do that
25 now, in conjunction with rehabilitation of the downtown

1 sections of a city.

2 Mr. Chapoton. If we are talking about rehabilitation
3 of low income housing, there are other benefits under the
4 law. There is a five-year write-off of those provisions.

5 Now if it isn't low income housing there would be no
6 benefit. It was thought that the problem addressed was
7 commercial and industrial and not residential.

8 Senator Matsunaga. Maybe some thought ought to be
9 given to --

10 Mr. Chapoton. We could look at that gain.

11 Senator Matsunaga. All right.

12 Now, relative to the 25 percent credit, assuming that
13 a certified historic structure was a residential unit,
14 would the 25 percent credit still apply?

15 Mr. Chapoton. It would, yes sir.

16 Senator Matsunaga. It would.

17 Mr. Chapoton. Yes, sir.

18 The Chairman. Could I ask a question of the Joint
19 Committee? Is there any danger of anybody receiving a
20 windfall under this provision?

21 It is fairly rich.

22 Mr. McConaghy. Well, Mr. Chairman, it certainly would
23 permit the combination of the credit, and certainly with
24 no basis reduction, depreciating the building over a period
25 of time that we end up with under ACRS.

1 The combination of those benefits are pretty great.
2 I think they are essentially over present value of one,
3 meaning more generous than expensing, computing it that
4 way.

5 So, the proposal does have certainly a lot of benefit
6 in it.

7 The Chairman. The Treasury is aware of that and has
8 no objection?

9 Mr. Chapoton. Yes, sir, we are aware of that. This is
10 a special provision aimed at a special problem.

11 The Chairman. It was in the Senate Bill last year.
12 I think it has strong bi-partisan support. Unless there
13 is objection, why it will be adopted on a tentative basis.

14 If you would, consult with Senator Matsunaga with
15 reference to his concern. Maybe we can accommodate that.

16 I wonder if we might move to the incentive stock
17 option.

18 This is a proposal of Senators Packwood and Bentsen.

19 Senator Packwood is not able to be here today. But I
20 think Senator Bentsen said he would like to take it up
21 before lunch.

22 He will be here in just a minute or two.

23 Then, maybe we could conclude the morning session and
24 this afternoon, meet at 2:30. We could move to IRA's and
25 the so-called marriage penalty, tax straddles.

1 Mr. Chapoton, could you give us the latest version of
2 the incentive stock option.

3 Mr. Chapoton. Mr. Chairman, this, as you know, this
4 provision was not in our proposal. As I understand it, it
5 would reinstate the old qualified stock option rules which
6 were repealed in 1976, which would basically say that a
7 corporate employer could grant employees the option to buy
8 stock in the employer corporation and if certain conditions
9 are met, the principle of those being that the option price
10 has to be equal to fair market value at the date the option
11 is granted.

12 Then, when the employee exercises that option, when
13 the price is increased, he exercises his option, pays for
14 the stock. At that time, he has no taxable income.

15 Whereas, without this special provision in the statute,
16 he does have taxable income on the date of exercise. The
17 corporation gets no deduction at that time.

18 The only tax incident comes when the employee sells the
19 stock he has received and at that time, provided he has held
20 it for three years, he does get capital gain treatment on
21 the sale.

22 The Chairman. Senator Bentsen?

23 Senator Bentsen. Mr. Chairman, again I think this is
24 a bi-partisan approach. Senator Packwood and I have worked
25 together in trying to assist and trying to develop an

1 entrepreneurial interest in a company, by management.

2 One of the problems we have with management today
3 in the United States is looking at short-term goals. That
4 is understandable because they have a place for them in the
5 way of incentives, how much better did the company do than
6 last year. That decides their bonus; what kind of a salary
7 they are going to get.

8 One of the differences we see with the Japanese is a
9 continuity of management and staying with a company and
10 being interested in long-term R & D.

11 Yet, in our country, many of the people in management
12 say, "Why worry about long-term R & D. I get no credits
13 for the long-term growth of this company. In turn, my
14 successor will probably benefit from that."

15 So what we are trying to do is to say that you can
16 have a stake in this company with a stock option. We are
17 trying to go back to what it was in 1969 and saying that
18 if you are granted a stock option, no more will the company
19 be allowed a deduction for that as they are under the
20 present rules, but that if you make it pay off for your
21 company and the value of the stock goes up because you have
22 been successful in its management, then you will have a
23 capital gains.

24 You have a stake in the long-term future of your
25 company.

1 You have a bunch of head hunters out here that come
2 around to American management today and offer them a bonus
3 if they will jump to another company.

4 So you have mobile management. What we are trying to
5 do is anchor people to stay with companies and take the
6 long-term outlook.

7 That is why. I think it is good. I would like to also
8 say we have some interim rules here that we have submitted
9 to staff and they have submitted to Treasury, as a part of
10 this. I don't think Treasury objects to it. I understand
11 staff has approved it.

12 The Chairman. It is my understanding the staff will
13 discuss those with Mr. Chapoton when we break up at noon.

14 Senator Bentsen. That will be fine.

15 The Chairman. The staff doesn't have any problem with
16 it. I am not certain about Mr. Chapoton.

17 Senator Bentsen. Right. Then I would also like Mr.
18 McConaghy to comment, if he will, -- I have had people talk
19 to me about restricted stock incentive plans for the
20 inclusion in this stock option.

21 I would ask such comments as he may have concerning
22 that part of the proposal.

23 Mr. McConaghy. Senator Bentsen, I think you are talking
24 about the SAR's, the stock appreciation rights.

25 Senator Bentsen. Yes.

1 Mr. McConaghy. Those aren't permitted now under the
2 existing law. I think you are suggesting an individual
3 employee could go ahead and surrender the option and
4 receive stock equal to the difference between the current
5 fair market value and the option price and not have to go
6 through making the exercise and then, of course, turning
7 around and selling the portion to pay it.

8 Or, you are suggesting I think he could receive both
9 cash and stock, the cash of which he could go ahead then
10 and buy the stock.

11 Neither one of those under current law would be
12 permitted. I think the bill, as modified, Senator Packwood's
13 bill would permit the option to be exercised with property,
14 including stock, but a further modification would have to
15 be made if you are going to permit cash payments at the
16 time that the option was granted or essentially to permit
17 stock appreciation rights.

18 Senator Bentsen. How about the other type where you
19 have a restricted stock where the fellow is allowed to
20 receive the dividends and even vote the stock. It is
21 called a restricted incentive stock plan.

22 Do you have a comment concerning that one?

23 Mr. McConaghy. I would have to look at that, Senator
24 Bentsen.

25 Senator Bentsen. All right.

1 Senator Durenberger. Mr. Chairman.

2 The Chairman. Senator Durenberger.

3 Senator Durenberger. I would say this proposal is
4 not just good, it is terrific. It did a lot for America
5 back in the late '60's and early '70's, when it was the
6 law of the land, particularly as Senator Bentsen has pointed
7 out, for small and growing businesses that had demands for
8 particular kinds of talent that they wanted to hang on to
9 as part of their growth.

10 I think this provision has been included in all of
11 our small business capital formation bills of one kind or
12 another. It is just terribly important to small business
13 in the country.

14 Senator Bentsen. Mr. Chairman, I would urge the passage
15 of the Packwood-Bentsen stock option.

16 Senator Matsunaga. Mr. Chairman.

17 The Chairman. Yes.

18 Senator Matsunaga. I wish to comment my colleagues,
19 Senator Bentsen and Senator Packwood for offering this
20 innovative proposal in the form of executive compensation.
21 It would help, as well as in the high technology industries
22 to reward key workers.

23 But as I understand it, this option is open for a 10
24 year period to be exercised; is that correct?

25 The Chairman. A 10 year period, Mr. Chapoton?

1 Mr. Chapoton. Yes, sir; 10 years.

2 Senator Matsunaga. If there is no objection from the
3 proposers, I would suggest a 20 year period to exercise the
4 option so that qualified employees would have a chance of
5 more firmly establishing themselves and be able to exercise
6 such options.

7 The Chairman. Does Treasury have any objection?

8 Senator Matsunaga. As the co-author had indicated,
9 under the Japanese system, they have this life-time period
10 with the so-called -- a 20 year period would be perhaps one
11 which would even further the purpose of this proposal.

12 Senator Bentsen. Mr. Chairman, I see no objection to
13 that, subject to what staff might say.

14 I suppose you are talking about the life of the plan
15 rather than the option, are you? Or are you talking about
16 the option itself?

17 Mr. Chapoton. This would be so that an employee who
18 received an option would have a 20 year period within which
19 to exercise.

20 Senator Matsunaga. Correct.

21 Mr. Chapoton. Off hand, I don't think I see any
22 objection.

23 The Chairman. Off hand, we will accept it.

24 Mr. Chapoton. Could I ask what we did or what you did
25 on the stock appreciation right? I think we would have

1 serious reservations about that.

2 The Chairman. That is not a part of the proposal
3 before us as I understand it.

4 Senator Matsunaga. One further question. Am I correct
5 in my understanding that your proposal does not make
6 sequential exercise mandatory?

7 Senator Bentsen. That's correct.

8 The Chairman. Senator Bradley.

9 Senator Bradley. Mr. Chairman, I think this is one
10 of those things that virtually everyone here thinks is a
11 good thing. I think it is important to get new companies
12 off the ground, particularly high technology companies. I
13 strongly support it.

14 The Chairman. Senator Baucus.

15 Senator Baucus. Mr. Chairman, I join too. Of course,
16 you all know that when the Act was changed venture capital
17 was scarce.

18 The Chairman. I don't know of any objection. I want to
19 make certain we are in agreement on what we are about to
20 accept.

21 Would you state the proposal you think you are about
22 to accept, Mr. Chapoton.

23 Mr. Chapoton. As I understand it, Mr. Chairman, it
24 would be basically a reinstatement of the qualified stock
25 option rules that were repealed in 1976, extending the 10

1 year option, the permissible period from 10 to 20 years.

2 On sequential, there is a rule under present law
3 that you must grant the oldest option, I believe it is
4 the oldest option outstanding.

5 Was there a change in that rule? I was not clear on
6 that.

7 Senator Bentsen. Yes, we said it did not have to be
8 sequential. I would urge that Treasury on the question of
9 the SAR's that we take a look at that and see if there is
10 some limitations we can put on it to make it feasible and
11 we negotiate on that if that is all right.

12 Mr. Chapoton. We will take a look at that.

13 The Chairman. Senator Moynihan.

14 Senator Moynihan. Mr. Chairman, I would like, if I
15 can, just to use this moment to say while we are taking
16 an important step with regard to the establishment and
17 management of venture capital firms and high technology
18 firms, new entries, we have yet before us a larger question
19 of corporate capital gains question.

20 The decision to form small firms is considerably
21 influenced by the marginal rates on what capital gains they
22 will have.

23 We had a very strong response to our 1978 reduction
24 which was only two points, 28. But in 1977, venture
25 capital firms raised \$39 million. In 1980 they raised

1 \$900 million.

2 Now what correlation does not imply causality and you
3 never fully know. We have had some pronounced change in
4 those numbers. I hope will, of course, later get to the
5 question of -- if we combine bringing capital gains down
6 to 20 percent and this measure, I think we have done about
7 as much as we would ever be expected. I hope some people
8 might even be grateful.

9 The Chairman. I might say since the Senator raised
10 that question yesterday, we asked the Treasury to take a
11 look at it and see whether we within the confines that we
12 have, work out some accommodation. Maybe it wouldn't be
13 immediate, but it would be eventual.

14 If there is no objection then, we will accept as we
15 have the other provisions, on a tentative basis, the
16 incentive stock option provision of Senator Bentsen and
17 Senator Packwood.

18 Unless anybody -- Mark.

19 Mr. McConaghy. I think I can answer Senator Bentsen's
20 question, clarifying what he was talking about. There is
21 a plan evidently which a couple companies have which permit
22 the issuance of stock for a nominal amount to the employee.
23 The employee has the right to dividends and he has a right
24 to vote the stock.

25 He can buy the stock later, but if he leaves employment

1 or doesn't want to buy the stock, the employer can buy
2 that stock back at a nominal cost.

3 The question really is, is it an option to which
4 obviously these would apply.

5 We think it is clear that under the regulations, under
6 Section 83, it would be treated as an option. We could
7 make that clarifying change if you wish so.

8 The only other question is the question of effective
9 date on stock options. I am assuming that you are essentially
10 adopting S. 639. But, the question was: Is this intended.
11 I assume to apply to newly-granted options and to old
12 options that were not exercised before '81, and old options
13 which were pre-'81 grants, unless the employer elects out.

14 The other remaining question is, is it intended to
15 apply to old options that allow them to be amended within
16 the period of time such as 12 months.

17 Senator Bentsen. Those were some of the transitional
18 things we had proposed and discussed with staff and submitted
19 to Treasury, at your urging, Mr. Chairman.

20 The Chairman. Maybe over the noon hour they can see.

21 Senator Bentsen. We had agreement on it, didn't we?

22 Mr. Chapoton. We would not have any problem with
23 those.

24 Senator Bentsen. So I would like to have that included
25 in it, Mr. Chairman.

1 The Chairman. Fine.

2 We will start this afternoon at 2:30 with IRA's. I
3 will ask Mr. Chapoton to stay around for a few minutes in
4 case somebody would like to talk with him now about some-
5 thing for 15 minutes. We could save an hour this afternoon

6 Mr. Chapoton. Sure.

7 (Whereupon, at 12:01 p.m., the Executive Session
8 recessed, to reconvene at 2:30 p.m., the same day.)

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AFTERNOON SESSION

1
2
3 The Chairman. I wonder if we might start on the
4 individual retirement accounts, which is number 4, in the
5 index. I think there will be some discussion of that and
6 maybe some change in procedural position by the Adminis-
7 tration.

8 Perhaps, Mr. Chapoton, you can explain the Adminis-
9 tration's IRA proposal, which in essence is the proposal
10 of Senator Chafee and others on the Committee.

11 Then, I think there are a number of Senators who had
12 questions about some change.

13 Mr. Chapoton. All right, Mr. Chairman.

14 Our proposal is to increase the IRA limit for an
15 employee who is not covered by a plan, by an employer-
16 sponsored plan, to \$2,000, from \$1,500.

17 In the case of a spouse, that is, where an individual
18 retirement account is also established for an unemployed
19 spouse, an additional \$250. So that combined plans for
20 both spouses could be \$250 -- \$2,250.

21 We also proposed allowing, the establishment of IRA's
22 by employees who are covered by an employer-sponsored plan.
23 They would be allowed to contribute \$1,000 to an individual
24 retirement account for their benefit.

25 In the case of a spousal IRA, in that case, it would
be half the additional amount or \$125. So, for a total

1 contribution to both plans, both IRA's for a spouse, for a
2 worker and a spouse covered by an employer-sponsored plan,
3 it would be \$1,125.

4 We did not permit I guess the two most discussed items
5 here or whether mandatory contributions to an employer-
6 sponsored plans qualify for the income tax deduction.

7 They do not, under our proposal.

8 Secondly, do voluntary contributions, that is, not,
9 that are not required as a condition to participate in the
10 plan, whether they qualify for a tax deduction.

11 The answer is no, we have not allowed that under our
12 proposal.

13 In the case of voluntary contributions, employers can
14 establish employer-sponsored IRA's, and therefore facilitate
15 the creation of \$1,000 deductible contributions on behalf
16 of their employees, but we did not permit contributions to
17 their own plans, to the employer-sponsored plan.

18 I might say on that, Senator Chafee and I, and others
19 have discussed the second aspect on the voluntary contri-
20 bution. Whether voluntary contributions are deductible.
21 We might want to go into that just a bit.

22 The Chairman. Senator Chafee.

23 Senator Chafee. Yes, Mr. Chairman.

24 First, let me say that in the entire tax proposal that
25 we have here, except for the one year Danforth All Savers

1 provision, it seems to me that this is the only out year
2 savings encouragement in the bill.

3 I think significant steps have been taken. I might
4 say it is not what we originally sought, as you know, Mr.
5 Chairman.

6 The bill that Representative Moor and I put in would
7 permit \$2,000, on the so-called LIRA's and IRA's and also
8 would permit withdrawals for college education of children
9 and for first purchase of a home.

10 However, little steps for little feet. We are making
11 progress. This is something, one of the most significant
12 things that -- I am not sure Mr. Chapoton stressed, no
13 longer do we have the percentage deduction. That is, it is
14 the lower of \$2,000 or 15 percent.

15 If you make \$3,000, you can put \$2,000 of it aside
16 in an IRA. The percentage limitation is gone.

17 Now, that takes care of the IRA's.

18 Now, let's move to the LIRA's which apply to where
19 there is a qualified pension plan.

20 Here we permit a \$1,000 deduction by a member of a
21 pension plan, but the question is, what about his voluntary
22 contributions to a pension plan. Would that voluntary
23 contribution count?

24 Mr. Chapoton said that in the Administration's
25 proposal, that does not take place.

1 I would urge that we do permit the voluntary. This is
2 the first of three wishes I have. This is the most modest.

3 The next being the mandatory, and the next being let
4 it be \$2,000, and the third being include the mandatory as
5 well.

6 But let's start with the voluntary.

7 Mr. Chapoton and I ha-e spoken about that. Why don't
8 you proceed?

9 Mr. Chapoton. Our problem with allowing voluntary
10 contributions -- deductions for voluntary contributions is
11 principally the administrative problem.

12 We felt the limits on IRA's, that is, the present
13 law restrictions on an account established by an individual
14 for his own retirement, principally the restriction that
15 he cannot borrow against it and that he cannot withdraw
16 it before he reaches age 59 and a half, without a ten
17 percent penalty, that those restrictions and perhaps others
18 but those principally would have to apply in the case of
19 voluntary contributions to an employer-sponsored plan.

20 Once you decide that you have a number of administra-
21 tive difficulties in setting up those restrictions appli-
22 cable only to the employer's deductible contributions to
23 his own plan.

24 But if we could impose in a feasible way, and we
25 worked on it a bit here over noon and think perhaps we

1 could, those restrictions, then I think we would have no
2 objection to allowing a voluntary, deduction for voluntary
3 contributions for plans.

4 I don't know if Mr. McConaghy sees any further admin-
5 istrative problems in doing that.

6 The two we would want, Mark, would be the no borrowing
7 and penalty if withdrawal before age 59 and a half.

8 Mr. McConaghy. Well, I think those essentially --
9 I would agree with Mr. Chapoton. I think it would be
10 obviously necessary to have the employer keep in effect
11 separate sub-accounts. He presumably does that now with
12 a voluntary, non-deductible contribution and regular
13 qualified plan.

14 This deductible voluntary contribution, I think he
15 would have to keep a separate sub-account for and there
16 would have to be rules perhaps as to what happens if an
17 amount is pulled out.

18 Is it attributable to a qualified plan contribution
19 and voluntary non-deductible or a voluntary deductible
20 contribution.

21 My understanding is they can and are willing to
22 establish such accounts.

23 Senator Chafee. Well, the objective of course, is to
24 encourage use of these and to make it as simple as possible.

25 What would happen if you just counted the contribution

1 into the regular pension plan as it.

2 Now, true, there they could -- I presume when they
3 leave, they could take it. But no one is going to quit
4 their job in order to collect a few dollars on an IRA or
5 a LIRA, are they?

6 Mr. Chapoton. No, that's correct.

7 It is true, it would be a significant benefit as
8 compared to the non-employer sponsored IRA. If we can do
9 it without administrative difficulty, that is, we can
10 impose a penalty tax comparable to that imposed by early
11 withdrawal from an IRA, in such a case, unless an employee
12 puts it into another IRA immediately following withdrawal,
13 which he can do and avoid the tax.

14 Then it seems to me you would achieve comparability
15 and that would be desirable.

16 Senator Chafee. Well, I think that is fine. In other
17 words, we are a little vague here. You are going to be
18 working on it. We have the concept. The idea is to make
19 it as simple as possible to encourage the use of them so
20 that the salesman will go around and be able to make a
21 pitch to get into an IRA or a LIRA, so we are going to use
22 these.

23 Now the next, Mr. Chairman, was in connection with the
24 mandatory contributions, above what a non-Social Security
25 payer would pay.

1 In other words, if a Government -- you would not want
2 it for a Government employee -- anything above what he
3 would normally pay for Social Security, but anything else
4 he would want to put in.

5 Mr. Chapoton. What he would otherwise pay for Social
6 Security would not be deductible in any event.

7 Senator Chafee. Right.

8 Mr. Chapoton. Because the private sector, Social
9 Security, of course, is not deductible.

10 Senator Chafee. Right.

11 Mr. Chapoton. But we feel we cannot go the full route
12 and allow deduction for mandatory contributions, principally
13 because of the revenue cost involved.

14 There are an awful lot of plans now, Government and
15 private and that require mandatory contributions as a
16 condition to participation in the plan.

17 Of course, many Governmental bodies require contri-
18 butions to a retirement plan as a condition to employment.
19 That is not very usual. In quite, it is quite unusual in
20 the private sector. But it is quite usual for an employer-
21 sponsored plan in the private sector to require you to
22 contribute to the plan as a condition to participation in
23 the plan.

24 If we permitted a deduction for those amounts, we
25 would be talking about a revenue loss of over -- in our

1 estimates, \$4 billion, right away and without any immediate
2 increase in savings.

3 We feel we must oppose that.

4 Senator Chafee. Well, Mr. Chairman, I know they looked
5 on this. I know that Senator Matsunaga has been interested
6 in it.

7 I can't argue with the revenue statistics. We have
8 come in with an agreement here that we wouldn't go above
9 them.

10 I have had a good deal of concern expressed to me that
11 if you permit the voluntary contributions to be deductible,
12 then the mandatory plans are put at a disadvantage and
13 indeed, will try to make artificial changes in order to
14 qualify as voluntary plans. It will cause some wrenching
15 and distortions in the system.

16 At least, Mr. Chapoton indicated that he was sympathetic
17 toward the view of permitting the mandatory deduction.
18 Maybe we can work toward that and try and continue efforts
19 in this, perhaps when we get dealing with the Social Security
20 Bill in some way.

21 I think the great thrust of this effort, of course, is
22 to have a supplement to Social Security through the IRA's.

23 Senator Matsunaga. Mr. Chairman.

24 The Chairman. Senator Matsunaga.

25 Senator Matsunaga. I commend the Senator from Rhode

1 Island, Mr. Chafee, for offering his proposal. I fully
2 support his proposal. But his proposal doesn't go far
3 enough, limiting it to voluntary pension plans would
4 discriminate against the so-called mandatory plans.

5 Of course, the term "mandatory" might be misleading
6 for the reason that mandatory merely means that the employer
7 will contribute his share only if the employee will contri-
8 bute his share.

9 Mandatory does not mean that the employee is required
10 to be a part of the plan.

11 Because of this now, if we permit a tax deduction only
12 for IRA's and the voluntary plans, then we are going to
13 find an exodus from the so-called mandatory plans among
14 the employees who would like to take the tax deduction.

15 While it is true that under most plans they may
16 withdraw from the plans whenever they terminate their
17 employment, still the tax deduction is an attractive thing.

18 Let me point out some of the reasons which a coalition
19 an ad hoc coalition on employee retirement savings deduc-
20 tions consisting of the following have said.

21 Now, the American Council of Life Insurance, American
22 Society of Pension Actuaries, Association of Advanced Life
23 Underwriters, Association of Private Pension and Welfare
24 Plans, Bureau of Wholesale Salesman's Association, ERISA
25 Industry Committee, National Association of Life Underwriters,

1 National Automobile Dealers Association, National Federation
2 of Independent Business, Small Business's Council of America.

3 This coalition fully endorsed extension of the IRA
4 proposal as put forth by the Administration, to some
5 mandatory as well as voluntary plans, one for equity
6 reasons.

7 Then, the failure to treat mandatory and voluntary
8 contributions equally would discriminate against those
9 lower paid employees who can only afford to make mandatory
10 contributions necessary to participate in the employer's
11 plan.

12 Two, employees may cease to make mandatory contri-
13 butions and withdraw from company-sponsored plans, to set
14 up IRA's.

15 Now employees who withdraw would, one, lose their
16 benefits provided by the employer.

17 Two, lose incidental benefits under the employer's
18 plan, such as life insurance, annuity options, and three,
19 lose increased benefits through later plan amendments and
20 systematic savings through payroll deduction.

21 Next, employee who withdraw from participation in the
22 employer's plan, would adversely, and this is important,
23 would adversely affect the continued tax qualified savers
24 of the employers' plan, since the employer, as the Secretary
25 well knows, is required under the Internal Revenue Code, to

1 maintain minimum participation levels.

2 By being distracted from the mandatory plans to the
3 voluntary and the IRA's, the existing plans, which are very
4 salutory and ones which should be kept, would just dis-
5 integrate by withdrawal of the employees.

6 Then, new plan formation by small employers may be
7 discouraged since such employers must often depend on their
8 employees to help fund a plan in the early years.

9 Employees who do not participate in employer-sponsored
10 plans, even though they are eligible, will not have the
11 necessary incentive to join the employer's plan, and will
12 continue to be totally dependent on Social Security System.

13 Now, for this reason, I feel that perhaps we should
14 begin, if as Mr. Chapoton said, during the informal con-
15 versation we had, the discussion we had, that the revenue
16 impact would be too great, maybe we could start off with
17 just part of the mandatory pension plans sector.

18 That is, take the -- just the private sector to begin
19 with and leave the Government sector out for later integra-
20 tion into the plan.

21 How will that strike the Treasury?

22 Mr. Chapoton. Well, Senator, let me respond to a
23 couple of points.

24 One, I think it is a matter of concern as you state.
25 I certainly agree that we not undermine the private pension

1 system. There will be some pressure, unquestionably, for
2 employees to consider going their own way, having their
3 own individual retirement account and not participating.

4 But, at the same time, they have to recognize in
5 failing to, if they do that, they fail to participate in
6 the employer's contributions which are usually significant
7 and build up over the years and offer very important
8 benefits.

9 So that I think the case that this will dismantle the
10 private pension system overstates the situation consider-
11 ably, though there will be some pressure to move into their
12 own individual retirement account.

13 If we could allow employee mandatory employee contri-
14 butions to be deductible, it probably would be the best way
15 all factors considered, particularly if we made some
16 changes in the present rules that treat contributory plans
17 and non-contributory plans slightly differently.

18 But they are questions we don't need to get into now.

19 But I do not see any way to get there partially, and
20 I do not see any way to get there under the revenue con-
21 straints we now have.

22 If we went to private plans only, we would still be
23 talking about in 1982, calendar '82, \$1.6 billion. Even
24 then, I don't see how we could explain to workers for the
25 Federal Government and workers for state and local Governments

1 why their contributions would not be deductible, whereas
2 those in the private sector would be.

3 So, I do not see how we can go partially on this
4 question.

5 Senator Matsunaga. Supposing we lower the amount on
6 mandatory plans, rather than \$1,000, to begin with \$500
7 deduction.

8 That would mean considerable savings. You may have
9 the figures.

10 Mr. Chapoton. Well, it would be, according to these
11 figures, it is on a calendar year basis, it would be \$1.2
12 billion, calendar '82.

13 Senator Matsunaga. Well, I have figures here, '82, would
14 be \$.9 billion.

15 Mr. Chapoton. That must be a fiscal year.

16 Senator Matsunaga. In '83 it would be \$1.7 billion.
17 In '84, it would be \$1.9 billion. In 1985, \$2.0 billion and
18 in '86, \$2.1 billion, if we were to reduce the deduction to
19 \$500.

20 Mr. Chapoton. \$500. We would agree basically with
21 those figures. That is, I think, outside the budgetary
22 constraints under which we are operating.

23 Senator Matsunaga. Would that still be beyond what the
24 Administration would be willing to go?

25 Mr. Chapoton. Yes, sir.

1 We could not at this time. We would be happy to
2 consider that in the future. We could not at this time
3 agree to that type of additional expenditure.

4 Senator Matsunaga. Mr. Chairman, I would go on record
5 as offering my amendment regardless as to what the con-
6 sequences may be, to extend the tax deduction provisions for
7 IRA to voluntary and mandatory pension plans.

8 The Chairman. You are offering that in the form of an
9 amendment?

10 Senator Matsunaga. Yes.

11 The Chairman. Do you want a vote on that?

12 (Pause.)

13 The Chairman. Do you want a record vote?

14 Senator Chafee. Well, Mr. Chairman, I -- this puts me
15 in a very difficult spot. I have, as you know, been press-
16 ing the mandatory, along with the voluntary. But we are
17 in a situation where the Administration has convinced me
18 that we are not going to be able to do everything we want to
19 do on this bill.

20 I have seen a host of other proponents here hold back
21 on getting everything each one wanted.

22 So, I would not be able, sympathetic as I am, to the
23 Senator's proposal, I wish he wouldn't press it at this time.

24 Senator Matsunaga. Well, may I put it on this basis,
25 then. I will presently support the voluntary proposal, and

1 then, reserve my right to work up some maybe acceptable
2 proposition, acceptable to the Treasury as well as to those
3 on the other side of the aisle.

4 The Chairman. Fine.

5 Mr. Chapoton. Senator, if I could make one other point
6 that I should point out in this examination of this question,
7 under present law, since we allow \$1,500 contribution in the
8 case of an employee who is not covered by his plan, that is,
9 that applies, even though he could be covered, but elects
10 not to participate.

11 We already have something of an incentive for an
12 employee not to participate and make his contribution to
13 his own individual retirement account.

14 So we are not exacerbating that situation except to
15 the extent we are raising the \$1,500 to \$2,000.

16 So, we already have a problem in that regard, even
17 though the basic question you are addressing --

18 Senator Matsunaga. Yes, I realize that.

19 Senator Durenberger. Mr. Chairman.

20 The Chairman. Senator Durenberger.

21 Senator Durenberger. Mr. Chairman, I became lost
22 somewhere here in the revenue impacts of Senator from
23 Hawaii's suggestion was that a \$1,000 mandatory costs \$1.6
24 billion, in '82?

25 Mr. Chapoton. I will review it again. \$1,000 mandatory

1 covering only the private pension system, excluding state
2 and local governments and the Federal Government costs \$1.6
3 billion, in calendar '82.

4 Senator Durenberger. Does that mean that if we did the
5 -- I have to apologize for coming in late, but if we did what
6 we did last August, with just \$100, again, we wouldn't even
7 have to write out the Fed's people, because the amount is
8 so small.

9 But, just keeping it to the private, that would cost
10 \$160 million?

11 Mr. Chapoton. No, about \$342 million, calendar year.

12 Senator Durenberger. In everything we did yesterday
13 saving the savings and loans and giving the tax bracket, 30
14 percent tax bracket folks a good bump and taking it away from
15 all the little people on fixed incomes, below 30 percent,
16 did we save anything in there in that transfer that would
17 approximate \$342 million, next year?

18 The Chairman. I might say, I think there was some
19 savings, but we have the Budget Committee, I might say,
20 Senator Domenici and Senator Hollings and others are very
21 concerned about what we have done already in this bill.

22 We think we have reduced the cost by some \$35 billion
23 over the President's original proposal.

24 Senator Domenici thinks it is only \$18 billion. I
25 think both he and Senator Hollings think it should be \$100.

1 That is another problem we have.

2 I just hope we did not make it any more expensive.

3 Mr. Chapoton. If the \$342 million figure I gave you
4 was private plans only. If the state and local and Federal
5 Government were covered there would be \$656 million.

6 So we didn't save nearly that much.

7 Senator Durenberger. I don't want my question to be
8 misinterpreted, because I really appreciate how far the
9 Treasury has come on this issue.

10 I also appreciate the fact that Senator Chafee has
11 been put in a little box here that we all helped build for
12 him, because I think he really believes that the way to get
13 good capital formation and everything else is long-term
14 investment.

15 There is no better long-term investment than IRA's and
16 LIRA's and pensions and all that sort of a thing.

17 If he suggests that maybe there will be a second go-
18 around on these things where we can improve on them, I
19 guess then, maybe we will go along with it.

20 The Chairman. Do you have any further questions, Senator
21 Chafee?

22 Senator Chafee. Well, as you know, Mr. Chairman, I was
23 very anxious for the \$2,000 on the LIRA's. If we do our
24 adding and subtracting here from what Senator Danforth saved
25 us on the \$200 and \$400, when we finished with Senator

1 Danforth's All Savers and netted that out, in '84, we have
2 a \$1.6 plus net, a net on that, I show.

3 Then, in the next year, '85, we have nearly a \$3.5 net
4 increase.

5 So, I would like to see us go to the \$2,000 on the
6 LIRA. That seems to be a very modest cost. That is no
7 where near in the brackets of the mandatory; is it, Mr.
8 Chapoton?

9 Mr. Chapoton. No, it isn't, Senator. Let me see if we
10 can put a finger on that figure.

11 Senator Chafee. Well, I just happen to have it here.

12 (Laughter.)

13 The Chairman. It takes more than one finger.

14 Senator Chafee. In netting it out, in '82, I have a
15 net savings of \$14 million. In the next year, \$332 million.
16 In the next year, \$940 million.

17 These are pluses.

18 The next year, \$2.6, that is in '85. In the next year,
19 \$2.7.

20 That is after my proposal.

21 Mr. Chapoton. That is raising it from \$1,000 to \$2,000?

22 Senator Chafee. Yes.

23 Mr. Chapoton. Net of the additional to the All Savers
24 and then removing the \$400-\$200?

25 Senator Chafee. Right. Well, we didn't remove the

1 \$400 and \$200. We cut it down to --

2 Mr. Chapoton. Removing the extension it would go from
3 \$100 on dividends only?

4 Senator Chafee. Yes.

5 (Pause.)

6 Senator Chafee. Now we are truly in savings. These are
7 savings. That is what the whole thing is.

8 Also, one of the advantages, I think when you have
9 the \$2,000 across-the-board, you have something that is
10 understandable. It is \$2,000, not \$1,000 for one and \$2,000
11 for another.

12 I would say yes.

13 Mr. Chapoton. Senator, we --

14 (Laughter.)

15 Mr. Chapoton. -- I am reluctant to agree to that. I
16 grant you, we can see some advantages, and there are some
17 simplification advantages to it.

18 We have wanted to go slowly on the coverage on permitt-
19 ing employees who also participate in an employer plan. I
20 think, indeed, if you could do it perfectly, you would say
21 that for an employee who is covered by an employer-sponsored
22 plan, you would allow him to contribute an amount equal to
23 \$2,000 less the contribution on his behalf, by his employer.

24 You would try to draw a parity between the covered and
25 uncovered employee. In one case, the covered employee clearly

1 does have tax-free benefits, tax-free amounts accruing for
2 his benefit, whereas the uncovered employee does not.

3 So, it seems to me there is justification for a
4 differential here. I am reluctant to agree to abolishing
5 that differential.

6 We take a meat ax approach, that is, \$1,000, \$2,000,
7 because we do not want to go to the extreme difficulty of
8 determining the amount set aside for the covered employee.

9 But I have trouble saying we could do away with any
10 distinction whatsoever.

11 There is the revenue cost, while it does not completely
12 offset the savings from the Danforth amendment, there is
13 still cost versus not going up at all.

14 Senator Chafee. Well, I will tell you, why don't we
15 leave it this way. This is the S & L's and the credit
16 unions, as you know, and all of the thrifts really think
17 this is the savings measure.

18 Why don't we leave it. Why don't you have a good
19 night's sleep on this, Mr. Chapoton, and if we are here
20 tomorrow, we might see how things look, if we are here.

21 Mr. Chapoton. That will be fine.

22 The Chairman. Senator Bradley.

23 Senator Long. Is there any reason why we wouldn't be
24 here?

25 Senator Chafee. Well, we might finish this bill today.

1 Senator Long. I have no idea.

2 The Chairman. As I understand, well, I think Senator
3 Grassley raised a question this morning. I asked him to
4 discuss that with Mr. Chapoton, at noon, with reference to
5 this same provision.

6 Mr. Chapoton. Well, as I understood Senator Grassley's
7 concern, it has to do with the case where an IRA has been
8 established for a spouse, an unemployed wife, for example,
9 is allowed under present law, to establish an individual
10 retirement account for her own benefit, provided that the
11 husband also establishes one.

12 His concern was that if the husband does not continue
13 making contributions to her individual retirement account
14 or if they are divorced or he dies, could the law be changed
15 so that she could continue to make contributions to that
16 account.

17 We would agree that so long as they are married and
18 there is on a joint return, earned income, she could
19 continue to make contributions to her account. But following
20 death or divorce of the husband, death of the husband, or
21 if they are divorced, so that she does not on her return
22 have any earned income, then we do not feel we could go
23 forward with allowing her to contribute to individual
24 retirement accounts.

25 Keeping in mind, though, if she had any earned income

1 at all from odd jobs or whatever, as long as it achieved
2 the \$2,000 level, she could make a full \$2,000 contribution
3 to her own individual retirement account, because as Senator
4 Chafee has pointed out, the percentage limitation is
5 removed.

6 So, I think that would address that problem to some
7 extent.

8 Senator Durenberger. What is the policy judgment in
9 coming to that conclusion?

10 Mr. Chapoton. The policy behind the individual retire-
11 ment account is that the retirement benefit, the amount
12 put aside for retirement is a percentage of retirement or
13 a portion of earned income, and that if you have income
14 from capital, then the same considerations do not apply
15 because presumably that capital will be available and
16 producing income after retirement.

17 Senator Durenberger. That relates to source. The
18 purpose is still to provide for the retirement of one or
19 the other of two people.

20 You were good enough in this one to make a major step
21 forward in permitting the wife who is not employed outside
22 the home, to have half of the retirement account.

23 Mr. Chapoton. Correct.

24 Senator Durenberger. That is appropriate. That means
25 that she is going to have to retire some day too, and you

1 are acknowledging that. I think that is what Chuck is
2 doing in his recommendations.

3 So, what is the good public policy in worrying about
4 whether her continuation of this account is from earned
5 income or from some other source, if it started as a retire-
6 ment with earned income?

7 Mr. Chapoton. Once she no longer, neither she nor
8 her spouse no longer have earned income, then she is in
9 exactly the same position as any other person, any other
10 taxpayer who does not have earned income.

11 She has income or the proposal would be of no benefit
12 to her and whatever policy dictates that we limit this to
13 earned income, and that is the policy I just described,
14 would dictate it whether or not she had previously estab-
15 lished or her husband on her behalf, had previously
16 established an individual retirement account.

17 Senator Durenberger. But if we limit her as to amount
18 or whatever, are we abusing the Government of some right
19 or -- I really don't understand it.

20 Mr. Chapoton. I think if we did that, Senator, we
21 would have to say that any person, and indeed, it is not
22 an undesirable policy. I think it would be an expensive
23 policy, but it is not undesirable to say that any person
24 might be able to set aside a certain amount of any source
25 income for his or her retirement.

1 That would be the policy you would have to go to if
2 you did away with the earned income requirements.

3 Senator Grassley, Well, we didn't desire to go that
4 far. I suppose, if I had my druthers, I would like to go
5 as far as Senator Bentsen suggested in his legislation, but
6 we concluded that that was too costly for this legislation.
7 The amount of money we are talking about here is fairly
8 negligible, but there ought to be a point in somebody's
9 participation, in an IRA, that they ought to be able to
10 continue that based on their own right to do that, even
11 though that right originally came from somebody else.

12 - So that that plan for retirement can be continued,
13 regardless of the source of income. That is the principle
14 we are trying to establish here.

15 There is other advantages to it. The normal sex bias
16 within the Tax Code that there works against housewives
17 is one worthy goal, but it is a corollary one. The one
18 we ought to be establishing here is that when a person,
19 after a certain period of time, whether it be one year or
20 two years or three years, would pay into an IRA, they ought
21 to be able to continue that contribution.

22 That is what we are trying to gain here. It is more
23 a principle than a matter of money, because I think the
24 revenue loss would be negligible.

25 Mr. Chapoton. If that is the principle though, would

1 you not have to apply that to any case in which an individual
2 retirement account and then cease making contributions?

3 Senator Grassley. I am sure Senator Bentsen would
4 answer that question no, because he was concerned about one
5 large class of people that were being denied the benefits
6 of IRA's, jyst because they didn't happen to get a check
7 outside the home or have any income for their work within
8 the home.

9 I think we have to acknowledge they are contributing
10 as much to the income of the family by staying at home,
11 working at home, as if they were working outside the home
12 and getting paid for it.

13 Mr. Chapoton. That's correct. I think that is the
14 theory behind the spousal IRA, so long as one of the spouses
15 has earned income.

16 But I think when neither spouse has earned income or
17 a single person has no earned income, then the theory tends
18 to break down and the individual retirement account is an
19 effort to set aside income from labor, for retirement.

20 Senator Grassley. Right or wrong; the way we have
21 written our proposal, tends to agree with you, except that
22 we would say that at a certain period in time, when you
23 contributed to an IRA through a working spouse, then you
24 ought to have the right, on your own, independent, regardless
25 of the circumstances, where that individual spouse decides

1 not to continue it, or if the spouse should die, you ought
2 to have that right to continue that.

3 Senator Durenberger. Within this is another issue and
4 that is --

5 The Chairman. I wonder if we might get some resolution
6 of this issue. We have a vote pending. It is my understand-
7 ing they have accommodated, to some extent, Mr. Grassley's
8 concern. They have not, I guess in some part, some of
9 the concerns of others.

10 Senator Grassley. I would have to say they have
11 accommodated somewhat, but there is still the case of where
12 a person might be getting alimony. They want to contribute
13 to it.

14 The Chairman. I believe we can address that in a
15 second proposal.

16 Senator Grassley. Or even some legitimacy of unearned
17 income being used to continue. Something that is started
18 on earned income.

19 It seems to me that is a legitimate purpose.

20 The Chairman. There are a lot of legitimate concerns,
21 but we are not going to be able to address them all. That
22 is my point.

23 We have been able to accommodate --

24 Senator Grassley. Well, what we talked about
25 accommodating or not accommodating, is whether or not it is

1 going to cost a lot of money. We are not talking about a
2 lot of money here.

3 Senator Durenberger. Mr. Chairman, I suppose there
4 is a policy issue on the first one, but there is a legitimate
5 question to be answered I think relative to alimony. That
6 does tie back in to the unearned income side in one way.

7 Mr. Chapoton. Well, that question came up just before
8 noon also, in our private discussions. While alimony is
9 not tied to earnings, it is not earned income under present
10 law.

11 I think there is a degree of logic, I concede on that.
12 It would move away from the present structure. We do not
13 treat alimony as earned income for any other purpose. I
14 have a little difficulty saying for this purpose it should
15 be so treated.

16 On the other hand, as I state, I can see a degree of
17 logic there. That gets closer to the line. I am not
18 quite sure how we would handle it mechanically. I suppose
19 it certainly could be done though.

20 The Chairman. Well, is it satisfactory to the members
21 of the Committee if we tentatively accept what we have
22 agreed upon and then if there is some way to accommodate
23 the alimony portion or the other portion of Senator Grassley's
24 concern, we can still do that.

25 We would like to dispose of what we have agreed upon at

1 this time, unless there is some objection.

2 We would like to finish this bill tomorrow if we can.

3 Senator Grassley. Well, I am not sure to what extent
4 we have reached agreement here, even on what he has spoken
5 to.

6 The Chairman. Let's find out.

7 Mr. Chapoton. The one thing that Senator Grassley I
8 believe we have reached agreement is on following a husband
9 -- if a husband ceased making contributions to an individual
10 retirement account for a spouse, she could pick it up
11 whether or not he chose to do so, provided they filed a
12 joint return and provided there was at least \$2,000 of
13 income on a joint return, on their joint return.

14 \$2,000 of earned income on their joint return.

15 The Chairman. That would cover more cases than the
16 exceptions I would think.

17 Mr. Chapoton. That would cover a great number of the
18 case. In addition, following a divorce or death, if she had
19 any earned income, even if she only had \$2,000 of earned
20 income, she could make the full contribution, the maximum
21 contribution to an individual retirement account.

22 So, it would be a very unusual case that she was
23 prohibited from continuing contribution.

24 Senator Grassley. State that again. Under condition
25 of death the surviving spouse could still contribute to the

1 same --

2 Mr. Chapoton. To her individual retirement account,
3 provided the full \$2,000, if she had at least \$2,000 of
4 earned income. That is all she would need, and then she
5 could make the maximum contribution and certainly would
6 have the same treatment as she would have under your
7 proposal.

8 Senator Grassley. But, the point is then, if she had
9 no earned income, but had unearned income, then she is not
10 going to be able to build up that.

11 Mr. Chapoton. That's correct. She is limited by 100
12 percent of her earned income or \$2,000, which ever is less.

13 The Chairman. Mr. McConaghy, have you been following
14 the debate there?

15 Mr. McConaghy. Yes.

16 The Chairman. Do you understand it as decided by staff?

17 Mr. McConaghy. I think so.

18 The Chairman. Can we agree on what -- that much of it
19 and then we can come back if there is a way to expand it,
20 if it is a matter of policy, then we need to discuss it
21 with Treasury some more.

22 Is it all right with you to accept what we have agreed
23 on, including the portion you had a question and Senator
24 Chafee?

25 (No response.)

1 The Chairman. Without objection then, when we come
2 back I will recognize Senator Bradley for an amendment.

3 (A short recess was taken.)

4 The Chairman. The Committee will come to order.

5 On last Thursday, the Senator from New Jersey indicated
6 that at an appropriate time he would propose, I am not
7 certain how many amendments, but at least some amendments,
8 and I now recognize the Senator from New Jersey for that
9 purpose.

10 Senator Bradley. I thank the Chairman.

11 As he stated, last week I said I would propose two
12 sets of amendments.

13 The first set I will propose now. This set deals with
14 targeting the tax cut, the individual tax cut much more
15 to the middle and lower income individual.

16 I have two amendments that would do that. I would like
17 to deal with them sequentially.

18 The first amendment is a counter tax proposal to the
19 Administration's 5-10-10. It is a tax cut which is for
20 one year, effective January, 1982.

21 I might say that each member has a fact sheet at his
22 desk. It would have a revenue loss of \$28 billion, in '82;
23 \$53 billion, in '83; \$63 billion, in '84 and \$74 billion
24 in '85.

25 The tax cut consists of first reducing the marginal

1 rate on investment income from 70 percent to 50 percent.

2 It would target the rate reductions to the middle and
3 low income taxpayer. By that it is the taxpayer under
4 \$50,000 in income. The last page of the document that has
5 been presented is the rate cut.

6 In addition to that it increases the zero bracket
7 amount by \$200 for single returns and \$400 for joint returns.

8 The earned income credit is increased from 10 percent
9 to 11 percent. The income range is expanded from \$6,000 to
10 \$10,000, from that to \$8,000 to \$12,000.

11 In addition, the 10 percent marriage tax penalty
12 deduction goes into effect immediately in 1982. It is not
13 phased in over two years. The deduction is up to \$4,000
14 in income.

15 Now on the second page of the document that has been
16 circulated, is a comparative analysis of the individual tax
17 relief provided to middle income Americans by the revised
18 Administration proposal which was tentatively adopted last
19 week, by the Finance Committee in the proposal that I offer
20 today.

21 To give you some example of the difference in individual
22 cut, a joint tax return, with two dependents, under the
23 Administration proposal, earned and that individual earning
24 \$35,000, would receive a tax cut of \$538.00, in 1982.

25 Under the proposal I have offered today, that couple

1 would receive \$699 in tax relief.

2 Generally, anyone who earns under \$50,000 in income
3 would receive greater tax relief in the proposal that I have
4 suggested, than the Administration plan.

5 The third page of the proposal compares the percent
6 reduction in income taxes under the proposal I have offered
7 and the Administration proposal.

8 In addition to that, it takes into account the
9 increased taxes that Americans will be paying from inflation,
10 bracket creep and the increased Social Security Taxes.

11 A comparative analysis of these two rate schedules I
12 think is instructive. What it shows is, under my proposal,
13 an income level of \$30,000 to \$50,000 would get a 15.2
14 percent reduction in their income taxes.

15 While the Administration's proposal is a 12.5 percent
16 increase.

17 \$20,000 to \$30,000 of income, under my proposal would
18 get a 15.7 percent reduction in taxes, while the Adminis-
19 tration's would be 11.8 percent reduction in taxes.

20 The \$15,000 to \$20,000, under my proposal, the income
21 level of \$15,000 to \$20,000 would receive a 15 percent
22 reduction; the Administration, an 11 percent reduction.

23 The \$5,000 to \$10,000 individual would receive
24 basically a 30 percent reduction; the Administration a 14
25 percent reduction.

1 The Chairman. Fine.

2 We will start this afternoon at 2:30 with IRA's. I
3 will ask Mr. Chapoton to stay around for a few minutes in
4 case somebody would like to talk with him now about some-
5 thing for 15 minutes. We could save an hour this afternoon

6 Mr. Chapoton. Sure.

7 (Whereupon, at 12:01 p.m., the Executive Session
8 recessed, to reconvene at 2:30 p.m., the same day.)

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AFTERNOON SESSION

1
2 The Chairman. I wonder if we might start on the
3 individual retirement accounts, which is number 4, in the
4 index. I think there will be some discussion of that and
5 maybe some change in procedural position by the Adminis-
6 tration.

7 Perhaps, Mr. Chapoton, you can explain the Adminis-
8 tration's IRA proposal, which in essence is the proposal
9 of Senator Chafee and others on the Committee.

10 Then, I think there are a number of Senators who had
11 questions about some change.

12 Mr. Chapoton. All right, Mr. Chairman.

13 Our proposal is to increase the IRA limit for an
14 employee who is not covered by a plan, by an employer-
15 sponsored plan, to \$2,000, from \$1,500.

16 In the case of a spouse, that is, where an individual
17 retirement account is also established for an unemployed
18 spouse, an additional \$250. So that combined plans for
19 both spouses could be \$250 -- \$2,250.

20 We also proposed allowing, the establishment of IRA's
21 by employees who are covered by an employer-sponsored plan.
22 They would be allowed to contribute \$1,000 to an individual
23 retirement account for their benefit.

24 In the case of a spousal IRA, in that case, it would
25 be half the additional amount or \$125. So, for a total

1 contribution to both plans, both IRA's for a spouse, for a
2 worker and a spouse covered by an employer-sponsored plan,
3 it would be \$1,125.

4 We did not permit I guess the two most discussed items
5 here or whether mandatory contributions to an employer-
6 sponsored plans qualify for the income tax deduction.

7 They do not, under our proposal.

8 Secondly, do voluntary contributions, that is, not,
9 that are not required as a condition to participate in the
10 plan, whether they qualify for a tax deduction.

11 The answer is no, we have not allowed that under our
12 proposal.

13 In the case of voluntary contributions, employers can
14 establish employer-sponsored IRA's, and therefore facilitate
15 the creation of \$1,000 deductible contributions on behalf
16 of their employees, but we did not permit contributions to
17 their own plans, to the employer-sponsored plan.

18 I might say on that, Senator Chafee and I, and others
19 have discussed the second aspect on the voluntary contri-
20 bution. Whether voluntary contributions are deductible.
21 We might want to go into that just a bit.

22 The Chairman. Senator Chafee.

23 Senator Chafee. Yes, Mr. Chairman.

24 First, let me say that in the entire tax proposal that
25 we have here, except for the one year Danforth All Savers

1 provision, it seems to me that this is the only out year
2 savings encouragement in the bill.

3 I think significant steps have been taken. I might
4 say it is not what we originally sought, as you know, Mr.
5 Chairman.

6 The bill that Representative Moor and I put in would
7 permit \$2,000, on the so-called LIRA's and IRA's and also
8 would permit withdrawals for college education of children
9 and for first purchase of a home.

10 However, little steps for little feet. We are making
11 progress. This is something, one of the most significant
12 things that -- I am not sure Mr. Chapoton stressed, no
13 longer do we have the percentage deduction. That is, it is
14 the lower of \$2,000 or 15 percent.

15 If you make \$3,000, you can put \$2,000 of it aside
16 in an IRA. The percentage limitation is gone.

17 Now, that takes care of the IRA's.

18 Now, let's move to the LIRA's which apply to where
19 there is a qualified pension plan.

20 Here we permit a \$1,000 deduction by a member of a
21 pension plan, but the question is, what about his voluntary
22 contributions to a pension plan. Would that voluntary
23 contribution count?

24 Mr. Chapoton said that in the Administration's
25 proposal, that does not take place.

1 I would urge that we do permit the voluntary. This is
2 the first of three wishes I have. This is the most modest.

3 The next being the mandatory, and the next being let
4 it be \$2,000, and the third being include the mandatory as
5 well.

6 But let's start with the voluntary.

7 Mr. Chapoton and I have spoken about that. Why don't
8 you proceed?

9 Mr. Chapoton. Our problem with allowing voluntary
10 contributions -- deductions for voluntary contributions is
11 principally the administrative problem.

12 We felt the limits on IRA's, that is, the present
13 law restrictions on an account established by an individual
14 for his own retirement, principally the restriction that
15 he cannot borrow against it and that he cannot withdraw
16 it before he reaches age 59 and a half, without a ten
17 percent penalty, that those restrictions and perhaps others
18 but those principally would have to apply in the case of
19 voluntary contributions to an employer-sponsored plan.

20 Once you decide that you have a number of administra-
21 tive difficulties in setting up those restrictions appli-
22 cable only to the employer's deductible contributions to
23 his own plan.

24 But if we could impose in a feasible way, and we
25 worked on it a bit here over noon and think perhaps we

1 could, those restrictions, then I think we would have no
2 objection to allowing a voluntary, deduction for voluntary
3 contributions for plans.

4 I don't know if Mr. McConaghy sees any further admin-
5 istrative problems in doing that.

6 The two we would want, Mark, would be the no borrowing
7 and penalty if withdrawal before age 59 and a half.

8 Mr. McConaghy. Well, I think those essentially --
9 I would agree with Mr. Chapoton. I think it would be
10 obviously necessary to have the employer keep in effect
11 separate sub-accounts. He presumably does that now with
12 a voluntary, non-deductible contribution and regular
13 qualified plan.

14 This deductible voluntary contribution, I think he
15 would have to keep a separate sub-account for and there
16 would have to be rules perhaps as to what happens if an
17 amount is pulled out.

18 Is it attributable to a qualified plan contribution
19 and voluntary non-deductible or a voluntary deductible
20 contribution.

21 My understanding is they can and are willing to
22 establish such accounts.

23 Senator Chafee. Well, the objective of course, is to
24 encourage use of these and to make it as simple as possible.

25 What would happen if you just counted the contribution

1 into the regular pension plan as it.

2 Now, true, there they could -- I presume when they
3 leave, they could take it. But no one is going to quit
4 their job in order to collect a few dollars on an IRA or
5 a LIRA, are they?

6 Mr. Chapoton. No, that's correct.

7 It is true, it would be a significant benefit as
8 compared to the non-employer sponsored IRA. If we can do
9 it without administrative difficulty, that is, we can
10 impose a penalty tax comparable to that imposed by early
11 withdrawal from an IRA, in such a case, unless an employee
12 puts it into another IRA immediately following withdrawal,
13 which he can do and avoid the tax.

14 Then it seems to me you would achieve comparability
15 and that would be desirable.

16 Senator Chafee. Well, I think that is fine. In other
17 words, we are a little vague here. You are going to be
18 working on it. We have the concept. The idea is to make
19 it as simple as possible to encourage the use of them so
20 that the salesman will go around and be able to make a
21 pitch to get into an IRA or a LIRA, so we are going to use
22 these.

23 Now the next, Mr. Chairman, was in connection with the
24 mandatory contributions, above what a non-Social Security
25 payer would pay.

1 In other words, if a Government -- you would not want
2 it for a Government employee -- anything above what he
3 would normally pay for Social Security, but anything else
4 he would want to put in.

5 Mr. Chapoton. What he would otherwise pay for Social
6 Security would not be deductible in any event.

7 Senator Chafee. Right.

8 Mr. Chapoton. Because the private sector, Social
9 Security, of course, is not deductible.

10 Senator Chafee. Right.

11 Mr. Chapoton. But we feel we cannot go the full route
12 and allow deduction for mandatory contributions, principally
13 because of the revenue cost involved.

14 There are an awful lot of plans now, Government and
15 private and that require mandatory contributions as a
16 condition to participation in the plan.

17 Of course, many Governmental bodies require contri-
18 butions to a retirement plan as a condition to employment.
19 That is not very usual. In quite, it is quite unusual in
20 the private sector. But it is quite usual for an employer-
21 sponsored plan in the private sector to require you to
22 contribute to the plan as a condition to participation in
23 the plan.

24 If we permitted a deduction for those amounts, we
25 would be talking about a revenue loss of over -- in our

1 estimates, \$4 billion, right away and without any immediate
2 increase in savings.

3 We feel we must oppose that.

4 Senator Chafee. Well, Mr. Chairman, I know they looked
5 on this. I know that Senator Matsunaga has been interested
6 in it.

7 I can't argue with the revenue statistics. We have
8 come in with an agreement here that we wouldn't go above
9 them.

10 I have had a good deal of concern expressed to me that
11 if you permit the voluntary contributions to be deductible,
12 then the mandatory plans are put at a disadvantage and
13 indeed, will try to make artificial changes in order to
14 qualify as voluntary plans. It will cause some wrenching
15 and distortions in the system.

16 At least, Mr. Chapoton indicated that he was sympathetic
17 toward the view of permitting the mandatory deduction.
18 Maybe we can work toward that and try and continue efforts
19 in this, perhaps when we get dealing with the Social Security
20 Bill in some way.

21 I think the great thrust of this effort, of course, is
22 to have a supplement to Social Security through the IRA's.

23 Senator Matsunaga. Mr. Chairman.

24 The Chairman. Senator Matsunaga.

25 Senator Matsunaga. I commend the Senator from Rhode

1 Island, Mr. Chafee, for offering his proposal. I fully
2 support his proposal. But his proposal doesn't go far
3 enough, limiting it to voluntary pension plans would
4 discriminate against the so-called mandatory plans.

5 Of course, the term "mandatory" might be misleading
6 for the reason that mandatory merely means that the employer
7 will contribute his share only if the employee will contri-
8 bute his share.

9 Mandatory does not mean that the employee is required
10 to be a part of the plan.

11 Because of this now, if we permit a tax deduction only
12 for IRA's and the voluntary plans, then we are going to
13 find an exodus from the so-called mandatory plans among
14 the employees who would like to take the tax deduction.

15 While it is true that under most plans they may
16 withdraw from the plans whenever they terminate their
17 employment, still the tax deduction is an attractive thing.

18 Let me point out some of the reasons which a coalition,
19 an ad hoc coalition on employee retirement savings deduc-
20 tions consisting of the following have said.

21 Now, the American Council of Life Insurance, American
22 Society of Pension Actuaries, Association of Advanced Life
23 Underwriters, Association of Private Pension and Welfare
24 Plans, Bureau of Wholesale Salesman's Association, ERISA
25 Industry Committee, National Association of Life Underwriters,

1 National Automobile Dealers Association, National Federation
2 of Independent Business, Small Business Council of America.

3 This coalition fully endorsed extension of the IRA
4 proposal as put forth by the Administration, to some
5 mandatory as well as voluntary plans, one for equity
6 reasons.

7 Then, the failure to treat mandatory and voluntary
8 contributions equally would discriminate against those
9 lower paid employees who can only afford to make mandatory
10 contributions necessary to participate in the employer's
11 plan.

12 Two, employees may cease to make mandatory contri-
13 butions and withdraw from company-sponsored plans, to set
14 up IRA's.

15 Now employees who withdraw would, one, lose their
16 benefits provided by the employer.

17 Two, lose incidental benefits under the employer's
18 plan, such as life insurance, annuity options, and three,
19 lose increased benefits through later plan amendments and
20 systematic savings through payroll deduction.

21 Next, employee who withdraw from participation in the
22 employer's plan, would adversely, and this is important,
23 would adversely affect the continued tax qualified savers
24 of the employers' plan, since the employer, as the Secretary
25 well knows, is required under the Internal Revenue Code, to

1 maintain minimum participation levels.

2 By being distracted from the mandatory plans to the
3 voluntary and the IRA's, the existing plans, which are very
4 salutory and ones which should be kept, would just dis-
5 integrate by withdrawal of the employees.

6 Then, new plan formation by small employers may be
7 discouraged since such employers must often depend on their
8 employees to help fund a plan in the early years.

9 Employees who do not participate in employer-sponsored
10 plans, even though they are eligible, will not have the
11 necessary incentive to join the employer's plan, and will
12 continue to be totally dependent on Social Security System.

13 Now, for this reason, I feel that perhaps we should
14 begin, if as Mr. Chapoton said, during the informal con-
15 versation we had, the discussion we had, that the revenue
16 impact would be too great, maybe we could start off with
17 just part of the mandatory pension plans sector.

18 That is, take the -- just the private sector to begin
19 with and leave the Government sector out for later integra-
20 tion into the plan.

21 How will that strike the Treasury?

22 Mr. Chapoton. Well, Senator, let me respond to a
23 couple of points.

24 One, I think it is a matter of concern as you state.
25 I certainly agree that we not undermine the private pension

1 system. There will be some pressure, unquestionably, for
2 employees to consider going their own way, having their
3 own individual retirement account and not participating.

4 But, at the same time, they have to recognize in
5 failing to, if they do that, they fail to participate in
6 the employer's contributions which are usually significant
7 and build up over the years and offer very important
8 benefits.

9 So that I think the case that this will dismantle the
10 private pension system overstates the situation consider-
11 ably, though there will be some pressure to move into their
12 own individual retirement account.

13 If we could allow employee mandatory employee contri-
14 butions to be deductible, it probably would be the best way
15 all factors considered, particularly if we made some
16 changes in the present rules that treat contributory plans
17 and non-contributory plans slightly differently.

18 But they are questions we don't need to get into now.

19 But I do not see any way to get there partially, and
20 I do not see any way to get there under the revenue con-
21 straints we now have.

22 If we went to private plans only, we would still be
23 talking about in 1982, calender '82, \$1.6 billion. Even
24 then, I don't see how we could explain to workers for the
25 Federal Government and workers for state and local Governments

1 why their contributions would not be deductible, whereas
2 those in the private sector would be.

3 So, I do not see how we can go partially on this
4 question.

5 Senator Matsunaga. Supposing we lower the amount on
6 mandatory plans, rather than \$1,000, to begin with \$500
7 deduction.

8 That would mean considerable savings. You may have
9 the figures.

10 Mr. Chapoton. Well, it would be, according to these
11 figures, it is on a calendar year basis, it would be \$1.2
12 billion, calendar '82.

13 Senator Matsunaga. Well, I have figures here, '82, would
14 be \$.9 billion.

15 Mr. Chapoton. That must be a fiscal year.

16 Senator Matsunaga. In '83 it would be \$1.7 billion.
17 In '84, it would be \$1.9 billion. In 1985, \$2.0 billion and
18 in '86, \$2.1 billion, if we were to reduce the deduction to
19 \$500.

20 Mr. Chapoton. \$500. We would agree basically with
21 those figures. That is, I think, outside the budgetary
22 constraints under which we are operating.

23 Senator Matsunaga. Would that still be beyond what the
24 Administration would be willing to go?

25 Mr. Chapoton. Yes, sir.

1 We could not at this time. We would be happy to
2 consider that in the future. We could not at this time
3 agree to that type of additional expenditure.

4 Senator Matsunaga. Mr. Chairman, I would go on record
5 as offering my amendment regardless as to what the con-
6 sequences may be, to extend the tax deduction provisions for
7 IRA to voluntary and mandatory pension plans.

8 The Chairman. You are offering that in the form of an
9 amendment?

10 Senator Matsunaga. Yes.

11 The Chairman. Do you want a vote on that?

12 (Pause.)

13 The Chairman. Do you want a record vote?

14 Senator Chafee. Well, Mr. Chairman, I -- this puts me
15 in a very difficult spot. I have, as you know, been press-
16 ing the mandatory, along with the voluntary. But we are
17 in a situation where the Administration has convinced me
18 that we are not going to be able to do everything we want to
19 do on this bill.

20 I have seen a host of other proponents here hold back
21 on getting everything each one wanted.

22 So, I would not be able, sympathetic as I am, to the
23 Senator's proposal, I wish he wouldn't press it at this time.

24 Senator Matsunaga. Well, may I put it on this basis,
25 then. I will presently support the voluntary proposal, and

1 then, reserve my right to work up some maybe acceptable
2 proposition, acceptable to the Treasury as well as to those
3 on the other side of the aisle.

4 The Chairman. Fine.

5 Mr. Chapoton. Senator, if I could make one other point
6 that I should point out in this examination of this question,
7 under present law, since we allow \$1,500 contribution in the
8 case of an employee who is not covered by his plan, that is,
9 that applies, even though he could be covered, but elects
10 not to participate.

11 We already have something of an incentive for an
12 employee not to participate and make his contribution to
13 his own individual retirement account.

14 So we are not exacerbating that situation except to
15 the extent we are raising the \$1,500 to \$2,000.

16 So, we already have a problem in that regard, even
17 though the basic question you are addressing --

18 Senator Matsunaga. Yes, I realize that.

19 Senator Durenberger. Mr. Chairman.

20 The Chairman. Senator Durenberger.

21 Senator Durenberger. Mr. Chairman, I became lost
22 somewhere here in the revenue impacts of Senator from
23 Hawaii's suggestion was that a \$1,000 mandatory costs \$1.6
24 billion, in '82?

25 Mr. Chapoton. I will review it again. \$1,000 mandatory

() 1 covering only the private pension system, excluding state
2 and local governments and the Federal Government costs \$1.6
3 billion, in calendar '82.

4 Senator Durenberger. Does that mean that if we did the
5 -- I have to apologize for coming in late, but if we did what
6 we did last August, with just \$100, again, we wouldn't even
7 have to write out the Fed's people, because the amount is
8 so small.

9 But, just keeping it to the private, that would cost
10 \$160 million?

11 Mr. Chapoton. No, about \$342 million, calendar year.

12 Senator Durenberger. In everything we did yesterday
13 saving the savings and loans and giving the tax bracket, 30
14 percent tax bracket folks a good bump and taking it away from
15 all the little people on fixed incomes, below 30 percent,
16 did we save anything in there in that transfer that would
17 approximate \$342 million, next year?

18 The Chairman. I might say, I think there was some
19 savings, but we have the Budget Committee, I might say,
20 Senator Domenici and Senator Hollings and others are very
21 concerned about what we have done already in this bill.

22 We think we have reduced the cost by some \$35 billion
23 over the President's original proposal.

24 Senator Domenici thinks it is only \$18 billion. I
25 think both he and Senator Hollings think it should be \$100.

1 That is another problem we have.

2 I just hope we did not make it any more expensive.

3 Mr. Chapoton. If the \$342 million figure I gave you
4 was private plans only. If the state and local and Federal
5 Government were covered there would be \$656 million.

6 So we didn't save nearly that much.

7 Senator Durenberger. I don't want my question to be
8 misinterpreted, because I really appreciate how far the
9 Treasury has come on this issue.

10 I also appreciate the fact that Senator Chafee has
11 been put in a little box here that we all helped build for
12 him, because I think he really believes that the way to get
13 good capital formation and everything else is long-term
14 investment.

15 There is no better long-term investment than IRA's and
16 LIRA's and pensions and all that sort of a thing.

17 If he suggests that maybe there will be a second go-
18 around on these things where we can improve on them, I
19 guess then, maybe we will go along with it.

20 The Chairman. Do you have any further questions, Senator
21 Chafee?

22 Senator Chafee. Well, as you know, Mr. Chairman, I was
23 very anxious for the \$2,000 on the LIRA's. If we do our
24 adding and subtracting here from what Senator Danforth saved
25 us on the \$200 and \$400, when we finished with Senator

1 Danforth's All Savers and netted that out, in '84, we have
2 a \$1.6 plus net, a net on that, I show.

3 Then, in the next year, '85, we have nearly a \$3.5 net
4 increase.

5 So, I would like to see us go to the \$2,000 on the
6 LIRA. That seems to be a very modest cost. That is no
7 where near in the brackets of the mandatory; is it, Mr.
8 Chapoton?

9 Mr. Chapoton. No, it isn't, Senator. Let me see if we
10 can put a finger on that figure.

11 Senator Chafee. Well, I just happen to have it here.
12 (Laughter.)

13 The Chairman. It takes more than one finger.

14 Senator Chafee. In netting it out, in '82, I have a
15 net savings of \$14 million. In the next year, \$332 million.
16 In the next year, \$940 million.

17 These are pluses.

18 The next year, \$2.6, that is in '85. In the next year,
19 \$2.7.

20 That is after my proposal.

21 Mr. Chapoton. That is raising it from \$1,000 to \$2,000?

22 Senator Chafee. Yes.

23 Mr. Chapoton. Net of the additional to the All Savers
24 and then removing the \$400-\$200?

25 Senator Chafee. Right. Well, we didn't remove the

1 \$400 and \$200. We cut it down to --

2 Mr. Chapoton. Removing the extension it would go from
3 \$100 on dividends only?

4 Senator Chafee. Yes.

5 (Pause.)

6 Senator Chafee. Now we are truly in savings. These are
7 savings. That is what the whole thing is.

8 Also, one of the advantages, I think when you have
9 the \$2,000 across-the-board, you have something that is
10 understandable. It is \$2,000, not \$1,000 for one and \$2,000
11 for another.

12 I would say yes.

13 Mr. Chapoton. Senator, we --

14 (Laughter.)

15 Mr. Chapoton. -- I am reluctant to agree to that. I
16 grant you, we can see some advantages, and there are some
17 simplification advantages to it.

18 We have wanted to go slowly on the coverage on permitt-
19 ing employees who also participate in an employer plan. I
20 think, indeed, if you could do it perfectly, you would say
21 that for an employee who is covered by an employer-sponsored
22 plan, you would allow him to contribute an amount equal to
23 \$2,000 less the contribution on his behalf, by his employer.

24 You would try to draw a parity between the covered and
25 uncovered employee. In one case, the covered employee clearly

1 does have tax-free benefits, tax-free amounts accruing for
2 his benefit, whereas the uncovered employee does not.

3 So, it seems to me there is justification for a
4 differential here. I am reluctant to agree to abolishing
5 that differential.

6 We take a meat ax approach, that is, \$1,000, \$2,000,
7 because we do not want to go to the extreme difficulty of
8 determining the amount set aside for the covered employee.

9 But I have trouble saying we could do away with any
10 distinction whatsoever.

11 There is the revenue cost, while it does not completely
12 offset the savings from the Danforth amendment, there is
13 still cost versus not going up at all.

14 Senator Chafee. Well, I will tell you, why don't we
15 leave it this way. This is the S & L's and the credit
16 unions, as you know, and all of the thrifts really think
17 this is the savings measure.

18 Why don't we leave it. Why don't you have a good
19 night's sleep on this, Mr. Chapoton, and if we are here
20 tomorrow, we might see how things look, if we are here.

21 Mr. Chapoton. That will be fine.

22 The Chairman. Senator Bradley:

23 Senator Long. Is there any reason why we wouldn't be
24 here?

25 Senator Chafee. Well, we might finish this bill today.

1 Senator Long. I have no idea.

2 The Chairman. As I understand, well, I think Senator
3 Grassley raised a question this morning. I asked him to
4 discuss that with Mr. Chapoton, at noon, with reference to
5 this same provision.

6 Mr. Chapoton. Well, as I understood Senator Grassley's
7 concern, it has to do with the case where an IRA has been
8 established for a spouse, an unemployed wife, for example,
9 is allowed under present law, to establish an individual
10 retirement account for her own benefit, provided that the
11 husband also establishes one.

12 His concern was that if the husband does not continue
13 making contributions to her individual retirement account
14 or if they are divorced or he dies, could the law be changed
15 so that she could continue to make contributions to that
16 account.

17 We would agree that so long as they are married and
18 there is on a joint return, earned income, she could
19 continue to make contributions to her account. But following
20 death or divorce of the husband, death of the husband, or
21 if they are divorced, so that she does not on her return
22 have any earned income, then we do not feel we could go
23 forward with allowing her to contribute to individual
24 retirement accounts.

25 Keeping in mind, though, if she had any earned income

1 at all from odd jobs or whatever, as long as it achieved
2 the \$2,000 level, she could make a full \$2,000 contribution
3 to her own individual retirement account, because as Senator
4 Chafee has pointed out, the percentage limitation is
5 removed.

6 So, I think that would address that problem to some
7 extent.

8 Senator Durenberger. What is the policy judgment in
9 coming to that conclusion?

10 Mr. Chapoton. The policy behind the individual retire-
11 ment account is that the retirement benefit, the amount
12 put aside for retirement is a percentage of retirement or
13 a portion of earned income, and that if you have income
14 from capital, then the same considerations do not apply
15 because presumably that capital will be available and
16 producing income after retirement.

17 Senator Durenberger. That relates to source. The
18 purpose is still to provide for the retirement of one or
19 the other of two people.

20 You were good enough in this one to make a major step
21 forward in permitting the wife who is not employed outside
22 the home, to have half of the retirement account.

23 Mr. Chapoton. Correct.

24 Senator Durenberger. That is appropriate. That means
25 that she is going to have to retire some day too, and you

1 are acknowledging that. I think that is what Chuck is
2 doing in his recommendations.

3 So, what is the good public policy in worrying about
4 whether her continuation of this account is from earned
5 income or from some other source, if it started as a retire-
6 ment with earned income?

7 Mr. Chapoton. Once she no longer, neither she nor
8 her spouse no longer have earned income, then she is in
9 exactly the same position as any other person, any other
10 taxpayer who does not have earned income.

11 She has income or the proposal would be of no benefit
12 to her and whatever policy dictates that we limit this to
13 earned income, and that is the policy I just described,
14 would dictate it whether or not she had previously estab-
15 lished or her husband on her behalf, had previously
16 established an individual retirement account.

17 Senator Durenberger. But if we limit her as to amount
18 or whatever, are we abusing the Government of some right
19 or -- I really don't understand it.

20 Mr. Chapoton. I think if we did that, Senator, we
21 would have to say that any person, and indeed, it is not
22 an undesirable policy. I think it would be an expensive
23 policy, but it is not undesirable to say that any person
24 might be able to set aside a certain amount of any source
25 income for his or her retirement.

1 That would be the policy you would have to go to if
2 you did away with the earned income requirements.

3 Senator Grassley, Well, we didn't desire to go that
4 far. I suppose, if I had my druthers, I would like to go
5 as far as Senator Bentsen suggested in his legislation, but
6 we concluded that that was too costly for this legislation.
7 The amount of money we are talking about here is fairly
8 negligible, but there ought to be a point in somebody's
9 participation, in an IRA, that they ought to be able to
10 continue that based on their own right to do that, even
11 though that right originally came from somebody else.

12 So that that plan for retirement can be continued,
13 regardless of the source of income. That is the principle
14 we are trying to establish here.

15 There is other advantages to it. The normal sex bias
16 within the Tax Code that there works against housewives
17 is one worthy goal, but it is a corollary one. The one
18 we ought to be establishing here is that when a person,
19 after a certain period of time, whether it be one year or
20 two years or three years, would pay into an IRA, they ought
21 to be able to continue that contribution.

22 That is what we are trying to gain here. It is more
23 a principle than a matter of money, because I think the
24 revenue loss would be negligible.

25 Mr. Chapoton. If that is the principle though, would

1 you not have to apply that to any case in which an individual
2 retirement account and then cease making contributions?

3 Senator Grassley. I am sure Senator Bentsen would
4 answer that question no, because he was concerned about one
5 large class of people that were being denied the benefits
6 of IRA's, just because they didn't happen to get a check
7 outside the home or have any income for their work within
8 the home.

9 I think we have to acknowledge they are contributing
10 as much to the income of the family by staying at home,
11 working at home, as if they were working outside the home
12 and getting paid for it.

13 Mr. Chapoton. That's correct. I think that is the
14 theory behind the spousal IRA, so long as one of the spouses
15 has earned income.

16 But I think when neither spouse has earned income or
17 a single person has no earned income, then the theory tends
18 to break down and the individual retirement account is an
19 effort to set aside income from labor, for retirement.

20 Senator Grassley. Right or wrong; the way we have
21 written our proposal, tends to agree with you, except that
22 we would say that at a certain period in time, when you
23 contributed to an IRA through a working spouse, then you
24 ought to have the right, on your own, independent, regardless
25 of the circumstances, where that individual spouse decides

1 not to continue it, or if the spouse should die, you ought
2 to have that right to continue that.

3 Senator Durenberger. Within this is another issue and
4 that is --

5 The Chairman. I wonder if we might get some resolution
6 of this issue. We have a vote pending. It is my understand-
7 ing they have accommodated, to some extent, Mr. Grassley's
8 concern. They have not, I guess in some part, some of
9 the concerns of others.

10 Senator Grassley. I would have to say they have
11 accommodated somewhat, but there is still the case of where
12 a person might be getting alimony. They want to contribute
13 to it.

14 The Chairman. I believe we can address that in a
15 second proposal.

16 Senator Grassley. Or even some legitimacy of unearned
17 income being used to continue. Something that is started
18 on earned income.

19 It seems to me that is a legitimate purpose.

20 The Chairman. There are a lot of legitimate concerns,
21 but we are not going to be able to address them all. That
22 is my point.

23 We have been able to accommodate --

24 Senator Grassley. Well, what we talked about
25 accommodating or not accommodating, is whether or not it is

1 going to cost a lot of money. We are not talking about a
2 lot of money here.

3 Senator Durenberger. Mr. Chairman, I suppose there
4 is a policy issue on the first one, but there is a legitimate
5 question to be answered I think relative to alimony. That
6 does tie back in to the unearned income side in one way.

7 Mr. Chapoton. Well, that question came up just before
8 noon also, in our private discussions. While alimony is
9 not tied to earnings, it is not earned income under present
10 law.

11 I think there is a degree of logic, I concede on that.
12 It would move away from the present structure. We do not
13 treat alimony as earned income for any other purpose. I
14 have a little difficulty saying for this purpose it should
15 be so treated.

16 On the other hand, as I state, I can see a degree of
17 logic there. That gets closer to the line. I am not
18 quite sure how we would handle it mechanically. I suppose
19 it certainly could be done though.

20 The Chairman. Well, is it satisfactory to the members
21 of the Committee if we tentatively accept what we have
22 agreed upon and then if there is some way to accommodate
23 the alimony portion or the other portion of Senator Grassley's
24 concern, we can still do that.

25 We would like to dispose of what we have agreed upon at

1 this time, unless there is some objection.

2 We would like to finish this bill tomorrow if we can.

3 Senator Grassley. Well, I am not sure to what extent
4 we have reached agreement here, even on what he has spoken
5 to.

6 The Chairman. Let's find out.

7 Mr. Chapoton. The one thing that Senator Grassley I
8 believe we have reached agreement is on following a husband
9 -- if a husband ceased making contributions to an individual
10 retirement account for a spouse, she could pick it up
11 whether or not he chose to do so, provided they filed a
12 -joint return and provided there was at least \$2,000 of
13 income on a joint return, on their joint return.

14 \$2,000 of earned income on their joint return.

15 The Chairman. That would cover more cases than the
16 exceptions I would think.

17 Mr. Chapoton. That would cover a great number of the
18 case. In addition, following a divorce or death, if she had
19 any earned income, even if she only had \$2,000 of earned
20 income, she could make the full contribution, the maximum
21 contribution to an individual retirement account.

22 So, it would be a very unusual case that she was
23 prohibited from continuing contribution.

24 Senator Grassley. State that again. Under condition
25 of death the surviving spouse could still contribute to the

1 same --

2 Mr. Chapoton. To her individual retirement account,
3 provided the full \$2,000, if she had at least \$2,000 of
4 earned income. That is all she would need, and then she
5 could make the maximum contribution and certainly would
6 have the same treatment as she would have under your
7 proposal.

8 Senator Grassley. But, the point is then, if she had
9 no earned income, but had unearned income, then she is not
10 going to be able to build up that.

11 Mr. Chapoton. That's correct. She is limited by 100
12 percent of her earned income or \$2,000, which ever is less.

13 The Chairman. Mr. McConaghy, have you been following
14 the debate there?

15 Mr. McConaghy. Yes.

16 The Chairman. Do you understand it as decided by staff?

17 Mr. McConaghy. I think so.

18 The Chairman. Can we agree on what -- that much of it
19 and then we can come back if there is a way to expand it,
20 if it is a matter of policy, then we need to discuss it
21 with Treasury some more.

22 Is it all right with you to accept what we have agreed
23 on, including the portion you had a question and Senator
24 Chafee?

25 (No response.)

1 The Chairman. Without objection then, when we come
2 back I will recognize Senator Bradley for an amendment.

3 (A short recess was taken.)

4 The Chairman. The Committee will come to order.

5 On last Thursday, the Senator from New Jersey indicated
6 that at an appropriate time he would propose, I am not
7 certain how many amendments, but at least some amendments,
8 and I now recognize the Senator from New Jersey for that
9 purpose.

10 Senator Bradley. I thank the Chairman.

11 As he stated, last week I said I would propose two
12 sets of amendments.

13 The first set I will propose now. This set deals with
14 targeting the tax cut, the individual tax cut much more
15 to the middle and lower income individual.

16 I have two amendments that would do that. I would like
17 to deal with them sequentially.

18 The first amendment is a counter tax proposal to the
19 Administration's 5-10-10. It is a tax cut which is for
20 one year, effective January, 1982.

21 I might say that each member has a fact sheet at his
22 desk. It would have a revenue loss of \$28 billion, in '82;
23 \$53 billion, in '83; \$63 billion, in '84 and \$74 billion
24 in '85.

25 The tax cut consists of first reducing the marginal

1 rate on investment income from 70 percent to 50 percent.

2 It would target the rate reductions to the middle and
3 low income taxpayer. By that it is the taxpayer under
4 \$50,000 in income. The last page of the document that has
5 been presented is the rate cut.

6 In addition to that it increases the zero bracket
7 amount by \$200 for single returns and \$400 for joint returns.

8 The earned income credit is increased from 10 percent
9 to 11 percent. The income range is expanded from \$6,000 to
10 \$10,000, from that to \$8,000 to \$12,000.

11 In addition, the 10 percent marriage tax penalty
12 deduction goes into effect immediately in 1982. It is not
13 phased in over two years. The deduction is up to \$4,000
14 in income.

15 Now on the second page of the document that has been
16 circulated, is a comparative analysis of the individual tax
17 relief provided to middle income Americans by the revised
18 Administration proposal which was tentatively adopted last
19 week, by the Finance Committee in the proposal that I offer
20 today.

21 To give you some example of the difference in individual
22 cut, a joint tax return, with two dependents, under the
23 Administration proposal, earned and that individual earning
24 \$35,000, would receive a tax cut of \$538.00, in 1982.

25 Under the proposal I have offered today, that couple

1 would receive \$699 in tax relief.

2 Generally, anyone who earns under \$50,000 in income
3 would receive greater tax relief in the proposal that I have
4 suggested, than the Administration plan.

5 The third page of the proposal compares the percent
6 reduction in income taxes under the proposal I have offered
7 and the Administration proposal.

8 In addition to that, it takes into account the
9 increased taxes that Americans will be paying from inflation,
10 bracket creep and the increased Social Security Taxes.

11 A comparative analysis of these two rate schedules I
12 think is instructive. What it shows is, under my proposal,
13 an income level of \$30,000 to \$50,000 would get a 15.2
14 percent reduction in their income taxes.

15 While the Administration's proposal is a 12.5 percent
16 increase.

17 \$20,000 to \$30,000 of income, under my proposal would
18 get a 15.7 percent reduction in taxes, while the Adminis-
19 tration's would be 11.8 percent reduction in taxes.

20 The \$15,000 to \$20,000, under my proposal, the income
21 level of \$15,000 to \$20,000 would receive a 15 percent
22 reduction; the Administration, an 11 percent reduction.

23 The \$5,000 to \$10,000 individual would receive
24 basically a 30 percent reduction; the Administration a 14
25 percent reduction.

1 Now, I think that is instructive in and of itself
2 because it clearly shows that a great amount of the in-
3 dividual tax reduction goes to people earning under \$50,000
4 in income.

5 The way that is achieved is by targeting the rates,
6 increasing the zero bracket amount and the earned income
7 credit, and by providing a more generous marriage tax penalty,
8 marriage tax proposal that goes into effect in 1982, fully
9 into effect in 1982.

10 Now, the purpose of this amendment is to focus
11 attention on the relative reductions in tax in real reductions
12 in tax. That is what the last column of the third page does.

13 If you take what individuals will be paying in increased
14 Social Security Taxes and increased inflation, the Adminis-
15 tration's proposal provides for the income level of \$15,000
16 to \$20,000 in effect, a 2.5 percent income tax reduction;
17 not a 10 percent, not a 12 percent, but a 2.5 percent
18 reduction.

19 For the individual who earns between \$20,000 and
20 \$30,000, that is about a 3.3 percent reduction.

21 For the individual that earns between 5 and 10 percent,
22 he does not get an effective tax reduction.

23 For the individual who earns between 10 and \$15,000,
24 he gets a five tenths of one percent reduction in his taxes
25 for the year 1982.

1 So, I think this is clear evidence that the individual
2 portion of the Administration's proposal is targeted much
3 more to the higher income individual. For example, the
4 individual that makes over \$200,000, gets almost 16 percent
5 reduction in his or her taxes.

6 So the point of this amendment, Mr. Chairman, is as
7 I said initially, to try to focus attention on what is fair
8 and what is equitable.

9 In my proposal I have provided for a reduction in
10 investment income tax rate from 70 to 50. That is indeed
11 where the higher income individual is going to get a tax
12 reduction.

13 He is going to get a tax reduction there while he is
14 in the process of increasing investment in our economy and
15 increasing our competitiveness.

16 I see no reason to discriminate against those that
17 make less money, less than \$50,000. I would argue, as this
18 amendment does, that the rest of the individual tax
19 reduction should be targeted to them.

20 They are the ones that are hardest hit by inflation.
21 That are hardest hit by Social Security increases and are
22 the primary taxpaying public in this country and deserve
23 the relief.

24 The Administration's program does not do that. This
25 proposal does that.

1 So, Mr. Chairman, that is the proposal I offer today
2 in hopes that the Committee will at least recognize that the
3 Administration's proposal is targeted much more for the
4 higher income individual, than it is to the individual that
5 earns under \$50,000 in income, and that the Committee will
6 recognize that this cut is balanced. It is equitable. It
7 is aimed toward creating risk investment and capital
8 formation, while at the same time, it provides the maximum
9 individual tax relief to individuals and couples earning
10 under \$50,000 in income.

11 The Chairman. Senator Mitchell, do you want to be
12 heard?

13 Senator Mitchell. Thank you, Mr. Chairman.

14 I would like to add a few words in support of the
15 alternative proposal proposed by Senator Bradley.

16 I think the impact of the Administration proposal on
17 various categories of taxpayers in comparison with Senator
18 Bradley's proposal is best established by comparing the net
19 tax reduction after the effects of inflation and the increase
20 in Social Security taxes are calculated.

21 If we look at that, I think we get a clear and in-
22 structive message regarding the Administration's proposal.

23 For those taxpayers with incomes up to \$20,000, under
24 present law, their burden of taxes amounts to 16 percent of
25 the total.

1 The Administration's proposal, after inflation and
2 Social Security increase are factored in, would give to them
3 a net tax reduction of 3 percent.

4 The alternative proposal would give to them a net
5 tax reduction of 12 percent.

6 For those taxpayers with incomes of between \$20,000
7 and \$50,000, they now bear 50 percent of the tax burden.

8 The Administration's proposal would give them a net
9 tax reduction of 42 percent.

10 The alternative suggested by Senator Bradley would
11 give them 53 percent.

12 Finally, for those taxpayers in excess of \$50,000,
13 they now bear 34 percent of the total tax burden.

14 The Administration's proposal would give them 62
15 percent of the total tax cut.

16 The alternative proposal by Senator Bradley would
17 give them 34 percent. That is a figure identical to their
18 present burden under existing law.

19 To repeat and summarize, the alternative proposed
20 would provide net tax reduction, after inflation and Social
21 Security are calculated, to each of the three categories of
22 taxpayers, zero to \$20,000; \$20,000 to \$50,000, and over
23 \$50,000, roughly approximate to their present tax burden.

24 The Administration's proposal, however, would give
25 overwhelmingly relief to those with incomes of over \$50,000.

1 They now bear 34 percent of the total tax load. They
2 would get 62 percent of the tax cut. Whereas, those with
3 incomes of from zero to \$20,000 who now bear 16 percent of
4 the tax load, would get 3 percent of the tax reduction.

5 I think that more than anything illustrates the
6 tremendous bias in the Administration's tax program toward
7 those with higher incomes.

8 And, it is unfortunately consistent with almost every-
9 thing else that has been done with respect to this tax bill.

10 Consider what the Committee has done so far. We
11 have reduced the maximum rate on unearned income from 70
12 percent to 50 percent.

13 Which of the three categories of taxpayers previously-
14 mentioned does that favor?

15 Zero to \$20,000?

16 \$20,000 to \$50,000?

17 Or those with incomes in excess of \$50,000? The
18 answer to that is clear.

19 The effect of that reduction has produced a second
20 effect and that is the maximum capital gains rate has been
21 reduced from 28 percent to 20 percent.

22 Which of the three categories of taxpayers does that
23 proposal favor? zero to \$20,000? \$20,000 to \$50,000? Or
24 over \$50,000?

25 The answer to that is clear.

1 We have terminated the exclusion for interest earned
2 while extending the exclusion for dividends earned.

3 Which of the three categories of taxpayers does that
4 most favor?

5 Clearly, those in excess of \$50,000.

6 We have virtually eliminated the estate tax.

7 Which of the three categories of taxpayers does that
8 most favor? Clearly, those earning in excess of \$50,000.

9 We have increased the gift tax exemption from \$3,000
10 to \$10,000 annually. Which of the three categories of
11 taxpayers does that provision most favor?

12 Clearly, those earning above \$50,000 a year.

13 So the fact of the matter is, every single action taken
14 by this Committee so far, has principally benefited those
15 taxpayers in the category of incomes in excess of \$50,000
16 and has provided little or no relief for those taxpayers in
17 the categories of up to \$20,000 and very, very modest relief
18 for the overwhelming majority of American taxpayers in the
19 income category of \$20,000 to \$50,000.

20 Now, what Senator Bradley has proposed is a very modest
21 change in the Administration's proposal. It would have the
22 effect of simply saying that the amount of the reduction
23 would not be 10 percent across-the-board or any other figure
24 across-the-board, but would vary, depending upon the level
25 of one's income.

1 At an income of \$12,000 a year the taxpayer would get
2 a 19 percent reduction.

3 An income of \$15,000, the taxpayer would get a
4 reduction of 18 percent.

5 So, gradually down, until a taxpayer making \$50,000
6 a year would in effect get a 10 percent reduction.

7 So that those persons in this country with incomes of
8 less than \$50,000 would get a tax reduction of greater than
9 10 percent, and those taxpayers of more than \$50,000 would
10 get a reduction of less than 50 percent on a declining
11 scale that gets down to 4 percent for persons with incomes
12 above \$100,000.

13 That would be fair even if we had not taken all of the
14 actions we have taken that already provide maximum benefit,
15 maximum relief, maximum assistance, to those with incomes
16 in excess of \$50,000.

17 But when those actions are considered, then this
18 alternative is even more compelling in the name of common
19 sense, and surely in the name of equity.

20 Mr. Chairman, I strongly urge upon all Committee
21 members that we do something on this bill, that we do some-
22 thing to provide a greater portion of relief to those tax-
23 payers who are making less than \$50,000 a year, because they
24 are the taxpayers who most need it.

25 We all know that those persons making more than \$50,000

1 a year are able, by virtue of their income, to take advantage
2 of those preferences, deductions and shelters, which while
3 legally available to all Americans, are not as a practical
4 matter, available for a working man making \$18,000, \$19,000
5 or \$20,000 a year.

6 He is worried about paying next month's oil bill. He
7 is not worried about a real estate tax shelter.

8 At the other end of the scale, we have very low
9 income persons, who as we know, pay little in taxes and are
10 the beneficiaries of most Government programs.

11 In between, in the category up to \$50,000, \$20,000
12 to \$50,000; \$15,000 to \$45,000, somewhere in that range,
13 are the overwhelming majority of American taxpayers, the
14 average American family, the middle class citizen who in
15 the aggregate pay most of the taxes in this country, get
16 the least of the benefit.

17 It is that group of Americans to which we should be
18 addressing relief in this bill. It is that group of Americans
19 that deserves, indeed, demands this type of relief.

20 I think this alternative would do that in a way that
21 does not injure anybody. It is not pit one group against
22 another, but simply recognizes that that is the group that
23 most needs assistance. That is the group that hasn't gotten
24 a thing in the three days we have been here so far, in
25 contrast to those of \$50,000 and over whose welfare has been

1 our almost exclusive preoccupation under the provisions of
2 the bill we have discussed so far.

3 Senator Bradley. Mr. Chairman, I would just like to
4 follow on to what Senator Mitchell said, to say that I think
5 the Administration might be blowing a once in a generation
6 opportunity, and that is an opportunity to create a bi-
7 partisan consensus for economic growth in the next decade.

8 I think that if you look at the proposals that the
9 majority in fact in many cases unanimously, from the
10 Democratic side, that we have supported, that one is embodied
11 in this, the reduction of investment income from 70 to 50.

12 You see a very clear commitment on this side to do
13 what is necessary to make America competitive again in the
14 world.

15 You saw that on the tax bill that was passed out of
16 the Senate Finance Committee last year, 19 to 1. Recognizing
17 the need not only to rebuild America, but to target the tax
18 relief to the middle and lower income people.

19 In last year's Senate Finance Committee bill we had
20 a zero bracket increase. We had an earned income credit
21 increase.

22 We targeted the rate relief. That is absent in this
23 tax bill. I am afraid, Mr. Chairman, that down the road
24 another year or two or three years when the full impact of
25 this 5-10-10 is known and the relative benefits are

1 demonstrated, that you are going to have the traditional
2 debate between left and right, that you are going to polar-
3 ize the society, and we will have lost the opportunity that
4 is present now to build a bi-partisan consensus for the
5 policies that are needed to rebuilt America and achieve the
6 economic growth that is essential to our political insti-
7 tutions in the 1980's and 1990's.

8 So, it is with that in mind, that we rather ruthlessly
9 but nonetheless precisely, crafted this tax cut and aimed it
10 directly for middle to lower income people because we believe
11 that the working people in this country is not going to be
12 fooled and that two to three years down the road we are
13 going to need them as a part of the economic growth coalition
14 and that without them we are not going to achieve what we
15 all want which is a better living standard for ourselves and
16 for our children.

17 Senator Mitchell. Mr. Chairman, I want to correct one
18 thing, one statement I made that was in error. I said that
19 persons in the income category of up to \$20,000 now bear a
20 tax burden of 16 percent of the total.

21 That, under the Administration's proposal, after
22 inflation and Social Security are factored in, they would
23 get 3 percent of the relief.

24 Under the alternative they would get 12 percent of the
25 relief. I was wrong. They would not get 3 percent of the

1 relief. They would get no relief. The figure in fact is
2 minus 3 percent.

3 In effect it would be an increase for those persons in
4 the category of zero to \$20,000 in the aggregate.

5 The Chairman. Thank you.

6 Well, I would just say I think we understand the
7 proposal. It is an effort to skew the across-the-board rate
8 cuts. I don't quarrel with that as an effort to set it
9 apart from the Administration's proposal.

10 But the President, the cornerstone of his proposal is
11 across-the-board rate cuts. That is what it is all about.
12 He has made some concessions.

13 I would say you could do about any figures -- it is
14 hard to compare these two bills because the proposal by
15 Senator Bradley, it costs about \$6 billion more at the outset.
16 So it is hard to say who gets a few dollars more if you are
17 talking about a bill that is \$6 billion more expensive than
18 the President's.

19 Senator Bradley. \$2 billion.

20 The Chairman. Secondly, according to the Department of
21 Treasury figures, under the Administration's tax bill those
22 between zero and \$10,000 would pay 2.3 percent of the taxes.
23 They would get 2.9 percent of the benefits.

24 When fully effective they would pay about 2.1 percent
25 of the taxes.

1 Those between \$10,000 and \$60,000 pay under current
2 law about 71.7 percent of the taxes. They will receive
3 about 74 percent of the benefits under the Administration's
4 tax bill. They will pay about 9 percent when it is fully
5 effective -- 70.9 percent when it is fully effective.

6 \$60,000 and over, those of the rich referred to in
7 the Bradley proposal, under current law pay 26 percent of
8 the taxes. They will get 23.1 percent of the benefits under
9 the Reagan plan.

10 When it is fully effective they will still pay 27.1
11 percent of the taxes.

12 So, I just suggest that it is difficult to be precise
13 when we are dealing with different brackets and different
14 numbers.

15 I think another point I would make that the Bradley
16 skewed rates would create a rather set of cliffs. For
17 example, if you are in the \$20,000, \$20,000, \$24,600 range
18 you would pay at a rate of 22 percent.

19 If you are in the \$24,600 to \$24,900 you would pay a
20 30 percent, which is an 8 percent difference.

21 So, I just suggest there are a lot of good ideas in
22 this proposal. One was the 70 to 50, which we have taken
23 care of this morning.

24 The other is the marriage penalty which we will take
25 care of later, maybe not at that full 10 percent. Because we

1 are concerned about the budget and concerned about some
2 restraint.

3 So, I would suggest, let us give the President an
4 opportunity to see if his program will work. We tried -- this
5 is a tax reduction program, not a redistribution program.

6 It would seem to me that if we want to get into
7 redistribution, then maybe we should address it in other
8 legislation.

9 But, having said that, I think the Treasury may have a
10 comment.

11 Do you support this proposal?

12 Mr. Chapoton. No, we do not, Mr. Chairman. We would
13 simply concur in what the Chairman states, that it is hard
14 to compare this proposal with the Administration's proposal
15 because ours is a three-year cut, 25 percent over 3 years.
16 I am not quite certain what the percent is in this proposal,
17 but it is a one year cut.

18 If you take it out beyond this we will, you will not
19 offset the effects of inflation in the later years. I think
20 you would have to compare it with ours over three years.

21 As you mentioned, we are directing ours strictly
22 across-the-board deciding that the tax burden is too heavy
23 across-the-board and wish to reduce the tax burden up and
24 down the income scale.

25 We do not specifically address the problem of Social

1 Security, though Congress must deal with that problem at
2 some point. It is not addressed in this proposal.

3 Senator Baucus. Mr. Chairman.

4 The Chairman. Senator Baucus.

5 Senator Baucus. Mr. Chairman, I wonder if the Joint
6 Committee staff, perhaps Treasury could indicate to us the
7 number of taxpayers or percentage of taxpayers in each of
8 the various categories under the Bradley proposal? That is,
9 the number of taxpayers 5 to 10, the percentage of American
10 taxpayers in that bracket?

11 I am trying to get a sense for the number of taxpayers
12 that are affected by the Bradley proposal.

13 Mr. McConaghy. Senator Baucus of individual returns
14 that would be obviously counting a joint return as one
15 return, for two people, there are 75,960,000 taxable returns
16 that were filed.

17 Of that number, I can give you the break out below
18 \$5,000 and \$5,000 to \$10,000 and \$10,000 to \$15,000 and so
19 forth if you want to.

20 Senator Baucus. Let us take those \$50,000 and below
21 and compare it with those above \$50,000.

22 Mr. McConaghy. Of the 75,960,000 there are approximate-
23 ly 4,300 returns, taxable returns above \$50,000, which
24 would -- 4.3 million which would represent about 5.7 percent
25 of taxable returns.

1 Senator Baucus. So 5.7 percent of the tax returns
2 are in the category of income of \$50,000 or below.

3 Mr. McConaghy. Correct.

4 Senator Baucus. The balance is below, right?

5 Mr. McConaghy. Correct.

6 Senator Baucus. Yes.

7 Mr. McConaghy. They pay about 32 percent of the tax
8 liability, about 33 percent.

9 Senator Baucus. When you say "they," who is that?

10 Mr. McConaghy. Those returns above \$50,000.

11 Senator Baucus. It is obvious under the Bradley
12 proposal, certainly in the first year, that the vast majority
13 of taxpayers are below \$50,000, would get more tax relief
14 than those taxpayers above \$50,000.

15 Mr. Chairmman, one thing that strikes me in listening
16 to this debate is a point touched on by Senator Bradley as
17 well as by Senator Mitchell, and that is the attempt on the
18 part of the Congress as well as the Administration, to try
19 to reestablish some economic order and more than that,
20 stimulate the economy in some basis where there is a
21 national consensus.

22 It strikes me that when American public becomes more
23 and more aware of the increasing disparity of income in our
24 country, certainly compared with other countries, that there
25 is in effect a time bomb in the 5-10-10 proposal.

1 As the months and years go by, I think that more
2 Americans are going to realize that under this tax package
3 as proposed by the Administration, it is true that the
4 wealthy are going to become more wealthy, get greater tax
5 breaks. The middle income and low income are going to not
6 get the same tax breaks. The disparity between them and
7 the very wealthy are going to become greater.

8 If we are going to not have this time bomb go off,
9 I suggest that we do whatever we can here to fashion tax
10 reduction, on the individual side, that does address the
11 problem, that is gives the most relief to the most taxpayers
12 and not the most relief to the less number of taxpayers.

13 It also strikes me as a little bit disconcerting when
14 we keep hearing, "Well, this is the President's proposal."
15 I mean, I don't think we are in lock step with the President.
16 There are after all, three separate branches of Government.
17 One of them happens to be the legislative.

18 I think we in the Congress, by and large, should pay
19 very close attention to the November 4th election and
20 certainly to the President's proposals, because I think
21 the American public, to some degree, I won't debate what
22 degree, did speak on November 4. We the Congress, should
23 largely follow that mandate.

24 But, we do have another responsibility here and that
25 is to do what we think is best. I think that if each of us

1 were polled privately on this, that each of us would think
2 it best to give a somewhat greater proportionate tax
3 reduction to the middle income taxpayer, to the bulk of
4 America, and not a somewhat simplistic 10-10-10.

5 We all know that really Kemp-Roth, 10-10-10 is not
6 based upon economic analysis, not based upon a look at which
7 taxpayers would get the most benefit, but rather its genesis
8 is largely a political rhetoric. It is simple. It sounds
9 good, 10-10-10.

10 Those who proposed it years ago really didn't think
11 it would have much chance of passing. Lo and behold, the
12 band wagon started moving and it gained momentum and people
13 started believing in it.

14 I just suggest that we here either adopt the Bradley
15 proposal or something similar to it, that gives the bulk,
16 a greater proportion of the tax reduction to more Americans
17 than to fewer Americans.

18 I think this proposal is a good idea.

19 The Chairman. Would you like a roll call on this,
20 Senator Bradley?

21 Senator Bradley. Yes, I would, Mr. Chairman. I have
22 some more things to say. I think Senator Mitchell would like
23 to make a few more points.

24 The Chairman. It won't change the minds of those
25 proxies I have, but go ahead.

1 (Laughter.)

2 Senator Bradley. You know, this debate about the
3 10-10-10 or 5-10-10 and the unwillingness to be flexible at
4 all in trying to craft a tax cut that really has bi-partisan
5 support, as I said earlier, I think is short sighted. That
6 draws a line and separates people at a point where you could
7 actually bring people together.

8 But it also is a little bit like, I don't know if
9 Senator Long told me this story or who told me, about the
10 guy that goes to the doctor. He is losing a little of his
11 hair. He goes to the doctor and asks what can he do to grow
12 hair.

13 The doctors says, well you follow these 13 steps.
14 You rub a little on here. You powder a little there. You
15 massage a little there. If you only follow 12 of them,
16 if you only follow 11, if you get them out of order, I can't
17 be responsible your hair is not going to grow.

18 It seems to me that that is the way the Administration
19 is telling us what this economic package is. That somehow
20 or another it has to be exactly as they have stated it, and
21 unless we give it to them exactly as they have stated it,
22 that the economy will not grow.

23 I do not think there is any kind of historical
24 precedent for that. But, as I said, I think it is short
25 sighted.

1 I think it is -- I would make a number of other
2 points that the amendment I am offering, the tax cut I
3 am offering, is very similar to what the Finance Committee
4 did last year 19 to 1, at a time when 10-10-10 was floating
5 around, was proposed and advocated by members of the
6 Committee, but we chose rather than target the individual
7 relief to the middle and lower income people, instead of
8 being doctrinaire about the rate cuts.

9 Finally, I would simply make the point again, and
10 the Joint Tax Committee can confirm this, that the tax cut
11 I have proposed provides real tax relief for precisely those
12 people who are paying the bulk of the taxes. \$20,000 to
13 \$30,000 in income, after the increase in Social Security,
14 after inflation pushing people into higher brackets, get a
15 real tax reduction of 7.6 percent.

16 While the Administration's program, after inflation
17 pushes people into higher brackets, even though those
18 brackets have been widened, and after Social Security taxes
19 have increased, that same individual or couple gets a real
20 tax reduction of 3.3 percent.

21 So, Mr. Chairman, I don't think I will belabor the
22 argument any further except to try to make it again as
23 clear as possible that this is the first of a set of
24 amendments to try to get the members of the Committee to
25 focus on where the individual tax relief should be made.

1 Senator Matsunaga. Will the Senator yield?

2 Senator Bradley. Yes.

3 Senator Matsunaga. How does your proposal compare to
4 the proposal being made in the House, in the Ways and Means
5 Committee?

6 Senator Bradley. I have no idea.

7 Senator Matsunaga. I will say as an aside, I don't
8 mind the doctor prescribing 13 steps. It is when they say
9 you have to wear a wig.

10 The Chairman. Well, this is a disguise, this proposal.

11 Senator Mitchell. Mr. Chairman, could I make one
12 comment?

13 The Chairman. Sure.

14 Senator Mitchell. On the question of whether or not
15 it is our intention to have a redistribution of the tax
16 burden.

17 When you say across-the-board it sounds as though that
18 is not what you are doing, and that may not be our intention.
19 But let nobody misunderstand that is the effect of what we
20 are doing.

21 If those persons within incomes of in excess of \$50,000
22 a year now pay in the aggregate 34 percent of the tax burden,
23 and they get 62 percent of the reduction under this bill,
24 then the resulting burden on them will be less and on the
25 other segments of the taxpaying public will be higher.

1 So the effect is a redistribution, whether intended
2 or not. There ought be no mistake about that. And when
3 combined with all the other steps we have taken which reduce
4 the total tax burden, not only in income taxation but in
5 other forms of taxation, we are producing a significant
6 redistribution of the tax burden in this country away from
7 those persons making more than \$50,000 a year and necessarily
8 therefore shifted on to those persons making less than
9 \$50,000.

10 Senator Bradley. Would the Senator yield there? I
11 think that the implication, when you charge this is a re-
12 distribution is that somehow or another we are taking from
13 the rich and giving to the poor which historically has been
14 the debate in the Finance Committee.

15 I think that I would rather get beyond that debate and
16 frame this amendment in the context of what it takes to get
17 a consensus for economic growth. I don't think you have
18 seen many redistribution amendments in the past that have
19 proposed a reduction in investment income from 70 to 50.

20 But at the same time, recognize that if you are going
21 to get the broad based support for the kind of investment
22 that has to be made in the country, you can't be doctrinaire
23 about individual tax relief.

24 I view the Administration's proposal as being doctrin-
25 aire and this proposal as being pragmatic in the tradition of

1 the Finance Committee and in my view in the best long-term
2 interest for fostering economic growth in the country.

3 The Chairman. The clerk will call the roll.

4 The Clerk. Mr. Packwood.

5 The Chairman. No.

6 The Clerk. Mr. Roth.

7 The Chairman. No.

8 The Clerk. Mr. Danforth.

9 The Chairman. No.

10 The Clerk. Mr. Chafee.

11 Senator Chafee. No.

12 The Clerk. Mr. Heinz.

13 (No response.)

14 The Clerk. Mr. Wallop.

15 The Chairman. No.

16 The Clerk. Mr. Durenberger.

17 The Chairman. No.

18 The Clerk. Mr. Armstrong.

19 The Chairman. No.

20 The Clerk. Mr. Symms.

21 Senator Symms. NO.

22 The Clerk. Mr. Grassley.

23 The Chairman. No.

24 The Clerk. Mr. Long.

25 Senator Long. No.

1 The Clerk. Mr. Byrd.

2 Senator Byrd. No.

3 The Clerk. Mr. Bentsen.

4 Senator Bentsen. No.

5 The Clerk. Mr. Matsunaga.

6 Senator Matsunaga. Aye.

7 The Clerk. Mr. Moynihan.

8 Senator Bradley. Aye by proxy.

9 The Clerk. Mr. Baucus.

10 Senator Baucus. Aye.

11 The Clerk. Mr. Boren.

12 Senator Long. No, by proxy.

13 The Clerk. Mr. Bradley.

14 Senator Bradley. Aye.

15 The Clerk. Mr. Mitchell.

16 Senator Mitchell. Aye.

17 The Clerk. Mr. Chairman.

18 The Chairman. No.

19 (Pause.)

20 The Chairman. On this vote there are 14 yeas and 5

21 -- excuse me, 5 yeas and 14 nays. The amendment is not
22 agreed to.

23 I wonder if we could now move to the so-called marriage
24 penalty, number 2.

25 Senator Bradley. Mr. Chairman, I would just have one

1 sir.

2 The Chairman. Yes.

3 Senator Bradley. The amendment I would now offer
4 simply isolates the skewing issue. It takes 5-10-10, the
5 Reagan Tax Cut. It accepts the revenue loss figures of
6 the Administration. It accepts it as a three year tax cut
7 and it even accepts the July withholding schedules that are
8 embodied in the Administration approach.

9 But I am told by Joint Tax Committee we could, after
10 reducing the top rate on investment income from 70 to 50,
11 come up with \$1.1 billion to \$2 billion that we could target
12 more by skewing the rates to middle and low income people in
13 each of the three years.

14 I would like to ask Joint Tax Committee to confirm
15 that or explain it.

16 Mr. McConaghy. I think, Senator, it would be possible
17 to look at the rate schedules and to try to take from certain
18 brackets an amount equivalent to your suggestion of \$1
19 billion or \$1.5 billion and try to put that money so it
20 falls down in lower brackets.

21 Senator Bradley. In the out years it would be a little
22 more than \$1.5 billion; is that correct?

23 Mr. McConaghy. Yes, I think so.

24 Senator Bradley. So, Mr. Chairman, I would move that
25 consistent with the President's program, revenue figures,

1 years, withholding schedules, that we simply again agree to
2 move away from the doctrinaire approach, towards a skewing
3 approach of the \$ 2 billion to people with incomes under
4 \$50,000.

5 Mr. Chapoton. I am not sure where the \$1.5 billion
6 or \$2 billion came from, Senator.

7 Senator Bradley. It came from the Joint Tax Committee.
8 (Laughter.)

9 The Chairman. Right. Check or money order.

10 Mr. Chapoton. Are you adding that much tax relief to
11 the bill?

12 Senator Bradley. No. What you are doing is you are
13 taking the 10 percent tax relief that goes to people above
14 \$50,000, after you take what is accredited to the -- attri-
15 buted to the 70 to 50 reduction investment income and that
16 is about \$1.5 billion.

17 You are pushing it into the under \$50,000.

18 Mr. Chapoton. I would simply add, Senator, we have not
19 tried to be doctrinaire on this. We have had as a corner-
20 stone of our proposal, across-the-board cuts in marginal
21 rates.

22 This does deviate much less from that principle than
23 your earlier proposal.

24 We do feel, however, that the across-the-board cuts
25 are the best way to do it because it affects marginal rates,

1 it reduces all marginal rates. It has the incentive effect
2 up and down the income scale we sought to achieve.

3 You can have more or less redistribution or targeting
4 of that relief may or may not affect the overall economic
5 impact, depending on the amount involved.

6 But we have stayed with this across-the-board and we
7 would not like to deviate from that.

8 Senator Bradley. I thought the argument was certainty,
9 a three year cut. You could plan how you were going to save
10 it.

11 Mr. Chapoton. That would be true as long as you have
12 a three year cut in place no matter.

13 Senator Bradley. I am saying keep the three year cut
14 for certainty, but you simply give the person under 50 more
15 to save if you believe he is going to save.

16 Mr. Chapoton. We believe all taxpayers will save to
17 some extent, but we believe if you decide the tax burden in
18 this country is too heavy, that it ought to be reduced at
19 all income levels.

20 So we reached the conclusion the fairest way to do
21 that is to do it across-the-board.

22 We are also making other changes in the bill, the
23 marriage tax penalty, the IRA and LIRA, all of which fall
24 at different scales in the income.

25 But in the rate cuts, we feel that the fairest way to

1 do it is straight across-the-board up and down the income
2 scale.

3 The Chairman. Do you want a record vote?

4 Senator Bradley. Yes, I would.

5 The Chairman. You are opposed to the amendment?

6 Mr. Chapoton. Yes, sir.

7 The Chairman. The Clerk will call the roll.

8 The Clerk. Mr. Packwood.

9 The Chairman. No.

10 The Clerk. Mr. Roth.

11 The Chairman. No.

12 The Clerk. Mr. Danforth.

13 The Chairman. No.

14 The Clerk. Mr. Chafee.

15 Senator Chafee. No.

16 The Clerk. Mr. Heinz.

17 The Chairman. No.

18 The Clerk. Mr. Wallop.

19 The Chairman. No.

20 The Clerk. Mr. Durenberger.

21 The Chairman. No.

22 The Clerk. Mr. Armstrong.

23 The Chairman. No.

24 The Clerk. Mr. Symms.

25 The Chairman. No.

1 The Clerk. Mr. Grassley.
2 The Chairman. No.
3 The Clerk. Mr. Long.
4 Senator Long. No.
5 The Clerk. Mr. Byrd.
6 Senator Byrd. No.
7 The Clerk. Mr. Bentsen.
8 Senator Bentsen. No.
9 The Clerk. Mr. Matsunaga.
10 Senator Matsunaga. Aye.
11 The Clerk. Mr. Moynihan.
12 Senator Bradley, Aye, by proxy.
13 The Clerk. Mr. Baucus.
14 Senator Baucus. Aye.
15 The Clerk. Mr. Boren.
16 (No response.)
17 The Clerk. Mr. Bradley.
18 Senator Bradley. Aye.
19 The Clerk. Mr. Mitchell.
20 Senator Bradley. Aye, by proxy.
21 The Clerk. Mr. Chairman.
22 The Chairman. No.
23 (Pause.)
24 The Chairman. The vote is 13 nays and 5 yeas. The
25 amendment is not agreed to.

1 Mr. Chapoton, I wonder if you would explain the
2 Administration's marriage penalty provision.

3 The absentees will be permitted to recover their votes.

4 Mr. Chapoton. Mr. Chairman, our proposal to deal with
5 the marriage penalty problem is that the deduction of an
6 amount equal to ten percent of the income of the lower
7 earning spouse, limited to \$3,000.

8 We would phase that in a partial step beginning July
9 1, 1982, so the deduction in that year would be 5 percent
10 of the income of the lower earning spouse, not to exceed
11 \$1,500 and then beginning July 1, 1983, a deduction equal
12 to 10 percent of the income of the lower earning spouse not
13 to exceed \$3,000.

14 That would be permanent after that point in time.

15 The Chairman. Is this the same provision we had in
16 last year's Senate Bill?

17 Mr. McConaghy. Yes, it is, Mr. Chairman.

18 The Chairman. Any changes at all, Mr. McConaghy?

19 Mr. McConaghy. No, It phases in 5 percent the first
20 year and 10 percent the second year.

21 It is pushed back is all, one year is all.

22 The Chairman. Is there any amendment to this provision?

23 Senator Long. Let me make one comment. We got in
24 this situation where you had a marriage penalty because of
25 the amendments I had opposed down through the years just

1 because it was my duty to oppose them. Those were amend-
2 ments that were being advocated by single people at that
3 point. They were contending that the fact you had community
4 property income and the fact that married people could file
5 a joint return, gave the married people an advantage.

6 So we eventually the amendment prevailed with regard
7 to providing this special advantage for single people.

8 Then we go down the road a while and we find that
9 people find it very much worth their while to get divorced
10 before the end of the year, they can take a trip, as long
11 as they are not married, they can take a trip and pay all
12 the expenses of a trip to the Islands by what they save by
13 divorcing in December and then marrying again come January.

14 So that type of ridiculous fiasco went on for a while
15 and after a while people realized we better try to do
16 something about it. The married people started complaining.

17 Now as I understand it to wipe out the marriage
18 penalty by then now going and voting to give an add on
19 advantage to married people would cost about \$14 billion.

20 This would get rid of about half of it and that would
21 cost about \$7 billion. It wouldn't cost nearly as much to
22 get out of that trap the way Larry Woodward was suggesting
23 ought to be done. He was over at Treasury when he died, but
24 he was the Chief of our Joint Staff, the same job Mr. McConaghy
25 has now. He used to tell me the way to get out of that trap

1 was to have to have a chance to have these tax cuts like
2 this one, just don't cut the taxes for single people as much
3 as you cut them for married people and in due course you
4 will work your way out of that trap without the tremendous
5 revenue loss that is implicit in doing it the other way.

6 Now this is one of the big cost items in this bill,
7 \$7 billion. I honestly think we ought to be getting out of
8 this trap by reducing taxes for married people more and
9 reducing taxes for single people less until we get out of
10 this fiasco which never should have been created to begin
11 with.

12 As one who was around this and had this burden of
13 debating all that, it seems to me in this bill, we could
14 have found better priorities than to put \$7 billion into
15 getting out of the trap that way.

16 We should have just reduced the taxes on single people
17 by a lesser amount than what we reduced the tax on married
18 people.

19 If we still have to find a way to make everything fit
20 inside the package, I think we ought to still consider that
21 possibility, Mr. Chapoton.

22 You ought to be willing to look at that and think about
23 it. I don't think you are going to wind up reducing every-
24 body's taxes precisely 25 percent anyway. I think there are
25 too many variables involved in your income this year as

1 against last year when you move a figure up a little bit
2 here and up a little bit somewhere else, it doesn't work
3 out to precisely 25 percent where you seek to average out
4 to it.

5 I think we get out of the trap with far less burden
6 on the Treasury and with just as much economic justice,
7 maybe not quite as much political advantage, but I don't
8 think much difference if we just wouldn't cut the taxes for
9 the single people quite as much as we cut them for married
10 people.

11 This would have been an ideal time to do it. I still
12 think we ought to narrow that gap in that respect to some
13 degree before this bill is finally acted on.

14 Mr. Chapoton. Well, Senator, as I think I have
15 mentioned, in the past, we did review changes in the rate
16 structure, in individual rate and joint return rate
17 structures.

18 It is possible to correct part or a large part of the
19 marriage penalty that way. There are other ways to correct
20 this problem or to try to correct the problem. It is very
21 difficult to try to correct it entirely or equitably across-
22 the-board.

23 We did not choose to go that way. We did want up and
24 down rate cuts in marginal rates. So we selected this other
25 way, which as you point out, does -- is an expensive way to

1 do it any way you do it. But it does set out the expense
2 by itself. It is a strict marriage penalty relief. It is
3 very expensive.

4 Senator Long. Mr. Chapoton, I was around here when the
5 initial mistake was made, when the marriage penalty was
6 created. It was created by voting an amendment that was
7 supposed to give a break to single people.

8 I look back on it and some of those nice, attractive
9 single people around this Capitol Hill --

10 The Chairman. They got married.

11 Senator Long. And also some of those attractive
12 single people who were with the media, including the
13 Washington newspapers, since that time most of them have
14 married and have changed their attitude about the whole thing.

15 (Laughter.)

16 Senator Long. I won't pursue it any further.

17 The Chairman. Is there a marriage bonus if we move
18 this way?

19 Mr. Chapoton. At some income levels any way you try
20 to correct this problem there will be a marriage bonus.

21 Senator Long. Where the so-called marriage bonus
22 exists only in the event you take the view that wife, working
23 in that home is not earning her keep.

24 I wouldn't suggest you make that statement before
25 any audience of women.

1 Mr. Chapoton. No, Senator. I think the marriage bonus
2 will occur more often when they are a two-earner family.

3 It is at the lower income of the scale. When both
4 spouses work there are additional expenses. It is a very
5 difficult problem. You try to keep the marriage bonus
6 situation to a minimum and correcting as much of the
7 marriage penalty as you can. We do not correct it all by
8 any means, at all income levels.

9 Senator Long. I believe you understand how this
10 got started.

11 Mr. Chapoton. Yes.

12 Senator Long. It started with our community property
13 system in states like Louisiana.

14 Mr. Chapoton. That's correct, Senator Long.

15 Senator Long. Under our laws, when a couple marry
16 their partners, and they are both working to make a success
17 of that marriage. Which ever one goes out and earns some
18 money, that is income of the community, of the partnership.

19 The other one is presumably in the home slaving away
20 over the hot stoves or whatever, to support the family.
21 Theoretically, they are making an equal contribution and the
22 money belongs equally to both of them.

23 Now this income splitting was a compromise that occurred
24 when the community property law was challenged. It was upheld
25 as far as the income tax is concerned, but not upheld insofar

1 as certain aspects of the estate tax were concerned.

2 If you think, if you are willing to accept the view
3 that both of them are contributing what they can in a joint
4 endeavor, then there really is no marriage bonus by the two
5 of them marrying.

6 Mr. Chapoton. I think the income tax law does accept
7 that, that they are an economic unit, they pay a lower rate
8 of tax than they would if they were not.

9 I misspoke, I said the two earner family. You are
10 correct, it is the one earner family where the marriage
11 bonus is likely to occur.

12 Senator Long. The moment you buy the theory that is
13 implicit in community property law, that the income belongs
14 equally to both of them, then there is no marriage bonus.

15 The Chairman. Are there any additions, amendments or
16 modifications of this proposal?

17 Senator Bradley. Mr. Chairman, I think this is one
18 of those proposals, again, where there is strong bi-partisan
19 support.

20 I think sometimes in this kind of an issue we are
21 hypmetised by the equality question. I would prefer to stress
22 the productivity question and work incentive question.

23 If you are going to tax people more who are married
24 and both of whom work, there is a real disincentive to work,
25 especially to work to earn higher income.

1 I look at this as rectifying that and thereby
2 encouraging upwardly mobile couples who are -- where both
3 spouses work.

4 I am curious to know what is the rationale for cutting
5 it off at \$3,000 and \$30,000 in income.

6 Mr. McConaghy. I think it is about \$200 million more
7 to go to \$40,000. So there would be a maximum \$4,000
8 deduction and another \$150 million to go up to \$50,000 and
9 have a maximum \$5,000 deduction.

10 Senator Bradley. So, for roughly \$300 million, you
11 could make it the marriage tax could be 10 percent up to
12 \$5,000, with a \$50,000 max?

13 Mr. McConaghy. Those numbers are a little bit shaky
14 up there, Senator Bradley. Within \$300 to \$500 million.

15 Senator Bradley. Mr. Chairman, I did not know if there
16 was any rationale for the \$30,000. What you are saying
17 basically is to professional women, they still don't get
18 the kind of treatment under the law. They are not a whole
19 lot and that is why the \$350 million figure is there to get
20 the \$50,000 or \$200 million more to get the \$40,000.

21 It seems to me if we want to utilize all the person
22 power in our work force, then indeed, we have to try to
23 encourage upwardly mobile women to work.

24 I am just curious if there isn't any reason why we
25 shouldn't simply up the limit. Why 30?

1 The Chairman. I think it is our concern for those
2 people you talked about in the last amendment, the ones
3 with the lower. Now you are talking about the rich.

4 Senator Bradley. No, I framed the last one under
5 \$50,000. This amendment is under 50.

6 The Chairman. I think again, beyond that, I think there
7 is come concern about revenue. This is one that passed this
8 Committee last year unanimously.

9 I have a conflict of interest in this amendment. I
10 don't dare say anything.

11 (Laughter.)

12 Mr. Chapoton. Senator, if we are talking about the
13 income of the lower earning spouse. If the maximum of
14 \$30,000, that means necessarily the couple has income in
15 excess of \$60,000.

16 So that you go above that, above the \$30,000 to \$40,000
17 or \$50,000, you are moving above \$60,000 to \$70,000 income
18 on the joint return range.

19 Senator Bradley. For the couple.

20 Mr. Chapoton. Yes.

21 Senator Bradley. What in effect you are saying is
22 if the female earns over \$30,000 in income, she doesn't
23 really get the full benefit of the incentive we are trying
24 to provide for work.

25 Mr. Chapoton. That is correct. It is a factor of the

1 relative income sizes also, the extent of the benefit. But
2 above \$30,000 on the second earner, there is no additional
3 relief for that second earner spouse.

4 The Chairman. Do you have any amendment?

5 I am sympathetic with what you say, but I can't say
6 it.

7 (Laughter.)

8 The Chairman. If there isn't any objection to this
9 watered down amendment, we will accept it on the same basis.

10 Senator Bradley. Could I then, Mr. Chairman, propose
11 what was embodied in my original package which was the 10
12 percent deduction up to \$4,000, which as we heard from Joint
13 Tax, will cost another \$200 million.

14 I would so move.

15 The Chairman. Do you care for a vote?

16 Senator Bradley. Yes.

17 The Chairman. The clerk will call the roll.

18 The Clerk. Mr. Packwood.

19 (No response.)

20 The Clerk. Mr. Roth.

21 The Chairman. No.

22 The Clerk. Mr. Danforth.

23 The Chairman. No.

24 The Clerk. Mr. Chafee.

25 Senator Chafee. No.

1 The Clerk. Mr. Heinz.
2 The Chairman. No.
3 The Clerk. Mr. Wallop.
4 The Chairman. No.
5 The Clerk. Mr. Durenberger.
6 The Chairman. No.
7 The Clerk. Mr. Armstrong.
8 The Chairman. No.
9 The Clerk. Mr. Symms.
10 Senator Symms. No.
11 The Clerk. Mr. Grassley.
12 Senator Grassley. No.
13 The Clerk. Mr. Long.
14 Senator Long. No.
15 The Clerk. Mr. Byrd.
16 Senator Byrd. No.
17 The Clerk. Mr. Bentsen.
18 Senator Bentsen. No.
19 The Clerk. Mr. Matsunaga.
20 Senator Matsunaga. No.
21 The Clerk. Mr. Moynihan.
22 (No response.)
23 The Clerk, Mr. Baucus.
24 Senator Baucus. Aye.
25 The Clerk. Mr. Boren.

1 (No response.)

2 The Clerk. Mr. Bradley.

3 Senator Bradley. Aye.

4 The Clerk. Mr. Mitchell.

5 Senator Mitchell. No.

6 The Clerk. Mr. Chairman.

7 The Chairman. No.

8 (Pause.)

9 The Chairman. On this vote the nays are 14, the yeas
10 are 2. I am not certain I had Senator Packwood's proxy on
11 this. They can be -- those who did not vote could be
12 recorded.

13 I am wondering now if we could move to the next to
14 the last item, the ACRS, and have an explanation by the
15 Administration.

16 Senator Matsunaga may have a non-controvertial
17 amendment.

18 Senator Matsunaga. Item 3.

19 The Chairman. Senator Grassley has an amendment. I
20 know Senator Heinz has one.

21 Mr. Chapoton. I will explain the ACRS proposal
22 briefly.

23 This is a modified 10-5-3 proposal where all equipment
24 would be put in either one of three classes, three year, five
25 year or ten year class.

1 All equipment with an ADR life, a midpoint life of
2 four years or below would be put in a three year class,
3 recovered over three years, using 150 percent declining
4 balance method of cost recovery, with a 6 percent investment
5 tax credit.

6 All other equipment, long lived utility property would
7 be put in a five year class.

8 Also recovered through 150 percent declining balance
9 recovery method, with a 10 percent investment tax credit
10 and long lived utility property, that is, utility property
11 with an ADR life of more than 18 years would be put in a
12 10 year class, also recovered with 150 percent declining
13 balance cost recovery, and also a 10 percent investment tax
14 credit.

15 All structures would be put in a 15 year class,
16 depreciated at the election of the taxpayer, either under
17 a 200 percent declining balance method of depreciation or
18 straight line.

19 If 200 percent declining balance is elected on a
20 disposition of the structure, it would be full 1245 recapture,
21 that is all depreciation previously claimed would be re-
22 captured on the disposition as ordinary income, except in
23 the case of housing.

24 For housing there would be Section 1250 recapture which
25 is basically depreciation claimed in excess of straight line

1 depreciation would then be recaptured.

2 Basically, Mr. Chairman, that is our proposal. The
3 change from the earlier proposal is that we would eliminate
4 the qualified progress expenditure deductions the initiation
5 of cost recovery when qualified progress expenditures are
6 made.

7 We have provided a liberalization of the leasing rules
8 under present internal revenue code and administrative rules
9 so there would be more availability to companies that cannot
10 use the deductions and credits for one reason or another,
11 new companies or companies that are currently in a loss
12 position through leasing and receiving the benefits through
13 lower lease of rentals while passing the tax benefits to the
14 leasor.

15 That in a nutshell is the proposal.

16 Senator Chafee. Don't you go up to 200 percent after
17 a couple of years though?

18 Mr. Chapoton. Correct. I am sorry, in 1985 on
19 equipment the accelerated method would increase to 175
20 percent declining balance and in 1986 it would thereafter
21 be 200 percent declining balance cost recovery.

22 Senator Chafee. When do you go to the 175?

23 Mr. Chapoton. Calendar 1985.

24 The Chairman. Senator Matsunaga, do you have a non-
25 controvertial amendment?

1 Senator Matsunaga. Yes, Mr. Chairman. Under the
2 accelerated cost recovery system some mischief is being
3 done by being overgenerous to them. The railroad tank car
4 leasing companies now have all the benefits they can use
5 they tell me. They cannot utilize the extra benefits
6 provided by ACRS.

7 In fact, ACRS would make these companies targets for
8 acquisition by other corporations, especially giant ones
9 who are anxious to obtain the added tax benefits.

10 The railroad tank car leasing industry does not want
11 the benefit of the proposed ACRS. It would prefer to have
12 railroads placed under the 10 year category.

13 I so move.

14 The Chairman. I understand there are only 5 companies
15 involved and they were all contacted and they all agree with
16 this amendment.

17 Senator Matsunaga. Yes.

18 The Chairman. I am prepared to accept the amendment.
19 I havent' discussed it with the Administration, but it seems
20 to me --

21 Mr. Chapoton. I don't off hand see any basis for
22 objection.

23 The Chairman. Without objection, the amendment will be
24 agreed to.

25 Senator Grassley.

1 Senator Grassley. Mr. Chairman, I visited with Mr.
2 Chapoton about this. I brought it up in the hearings we
3 had a month ago.

4 About the fact that special purpose agricultural build-
5 ings are treated one way for investment credit and another
6 way for depreciation.

7 We ought to treat them the same way and that would mean
8 for special purpose agricultural buildings for them to
9 depreciate in five years.

10 We were told in our hearing that is the way they would
11 be treated and the way the bill was written it came out in
12 15 years.

13 So, I am proposing we change that for that special
14 category of buildings to 5 years so they would be treated
15 the same.

16 Mr. Chapoton. Yes. I thought at that time they were
17 classed as equipment in the earlier year when it was made
18 eligible for the investment tax credit, but in fact it was
19 not reclassified as equipment, but just real estate that
20 was given the investment tax credit.

21 I assume your amendment would not apply to all
22 structures or all structures even used on the farm. It
23 would be --

24 Senator Grassley. You are correct. We are talking
25 about that special category that have been in dispute since

1 1972 when Congress had intended to report language that
2 the investment credit apply and then through dispute with
3 IRS we had to eventually had to pass clarifying legislation
4 in 1978 and we did get it classified for investment credit.

5 So it is treated one way for investment credit and
6 one way for depreciation. They both should be treated the
7 same.

8 Mr. Chapoton. Senator, we reviewed hurriedly the
9 history behind this at lunch. It is -- was a hotly contested
10 item by the IRS for some years. There was some controversy
11 when this credit was given to these items.

12 They have remained classified as structures but have
13 remained eligible for the investment tax credit. As
14 structures they would receive faster depreciation. They
15 would receive 200 percent declining balance depreciation,
16 that is, faster than present law.

17 I think we would have difficulty agreeing that they
18 should be brought down to the five year class. They are still
19 structures. We are not doing that for other structures.

20 The compromise that was struck then to give them the
21 investment tax credit seems a reasonable compromise and is
22 still, of course, in effect.

23 That is, they would get the credit and they would get
24 the faster depreciation available for structures.

25 The Chairman. Are they better off than they were before?

1 Mr. Chapoton. They are better off. I think they would
2 be in the neighborhood of 20 years before, under present
3 law. With 20 year cost recovery, they would move to 15
4 year.

5 The Chairman. Do you have anything on that from the
6 Joint Committee?

7 Mr. Wetzler. Senator Dole, the problem is the Treasury
8 thinks they are a structure with a 20 year life. Some of
9 the taxpayers think they are equipment with a much shorter
10 life.

11 So if the taxpayers win the case, I really am not
12 capable of judging whether they will win or not, but if they
13 are right, then putting them up in the 15 year class would
14 make them worse off than they think they are, even if it
15 would make them better off than the Treasury.

16 The Chairman. Is there a case pending? Is that it?

17 Senator Grassley. The point is, some people in IRS
18 contend that these buildings can be used for other things.
19 Maybe some can, but all can't. Particularly in the case of
20 hog confinement feeding facilities, it is very difficult to
21 use them for any other thing than just that purpose.

22 We better come to the conclusion that it is equipment
23 and make this decision and forget this controversy of the
24 last eight years.

25 Why should we be going through what we have been going

1 through between '72 and '78? For just the investment
2 credit.

3 Mr. Chapoton. They clearly have the investment credit
4 now. I did not understand there was any question after the
5 1978 amendment that they might also be equipment.

6 Senator Grassley. But special purpose agricultural
7 buildings are different, as you said, than agricultural
8 buildings per se or any buildings on a farm.

9 These are special purpose and they legitimately ought
10 to be treated as equipment. It is a controversy that I
11 think only this Congress can settle. We relied upon settle-
12 ment in the IRS between '72 and '78 and we eventually had
13 to pass legislation to do it.

14 The Chairman. We may not be able to settle it this
15 evening. That is the secon roll call. Maybe we can take
16 a look at it overnight.

17 (Whereupon, at 5:01 p.m., the Executive Session
18 recessed, to reconvene at 9:30 a.m., the next day.)

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