

# THE TOBACCO INSTITUTE

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SAMUEL D. CHILCOTE, JR.  
President

April 25, 1986

## MEMORANDUM

TO: The Members of the Executive Committee

FROM: Samuel D. Chilcote, Jr. *Sam*

RE: Finance Committee Hearings

Enclosed please find five statements which were not available to us earlier for your information.

SDC:dlt

Enclosures

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TESTIMONY OF SENATOR WENDELL H. FORD  
SENATE FINANCE COMMITTEE  
APRIL 21, 1986

MR. CHAIRMAN: I very much appreciate the opportunity to appear before the Finance Committee this morning to express my concerns about the excise tax provisions of your tax reform proposal. On behalf of the forty two non-Finance Committee members who joined Senator McConnell and myself in requesting these hearings, I want to thank you for being so accommodating in scheduling this hearing. The excise tax package is the linchpin of your proposal, and I appreciate your willingness to subject it to public scrutiny. I think it indicates your true desire to move tax reform and produce a bill that is palatable to a majority of the Senate.

Let me first join the long list of those who are commending you for your efforts. Like others I appreciate the tremendous task you had and congratulate you on keeping the tax reform movement alive. I must respectfully disagree, however, with the way in which you propose to pay for tax reform -- that is the \$75 billion excise tax and tariff package.

Mr. Chairman, this proposal is nothing short of a tax on a tax. The industries that collect federal excise taxes act as nothing more than a collection agent for the United

these very same taxpayers are the ones who will bear the burden of financing reform. The stated purpose of the tax reform exercise is to produce a more simple and fair system of taxation. Using excise taxes to raise the necessary revenue to make such a bill revenue neutral ensures that the bill will be anything but fair and equitable.

This proposal will have a particularly harsh effect upon Kentucky, causing us to bear an unfair burden for national tax reform. Three of the five major excise taxes are levied on Kentucky products: coal, tobacco and distilled spirits. Close to 1,700 Kentuckians would lose their jobs under this proposal, and at a time when unemployment is over 20 percent in about a fifth of our counties and over 12 percent statewide. Kentucky can simply not afford this tax reform proposal. Kentucky is second only to California in the number of jobs lost from the excise tax proposal, and represents over 14 percent of the total job losses nationwide.

The effect on Kentucky is particularly harsh when compared to the House-passed bill. The Chairman's plan would eliminate 69 percent of the relief provided under the House bill to Kentucky families making under \$11,000 a year. Median income families, those making \$25,800 a year, would lose 45 percent of the savings gained in the House-passed bill.

and that is that they cannot absorb the loss of the deduction and will have to pass it on. Clearly, in the case of those industries which will suddenly incur tax liabilities in excess of their gross income, the loss of the deduction will be passed on in full. The loss of the deduction increases the cost of production, and as with any other costs, will be passed on in the price of the goods. There is no doubt that this proposal will have the same effect as an outright increase of up to 54 percent excise taxes.

The original purpose of tax reform was to make the tax laws more simple and fair. I don't think anyone will contend that any of the main proposals are more simple. That leaves the goal of fairness. There is nothing fair, nor equitable, in using regressive excise taxes to lower wealthy corporate and individual tax rates. Tax reform which must be paid for with excise tax revenues is not reform at all. If there are no alternative revenue sources, then I would suggest that we be honest with the American people about what the real purpose of tax reform is -- to give further tax breaks to the rich to be paid for out of the pockets of poor and middle income taxpayers.

The Committee will be hearing from other witnesses today who will argue in favor of this proposal as a way of using the tax code to discourage consumption of certain products. Unfortunately, this argument misses the point. The purpose

provision. As the affected industries lose the ability to deduct excise taxes, they will be forced to pass some, if not all, of this additional cost of doing business on to the consumer. That means higher prices, which then will trigger the indexing of the tax. As the excise tax increases, the industries will again pass a part of the increase on, again triggering the indexing of the tax. And the process continues without end in a vicious, inflationary cycle.

Other governments which have used indexing as a means of raising revenues have found that it did not work. In 1981 the Canadian government indexed the federal alcohol excise tax. As a result, alcohol taxes increased five times between April 1981 and September 1984, resulting in a loss of 3,200 Canadian jobs. Due to the disastrous result, indexing was repealed in May 1985.

But there is an equally disturbing issue raised by this proposal. Disallowing the deduction for excise taxes and tariffs means that industry must now include the income that they receive as a collection agent for the government in their total gross income. There is a strong argument to be made that this is an unconstitutional tax on capital, as opposed to income, under the Sixteenth Amendment. Federal excise taxes and tariffs have long been recognized as a cost of the goods sold. In order to determine gross income, to be taxed under the Sixteenth Amendment, cost of goods sold must

Statement By  
SENATOR MITCH McCONNELL

Before the  
Committee on Finance  
United States Senate

April 21, 1986

Public Hearing on Chairman's Tax Reform Proposal  
Relating to Excise Taxes

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Mr. Chairman, custom dictates that I begin by thanking you for scheduling this hearing. But my appreciation for you taking time to discuss the excise tax and tariff issues in the tax reform proposal now before the Committee, goes far beyond custom. There is perhaps no state in America more affected by these excise tax provisions than Kentucky, and it is on behalf of the residents of my state that I thank you for focusing on a topic that so directly affects their lives.

By its very nature, Mr. Chairman, the process of forging a tax reform plan involves choosing winners and losers. While I recognize that it is impossible to agree on comprehensive reform provisions that make everyone happy, the goal of the legislative process should be to produce legislation based on equitable economic assumptions.

I have asked for this time, therefore, to express my grave reservations about proposals which would effectively increase excise taxes for American industry and ultimately millions of American consumers--consumers for products whose diversity ranges from cigarettes to gasoline, distilled spirits to tires, diesel fuel to coal, airline tickets to telephone services.

The Witness List before you represents an exhaustive catalogue of the industries affected. Before the day is out this Committee will hear over and over again the arguments, based on fundamental principles of equitable tax policy, against ending the deductibility of excise taxes and tariffs, or accepting further increases in these taxes.

Those that follow will no doubt emphasize the regressive nature of excise taxes, the disregard for fundamental and equitable principles of accounting represented by the elimination of deductibility for excise taxes and tariffs, and the serious Constitutional questions raised by nondeductibility. While outlining these arguments is important, I am here this morning for a different reason. If this Committee chooses to accept the excise tax proposals now before them, I want you to know in the clearest possible terms the consequences for the Commonwealth of Kentucky.

In the coal fields of my state there are 40,000 persons employed in coal production, and perhaps that many again who provide materials, equipment and services to the industry. Recent studies show that nearly 6% of total personal income in Kentucky can be attributed to the coal industry. And yet the future does not look bright. Nationwide there are 60,000 workers who the coal industry can no longer support. Since 1981 coal exports have declined by 27% with the Department of Commerce forecasting continued increases in coal imports. The reality, especially in light of falling oil

prices, is that the coal industry is faced with a future of economic challenge.

It is in this context, then, that the Committee is considering eliminating the deductibility of excise taxes. This action would result in new tax liability for the coal industry exceeding \$1 billion over the next five years. That is an effective increase in the Black Lung excise tax of 54%. In an economic environment where being competitive is everything, that tax increase is tantamount to putting a ball and chain around America's coal companies.

Not surprisingly, the tobacco industry would be affected by the proposed changes similarly. 150,000 Kentuckians depend on this industry to earn their living. If you eliminate deductibility for the cigarette manufacturer you, in effect, increase by at least half the excise tax on a package of cigarettes. It is the consumer that will pay this \$6 billion in extra taxes and the low-income consumer that will feel the cost most acutely.

Kentucky, Mr. Chairman, is also the largest producer and bottler of distilled spirits in the nation. Nearly 13,000 Kentuckians work in the distilled spirits industry which contributes over \$400 million per year in payroll and profits to the states's economy. Incredibly, nearly 40% of the retail price of a typical bottle of spirits sold in Kentucky can be attributed to taxes. The Federal portion of that alone is over 28%, and eliminating deductibility increases the tax on spirits at least another 50%.



The result will be an increase by at least one-fourth in price, a drop in demand, and a greater number of Kentuckians unemployed.

There are, of course, in addition to the industries mentioned, residents of Kentucky that earn their living in the rubber, airline, gasoline, communications, and transportation industries. If this Committee approves an excise tax increase of \$75 billion these workers, and the consumers who purchase their products, will bear the cost.

Mr. Chairman, I came to the United States Senate wanting to support tax reform. And while I continue to believe that the American taxpayer deserves something better than the current tax code, I am not yet convinced that Congress is moving in that direction. That is not to say, Mr. Chairman, that there is not much in your proposal that I could support--there is.

What I cannot explain to my constituents is paying for tax reform with an unprecedented increase in the most regressive taxes of all. We began this debate well over a year ago because it was evident that U.S. taxpayers believe the tax code is unfair. In the final analysis, the tax reform bill this committee reports will be judged primarily by one standard--the standard of equity. And I would be less than candid if I did not tell you that from no perspective can the nondeductibility and possible increase of excise taxes be viewed as fair by those I represent.