CTJ NEWS

CTJ

In the NEWS

1989

CTJ studies, articles and press releases generated hundreds of news stories across the country. The following pages are a small sample of our print media coverage in 1989.

Citizens for Tax Justice

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The New York Times

NEW YORK, FRIDAY, OCTOBER 27, 1989

50 cents beyond 75 miles from New

Number of Untaxed Companies Is Said to Decline

By ROBERT D. HERSHEY Jr.

Special to The New York Times

WASHINGTON, Oct. 26 — Many large and profitable companies that once managed to pay little or no Federal income tax have been pushed back onto the tax rolls by the 1986 overhaul of the tax code, Citizens for Tax Justice said today, citing its own survey.

"Tax reform is working," declared Robert S. McIntyre, president of the labor-financed research group.

The Tax Reform Act of 1986 cut both corporate and individual rates while broadening the tax base through the elimination or reduction of various preferences and incentives. It also imposed a minimum tax of 20 percent, one of the main factors in insuring that almost all companies pay some Federal income tax, the study said.

Only 7 of the 250 profitable companies examined in the survey paid no income tax in 1988, the group said, in contrast to an average of 50 such companies annually in the 1981-85 period. The seven were Kroger, Pinnacle West, CSX, Illinois Power, Media General, Santa Fe Southern Pacific and Gulf States Utilities. All but Gulf States got refunds, which totaled $120 million. A corporation can have a profitable year and still get a net refund on its Federal taxes by carrying forward credits or losses from prior years or from using some special credits for investment that the 1986 changes did not eliminate.

As additional evidence that corporate taxes are up, Citizens for Tax Justice said its survey put the average effective tax rate for all 250 companies last year at 26.5 percent, nearly double the 14.3 percent average during the 1981-85 period for a largely identical list of companies.

The maximum tax rate for corporations was cut by the new law to 34 percent from 46 percent.

"The reforms enacted in 1986 put many of the most notorious corporate tax avoiders back on the rolls and cut the number of no-tax companies dramatically," Mr. McIntyre said.

But the group's findings were greeted with some skepticism by other tax analysts and from business.

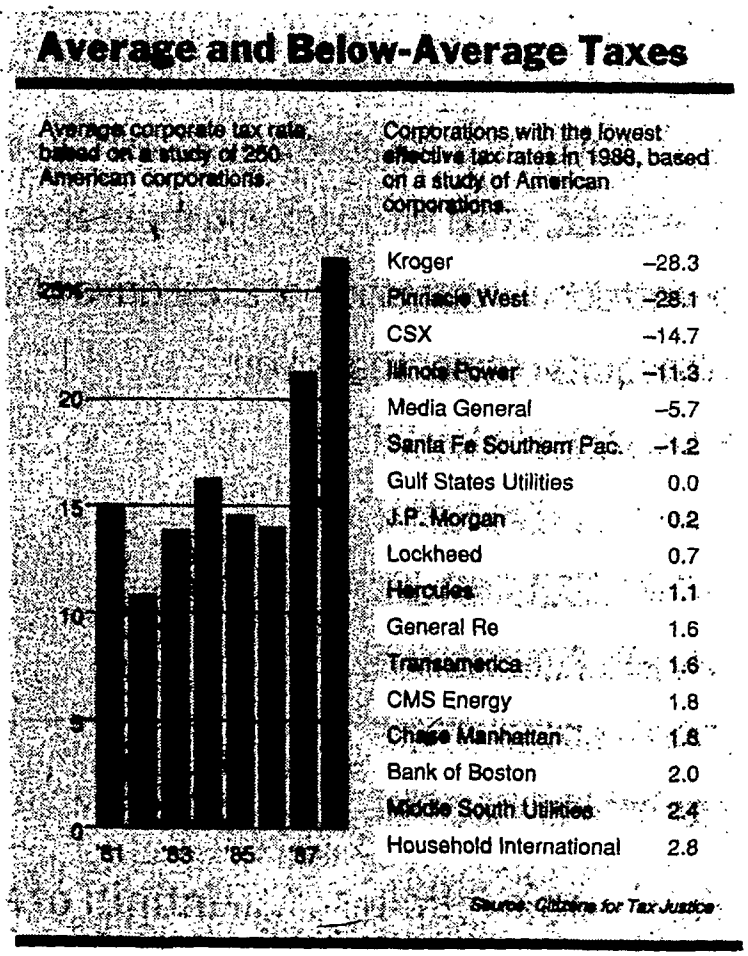
John Makin, a tax specialist for the American Enterprise Institute, a centrist policy group in Washington, said that while he supported the 1986 changes, he doubted whether their effect had been as great as Mr. McIntyre's study suggests. Mr. Makin said that much of the rise in corporate taxes reflected a jump in profits that was more a result of the business cycle than of changes in the tax law.

Some Doubts Expressed

Others questioned the study's linking the tax changes to what the coalition said was a marked shift in investment "away from tax shelters and toward the types of business machinery and equipment that are most crucial" to the nation's economic future.

An oil industry executive, whose company was among those included in the study, said, "Corporate investment is based on many things, of which taxes is only a part." This executive, who declined to be identified, said that the investment effects of tax code changes made in 1986 would not be too evident yet because oil projects, for example, could take as long as eight years from planning to completion.

Nonetheless, there appeared to be little doubt that the 1986 law is causing corporate America to pay more income tax, mainly because of the imposition of a much tougher corporat minimum tax, repeal of the invest ment tax credit, a tightening c credits for foreign taxes paid an sharp restrictions in the use of th completed-contract method of ac counting that had been of particularl great benefit to military contractors.



The New York Times/Oct. 27, 198

THE WALL STREET JOURNAL.

EASTERN EDITION FRIDAY, OCTOBER 27, 1989 WHITE OAK, MARYLAND

Few Profitable Firms Still Don't Pay Federal Income Taxes, Study Finds

By HILARY STOUT
Staff Reporter of THE WALL STREET JOURNAL.

WASHINGTON—The 1986 Tax Reform Act has nearly eliminated the number of large, profitable corporations that don't pay federal income tax, according to Citizens for Tax Justice, a nonprofit, labor-funded research and lobbying group.

In a study of 250 of the nation's richest companies, the group found that only seven managed to avoid paying federal income taxes last year compared with 40 in 1986, the last year the old tax rules were in effect, and 16 in 1987, when some of the new tax provisions went into effect.

Moreover, 41 companies that paid no federal income tax from 1981 through 1985—despite billions of dollars of profits—ended up paying an average of 27.9% of their income in federal taxes in 1988.

The report, released yesterday, comes as Congress is considering a number of special tax breaks only three years after the sweeping tax-revision legislation abolished or curtailed many loopholes.

In the corporate realm, the 1986 law abolished the investment-tax credit, scaled back use of an accounting method that allowed large contractors to defer taxes until a project was completed and strengthened the so-called alternative minimum tax, a levy to ensure all moneymaking businesses pay some federal tax.

The combination of lower rates and fewer loopholes has meant that the so-called average effective tax rate—the rate actually paid—of the 250 corporations surveyed reached 26.5% in 1988, compared with 14.3% in the years from 1981 through 1985, according to the study.

In addition, corporations are now shouldering a bigger share of the tax burden, as the authors of the 1986 law hoped. Corporate taxes paid for almost 12% of federal spending in 1988—excluding Social Security—compared with less than 8% in the first half of the 1980s, the study found.

"Tax reform is working," the study said. "Under the new tax-reform law, the days of widespread, wholesale corporate tax avoidance have come to an end."

Still, **Kroger Co.**, **Pinnacle West Capital Corp.**, **CSX Corp.**, **Illinois Power Co.**, **Media General Inc.**, **Santa Fe Southern Pacific Corp.** and **Gulf States Utilities Co.**, didn't pay any federal income tax last year although they garnered a total of $1.2 billion in profits, the group said. In fact, six of those companies received refunds, which totaled $120 million.

The lobbying group used publicly available information to calculate each company's domestic profits and its federal income tax payments. This is the fifth year Citizens for Tax Justice has released a study on corporate tax bills. Earlier reports, which revealed that as many as 73 companies were avoiding income tax legally, have been credited with helping galvanize efforts to overhaul the tax code.

But even though companies are paying more taxes, many are still paying less than the statutory rate, the report said. And 45 companies paid effective tax rates of below 10% of their income. "While the overall picture is very encouraging, significant corporate tax avoidance continues," the study said.

THE NATION'S NEWSPAPER

USA TODAY

NO. 1 IN THE USA...6.3 MILLION READERS EVERY DAY

Reform has fewer firms paying no tax

By Harriet Brackey
USA TODAY

Only seven of the USA's 250 largest, profitable corporations paid no federal taxes last year, down from 72 non-payers in 1982, says watchdog group Citizens for Tax Justice.

"The message is basically that tax reform is working," says Sen. Bill Bradley, D-N.J.

CTJ director Robert S. McIntyre says thanks to the Tax Reform Act of 1986, businesses are devoting more time to productive investments than to wiggling through loopholes. The 1986 law lowered tax rates but closed many loopholes.

Also, the average tax bill is bigger now. On average, the companies paid 26.5 percent of profits in federal taxes, up from an average of 14.3 percent between 1981 and 1985.

All the non-payers did so using legal means.

▶ Five dispute results: CSX, Media General, Illinois Power, Gulf States Utilities, Kroger Co.

The study "conveniently ignores that we're $5 billion in debt because we went through a major corporate restructuring to avoid a takeover," says Kroger's Paul Bernish. Companies can deduct interest payments on debt.

▶ Not disputing: Santa Fe Pacific Co. and Pinnacle West Capital Corp.

HAZY
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The Washington Times

FRIDAY, OCTOBER 27, 1989 ★ WASHINGTON, D.C. PHONE 636-3000 SUBSCRIBER SERVICE 636-3333 25 cents

CSX squeezes through tax loophole, group says

By Karen Riley
THE WASHINGTON TIMES

CSX Corp. of Richmond and six other profitable companies used tax loopholes to avoid paying tax last year, according to a study by Citizens for Tax Justice.

The number has declined sharply since the Tax Reform Act of 1986, when as many as 70 profitable companies legally avoided paying any tax.

"Tax reform is working," said Robert S. McIntyre, executive director of the labor- and consumer-financed organization.

"Business investment has boomed since tax reform, as money that used to go into wasteful tax shelters has returned to the productive economy," he said in releasing the organization's fifth annual survey, which is credited with goading Congress to enact a wholesale reform of the nation's tax code.

Since 1986, total real business fixed investment has grown at an annual rate of 6 percent, nearly triple the 2.1 percent rate of growth over the previous five years, the report pointed out.

In addition, investment in industrial equipment, which actually declined by 8.4 percent from 1981 to 1986, has jumped by a total of 19.1 percent since tax reform was enacted.

"American business people have gotten smarter about their investments. They are no longer investing in tax shelters that lose money just to reduce their taxes. They are investing to make their businesses more profitable. That is how it should be," said Sen. Bill Bradley, New Jersey Democrat and a principal author of tax reform.

The nation's 250 biggest money-making companies paid an average tax rate of 26.5 percent last year, the report said, compared with an average tax rate of 14.3 percent in 1981 through 1985. Forty-five corporations still paid less than 10 percent of their profits in taxes, fewer than half the number reported a year earlier.

Critics of the annual survey say it is based on a flawed judgment of corporations' annual reports.

The report found that CSX, a railroad, transportation and energy company, posted $402 million in profit but actually claimed a loss of 14.7 percent.

"While we haven't seen the details of the report and can't tell you where they made their error, the fact of the matter is, the report is wrong. CSX corporations paid more than $84 million in cash taxes in 1988," said Thomas Hoppin, vice president for corporate communications.

"These people are wrong. We paid a substantial amount of income tax in 1988 and 1989," said CSX spokesman Suzanne Walton.

Another railroad, Santa Fe Southern Pacific, also was listed among the group of seven. The report said the company had profits of almost $180 million, received a $2.1 million refund of past taxes paid, and thus had a negative tax rate of 1.2 percent.

"We had a net loss in 1988 of $46.5 million as a result of a charge of about $627 million relating to divestiture of Southern Pacific Railroad, which we were required to do by the Interstate Commerce Commission," said Bob Gehrt, a Santa Fe vice president in Chicago.

The Detroit News

Thursday
October 26, 1989

Tax group: Reform is paying off

By John E. Peterson
News Washington Bureau

WASHINGTON — Companies in Michigan and elsewhere are paying Uncle Sam a lot more in tax dollars since the landmark 1986 Tax Reform Act, a tax group says.

"Our findings demonstrate that economic growth and tax fairness are natural partners and that tax reform is working," said Robert S. McIntyre, director of Citizens for Tax Justice, a labor-backed group actively opposing the Bush administration's efforts to lower the capital gains tax.

All but three of the 11 Michigan companies listed in the group's report had a higher federal tax rate in 1988 than between 1981 and 1985, the years immediately before tax revision. The exceptions were K mart, which paid 1.4 percent less in taxes; Kellogg, at 2.9 percent less; and Whirlpool, at 11.4 percent less.

AND THREE other Michigan firms paid substantially below the average 1988 tax rate of 26.5 percent of the 250 companies surveyed. They are: CMS Energy (formerly Consumers Power) with an effective rate of 1.8 percent; Detroit Edison at 7.9 percent; and Chrysler Corp. at 8.8 percent.

These three companies used millions of dollars in tax loss carry forwards, investment tax credits and accelerated depreciation allowances to substantially reduce their 1988 federal tax bills, the group said.

General Motors Corp., a strong supporter of the 1986 tax changes, paid a whopping federal tax rate of 52.8 percent in 1988 — or $1.6 billion of its $3.1 billion profit. That was a dramatic shift from 1987, when the company earned $2.3 billion in profits and received a $655 million refund — for a negative tax rate of 27.9 percent.

GM's turnaround results from the firm suddenly having to pay huge amounts of taxes deferred from previous years, the group said.

CITIZENS FOR Tax Justice's first report in 1985 has been cited as one of the burs in Congress' saddle to revise corporate tax laws. The next year, individual and corporate tax rates were lowered, while dozens of tax breaks and loopholes were eliminated.

The report says that only seven of the 250 profitable firms surveyed did not pay any taxes in 1988, the first year that the tax changes took full effect. By contrast, between 1981 and 1985 — immediately before tax revision — about 50 companies each year paid no federal taxes, the group said.

The average tax rate for all 250 companies was 26.5 percent in 1988 — nearly double the 14.3 percent average effective rate in the 1981-85 period.

Some in the business community called the report inaccurate and misleading.

"Based on what we've seen in the past, we think that a lot of their information is distorted," said Donna Harman, a tax policy specialist at Dow Chemical Co. of Midland. Dow Chemical was cited in the original 1985 report as one of the worst corporate "freeloaders."

"We think they're doing this for a political purpose," Harman said, "and we understand that."

A taxing business

Citizens for Tax Justice says companies in Michigan and elsewhere are paying more in taxes now than in the five years before tax overhaul in 1986. (Numbers are in millions)

Company	1988 Profit	1988 Tax	1988 Percent Rate	Pretax reform 1981-85 Profit	Pretax reform 1981-85 Tax	Pretax reform 1981-85 Average rate
Chrysler	$1,314.6	$116.0	8.8	$4,562.1	$31.3	0.7
Chrysler	1,314.6	116.0	8.8	4,562.1	31.3	0.7
CMS Energy	357.2	6.4	1.8	971.0	4.7	0.5
Comerica	140.1	40.4	28.9	184.5	−10.2	−5.5
Detroit Edison	510.7	40.3	7.9	2,194.9	36.3	1.7
Dow Chemical	1,756,0	526.0	30.0	771.0	−200.0	−25.9
Ford Motor Co.	4,389.4	1,426.3	32.5	5,108.4	691.9	13.5
General Motors	3,108.1	1,641.6	52.8	18,492.5	4,395.6	23.8
K mart	1,015.0	330.0	32.5	2,670.5	905.1	33.9
Kellogg	544.0	181.6	33.4	1,614.7	586.6	36.3
Upjohn	372.9	77.8	20.9	1,203.5	250.0	20.8
Whirlpool	221.5	60.4	27.3	1,228.0	475.2	38.7

Source: Citizens for Tax Justice/annual corporate reports

DAILY NEWS

35¢ (50¢ in Ulster/New Haven Counties) NEW YORK'S PICTURE NEWSPAPER® Friday, October 27, 1989

More big biz paying taxes

By JEROME CAHILL
News Washington Bureau

WASHINGTON — The number of major corporations avoiding federal income taxes has dropped sharply since Congress abolished scores of business tax loopholes three years ago, a private research group said yesterday.

Citizens for Tax Justice, a labor- and consumer-backed organization, said seven of 250 big U.S. corporations paid no federal income tax last year, compared with 132 that had at least one "no-tax" year in the five years before passage of the Tax Reform Act of 1986.

The study found the effective tax rate on domestic profits paid by corporations rose dramatically, from an average 14.3% in the five years before the 1986 reforms to 26.5% in 1988.

Despite an estimated $15 billion increase in taxes paid by corporations last year, the watchdog group said, business investment has nearly tripled since 1986, while outlays for industrial equipment jumped 19.1% in the same period.

"Tax reform is working," declared Robert McIntyre, executive director of the group. "Business investment has boomed since tax reform, as money that used to go into wasteful tax shelters has returned to the productive economy."

Sen. Bill Bradley (D-N.J.), one of the architects of tax reform, joined McIntyre in a call for further efforts to close loopholes that escaped the reformers three years ago.

Bradley blasted as "unfathomable, from an economic or fairness standpoint," President Bush's attempt to push a cut in the capital gains tax rate through this session of Congress.

"The President's efforts to put loopholes back into the Tax Code will only drive rates up for the average taxpayer and business so that some taxpayers can go back to paying no taxes," Bradley said. "That is simply unacceptable."

Meanwhile, Senate Republican leaders announced they would try to attach a capital gains tax to a $1 billion aid bill for Poland and Hungary. Senate Majority Leader George Mitchell (D-Maine) said the move could delay or kill the aid measure.

Citizens for Tax Justice identified the seven profitable corporations that paid no 1988 federal taxes as Kroger, Pinnacle West, CSX, Illinois Power, Media General, Santa Fe Southern Pacific and Gulf States Utilities.

In several instances, losses and unused tax benefits from earlier years apparently were used by the companies to wipe out their taxes.

Santa Fe Southern Pacific, for example, reported a net loss of $46.5 million from its divestiture of Southern Pacific, as required by the Interstate Commerce Commission.

Group errs on taxes, 2 area firms say

From staff, wire dispatches

Two Richmond-based corporations are among seven profitable companies that were able legally to avoid paying federal income tax last year, according to a study by Citizens for Tax Justice, a labor-financed research organization.

Media General Inc. and CSX Corp. responded immediately that the group was wrong.

Citizens for Tax Justice's fifth annual report on corporate taxes said six companies — Media General, CSX, Santa Fe Southern Pacific, Kroger Co., Pinnacle West Capital and Illinois Power — paid no taxes in 1988 and received refunds of taxes for the past year, resulting in negative tax rates.

The seventh company, Gulf State Utilities, didn't pay taxes but didn't receive a refund, according to the study released yesterday in Washington.

CSX Corp. made a profit of $402 million but had a negative tax rate of 14.7 percent, Citizens for Tax Justice said.

But Thomas Hoppin, CSX vice president for corporate communications, said, "While we haven't seen the details of the report, and can't tell you where they made their error, the fact of the matter is that the report is wrong. CSX Corp. paid more than $84 million in cash taxes in 1988."

Media General, the parent company of Richmond Newspapers Inc., publisher of The Richmond Times-Dispatch and The Richmond News Leader, made $75 million profit, with a tax rate of minus 5.7 percent, according to the study.

Robert W. Pendergast, director of corporate communications for Media General, called the report incorrect.

Media General profits were about $14.2 million and the company paid about $5.38 million in taxes in 1988, Pendergast said. "That meant our net income was $8,819,000. We earned 31 cents a share, down from $1.50 a share," he added.

The taxes paid for 1988 did reflect a $36.3 million writeoff that Media General took on its broadcast division, mainly on losses experienced by Media General Broadcast Services in Tennessee, which was sold in December 1988, Pendergast said. They also reflected a $5.6 million writeoff for losses by Highlander Publications of California, which was recently put up for sale.

The company expects a refund on its 1988 taxes, said Pendergast. But he added that was because Media General had overpaid taxes since 1985 in anticipation of income that didn't materialize, from the Media General Broadcast Services and Highlander Publications.

"In essence, we are in absolute and complete compliance with tax laws and regulations. We're not going to cheat on our taxes and we're not going to pay more."

The report's figures for the other profitable companies that it said paid no tax in 1988 and showed negative tax rates were: Santa Fe Southern Pacific, with profits of almost $180 million and a negative tax rate of 1.2 percent; Kroger, $29 million profit and a negative tax rate of 28.3 percent; Pinnacle West, $75 million profit, minus 28.1 percent; and Illinois Power, $227 million profit, minus 11.3 percent.

Gulf State Utilities was reported as having a profit of $164 million.

Because the studies are based on the organization's interpretation of corporate reports, they often are disputed by companies cited.

"We had a net loss in 1988 of $46.5 million as a result of a charge of about $627 million relating to divestiture of Southern Pacific Railroad, which we were required to do by the Interstate Commerce Commission," said Bob Gehrt, a Santa Fe vice president in Chicago.

The study also concluded that the number of corporations that legally avoided taxes had declined from 50 because of the 1986 tax reform.

Citizens for Tax Justice said the average tax rate paid by the 250 biggest money-making companies rose last year to 26.5 percent, compared with 14.3 percent in 1981 through 1985.

Forty-five corporations still paid less than 10 percent of their profits in income taxes, fewer than half the number reported a year earlier.

The study found the new law is shifting a greater share of the burden to corporations, as it was intended to do. Corporate taxes paid 12 percent of the non-Social Security budget last year, up from 8 percent in the first half of the 1980s, the report stated.

The law enacted in 1986 repealed the investment tax credit; sharply curtailed an accounting method that allowed large contractors to defer taxes until a project was completed; eliminated the tax preference for capital gains and tightened the "minimum tax," a special levy aimed at profit-making businesses that use large writeoffs to avoid all or most of their tax liability.

"Tax reform is working," Robert S. McIntyre, executive director of Citizens for Tax Justice, said in releasing the report. "Business investment has boomed since tax reform, as money that used to go into wasteful tax shelters has returned to the productive economy."

The highest effective tax rate among the 250 companies was paid by Rockwell International, at 192.5 percent. The company, a major defense contractor, paid $1.37 billion tax last year on profits of $714 million. The study said the high rate reflected Rockwell's payment of more than $1 billion in tax that was deferred during 1981-1987.

The 250 companies in 1988 paid $34.5 billion in taxes on $130 billion in profits.

Richmond Times-Dispatch, Friday, October 27, 1989 C-5

News in brief

National

Kroger, 6 other companies paid no income taxes in '88

Herald-Leader wire services

WASHINGTON — Seven of the largest U.S. corporations paid no federal income taxes for 1988, according to a study by Citizens for Tax Justice, a "public-interest" group.

The seven — Kroger, Pinnacle West, CSX, Illinois Power, Media General, Santa Fe Southern Pacific and Gulf States Utilities — together earned profits totaling more than $1.1 billion, Citizens for Tax Justice said.

But most big companies are paying much heavier taxes than they did before the 1986 tax code overhaul, the group said. And, despite the heavier tax burden, the largest companies have nearly tripled their pace of capital investment since 1986 compared with the 1981-85 average.

The Hartford Courant

I. CLII No. 300 Friday, October 27, 1989— 6 Sections ★3 Copyright 19

Tax study

WASHINGTON — Seven of the largest U.S. corporations paid no federal income taxes for 1988, according to an authoritative study by Citizens for Tax Justice, a respected public-interest group here.

The seven — Kroger, Pinnacle West, CSX, Illinois Power, Media General, Santa Fe Southern Pacific and Gulf States Utilities — together earned profits of more than $1.1 billion, the group said.

However, most big companies are paying much heavier taxes than they did before the 1986 tax code overhaul, the group said. And, despite the heavier tax burden, the largest companies have nearly tripled their pace of capital investment.

Study Says Seven Big Corporations Paid No Federal Income Tax in 1988

by Jim Luther
Associated Press

Washington, Oct. 26, 1989, AM. Seven huge profitable corporations were able legally to avoid paying federal income tax last year—a decline from 50 because of the 1986 tax overhaul, a private study concluded Thursday.

Citizens for Tax Justice, a labor-financed research organization, said the average tax rate paid by the nation's 250 biggest money-making companies rose last year to 26.5 percent, compared with 14.3 percent in 1981 through 1985. Forty-five corporations still paid less than 10 percent of their profits in income taxes, fewer than half the number reported a year earlier.

The study found the new law is shifting a greater share of the tax burden to corporations, as it was intended to do. Corporate taxes paid 12 percent of the non-Social Security federal budget last year, up from 8 percent in the first half of the 1980s, the report stated.

"Tax reform is working," Robert S. McIntyre, executive director of Citizens for Tax, said in releasing the organization's fifth annual report on corporate taxes. "Business investment has boomed since tax reform, as money that used to go into wasteful tax shelters has returned to the productive economy."

McIntyre's past reports, which found that as many as 70 of the 250 profitmaking giants paid no income tax in one or more years, were credited with helping to goad Congress into overhauling the tax law.

However, because the studies are based on the organization's interpretation of corporate reports, they often are disputed by some of the companies cited.

"Tax reform is working," said Robert S. McIntyre of Citizens for Tax Justice. "Business investment has boomed. Money that used to go into wasteful tax shelters has returned to the productive economy."

For example, the new report listed Santa Fe Southern Pacific as one of the seven profitable companies that paid no tax in 1988. The report said the company had profits of almost $180 million, received a $2.1 million refund of past taxes paid, and thus had a negative tax rate of 1.2 percent.

"We had a net loss in 1988 of $46.5 million as a result of a charge of about $627 million relating to divestiture of Southern Pacific Railroad, which we were required to do by the Interstate Commerce Commission," said Bob Dehrt, a Santa Fe vice president in Chicago.

The new tax law enacted in 1986 repealed the investment tax credit; sharply curtailed an accounting method that allowed large contractors to defer taxes until a project was completed; eliminated the tax preference for capital gains and tightened the "minimum tax," a special levy aimed at profitmaking businesses that use large writeoffs to avoid all or most of their tax liability.

The report said that, in addition to Santa Fe Southern, five large companies paid no tax in 1988 and actually received refunds of past-year taxes, resulting in negative tax rates.

They were: Kroger, $29 million profit and a negative tax rate of 28.3 percent; Pinnacle West, $75 million profit, minus 28.1 percent; CSX, $402 million profit, minus 14.7 percent; Illinois Power, $227 million profit, minus 11.3 percent, and Media General, $75 million profit, minus 5.7 percent.

Gulf States Utilities was reported as having a profit of $164 million and neither paying a 1988 tax nor receiving any refund.

The highest effective tax rate among the 250 companies was paid by Rockwell International, at 192.5 percent. The company, a major defense contractor, paid $1.37 billion tax last year on profits of $714 million. The study said the high rate reflected Rockwell's payment of more than $1 billion of tax that was deferred during 1981-87.

The 250 companies in 1988 paid $34.5 billion tax on $130 billion in profits, an average effective rate of 26.5 percent.

Los Angeles Times

Monday, October 2, 1989

Bush Crowd Has a Plan for Broad Tax Retreat

Bite Will Be on Middle and Lower Class

By BRUCE L. FISHER

The Bush Administration's current drive to cut the tax on capital gains is part of a larger economic policy agenda that, if enacted, will fundamentally change the nation's tax system while swelling the federal budget deficit—all at the expense of middle- and lower-income Americans.

The Administration has persuaded the House (and now awaits a Senate vote) to cut the capital-gains tax, at a net cost of $21 billion over 10 years. Bush also wants "incentives" for savings, such as expanded Individual Retirement Accounts (IRAs), arguing, against a mountain of contrary evidence, that this will stimulate personal savings. Treasury Secretary Nicholas F. Brady has proposed a cornucopia of costly corporate tax breaks, including a deduction for stock dividends that would cost $40 billion a year.

To deal with the budget-busting impact of these changes, the President's team is likely to seek enactment of a regressive national sales tax similar to the value-added taxes assessed in Europe.

Unfortunately, some key House and Senate members are receptive to these ideas. The Democratic congressional leadership had already endorsed expanding tax breaks for IRAs. And Senate Finance Committee Chairman Lloyd Bentsen has said that "there'd be a good chance" for enacting a national sales tax if Bush gave the plan his full support.

These proposals will all swell the deficit. They will all contribute to a further shift of wealth from the middle class to the wealthy. None of them will increase savings or reduce the cost of capital.

These proposals are on the table because the 1986 Tax Reform Act has been an economic success but a political failure. Although tax sheltering is down and both savings and investment are up since the tax bill was enacted, the public has never been convinced that the Reagan Administration and Congress did the right thing three years ago.

Public skepticism has left tax reform vulnerable to special-interest lobbyists who want pre-1986 tax breaks restored in the name of helping business capital formation.

Advocates of capital formation point with alarm to our high real-interest rates and our low national-savings rate. Capital costs in the United States are indeed higher than in Japan and West Germany. But the primary cause is Washington's excessive borrowing—to cover the debt run up by the supply-side tax cuts of the early 1980s.

Moreover, Commerce Department data show that the personal savings rate is now on an upswing, from a low of 2.3% of GNP in 1987 to 4.0% for the first two quarters of 1989. This resurgence in personal savings has occurred despite the limitations on IRA tax deductions enacted in 1986, whereby they were restricted to families that make less than $50,000 or have no other private retirement plan. Congress took the heat on IRAs in the 1986 tax reform act because it saw that unrestricted IRAs were merely a tool used by high-income people to shift existing savings into tax-advantaged accounts.

Meanwhile, since the 1986 reforms eliminated many of the costliest tax breaks for business, corporate profitability has grown. Real capital spending has grown at an annual rate of 6.1% since 1986, compared to an anemic 2.1% over the previous five years.

The fact is that tax reform has worked and worked well but that the federal deficit continues to hang like a millstone around the economy's neck. The Bush agenda would reprise the early Reagan Administration program, which then-President Ronald Reagan himself abandoned in 1986, and fund it with a national sales tax, which will take a larger share of the disposable incomes of lower-income people than of higher-income people.

Studies by the Congressional Budget Office show that between 1977 and 1988, the richest 1% of Americans enjoyed a 74% jump in real after-tax incomes, while real incomes for low- and middle-income families stagnated or declined.

And the lesson of the early Reagan years is that if you give the rich more money, they don't save it—they spend it. Between 1983 and 1986, for example, U.S. sales of Jaguars went up 55%, Mercedes, 35%; Porsches, 40%, and BMWs, 63%, while sales of U.S.-made cars grew by only 21%.

The Bush agenda would swell the deficit and then raise taxes on working people, all in the name of helping business. The fact that business is doing just fine now goes unnoticed. The fact that the deficit impedes business capital formation is ignored. It's time for Congress to come to its senses and reject the whole Bush agenda on this issue and get to work on our largest national problem: the federal budget deficit.

Fisher is research director of Citizens for Tax Justice based in Washington.

Companies Paying More Taxes, Public Interest Group Says

Reuters

Washington, Oct. 26, 1989. Less of the largest U.S. companies have been getting away with paying no federal income taxes since the 1986 Tax Reform Act was enacted into law, a public interest group said.

Citizens for Tax Justice, a coalition of labor and public interest groups, said that last year seven of the top 250 profitable corporations, earning a total $1.1 billion in profits, paid no income taxes, compared with an average of 50 companies per year during the 1981-85 period.

"Tax reform is working," said the group's director Robert McIntyre. The groups said its study showed that 45 companies had effective tax rates below 10 percent in 1988, down from an average 117 a year from 1981 to 1985.

The group said 192 of the top 250 companies paid less than the 34 percent corporate income tax rate in 1988, while 91 companies paid less than the alternative minimum tax of 20 percent in 1988.

Taxes

by Sabrina Eaton
States News Service

Washington, Oct. 26, 1989. While many of America's most profitable companies still pay less than the standard corporate income tax rate, tax reforms have reduced avoidance, according to a study released Thursday by a nonprofit public interest group.

Only seven out of 250 corporations examined by Citizens for Tax Justice paid zero or less in federal income taxes last year. Before tax reform, as many as 73 paid no taxes or got refunds in a single year, the study reported.

"The reforms enacted in 1986 put many of the most notorious corporate avoiders back on the rolls and cut the number of no-tax companies dramatically," said CTJ director Robert S. McIntyre. "Just as important, business investment has boomed since tax reform, as money that used to go into wasteful tax shelters has returned to the productive economy."

The average tax rate for companies in the study was 26.5 percent in 1988, up from 14.3 percent between 1981 and 1985. The standard corporate tax is 34 percent.

For Missouri corporations, the average rose to 32.2 percent from 11.6 percent.

McDonnell Douglas paid the lowest tax rate of Missouri companies the study examined, remitting $75 million of its $440 million 1988 profits to the federal government for a 16.9 percent tax rate. CTJ said the defense contractor's rate between 1981 and 1985 was only 0.7 percent.

Southwestern Bell, which paid 7.2 percent of its profits in taxes between 1981 and 1985, paid 39 percent of its profits in 1988 taxes, the highest rate for any Missouri company examined in the report.

Let's Tax Capital Gains on Inherited Property

By Robert S. McIntyre

MALCOLM FORBES is throwing $2 million parties which are possibly tax-deductible. Leona Helmsley has just been convicted of tax fraud. And President George Bush, along with numerous members of Congress, says that what Forbes and Helmsley need is a tax cut.

According to the president, Helmsley's problem is not that she may be locked up, but that she's locked in. Bush maintains that Helmsley and others like her are deterred from cashing in their profits on stocks, real estate and other assets by the 1986 Tax Reform Act, which eliminated the special tax preference for capital gains.

Robert S. McIntyre is director of Citizens for Tax Justice in Washington, D.C.

Restore the capital gains break, asserts the president, and wealthy people will rush to sell their holdings. This in turn will mean added revenue to the Treasury, not to mention more savings and investment, from previously "locked-in" asset holders.

Before cognitive dissonance fully sets in, let's note that there is a respectable argument for the proposition that a cut in the capital gains tax might raise revenues in the short run — especially if the cut is a temporary one. For instance, in late 1986, after the capital gains tax hike had been enacted but before it took effect, there was a huge surge in asset sales.

Including several hundred thousand dollars in gains cashed by then-Vice President Bush, total reported capital gains in 1986 were a record-breaking $321 billion, double their 1985 level. Of course, that meant there were fewer gains to report in 1987 and 1988, when reported gains fell off to $133 billion and $162 billion, respectively. (Gains are expected to be back up to about $180 billion this year and $200 billion in 1990.)

Enacting a temporary cut in capital gains taxes, to be followed by a scheduled increase, to be followed by another cut — the plan that Bush supports — might have the same yo-yo effect. And the idea of a potential one-shot surge in tax revenues at the expense of the future has short-sighted politicians in Washington, of whom there are more than a few, salivating. Indeed, our forward-looking president wants to use the hoped-for revenue blip to pay for (permanent) tax cuts for big business.

If unlocking the wealthy really is the goal, however, there's a much better and more straightforward way to do it, one that promises to increase tax revenues not just for one year, but over the long term as well.

Right now, the tax law totally forgives capital gains taxes on inherited property. This means that if someone inherits $10 million in stock that was originally purchased for $1 million, he or she can sell it and pay no capital gains tax at all on the $9 million profit.

Obviously, this tax break for bequests creates a pretty big incentive for well-off people to hold onto assets for their entire lives so their heirs can avoid capital gains tax. And lots do. According to Treasury analysts, it's the main reason why three-quarters of accrued capital gains are never realized and thus never reported on income tax returns.

Eliminating this loophole would add upwards of $5 billion a year to federal revenues directly, plus whatever would accrue from the "unlocking" effect of more lifetime sales.

Taxing unrealized gains on inherited property is not a new idea. It's already the practice in Canada, for example. President John F. Kennedy proposed this tax reform in 1962, and in 1976 Congress enacted a weakened version, which required heirs to pay capital gains tax if and when they sold inherited assets. The 1976 reform, however, was "temporarily" delayed, and ultimately repealed by the supply-side Congress of 1980.

Opponents of taxing unrealized gains on inherited property argue that such a change would unfairly victimize family farms and small businesses, forcing them to be sold rather than continued as family enterprises. If that's a real problem, however, the 1976 approach would solve it, by delaying the capital gains tax until heirs sell the farm or business.

In fact, if someone gives a farm or business to the kids before he or she dies, the law already requires the children to pay capital gains taxes when they sell. Why the law should favor bequests over lifetime gifts is hard to fathom.

The president's ill-advised "solution" to capital gains lock-in would reduce taxes by an average of $25,000 apiece for the richest 1 percent of the population, revitalize the tax shelter industry, add tens of billions of dollars to our long-run deficit problem and undermine the achievements of the 1986 Tax Reform Act.

In contrast, taxing gains on inherited property would enhance tax fairness and increase long-term federal revenues at a time when they are sorely needed. If we're going to unlock Leona, let's do it right.

Capitol pains on capital gains

A break for investors may be an idea whose time has come—again

Hollywood is not the only place cashing in on sequels this summer. On Capitol Hill, "Return of the Supply-Siders" has political leaders biting their nails. The drama hearkens back to 1981, when a newly elected Ronald Reagan managed to slash personal and corporate taxes, thanks to the backing of conservative boll-weevil Democrats. That seems to be happening again, with a renegade band of House Democrats doing their darnedest to help George Bush make good on his campaign pledge to restore the tax break for capital gains.

Only a few weeks ago, odds were against anything happening with capital gains this year. But some inept waffling on the issue by the usually adroit chairman of the House Ways and Means Committee, Dan Rostenkowski (D-Ill.), spurred a revolt by six Democratic members, most of them from the South. "The same people that gave us the budget deficit are back," laments Robert McIntyre, director of Citizens for Tax Justice, a labor-backed lobbying group in Washington, D.C. "The boll weevils and Republicans never really liked tax reform and now see the opportunity to stage a counterrevolution."

The rebellion threatens to undo the core provision of the 1986 Tax Act, which treats earned and investment income the same way. Individual rates came down dramatically in return for eliminating the break on capital-gains profits. The controversy also could undermine efforts to wrestle the federal-budget deficit down to the $64 billion limit mandated by the Gramm-Rudman-Hollings Act for fiscal year 1991.

Roller-coaster rates. Until the provision was dropped in 1986, preferential treatment of capital gains was a long-standing feature of the tax code. Since World War II, rates for investors in the top income bracket have varied from a high of 45.5 percent to a low of 20 percent, when the phaseout occurred. Currently, couples filing joint returns, who take two exemptions, pay 33 percent on all taxable income between $74,850 and $177,720—including capital gains; the rate falls back to 28 percent for higher incomes.

President Bush, who advocates dropping the maximum tax rate on investment gains to 15 percent, argues that restoring the break would spur risk taking and stimulate economic growth. Moreover, the government stands to

Man in the muddle. *Ways and Means Chairman Rostenkowski has a tax problem*

HOW AMERICA COMPARES WITH ITS PEERS

Maximum tax rates for capital gains on equities	Short-term tax rate	Long-term tax rate	Period to qualify for long-term gains treatment
U.S.	33%	33%	One year
Canada	19.33%	19.33%	None
France	16%	16%	None
Germany	56%	None	Six months
Italy	None	None	None
Japan	5%	5%	None
Britain	40%	40%	None

Note: State, provincial and local taxes not included. Canadian residents are allowed a lifetime capital-gains exemption of $84,175. France allows up to $42,027 to be exempted each year. In Germany, the first $524 of short-term capital gains is tax-exempt. Britain's rate is indexed for inflation.

USN&WR—Basic data: Prepared by Arthur Andersen & Company for the Securities Industry Association, updated by the American Council for Capital Formation Center for Policy Research, July, 1989

reap more in total revenues even though tax rates would be lower. Investors who now sit on their holdings would be encouraged to sell to take advantage of the reduced rates.

Even those who oppose special treatment for capital gains concede that, in the short run, the measure would indeed pour more money into federal coffers. However, after the initial windfall, the government winds up losing. A study this year by the congressional Joint Committee on Taxation estimates that paring the maximum capital-gains-tax rate to 15 percent would garner a modest $4 billion in the first 24 months but would then cost the Treasury $28 billion over the next four years.

LINDA L. CRESHTON

All smiles. *Bicentennial bash brings back Ways and Means alumni, President Bush and former Chairman Wilbur Mills, center*

The proposal by Representative Edgar Jenkins (D-Ga.), now under consideration in the House Ways and Means Committee, would exclude 30 percent of gains from being taxed, in effect cutting the top rate to 19.6 percent for all kinds of investments except art and collectibles. The break would only apply for two years, after which rates would bounce back to current levels.

This yo-yo strategy gives the Treasury a one-time $5 billion infusion as investors rush to take advantage of the narrow window of opportunity. But critics say the two-year proposal is a gimmick to help get the federal-budget deficit down to $100 billion for fiscal 1990. "This is not responsible economic policy; this is just more expediency," Senate Finance Committee Chairman Lloyd Bentsen (D-Tex.), a leading advocate of lower taxes on profits from stocks and other investments, told *U.S. News* last week. "If something is to be done on capital gains, it should be long term and not a quick fix to raise $5 billion through creative accounting." Bentsen, who will play a key role in the Senate debate, insists that any drop in capital-gains-tax rates should be tied to a comprehensive deficit-reduction effort—including raising some taxes.

Beer vs. bubbly. Unfortunately, economic issues are taking a back seat to what is shaping up as an increasingly heated political battle. In office just one month, House Speaker Thomas Foley (D-Wash.) finds himself on the spot. Members of his party are deeply divided on capital gains. Many feel that cutting rates on investment income is simply a sop to the rich in which "the beer drinkers are buying the rich people champagne," as liberal Pete Stark (D-Calif.), a senior member of the Ways and Means Committee, puts it. Then there are some 50 to 70 Democrats who believe that capital gains does boost the economy and who will probably side with Republicans. "If it comes to a vote on the floor, the Speaker realizes he could lose," says Norman Ornstein, a political scientist at the American Enterprise Institute in Washington, D.C. The President has steadfastly stuck to his no-new-taxes vow and, delighted by the turn of events in the Ways and Means Committee, sees no reason to compromise now.

So what happens next? Having given the rebels in Ways and Means their opening by putting capital gains back on the committee's agenda, Chairman Rostenkowski must search for some middle ground that will satisfy both liberal and conservative Democrats and also prevent Foley from suffering an embarrassing defeat in his first major test as the new Speaker. The likelihood is that Ways and Means will put off discussions until mid-September, when Congress returns from its summer recess.

Ideally, the Democrats would like to raise the maximum tax rate on high-income individuals to 33 percent in return for a cut in capital-gains taxes. But such a hike for the wealthiest taxpayers would require President Bush to renege on his promise not to raise taxes.

The most obvious compromise would be to index capital gains, taxing investment profits after they have been adjusted for inflation and forgoing a reduction in actual rates. However, that would not provide the one-time windfall that accrues from a temporary rate cut. And most analysts, including those at the Treasury, contend that indexing would cost the government billions of dollars in revenues.

The denouement could come on the House floor. Speaker Foley was conceding last week that the measure would probably pass if it were put to a vote of the entire House. The Senate is even more inclined to cut capital gains than the House. "We've got the votes" to pass a capital-gains bill, declared Office of Management and Budget chief Richard Darman last week, "but we can't actually get a vote." That's the trouble with sequels; even before they finish, there are enough loose ends to guarantee another. ■

by Jack Egan with Andy Plattner and Steven V. Roberts

Should investors sell or wait for a vote?

The suddenly sunnier outlook for a return of the capital-gains-tax break is giving investors pause. Should they wait to cash in their stocks to take advantage of a possible lowering of tax rates?

That is just the sort of question Congress hoped investors would not have to ask when it passed the 1986 Tax Act. One of the key principles behind the reform was to encourage individuals to emphasize economic rather than tax factors when making investment decisions. Even with the current talk of rate cuts, that is still the wisest way to proceed. A bird in the hand is still worth more than a promise, even from President Bush.

There is no way to predict what Congress will do on capital gains. The issue has grown as politically controversial as it is economically complex.

Also, consider what is happening in the stock market. Last week, Standard & Poor's 500-stock index hit all-time highs. And the Dow Jones industrials are just 3 percent below the peak set in August, 1987, six weeks before the Black Monday crash. Not that another debacle is in the making. Still, it would be a foolish investor who would think more about potential tax changes than about what is happening in the market and the condition of the economy.

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ARTHUR HAYS SULZBERGER, *Publisher 1935-1961*
ORVIL E. DRYFOOS, *Publisher 1961-1963*

Why Stroke the Rich?

The 1986 Federal tax reform became fully effective just six weeks ago, and already President Bush wants to start tearing it apart. Violating both the promise and the fairness of that landmark law, he seeks to revive favorable tax treatment for capital gains. That might spur investment, a little. More certainly it would benefit the rich, a lot.

Until the reform law, the maximum tax on gains from investments like securities, real estate, works of art and herds of cattle was 20 percent while ordinary income was taxed up to 50 percent. The 30-point difference was an invitation to create tax shelters.

In praiseworthy pursuit of tax equity and economic efficiency, the reform law wiped out the differential. Gains are now taxed like other income, at sharply reduced income tax rates — 28 or 33 percent for anyone with substantial income.

Mr. Bush proposes a narrower tax than existed pre-reform. Capped at 15 percent, it would apply to personal investments in securities and homes, but not to whole buildings, Picassos or beef. Even so, the Bush plan is biased toward the rich. Wealthy people invest much more, and so naturally would gain much more. Most of the benefit would fall to the richest 1 percent of taxpayers (see box).

The main argument for taxing capital gains less than ordinary income is to create an incentive for investment, growth and jobs. Some investors would surely be motivated, but it wouldn't make a whit of difference to the tax-free institutional investors — pension funds, endowments and others — that are major players in today's markets, especially in new ventures. If the goal is, as it should be, more investment, there are better ways including targeted investment tax credits for businesses.

Mr. Bush also contends that his capital gains tax cut would raise revenue, by almost $5 billion next year. But that argument is even less persuasive. As recently as 1984 the Reagan Treasury declared that an *increase* in the gains tax would raise revenues. To this day, competent experts debate the economic effects; some say a lower tax yields more revenue, others say less. The Federal Reserve chairman, Alan Greenspan, recently called all such estimates "very soft."

The Capital Gainers

According to Congress's Joint Tax Committee, taxpayers with incomes over $200,000 — less than 1 percent of all taxpayers — received three-quarters of the benefit of the old capital gains tax, averaging $42,000 apiece.

The committee has yet to analyze the Bush plan, but Citizens for Tax Justice, a public lobbying organization, calculates that two-thirds of the benefit would go to taxpayers with incomes over $200,000, or an average of $25,000 each.

It's equally hard to follow Mr. Bush's political logic. If a Democratic Congress could ever be brought to cut the tax on capital gains, it would at the very least insist on balancing the cut with higher top-bracket rates on other income. That would run smack into Mr. Bush's "no new taxes" pledge. In any case, Dan Rostenkowski, chairman of the House Ways and Means Committee and an architect of the 1986 reforms, isn't looking for trade-offs. He wants no tampering at all with the delicately balanced reform compromise.

As Vice President, Mr. Bush was part of that deal. It was, and is, a good deal for America. President Bush's capital gains proposal would, without plausible benefit to most taxpayers, dishonor it.

JERRY KNIGHT

A Nightmare on Capitol Hill: Tax Shelters Threatening to Rise From the Dead

In the postmodern castles of the nation's knighted lawyers and in the computerized dungeons of our anointed accountants, the Dr. Frankensteins of the tax-shelter business are working to bring their monsters back to life.

To the mad scientists of tax shelters, there is no more powerful magic than proposals for lowering the tax on capital gains that are now being debated in Congress. For the time being, Senate Majority Leader George J. Mitchell (D-Maine) is keeping the capital gains cut at bay, utilizing the golden crucifix, the silver bullet and all the legislative amulets at his disposal. But cutting the capital gains tax is an idea that never dies, and in anticipation of its next revival, the tax shelter Frankensteins are hard at work.

They have already figured out that the Jenkins-Archer capital gains cut passed by the House a few weeks ago will make it possible to bring back real estate shelters, says Theodore Seto, a tax lawyer in the Philadelphia firm of Drinker Biddle & Reath. Seto knows. He used to arrange them; now he helps investors whose shelters failed.

"The big problem with the incentives of the bad old days was that it tended to induce investors into things they shouldn't have gotten into," he explains.

Real estate tax shelters, in fact, grew into one of the most socially wasteful investment incentives ever created. The last experiment in giving real estate investments special tax breaks distorted our national spending priorities and led to the construction of thousands of unneeded office buildings. You can see the "For Lease" signs in Washington and every major city. Many of those see-through buildings were built not because the market demanded them, but because the tax incentives lured investors who paid no attention to the fundamentals of the leasing business.

Though the capital gains tax cut is being sold as a boon for small investors who want to cash in their stock market gains, "the people it really will help is real estate developers. We're going to see a lot more empty office buildings," says Seto.

"There are an infinite variety of ways" to create tax shelters under the House plan, he explains, but the key to all of them is leverage. "The more you borrow, the bigger the capital gains cut."

In its simplest, hypothetical form, the tax-shelter alchemy works this way: You buy a capital asset using borrowed money. You pay out $100 in interest. The property appreciates $100 and you sell it. In reality, you broke even—the interest expense offset the profit from appreciation. But under Jenkins-Archer, Seto says, that transaction produces a $30 tax break. You get to deduct the full $100 in interest, but you also get to exclude 30 percent of your capital gains, so for tax purposes you got only $70 in income. Thus there is $30 in deductions left over to shelter other income.

"Just add six zeros and make it a partnership," says Seto, and you've got a tax shelter.

People with a passing knowledge of the tax code may question the example. Individuals can't deduct interest, they'll say. True, but businesses can, partnerships can. That's how the tax-shelter Frankensteins make their living. What about the passive loss limits, the rules that restrict deducting investment losses from other income? That's another job for the tax-shelter Frankensteins.

"When you have an incentive that big, you'd find a way—even if you have to get the law changed," predicts Robert S. McIntyre, director of Citizens for Tax Justice, a longtime foe of capital gains cuts in general and tax shelters in particular.

McIntyre points out that the tax bill now on the table already contains a "technical amendment" that changes the way the passive loss rules are applied to the forestry industry and would seem to make tree-growing an ideal tax shelter. What you want in a shelter, McIntyre explains, is to deduct expenses against ordinary income and pay taxes on capital gains. Christmas tree farming would work very nicely. You write off the cost of trimming the trees and mowing between them and spraying with chemicals, and all the while your investment is literally growing into low-taxed capital gains.

Once the tree farmers get their tax shelter, how can Congress resist turning the tax law into a Christmas tree for all the other shelters?

Actually, Halloween is a more appropriate holiday for tax shelters. The creations of the tax-shelter Frankensteins will be playing trick or treat with all the ordinary taxpayers who don't have shelters. The average taxpayer will have to pay more, so those with shelters can pay less.

When the monsters costumed as capital gains cuts come knocking at the door, look down the front walk at those ghostly figures lurking in the shadows. Those are the senators and representatives who are digging up the tax shelters that were buried only three years ago. Happy Halloween.

PAUL BLUSTEIN

Compromise on Capital Gains Could Produce Some Pretty Weird Tax Policy

A few weeks ago, in celebration of April Fool's Day, the journal Tax Notes disclosed a Bush administration "secret proposal" to raise $60 billion in revenue over the next three years by making the capital gains tax rate zoom up and down.

Tax Notes dubbed the proposal "the Macadamia Plan," and said the nutty idea would work as follows: The capital gains rate would be cut this year from 28 percent to 15 percent, as President Bush has suggested. That would prompt people to sell their stocks and other assets to take advantage of the lower rate, creating a windfall for the Treasury. Then, next year, the capital gains rate would be restored to 28 percent, prompting even more selling by investors rushing to unload their holdings before the new higher rate took effect. Then, in 1991, the rate would be cut back to 15 percent again, generating yet another windfall. Tax Notes described administration officials as furious that their plans for a final rate cut had leaked out, because that would diminish the revenue harvest from the first two rate changes.

The Macadamia Plan was good for a chuckle on April 1, but it's not so funny anymore. In recent days, Washington has started buzzing about a potential grand compromise between the White House and Congress on the budget deficit in which the capital gains rate would be manipulated both to secure Bush's support and raise some quick revenue.

What provoked the buzz were some remarks by Rep. Dan Rostenkowski (D-Ill.), chairman of the House Ways and Means Committee, who—after months of vowing opposition to a capital gains tax cut—declared his willingness last week to negotiate with the White House on the issue. Rostenkowski said that given Bush's no-new-taxes pledge, the Ways and Means Committee can't seem to agree on any better way to raise the $5.3 billion for 1990 that is required under the terms of the current congressional budget resolution. The Illinois Democrat is said by informed insiders to be seriously considering a proposal that would lower the capital gains rate—but only temporarily—in order to generate some fast billions.

Rostenkowski's new stance on capital gains opens up some intriguing possibilities for tax and budget legislation this year. His willingness to negotiate may even improve the chances for significant deficit reduction, in part because Bush would be better able to wriggle out of his antitax promise if he could show the Republican right wing that he has obtained better treatment for capital gains.

But in the process, some pretty weird tax policy may be enacted. Under the proposal that Rostenkowski is considering, the maximum capital gains rate would drop to 20 percent for two years. Then the rate would rise back to its current levels (the same rates that apply to wages and salaries); presumably, investors would cash in a great profusion of assets during the window of lower-rate opportunity, and Rostenkowski's obligation to raise revenue for 1990 would have been discharged.

At the same time, the proposal would permanently change the tax treatment of capital gains in one important way: Gains would be "indexed" to inflation so that only real profits would be taxed, not the inflation-based paper profits attributable to increases in the general price level.

The idea of lowering and then raising the rate has drawn harsh criticism from all parts of the political spectrum.

"I call it the yo-yo. It's smoke and mirrors. It's uglier than Attila the Hun," said Mark Bloomfield, president of the American Council on Capital Formation, an industry-backed group that favors capital gains tax reduction.

On the left, Robert McIntyre, director of Citizens for Tax Justice, a labor-backed group, calls the idea "awful," "budgetary flimflam," and "the death knell for tax reform if it ever passes." The more reserved chairman of the Senate Finance Committee, Sen. Lloyd Bentsen (D-Tex.), calls it "bad tax policy" and "gimmickry."

But don't be too quick to write off the concept completely. Consider what various political factions could get from it.

Both Democratic and Republican lawmakers (and virtually all economists) like the idea of indexing capital gains to inflation. Indexing offers a politically ideal compromise between the White House and Capitol Hill. By itself, indexing wouldn't raise the revenue Rostenkowski needs. Combining it with the yo-yo would.

How about the administration? Would it go along? Officials say privately that they wouldn't, as the proposal currently stands. But some suggest that relatively modest modifications might suffice, such as offering long-term investors the alternative of using indexing or a reduced rate.

Democrats could get White House support for expanding social legislation such as child-care credits and the earned-income tax credit for the working poor. The revenue from the yo-yo (an estimated $15 billion over two years) could help to pay for much bigger expansions in such credits than the administration is now contemplating.

That could help reverse the trend toward greater income inequality that has arisen in recent years.

Finally, there is the tantalizing prospect of a capital gains compromise helping to eventually lure Bush into a megadeal on the deficit. In an interview last week, Rostenkowski suggested, without saying so directly, that this is his real goal. He disparaged the fiscal 1990 budget accord between the White House and congressional leaders, which included a number of questionable savings, and said he is eager to start negotiating a long-term fiscal package.

"I want to get by this so-called smoke-and-mirrors budget, to get at the real meat of deficit reduction," Rostenkowski said.

You might put it this way: To make an omelet, perhaps you've got to break some macadamia nuts.

Should capital gains taxes be lowered?

Wealthy will benefit and deficits worsen under reinvigorated tax shelter industry

By Robert S. McIntyre

Robert S. McIntyre is director of Citizens for Tax Justice in Washington D.C.

HERE WE GO AGAIN. Remember back in 1981 when President Reagan said that the cost of the defense buildup would be paid for with the "additional revenues" generated by his supply-side tax cuts? Well, now, a trillion and a half dollars in budget deficits later, President George Bush is singing the same tune. He says that he can pay for new tax loopholes for oil millionaires and multinational corporations with the "increased revenues" that will come from cutting taxes on capital gains!

A tax break for capital gains is nothing new, of course. In one form or another, capital gains enjoyed special tax treatment from 1921 all the way through 1986. The 1986 Tax Reform Act, however, changed all that. Profits from selling stocks, bonds, land and so forth now are taxed at the same rates as wages, interest or other kinds of income.

Eliminating the capital gains break was an essential feature of the 1986 reform act. Without this reform, it would have been fiscally and distributionally impossible to cut the top income tax rate to only 28 percent on the highest earners. (Indeed, continuing the old loophole or indexing gains for inflation, as some suggested, would have required a top rate of well over 40 percent to break even.) But President Bush wants to go back on the deal. He proposes to exempt 45 percent of capital gains from tax, with a maximum rate of 15 percent.

MANY CONTROVERSIAL CLAIMS have been made on behalf of the president's plan, but nobody disputes one basic fact: Cutting capital gains taxes would be a bonanza for the wealthy. Two-thirds of all capital gains go to the richest 685,000 people in the nation. Because capital gains account for more than a third of the income of these folks (who make an average of $640,000 a year), they would save at least $25,000 a year each in federal income taxes if the Bush plan were adopted. Almost 90 percent of the tax cuts would go to the best-off five percent of the population.

In contrast, the vast majority of taxpayers have no capital gains at all (other than on their homes, which usually aren't taxed under current law). If yours is one of the four out of five families earning $60,000 a year or less, your average tax savings from the Bush plan would be only $20.

On its face, the Bush proposal looks hugely expensive. If there were no change in behavior by wealthy people, the administration itself estimates that its tax-cut plan would add upwards of $17 billion a year to the federal deficit.

BUT, WITHOUT DOUBT, there would be changes in how rich people arrange their affairs. Most obviously, restoring the capital gains loophole would reinvigorate the tax shelter industry. Tax scams designed to convert ordinary taxable income into capital gains would proliferate, adding billions and billions of dollars more to the revenue cost.

The Bush administration doesn't disagree that tax shelters would be a serious problem — although it lowballs the revenue impact. But, hey, don't worry, be happy, says the president. Reducing capital gains taxes, he argues, will encourage savings. It will stimulate venture capital. And most important, Bush insists, lowering capital gains taxes for the wealthy will set off such a sustained surge of selling of stocks (and other eligible assets) that it will actually raise revenue for the Treasury.

It's a familiar litany, and it's been discredited time and time again. The virtually inexplicable claim about savings runs afoul of the fact that the personal savings rate plummeted to historic lows following the last round of capital gains tax cuts in 1978 and 1981. The idea that those previous tax cuts produced a flood of venture capital into risky but socially useful enterprises was refuted by a 1985 Congressional Budget Office report, which found:

- That the growth in the venture capital industry was well under way before the 1978 capital gains tax cut took effect (following a rapid surge in demand for high-technology electronic products in the mid-'70s).
- That almost all the increase in venture capital investment after 1978 came from tax-exempt pension funds and other entities that were unaffected by the tax changes.

IN CONTRAST, the share of venture capital supplied by individual investors — for whom the capital gains tax cuts were supposed to be an incentive — declined markedly.

You might be tempted to dismiss out of hand the president's final assertion: cutting capital gains taxes would increase tax collections. After all, the Reagan administration and the Congress only recently concluded that eliminating the capital gains loophole would significantly augment revenues. But, because that implausible premise is at the heart of the administration's case for undermining tax reform, it needs to be examined carefully.

The administration unabashedly predicts that if its plan is adopted, wealthy people will more than double their annual reported capital gains. In other words, according to the administration, capital gains will jump from about $150 billion a year to $300 billion a year!

IS THERE ANY REASON to expect that to happen?

The congressional Joint Committee on Taxation doesn't think so. It conservatively estimates that adopting the administration plan would cost $25 billion over the next several years. But Bush continues to press his argument. After the top capital gains tax rate was reduced from about 38 percent to 28 percent in 1978 and to 20 percent in 1981, he points out, reported capital gains increased rapidly. Post hoc, ergo propter hoc, he concludes. However, that may not be the case.

From 1977 to 1985, the total value of stocks listed on the New York Stock Exchange grew by more than $800 billion. It's no surprise, therefore, that reported capital gains on corporate stock were about $40 billion higher in 1985 than in 1977. You can't credit the capital gains tax cuts with the rise in the stock market. An incentive to sell doesn't boost prices.

Additionally, stock values almost doubled from 1982 to 1986, a period that saw no change in capital gains taxation. And they've gone up by 15 percent more since the end of 1986, after the top capital gains tax rate was increased from 20 percent to 28 percent.

Another big factor boosting reported capital gains was the boom in tax shelters that occurred in the first half of the 1980s. In 1985 alone, some $85 billion in tax shelter "losses" were reported on individual tax returns. There's no doubt that the 1978 and 1981 capital gains tax cuts spurred the shelter activity, since a primary purpose of shelters was to allow the rich to transform their regularly-taxed income into lightly-taxed capital gains. But this source of increased capital gains obviously didn't increase government tax collections. Quite the contrary.

AS MICHAEL KINSLEY of "The New Republic" has aptly noted, if the government gave a 50 percent tax cut to people whose name is "Bush," it's quite likely that taxpayers named "Bush" would pay more taxes, since a lot of people would change their names. But that hardly means the tax break would lead to higher total revenues.

Recently, a major source of reported capital gains has been the wave of corporate mergers, hostile takeovers and leveraged buyouts. These transactions have generated close to $600 billion in essentially forced stock sales over the past five years. The involuntary capital gains produced by these deals plainly aren't affected by the tax rate on capital gains.

The historical evidence seems clear. If capital gains taxes had not been reduced in 1978 and 1981, the government would have collected much more in revenues — and the federal budget deficits would have been much lower — than was actually the case.

In fact, that's exactly what happened in Canada, where reported capital gains grew in almost exactly the same pattern as in the United States, despite no change in Canada's tax treatment of capital gains.

WE CAN'T UNDO the errors of the past, but we certainly don't have to repeat them.

The congressional leaders in the 1986 fight for tax reform, like Dan Rostenkowski, D-Ill., chairman of the House Ways and Means Committee, firmly oppose President Bush's call for another supply-side round of tax giveaways to the rich. They need to persuade the president that extending tax reform, rather than sabotaging it, is imperative if we are to cut the budget deficit and curb the immoral borrowing from our children's future that has been the unfortunate hallmark of the 1980s.

Asian Wall St. Journal
Hong Kong, May 9, 1989

U.S. Tax Coupling Would Aid the Rich

By JEFFREY H. BIRNBAUM
Staff Reporter

WASHINGTON – It looks like a tax bill made in heaven: cutting the top tax rate on capital gains – which satisfies conservatives – and increasing the excise tax on gasoline, which pleases liberals.

The capital-gains tax reduction is backed by much of the business community, supply-side economists and President George Bush. They say the change would spur investment, help America grow and compete, and better yet, raise revenue for the government, at least in the short run.

A gasoline-tax rise is endorsed by environmentalists and by lawmakers who want to cut the budget deficit significantly, including the chief tax writer in the House, Democratic Rep. Dan Rostenkowski, chairman of the Ways and Means Committee. Each penny increase in the 9.1-cent-a-gallon federal tax raises $1 billion in federal revenue.

But a closer look suggests that this might not be such a heavenly match. The combination, which is being floated by some Bush administration officials as a possible compromise, is likely to face increasing opposition for a very fundamental reason: The poor would be the big losers while the winners would be the rich.

According to the Congressional Joint Committee on Taxation, nearly 80% of the tax benefit of President Bush's proposal to reduce the top tax on capital gains would go to those who earn more than $100,000 a year. And 60% of the proposed tax reduction – to 15% from the current maximum of 33% – would go to individuals who earn $200,000 a year and over. Those who earn $50,000 and less, who comprise more than 80% of all American families, would get only 8.6% of the benefit.

Poor Hit Hardest

While the rich would get most of the tax cut, the gasoline tax increase would fall mostly on the poor. According to the Congressional Budget Office, federal gasoline tax payments took 1.62% of the incomes of families making less than $5,000 a year in 1985. But families that make 10 times that amount, and more, spend only 0.34% of their incomes on federal gasoline taxes.

Citizens for Tax Justice, a labor-backed group headed by tax analyst Robert McIntyre, melded both analyses, using the Bush capital-gains proposal and a gasoline tax rise of 15 cents a gallon. Mr. McIntyre reports that the highest-earning 5% of American families – those making $100,000 a year or more – would get an average tax cut amounting to 2.2% of their income. Families of four that earn more than $225,000 a year – the top 1% of family incomes – would get an average tax reduction of $19,800, or 3.3% of their income.

The lowest-earning 40% of American families, with incomes of less than $30,000 a year, would have an average tax increase of 0.9% of their income. The poorest 20% of the nation's families, with incomes of less than $19,000 annually, would have an average tax increase of $132 a year under the proposal, or 1.1% of their income, Mr. McIntyre says. He says that 95% of families would pay more taxes, and only the highest-income 5% would pay less.

Who Benefits From Cut In Capital-Gains Tax

Percentage of tax benefit that would go to each income class under president's proposed cut in capital-gains tax:

INCOME GROUP	SHARE OF CUT
Less than $10,000	0.1%
$10,000-$19,999	0.9
$20,000-$29,999	1.5
$30,000-$39,999	2.6
$40,000-$49,999	3.5
$50,000-$74,999	6.6
$75,000-$99,999	5.2
$100,000-$199,000	19.7
$200,000 or more	60.0

Source: Congressional Joint Committee on Taxation

"They've carved out a constituency here," Mr. McIntyre says, chiding the anonymous authors of the combination compromise. "The top 5%."

California Rep. Robert Matsui, a liberal Democrat on the House Ways and Means Committee, agrees. "I just can't fathom that. I can't imagine us not being concerned about the income distribution. How do you possibly increase taxes on the lower and middle class and cut them for the wealthy?"

Some conservatives also have their doubts. While he would like to see the capital-gains rate reduced, Rep. Newt Gingrich, a Georgia Republican, says he opposes raising the gasoline tax, which would most burden the working man and woman. "No member (of Congress) from the suburbs or rural America is going to raise the price of gasoline," he says. "For 90% of working America, it's nonsense."

Conservative Republican Sen. William Armstrong of Colorado calls combining the two tax changes "a very poor idea. It just sounds like a big political deal, which is what it is: We'll give Mr. Bush what he wants on capital gains, and we'll give Mr. Rostenkowski what he wants on the gas tax."

There seems to be little question about where the compromise is vulnerable. "It takes from the poor and gives to the rich," says Robert Lighthizer, a lobbyist at Skadden Arps Slate Meagher & Flom, who represents a group of corporations and business groups that often ally themselves with liberal organizations to fight excise tax increases based on the income-distribution argument.

But backers of the capital-gains tax cut argue vigorously – and with increasing effectiveness on Capitol Hill – that a reduction in the rate would benefit more than just the wealthy. "If you have high capital-gains taxes, the wealthy don't realize capital gains and the government gets no revenue," says Richard Rahn, chief economist of the U.S. Chamber of Commerce.

Rate-cut proponents claim the reduction would lead to upper-income people paying far more in taxes than they do now, because the lower rate would provide greater incentive to trade more assets. They also argue that more low- and middle-income people would benefit from a lower capital-gains rate than the Joint Tax Committee calculation indicates. A better analysis, they contend, would show that a lot of people of relatively modest means are incorrectly classed as upper-income because of one-time sales of assets, such as houses or farms, that produce capital gains.

Mark Bloomfield, president of the American Council for Capital Formation, argues that when the temporarily rich are excluded, "lower- and middle-income people account for the vast majority of those who realize capital gains, and also a large amount of the actual capital gains."

Far Fewer

By his estimate, nearly half of all capital gains go to people with wage and salary income of less than $50,000 – an argument echoed recently by Roger Porter, the president's domestic-policy adviser. Congressional analysts agree that some poor people are wrongly put into high-income categories but contend that far fewer are involved than proponents of capital gains cuts claim.

The proposal for a gasoline tax increase is running into trouble on Capitol Hill on its own. Last week the Senate, in a nonbinding resolution, voted without dissent against raising the federal gasoline tax to reduce the budget deficit in the fiscal year beginning Oct. 1. Many lawmakers say they believe that excise-tax increases should be left until next year, when a big tax-increase bill appears more likely.

"I remain concerned that a gas tax could pop up at any time," says Kenneth Simonson, chief economist of the American Trucking Associations. "But I don't live in fear that it's on the verge of happening."

Yet the possibility of coupling a gasoline-tax increase with a cut in the capital-gains rates remains alive. "The question is: Will the president sign it?" asks Rep. Rostenkowski. "You know me; I'm a team man."

The Rosty Curve

Wall St.
Journal
June 12, 1989

With Speaker Wright's resignation, the time has returned for serious debate on Capitol Hill. At least, so we take it from Ways and Means Chairman Dan Rostenkowski's remark that for the right price he might cut the capital-gains tax after all.

If we're going to have a serious debate on the capital-gains issue, a few points need to be dusted off:

• By now everyone who counts agrees that a lower capital-gains tax will increase federal tax revenues in the first year, or maybe the first couple of years. The Treasury Department estimates that a cut in the top capital-gains rate from the present 33% down to 15% would yield $4.8 billion in new revenue in the first year. The congressional Joint Tax Committee figures that the rate cut would produce $3.3 billion.

The only serious argument is what happens in the out years. The folks who used to say a lower rate had to mean lower revenues have retreated to the position that early-year gains will be made up by losses later, because the early gains come from people selling assets sooner rather than later. Those of us now conceded to have been right about the early years continue to argue that a lower rate will boost the economy, producing more gains and more tax revenues indefinitely.

Try it, you'll like it.

• The current system does not tax capital gains "the same" as other income; the current system taxes capital gains punitively. Nearly everyone now concedes it's unfair to tax capital gains generated by inflation. But while income-tax brackets are now adjusted for inflation, the base of capital gains is not. The consumer price index has gone up 63% in the past 10 years, but if you bought a stock for $100 ten years ago and sell for $163 now, you will owe a tax of as much as $20.79.

Even more outrageously, the government plays heads-I-win, tails-you-lose with respect to capital losses. Capital gains count fully as "ordinary income," but capital losses can't be counted against ordinary income except in amounts less than $3,000 a year. This is the dirty little secret shared by the tax reformers, who are hypocritical about taxing all income the same, and the securities-industry lobbyists, who would rather perish than remind anyone about the possibility of capital losses.

Yet in fact the capital-loss asymmetry is the fundamental reason for a differential between rates on ordinary income and capital gains. The wholly neutral system sought by the New York Times and other earnest strivers would be fully indexed and allow full deduction of losses. This would be OK with us, but the tax-reform crowd would scream, as it did during the Depression, about millionaires paying no tax by realizing enough capital losses to offset their other income. Limits on loss deductions and a differential rate was the rough compromise.

It still is.

• International-competitiveness freaks should notice that other nations recognize these realities. The U.S. now has one of the highest capital-gains rates among the OECD nations. Japan's tax on the sale of securities is a paltry 5%. Canada's rate is 17.51%. In Germany, stock investments held longer than six months are tax-exempt. Why not join the crowd?

• You're only rich once. Capital gains is said to be a tax cut for the rich, though if a lower rate means more revenues someone must be paying more tax. In 1985, the year recently studied by the Treasury, nearly two-thirds of the total dollar volume of long-term capital gains went to people who made less than $50,000 in ordinary income. But Robert McIntyre of something calling itself Citizens for Tax Justice will give quotes and numbers on the rich to anyone who calls. Remember that in 1986 you were "rich"—in the top 5%—if you reported household income of $82,273. If you made $40,000 a year and cashed in a 10-year gain of $42,273, you were rich for one year. Congratulations.

In short, the capital-gains rate is the Great Liberal Totem. Because it is the clearest case in which lower rates produce more revenues, it was the cutting edge of tax reduction with the Steiger Amendment of 1978. The lower rate produced a whole string of revenue gains, apparently making it all the more an anathema to the "reformers." It was the lamb reformers wanted sacrificed when the rate was cut to 28% at the top, (with a big middle-income notch at 33%). That the 28% rate has produced good revenues only makes "reformers" all the more unwilling to do the obvious thing on capital gains.

Chairman Rostenkowski signaled he wants the revenues badly enough that he might be willing to give up the totem. Of course, in return he wants some things for the Democrats. Well, the Bush administration's capital-gains tax cut would apply only to stocks, land and non-depreciable assets. In return for going along with this proposal, the Democrats can get to cut the capital-gains rate on art, gold, depreciable assets and timber. If serious season really gets rolling on Capitol Hill, the Democrats can even cut the 33% notch in ordinary income back to 28%.

San Diego Daily Transcript
San Diego, Ca.
August 1, 1989

Bush's Capital-Gains Tax Cut Attacked

By JIM LUTHER
AP Tax Writer

WASHINGTON (AP) — President Bush's central argument for a cut in capital-gains taxes was challenged as nonsense yesterday by three organizations that advocate liberal government social policies.

Rather than stimulating new savings and job creation, as Bush contends, a capital-gains reduction would revive tax shelters, worsen the budget deficit by $5 billion a year and widen the gap between the rich and poor, the advocacy groups told a news conference.

"With all of the unmet needs in our country — for housing, health-care coverage, long-term care, education and the environment — it makes little sense to further pad the already ample bankrolls of wealthy investors," said Robert Greenstein, executive director of the Center on Budget and Policy Priorities.

The House Ways and Means Committee is considering Bush's call for a cut in the maximum tax on capital gains, which are profits from the sale of stock and other assets, from 33 percent to 15 percent. Those are the same rates that apply to wages and other income.

A majority of the committee — 13 Republicans and six Democrats — apparently favors a substitute plan by Rep. Edgar Jenkins, D-Ga., that would cut the top capital-gains rate to 19.6 percent for two years, then raise it to 28 percent and prevent taxation of gains that are caused solely by inflation.

At a news conference Friday, Bush said he is willing to compromise, while he repeated his major arguments for a reduction.

"If there's some compromise that can spur investment, spur jobs, increase employment — the cause of new jobs starting up — I'd be interested in it," Bush said.

Joan Claybrook, president of Ralph Nader's Public Citizen, said yesterday that "the claim that lower capital-gains (taxes) would stimulate new savings and venture capital is nonsense."

After cuts in 1978 and 1981, she said, savings plummeted to historic lows. Besides, Ms. Claybrook said, "Virtually all venture capital funds today come from tax-exempt pension funds and other institutional investors for whom the lower capital-gains tax provisions provide no benefit."

Robert McIntyre, executive director of the labor-funded Citizens for Tax Justice, noted that nonpartisan economists estimate 60 percent of the benefit from a capital-gains cut would go to those with incomes over $200,000 a year, and 80 percent to those over $100,000.

He said a compromise capital-gains cut being discussed — "indexing" assets to protect against inflation — would have similar effects. Most capital gains are never reported to the government at all, he said, either because they are not realized until the owner dies, and thus are not taxable, or through cheating.

With indexing, McIntyre said, "you just cash in the assets that indexing helps and hold on to those that aren't helped."

McIntyre and Ms. Claybrook noted the chief reason Congress removed the long-held tax preference for capital gains in 1986 was because most abusive tax shelters thrived on that benefit.

If capital gains are taxed at a lower rate than wages, Ms. Claybrook said, "our tax code would once again be haunted by all manner of unproductive tax shelters that are not profitable without the tax benefits — equipment leasing, billboards, oyster beds, and llama breeding — created to convert ordinary income into capital gains."

Bush contends that cutting the capital-gains tax would produce greater revenues by spurring investment, even though his Treasury Department forecasts a $20 billion loss in 1994 through 1996. The experts who advise Congress say that after a one-year gain of $4 billion, a cut would result in permanent revenue losses reaching as high as $11.4 billion in 1996.

Detroit, Mi. Free Press
May 15, 1989

in our opinion

TAXES : Two federal proposals, tied together, would unfairly benefit rich, hurt poor

A FAUSTIAN bargain proposed by some White House officials would give President George Bush the capital-gains tax cut he seeks in return for an increase in the federal gasoline tax, favored by several congressional leaders. Although each proposal has some individual appeal, we fear their combination could work a double whammy on poor households while offering an unnecessarily generous break to wealthy taxpayers. In any event, each plan is controversial enough that it ought to be debated and determined on its own merits, not packaged in a back-room budget deal.

Although Congress does not appear disposed to consider boosting the 9.1-cent-per-gallon federal gas tax this year, the idea is likely to receive serious attention next year. We believe a solid case can be made for the positive impact an increase would have on deficit reduction, fuel conservation, and environmental quality. Yet excise levies, like all other flat taxes, are regressive: A gas tax increase would fall somewhat more heavily on low-income motorists than wealthier ones. We would prefer to see such an increase accompanied by other measures, such as income tax adjustments, to help blunt its potential unfairness.

Tying a gas-tax increase to a cut in the maximum tax rate on capital gains could have the opposite effect. Proponents argue that reducing the top rate from 33 percent to 15 percent would stimulate business investment and productivity, adding as much as $10 billion a year in new federal revenue. They assert that a lower tax rate would offer an incentive to sell rather than hoard capital assets, causing wealthy Americans to pay more, not less, in taxes.

But the Congressional Joint Committee on Taxation — in a report disputed by tax-cut advocates — estimates that 60 percent of the tax benefit from the rate cut Mr. Bush proposes would go to households earning $200,000 or more a year, and just 1 percent to families with annual incomes of less than $20,000. Citizens for Tax Justice, a Washington-based tax analysis group, concludes that enactment of Mr. Bush's capital-gains scheme, coupled with a 15-cent increase in the federal gas tax, would result in an overall tax cut for the wealthiest five percent of U.S. households, and a net tax increase for the rest of us.

Congress agreed to cut the income tax rate for rich households as part of the 1986 tax-reform bill on the premise that capital gains and other income should be taxed equally, thus directing investment to its best use — an idea that Mr. Bush's plan to restore preferential tax treatment for capital gains would upset. Options such as indexing the base of capital gains to inflation and giving tax breaks to venture-capital firms and promising new businesses should be explored as alternatives to a rate cut.

Federal tax law ought to provide for deficit reduction and economic growth through savings and long-term investment, but not at the cost of further skewing America's income distribution. Before the president and Congress consider either a gas-tax increase or a capital gains tax cut, they need to look searchingly — and separately — at the implications of each.

Debate on IRAs Centers on Whether Tax Break Should Be Immediate or Put Off Till Retirement

By DAVID WESSEL
Staff Reporter of THE WALL STREET JOURNAL

WASHINGTON – The current debate over reinvigorating individual retirement accounts boils down to this: Would you prefer your tax break as an appetizer or as dessert?

Democrats would give taxpayers an immediate incentive to sock away more savings: Save $2,000, and you can deduct $1,000 on your tax return.

Republicans would defer the tax break: Save $2,000, and you'll escape taxes on all the interest that sum earns over the years till you retire.

Addressing the nation's savings shortage is once again politically fashionable. And there is ample reason for concern. The dearth of savings limits the resources available for investment in the future and forces the U.S. to import foreign savings.

But some economists suggest the politicians' new infatuation with IRAs may be misplaced at a time when Congress and the president aren't taking the more important step of shrinking the federal budget deficit. "If increasing savings is the object," says economist Jane Gravelle of the Congressional Research Service, "a reduction in the deficit would be a more certain and more powerful way of achieving such an end." (The nation's total savings is what's left after substracting government borrowing from household and corporate savings.)

The differences between the two IRA alternatives involve more than partisan manuevering—although there's plenty of that.

Problems With Immediate Rewards

The shortcoming of offering immediate rewards for putting money in an IRA, as the Democrats propose, is that it will widen the budget deficit by an estimated $12.5 billion over the next five years. "The big problem is the up-front cost," says Sen. William Roth (R., Del.), chief Republican cheerleader for IRAs.

The shortcomings of delaying the reward, as Sen. Roth and Sen. Robert Packwood (R., Ore.) propose, is that it may not boost savings much and, if it does, it may widen deficits in the future. "It looks like you haven't given anything away, but five, 10, 20, 40 years later, little bomblets go off," says Henry Aaron, a Brookings Institution economist.

Although IRA fans in Congress have been talking about restoring incentives that were curtailed in 1986, they gained momentum only after Senate Finance Committee Chairman Lloyd Bentsen (D., Texas) seized on IRAs as an alternative to cutting capital-gains taxes.

Republican senators, unwilling to concede the popular IRA issue to Democrats, suddenly embraced a scheme Sen. Roth had been pressing with little success. The Bush administration, which was planning to unveil an IRA proposal of its own next year, was quick to do the same. Both proposals would allow withdrawals not only for retirement, but also for buying a house or paying tuition bills.

Between 1981 and 1986, any worker could put $2,000 a year into an IRA and deduct that sum from his taxable income. As banks and mutual funds advertised heavily, hundreds of billions of dollars flowed into the accounts.

How Much Was New Savings?

Economists still disagree on how much was *new* savings and how much was shifts of existing savings by taxpayers in order to cut their tax bill. Economist David Wise of Harvard University figures 70% was actually new savings; many prominent economists—including Michael Boskin, chairman of the Council of Economic Advisers—agree that IRAs did result in significant new savings.

But Mr. Aaron, among others, continues to insist that the data are inconclusive. And Robert McIntyre, director of the labor-backed Citizens for Tax Justice and an admirer of the 1986 Tax Reform Act that limited IRAs, goes further. "They don't work," he contends. "They just give people a tax break for savings they would have done anyway."

In any event, IRA contributions fell sharply after the 1986 law that restricted the full tax break to couples earning less than $40,000 a year and individuals earning less than $25,000. Balances in IRA and Keogh accounts (retirement accounts for the self-employed), which had swelled by $75 billion in 1986, grew by only $48 billion in 1988, including interest on past contributions.

It isn't clear how Americans would react to the new IRA proposals because they are so different from the old scheme.

Some economists predict any IRA plan will boost savings because brokerage houses, mutual funds and banks will advertise them heavily. "It may well be that saving, like life insurance, is sold, not bought," says Lawrence Summers of Harvard University. He notes that as IRA ads vanished, even many middle-income Americans still eligible for the full IRA tax break stopped contributing.

Tax-Free at Retirement

Comparing the two proposals on the table, many economists say a rational person ought to prefer the Republican version because it offers a much bigger tax break.

Under the Democratic plan, a 40-year-old in the 33% tax bracket who saves $2,000 in an IRA would cut his tax bill by $175 immediately. When he retires 25 years later, his $2,000—assuming it were invested at 5%—would be worth $6,773. But $5,773 of that would be taxed when withdrawn from the IRA.

Republicans wouldn't give any up-front deduction for depositing $2,000 in the IRA. But at retirement 25 years later, the entire $4,773 in interest could be withdrawn tax-free, along with the already taxed $2,000 initial contribution.

Nonetheless, some economists argue that Americans simply won't save unless the government gives them an immediate reward. "This instant gratification overcomes the usual bias against savings," says John Skinner, a University of Virginia economist. The clincher, he says, is that people who owed money to the Internal Revenue Service were far more likely to put money in an IRA than those who were due a refund.

On the other hand, the case for delayed gratification is bolstered by evidence that a surprising number of upper-income Americans still are putting money in IRAs even though the only tax break is deferring tax on the interest the contributions earn.

The Employee Benefit Research Institute says about 23% of all workers earning more than $50,000 a year made IRA deposits in 1987, down from 56% in 1982 but still nearly one million people.

Donald Underwood, head of retirement planning for Merrill Lynch & Co., says he was surprised to discover that more money flowed into the firm's IRA accounts in 1986 than in 1987. (A big IRA fan, Mr. Underwood's license plate reads: IRA KEOGH.)

Merrill Lynch is convinced the Republican IRA plan would appeal to its customers, and it is lobbying strongly for it. "I think people are really concerned about what the tax rate will be in the future," Mr. Underwood says. The higher tax rates go in the future, of course, the more valuable the future tax breaks.

The bigger the incentive the government offers for savings, the more tax revenues a scheme would lose—or so many economists reason.

But that's not how Sen. Roth and his allies look at it. First, they would allow people with old-fashioned IRAs to shift the money to the new ones as long as they pay tax—at today's lower tax rates—on the previously deducted contributions. That would raise $11.5 billion for the Treasury over the next five years, congressonal tax experts estimate. But allowing the interest buildup on those contributions to escape taxation would cost the Treasury far more than that sum in the long run, the Congressional Budget Office says. "It's a huge giveaway," Mr. Summers protests.

Second, Sen. Roth insists that the extra savings his plan would produce would spur so much extra economic growth that the Treasury wouldn't suffer. The claim is an echo of the supply-side promise that the 1981 tax cuts that bear Sen. Roth's name would finance themselves through added growth or added savings.

Comparing IRA Proposals

BENTSEN PLAN

Maximum contribution: $2,000 a year

Deduction: 50% of contribution.*

Uses: For retirement, college tuition, purchase of first home.

Taxes: Withdrawals of interest are taxed as are 50% of contributions.

ROTH-PACKWOOD PLAN

Contribution: $2,000 a year, increases to $3,000 after 1995

Deduction: None.*

Uses: For retirement and, up to 25% of balance, for purchase of home, college tuition and books, catastrophic health expenses.

Taxes: Withdrawals of contribution and interest are tax-free.

*Taxpayers eligible for full IRA deduction under current law would continue to have that option

Investor's Daily
Los Angeles, Ca.
August 1, 1989

Groups Attack Bush's Proposal To Cut Taxes On Capital Gains

WASHINGTON (AP) — President Bush's central argument for a cut in capital-gains taxes was challenged as nonsense yesterday by three organizations that advocate liberal government social policies.

Rather than stimulating new savings and job creation, as Bush contends, a capital-gains reduction would revive tax shelters, worsen the budget deficit by $5 billion a year and widen the gap between the rich and poor, the advocacy groups told a news conference.

"With all of the unmet needs in our country — for housing, health-care coverage, long-term care, education and the environment — it makes little sense to further pad the already ample bankrolls of wealthy investors," said Robert Greenstein, executive director of the Center on Budget and Policy Priorities.

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Kenosha Labor
Kenosha, Wi.
April 28, 1989

Another tax break for the rich?

With the federal budget careening further into the red at a rate of $170 billion this year alone (up $15 billion from last year), we're told Uncle Sam can't afford to help Americans shoulder the staggering costs of medical insurance, can't affort to build housing for the homeless, can't afford adequate help for kids trying to get an education or for laid-off workers (less than a third of the unemployed even get jobless benefits), can't afford to protect the public against dangers at home and work, and can't afford to help cities and towns. Meanwhile, seniors have to shell out more and more of their own money for Medicare coverage.

It's Time We Got Help

With the typical American family's income lower than it was in 1979 (after inflation) and the poor in even worse shape, we badly need strong government services. While most of us are getting poorer, however, the rich keep getting richer, and the gap between the two is the greatest ever recorded. Meanwhile it's mostly the rich who benefit from the huge tax cuts of 1981.

So who should get more government help? The rich, of course.

That's how President Bush sees it, anyhow. Although the budget he sent to Congress was vague about the added cuts in services Bush says we need, it was very specific about one thing: the rich need another tax break. Bush wants to give another $350 million a year in tax breaks to his old buddies in the oil industry.

Cutting Their Taxes in Half

And he still wants to slash in half — from 33 percent to just 15 percent — the tax rate on profits the rich make from selling stocks, bonds, and land — called capital gains.

Nine times out of ten, that tax cut would benefit only the very richest 5 percent of Americans, says a report from Citizens for Tax Justice. People raking in more than $200,000 a year would each enjoy a tax cut of $25,000 or more a year — just when the feds need the money most. But families making up to $60,000 a year — which includes four out of five Americans — would average around $20 each. Among the big winners would be the wheelers and dealers already making a fortune from mergers, takeovers and leveraged buyouts. The tax break would give stockholders an added bonus for selling.

Don't worry, says George Bush. The rich will be so delighted with the new tax break they'll sell assets like crazy and the U. S. Treasury will be richer by $5 billion. Right, George. That sounds like the "voodoo economics" Bush once blasted — Ronald Reagan's claim that tax cuts for the rich would actually raise more money; instead the government was plunged into huge deficits.

To take advantage of the new capital gains tax break, the rich would set up tax-shelter scams to make regular income look like capital gains. That's what happened the last time the rich enjoyed a generous tax break for capital gains. "The capital gains tax break fuels tax shelters," the **Wall Street Journal** agrees.

Tax Shelters Galore

Congress closed that loophole in 1986, at the same time it slashed the top tax rate on the very wealthy from 50 percent to just 28 percent. "Congress boosted the capital gains rate primarily to prevent the 1986 tax act from becoming a giveaway to the wealthy," the **Wall Street Journal** explained (2/8/88). "The boost in capital gains taxes was the price conservatives had to pay for a top rate of only 28 percent." Now the rich want to weasel out of the bargain, and Bush is ready to help.

President Bush's capital gains cut might indeed bring in $3.3 billion more the first year, figures the Congressional Joint Committee on Taxation. But over five years, it will cost the U. S. Treasury over $13 billion.

We'd Pay More Than Stockholders

Many Democrats are appalled, and vow to fight the new tax gift. "I'm not about to tell the wage earners in Chicago that they should pay a higher tax rate than stockholders," warns Representative Dan Rostenkowski of Illionois.

—UAW-LUPA

Gains tax may slip away from the Street

BY NICKY ROBERTSHAW
CRAIN'S NEW YORK BUSINESS

WASHINGTON—After the stock market crashed in 1987, Shearson Lehman Hutton Inc. took to the airwaves to encourage Wall Street firms to join it in curbing program trading.

Now Shearson is back on television spiritedly pounding away at another crucial issue: cuts in the capital gains tax. This weekend, the investment firm debuted a new commercial calling for support for the proposed cuts, which President Bush made part of his campaign.

"We urge Congress to reaffirm the long-range perspective that built this country, by reducing the tax on long-term capital gains," the commercial says.

But Shearson's public stand on the issue sets it apart from other fans of favorable treatment for capital gains, including the rest of Wall Street. It has yet to make an aggressive stand, even as the president takes a pounding from critics who say the cut benefits only the very rich.

Although private sector support for the measure is strong, many proponents are hanging back and waiting for the issues to clarify before they roll out their big-gun lobbying effort. As a result, Mr. Bush risks appearing alone in his enthusiasm, except for his own experts.

Moreover, lobbyists say it's still uncertain whether the constituencies backing the tax cut—namely the securities industry, venture capitalists, small businesses and the American Council for Capital Formation—will hang together or splinter off, given their individual agendas or shifting priorities.

All of which may spell trouble for the proposal.

"We have not seen a lot of the people we usually hear from on this subject," says an aide to Charles Rangel, New York's senior Democrat on the House Ways and Means Committee, where the first heavy battle will be waged.

Supporters of the cut say that while they

Crain's New York Business, New York
February 20, 1989

The capital gains tax might slip away from Wall Street

From Page 3

are at the stage of gathering intelligence in a quiet way, the battle lines are not yet clear enough for the big guns to be called out.

"One reason that the business community is keeping its powder dry is that it's unclear, especially from the Ways and Means standpoint, on what's going to happen next," says Mari Lee Dunn, vice president of the American Council for Capital Formation, a Washington trade group that has been acting as an umbrella organization in support of a lower capital gains tax.

For example, no schedule is set for committee hearings, which serve to define just what form the tax-cut issue will take in the congressional debate. No one knows if the issue would be taken up as part of a major package or stand alone—nor do they know what the final version will look like.

Meanwhile, there are already signals that various groups supporting the cut may not be moving in lockstep. Some disagree on which form the cut should take.

Mr. Bush's proposal, which doesn't tax capital gains for those with adjusted gross incomes of $20,000 or less at all, gives individual taxpayers a choice between a 15% maximum tax on capital gains or a 45% exclusion on the gains from their taxable income, compared with a 28% to 33% income tax under current law. To qualify for the more favorable tax rate, the investor would have to hold the assets for a certain length of time that ranges from a year to three years by the mid-1990s.

But some supporters already have ideas of their own for changing Mr. Bush's version.

For instance, New York-based Securities Industry Association President Edward I. O'Brien wrote President Bush saying that while the group supports the proposal as a step in the right direction, it believes the three-year holding period is too long.

And some venture capitalists have their own agenda. "I don't think it goes far enough," says Edwin A. Goodman, a general partner with Manhattan-based Hambro International Venture Fund, of Mr. Bush's proposal. He thinks the individual who is willing to take the risk of investing in a start-up company should pay a lower tax rate as compensation.

But opponents of the measure aren't buying such arguments. They contend that the tax cut will only generate a brief flurry of increased revenue as individuals invest their money in stocks, for example, for the first few years to take advantage of the lower tax rate. After that, they say, revenue will actually decrease. It's an issue that economists, both inside and outside the federal government, disagree on widely.

Opponents, including Democrats in Congress as well as the Washington-based group Citizens for Tax Justice, also express outrage over the fact that 90% of the benefits would go to the wealthiest 5% of the population.

Given such criticism, Wall Street risks hanging back too long. ■

Wall St. Journal, October 13, 1989

Senate Panel Democrats Opposed Gains-Tax Cut But Voted for Giant Loopholes in Estate Levies

By ALAN MURRAY
Staff Reporter of THE WALL STREET JOURNAL

WASHINGTON – The Democrats on the Senate Finance Committee voted last week to block a cut in the capital-gains tax, arguing it's a "tax break for the wealthy."

But watch what they do, not what they say.

Under the direction of Sen. Lloyd Bentsen (D., Texas), the panel also voted to open two giant loopholes in the estate tax, benefiting only the very wealthiest people. If the provisions become law, tax experts say, they'll go a long way toward eliminating what little is left of the nation's only tax on inherited wealth.

"I suspect the people lurking behind this thing in the Senate were wealthy Democrats," says Rep. Pete Stark (D., Calif.), an opponent of weakening the estate tax. "We shouldn't be in the business of writing special relief bills for people with hundreds of millions of dollars worth of assets."

'It Stinks'

"It stinks," agrees Robert McIntyre, director of the labor-backed Citizens for Tax Justice.

The two provisions would eventually provide close to a billion dollars of tax relief each year to families with huge estates.

One would reopen a once-popular loophole, known as "estate freezes," that allowed wealthy individuals to bypass estate taxes by creating corporations, giving all the common stock to their children, and holding only preferred stock for themselves. Over time, the value of the common stock would grow, enabling the company to gradually pass to the children without tax.

The other provision, an extension of the so called "Gallo amendment," sidesteps the "generation-skipping" tax by allowing wealthy individuals to give as much as $2 million to each grandchild without paying the tax.

The Bush administration opposes both proposals. Treasury officials estimate that the annual cost of these changes would surpass $500 million in 1994 and grow larger in subsequent years. Eventually that would sharply reduce the revenue from the estate tax, which even now brings in only $9 billion a year.

Estate-Tax Decline

Revenues from estate taxes as a percentage of all federal tax revenues:

1976	1.75%	1984	0.9%
1980	1.20%	1988	0.8%

Source: Economic Policy Institute

'Soft and Blobby'

"The sense that I have is that Congress has been slowly letting the air out of the estate and gift tax," says Henry Aaron, a tax expert at the Brookings Institution. "It's such a soft and blobby tax already. After this, there won't be much left in it."

For his part, Sen. Bentsen defends both changes. He claims that the 1987 law that closed the estate-freeze loophole was a mistake. "Many senators have expressed their concerns about the effect those rules have on family businesses, and I share their concerns."

Likewise, he criticizes the generation-skipping tax, which he says, in combination with the gift tax, is "in effect a double tax on grandchildren." He adds, "I think that's wrong."

Although he joined other Democrats in opposing the capital-gains tax cut, Sen. Bentsen rejects any suggestion that he's being inconsistent. A man of considerable personal wealth, he studiously avoids the class-conscious rhetoric his colleagues use in calling capital gains a "tax break for the rich."

"It's not my nature" to use such rhetoric, Sen. Bentsen says. "I think you ought to correct inequities wherever they occur, at whatever level."

Simple Numbers

The estate tax's decline in recent years is clearly illustrated by a few simple numbers. In 1976, only $60,000 of an estate was exempt from taxation; today, the exemption is 10 times that—$600,000—and it's $1.2 million if half the estate goes to a surviving spouse. As a result of higher exemptions and other loopholes, the number of estates covered by the tax has declined precipitously. Only 40,000 estate-tax returns were filed in 1987, compared with 200,000 in 1977.

The 1981 tax bill, in particular, took such a large bite out of the law, according to Arne Anderson of the Economic Policy Institute, that it "virtually eliminated estate taxes for all but a handful of the super wealthy." Loopholes were so widespread that tax experts began calling the estate tax a "stupidity tax," as the only people paying it seemed to be those who failed to plan in advance for their decease.

One of the most popular loopholes was the estate freeze, which Congress effectively closed in 1987 by passing "Section 2036(c)." This section, which Sen. Bentsen would repeal, gave the Internal Revenue Service the power to treat common stock passed on to children as if it were part of the estate. But this new provision also caused howls from many in family businesses who were trying to pass those businesses on to their children.

Tax experts acknowledge that the 1987 law was clumsily fashioned. And the Treasury has said it is willing to consider modifications. But instead of trying to modify the measure, Sen. Bentsen and his colleagues on the Finance Committee have decided to repeal it outright. "I asked staff, do we have something now that we can do that we're convinced will satisfy the problem and get rid of the abuses?" Sen. Bentsen explains. "And they said, 'We don't have anything that definitive yet.' "

Back in Vogue

That means the estate-freeze loophole could quickly be back in vogue among the well-to-do. "I think section 2036(c) is excessively broad and much too vague," says Leo Schmolka, a professor at New York University Law School. "But the problem with straight repeal is it puts you right back on square one. There is a legitimate area of concern."

The generation-skipping tax was first adopted a decade ago, to try to stop wealthy families from circumventing the estate tax with giant trusts that passed the ownership of wealth from grandparents to grandchildren. The new tax helped assure that taxes on giant estates were paid by every generation, not just every other generation.

During the 1986 tax debate, however, Rep. Ed Jenkins (D., Ga.) sponsored a measure that allowed transfer of as much as $2 million to a grandchild without paying the special tax. The provision, called the "Gallo amendment" after the wealthy California wine-making family that had advocated it, was set to expire this year. But Sen. Bentsen's bill would make it permanent. "I can't see how you can justify penalizing someone because he leaves his estate to his grandchildren instead of his children," says Rep. Jenkins.

If the two changes are adopted by the full Senate, they may be challenged in a conference with the House. Some top House tax writers are likely to oppose the measures—especially repeal of Section 2036(c).

"We are not a country of nobility," says Rep. Stark, who built a fortune in the banking business before coming to Congress. "Personally, I'd love to pay for long-term health care for the elderly by really jacking up the inheritance tax."

Madison, WI - Capital Times
February 21, 1989

Oh, no! Here come the loopholes again

REMEMBER IN the old days — about two years ago — when the federal government revamped the income tax system?

A guiding principle of that reform was to squeeze out as many tax loopholes and to tax income as straightforwardly as possible. It was not a perfect reform, but it moved a lot closer to that goal than the old tax system. The tradeoff was to lower the top tax rates to offset for the abolished loopholes.

One of the loopholes that Congress squeezed out was a tax break on capital gains — the profits people make from the sale of stocks, real estate, antiques and the like. Under the current federal tax law, those profits are treated as straight income.

Now along comes President Bush and Wisconsin's own Sen. Robert Kasten leading the charge to give special tax treatment to capital gains again. It will increase long-term investment, they argue. It will paradoxically produce more federal revenue. It will make this country competitive in the world economy.

And if you believe that...

If the government wants to discourage short-term investing, rapacious profit-taking and corporate raiding, it can do so with higher taxes on short-term profits and a variety of other legal and economic tools. A tax break for long-term investments will only marginally address the race for short-term profit.

Furthermore, the venture capital — the money to start up new enterprises — comes from people who are willing to risk some money for big returns. They don't do this for the tax breaks but for the big financial killing.

The U.S. Treasury was arguing two years ago that dropping the federal gains tax would increase federal revenue. Now it argues that restoring it would increase federal revenue. One of those times it must have been wrong. We'll acknowledge that the first year out, there may be a boost in tax revenue as some people sell off accumulated stocks. Over time, however, a wide variety of economic analysts say a cut in the capital gains tax will reduce federal revenue.

That loss could be offset to some degree if the government were to raise other kinds of taxes on the wealthiest Americans. That, however, is not what Bush and Kasten have in mind. Here's where the capital gains proposals really do violence to the spirit of the 1986 reforms. Their plans would give the most tax benefits to those with the top 1 percent of income in the country.

Citizens for Tax Justice, for instance, argues that under the Bush plan, virtually every taxpayer with income over $200,000 would get a tax cut under a reduced capital gains rate and the average savings would be $25,000 each. Taxpayers earning less than $50,000 a year would see no or negligible tax savings from a capital gains cut.

FIDDLING WITH the tax system is not the way to rev up the American economy. That method was tried in the past and produced more grief than economic gain. Bush and Kasten want to go back to those old days with the capital gains tax cut. The American public instead ought to keep on the pressure for a tax code that is simple and fair.

Philadelphia, PA. Inquirer
February 19, 1989

Son of Voodoo? The plan to cut capital gains

By Robert A. Rankin
Inquirer Washington Bureau

WASHINGTON — In 1980, when seeking the Republican presidential nomination, George Bush denounced Ronald Reagan's proposed "supply-side" tax cuts as "voodoo economics."

Now Bush is proposing major tax cuts of his own; critics call this "Voodoo II."

One of Bush's main budget proposals is to cut taxes sharply on capital gains — profits from the sale of assets such as stocks, bonds, mutual-fund shares and houses.

As did Reagan in 1980, Bush contends this tax cut would spur the economy, promote prosperity, create jobs, improve U.S. competitiveness and generate extra revenue to help close budget deficits.

Critics contend that a cut in the capital-gains tax would represent a massive windfall for the rich. The money would not "trickle down" to stimulate the economy, they say; rather, the tax cut would reduce federal tax revenues and worsen budget deficits.

"George Bush has demonstrated that he understands the mathematics of voodoo economics," said Sen. Bill Bradley (D., N.J.), the intellectual godfather of the 1986 tax change. "If anyone really believed that cutting the tax rates would increase revenues, they'd cut them to almost nothing and eliminate the deficit."

Economists disagree, as usual, over these conflicting contentions. Harvard experts recently have produced rival studies boosting both sides of the argument. Most analyses favor the position of Bush's critics, however.

In addition, critics say Bush's tax cuts would fundamentally undermine the massive 1986 tax-code overhaul, one of the second-term achievements Reagan is proudest of and widely hailed as a rare bipartisan triumph of fairness and economic efficiency over politically powerful special interests.

Capital gains now are taxed at up to 33 percent of their full value, the same as income from wages or any other source. Bush would cut the rate to 15 percent, while excluding 45 percent of an asset's value from any tax at all.

That would push Bush's effective capital-gains tax rate as low as 8.25 percent, Treasury documents show. Meanwhile, tax rates for ordinary income would remain at 15, 28 and 33 percent, depending on income.

Bush's defense of such a cut rests largely on a Treasury study issued after his inauguration. It concluded that Bush's proposed cut would boost federal revenues by $16.1 billion over five years.

This Treasury study is suspect, however, because it directly contradicts a

(See CAPITAL GAINS on 2-G)

Cutting the gains tax: Will revenues increase?

CAPITAL GAINS, from 1-G

1986 Treasury study, as the Wall Street Journal recently reported. The 1986 study concluded that revenues would rise by $21.8 billion over five years, not by cutting the capital-gains tax, but by raising it.

The most authoritative analysis was issued last March by the nonpartisan Congressional Budget Office, which examined leading studies on all sides of the question and conducted new research, too.

CBO concluded that cutting the capital-gains tax to 15 percent probably would cut revenues and increase federal deficits by $4 billion to $8 billion a year.

However, "the range of uncertainty" is so pervasive that "one cannot reject the possibility that a 15 percent rate might increase revenues," CBO said.

CBO's most striking conclusion, however, was that the wealthiest 1 percent of Americans — those with annual incomes above $100,000 — would reap most of the gain from a cut in the capital-gains tax. The wealthiest 1 percent raked in 55 percent of the profits from capital gains between 1982 and 1985, CBO said.

Such a tax break would cut Bush's own federal taxes by $22,000 a year, Democratic presidential nominee Michael Dukakis contended in October. Bush's campaign dismissed the charge as trivial, but never denied it. Bush reported capital gains totaling $515,132 for 1985-1987.

The capital-gains cut is the centerpiece of several tax breaks Bush is proposing. He also would cut corporate taxes for expenses on research, oil and gas exploration, and investment in ghetto enterprise zones. In addition, he would give low-income parents a tax break for child-care expenses.

Together, those tax breaks would deepen federal deficits by $16.6 billion by 1993, according to the Treasury Department.

Bush's capital-gains proposal thus leads "a frontal attack on tax reform," said Bob McIntyre, head of Citizens for Tax Justice, a lobbying group.

The essential logic of the 1986 tax-code overhaul was to lower tax rates on all income, making up the resultant revenue loss by closing tax loopholes. The 1986 overhaul, which became fully effective only Jan. 1, closed tax shelters worth about $300 billion over five years.

Tax overhaul was intended to encourage investors to put their money into productive assets rather than choosing investments primarily to get tax benefits. Over time, economists believe, that should make the economy more efficient.

Eliminating the tax break for capital gains was an essential tradeoff, economically and politically, to achieve the 1986 overhaul. The tax overhaul lowered the income-tax rate for the wealthiest Americans to 28 percent from 50 percent without significantly reducing the total amount of taxes they paid.

Critics regard Bush's proposal as canceling the tradeoff, by keeping the low rates while giving back a big tax break on capital gains.

Even before Bush proposed his new budget, tax experts were pleading with Congress to stop changing the tax code. Since 1976, more than 8,500 sections of the tax code have been changed, 2,700 by the 1986 overhaul alone, according to Jacob R. Brandzel of Laventhol & Horwath, the Philadelphia accounting firm.

All those changes confuse taxpayers and tax experts alike, eroding confidence in the system, Brandzel contends. He is leading a national campaign asking Congress to impose a moratorium on tax changes.

"Without a moratorium, the tax system ... will crumble from its own weight," Brandzel said. "It will become impossible to administer and too complex for interpretation by even the most sophisticated tax practitioners."

More than 4,000 tax lawyers and accountants have written Brandzel to support his crusade. He invites supporting cards and letters addressed to him at Laventhol & Horwath, 19th floor, 1845 Walnut St., Philadelphia 19103.

Bush's proposed capital-gains tax cut faces an uphill fight in Congress. Sen. Lloyd Bentsen (D., Texas), chairman of the tax-writing Senate Finance Committee, says he would consider cutting the capital-gains tax only in combination with increases in taxes on the wealthy, a condition Bush flatly rules out.

Rep. Dan Rostenkowski (D., Ill.), chairman of the tax-writing House Ways and Means Committee, considers Bush's capital-gains proposal "the beginning of the unraveling" of the 1986 tax-code overhaul and vows to oppose it.

"I'm not about to tell the wage earners in Chicago that they should pay a higher tax rate than the stockbrokers," Rostenkowski said in a re-

New York, New York Daily News
February 26, 1989

This year, a rest for reforms

By JEROME CAHILL
News Washington Bureau

WASHINGTON — Taxpayers working against an April 17 deadline as they cope with seemingly endless changes in the nation's tax laws can take heart. Another big round of reforms is unlikely this year.

Tax lobbyists and Capitol Hill experts say the Democrats who control Congress are in no mood to take on a hefty new tax bill, given President Bush's unremitting defense of his "read my lips" campaign pledge against tax hikes.

You might call it the calm before the storm.

"The chickens will come home to roost in 1990," predicts economist Joseph Minarik, referring to the rosy economic forecast that Ronald Reagan bequeathed his successor and that Bush is counting on to shrink the budget deficit without recourse to new revenues. Minarik is staff director of the congressional Joint Economic Committee and one of the drafters of the 1986 reforms.

Many analysts outside the administration agree with Minarik that the forecast is too rosy and that Bush will be forced to face up to unpleasant realities next year, when the Gramm-Rudman balanced-budget law really gets tough, requiring severe budget cuts to bring the deficit down to $64 billion. (Currently, it's $170 billion.)

"You are going to need $40 billion in deficit reductions," says Paul Huard, vice president of the National Association of Manufacturers. "Without more revenues, that is a low-probability occurrence." Huard believes the most likely candidates are a hike in gasoline taxes "and some oddball changes that won't affect the average taxpayer."

President Bush is pushing for a cut in the capital-gains tax on profits from the sale of stocks and bonds — from the current 33% top rate to 15% — but that proposal has encountered stiff opposition among liberal Democrats who contend the change would be a revenue loser and a tax windfall for the wealthy.

Business groups eager to get the tax break on grounds that it would spur investment think they have "a pretty decent chance" next year, according to Huard. But they may have to pay the price in the form of a hike in the top tax rate on the richest taxpayers. Under current law, the top rate falls from 33% to 28% when incomes exceed certain levels.

Robert McIntyre, director of Citizens for Tax Justice, believes the Bush administration eventually will cave in on its no-new-taxes pledge. But he agrees that the first targets will be business taxpayers, not ordinary people. "I don't think they will raise the top rate this year," McIntyre adds.

Some members of Congress are looking at the big tax break homeowners currently receive on their mortgage interest as a possible source of "Folks see it as the key to the future."

revenue, with what Minarik calls "the second-mortgage game" getting a lot of attention. That's the use of tax-deductible home-equity loans to dodge the restrictions on interest deductions for consumer loans that Congress approved in 1986.

However, the idea of tampering with one of the most cherished tax breaks enjoyed by Middle America — even around the edges — doesn't have widespread appeal in Congress. "All these guys have got mortgages of their own," Huard says of the lawmakers. "I don't believe they are going to touch the deduction, particularly in an election year."

Another nonstarter is the proposal to tax the value of employer-provided benefits such as health insurance.

"Taxing fringe benefits could generate a lot of money, but politically it's very difficult," says Minarik. He notes that organized labor is strongly opposed to the idea.

Minarik also gives a low probability rating to Bush proposals for child-care tax credits for low-income families and tax-supported "enterprise zones" in depressed urban and rural neighborhoods, on grounds that both proposals, as drafted, would be ineffective.

Tax breaks for companies engaged in research and development could fare better, however. "R&D has an aura about it," says Minarik.

San Diego Daily Transcript
San Diego, Ca.
March 15, 1989

'Important For Economic Growth'

Capital-Gains Tax Cut Defended

By JIM LUTHER
AP Tax Writer

WASHINGTON (AP) — The Bush administration yesterday defended its proposed capital-gains tax cut as an important tool for economic growth, but key senators questioned whether it would feed an impression that the tax laws are unfair.

Sen. Lloyd Bentsen, D-Texas, chairman of the Senate Finance Committee, a longtime backer of a lower capital-gains tax, offered another reason for skepticism. "There is a very real danger that the president's proposal would work against our long-term effort" to reduce the federal deficit, he said.

Dennis E. Ross, acting assistant secretary of the treasury for tax policy, told the committee that cutting the top capital-gains tax rate from 33 percent to 15 percent "will provide an important incentive for long-term savings and investment, which over time will boost productivity and economic growth."

Sen. Bob Packwood of Oregon, senior Republican on the committee, told Ross: "Your capital-gains proposal is a step away from the perceived fairness (of the tax system) by the $18,000-a-year sawmill worker." Taxing such gains — which are profits from the sale of stocks and other assets — at lower rates than those applying to wages could lead some to believe that rich people are getting by without paying their share, Packwood suggested.

Eighty percent of the tax benefits from Bush's proposal would go to about 1.2 million taxpayers with incomes over $100,000 a year. Sixty percent would go to those above $200,000, who would get tax cuts averaging $30,820 each, according to staff of the Joint Committee on Taxation.

Until the 1986 tax overhaul was enacted, capital gains had enjoyed a lower tax rate for 65 years. Congress and then-President Reagan agreed to wipe out that preferential treatment, along with several other deductions and exclusions, so that tax rates could be cut across the board.

Now, with considerable support from Republicans and Democrats, Bush is calling for a restoration of a capital-gains preference as an incentive for savings and investment.

Under Bush's plan, gains from the sale of qualifying investments would be taxed at a maximum rate of 15 percent. A single person with income under $10,000 (or a couple under $20,000) would pay no tax on any capital gain.

The administration argues that a lower capital-gains rate would induce so much investment that government tax collections would increase by $16 billion over five years. The staff of the Joint Committee on Taxation calculates the proposal would actually reduce collections by $13 billion during the same period.

Each side defended its figures at Tuesday's hearing.

"Until a taxpayer sells his asset, the rate of tax is zero," said Ross. "Capping the statutory tax rate at 15 percent will cause many taxpayers, who would otherwise elect a zero tax rate by retaining their investments, to realize their gains and pay some tax."

Ronald A. Pearlman, who formerly held Ross's position but now is chief of staff for the Joint Committee on Taxation, acknowledged his figures are nothing more than an estimate. But as for the administration's prediction that a rate cut would be a permanent revenue raiser, he said, "We simply do not believe this conclusion is realistic."

During the seven years ending in 1987, when capital-gains rates were cut twice and the stock market was rising, taxpayers realized $1 trillion of capital gains, Pearlman said. For Bush's proposal to permanently raise revenues, gains would have to surpass $2 trillion during a five-year period, Pearlman said.

Public witnesses testifying before the committee offered opinions that varied as wildly as those from government officials.

Paul Craig Roberts, a former Treasury official who was an architect of Reagan's 1981 tax cut, disputed assertions that a capital-gains cut was unfair to lower-income Americans. "Tax actions that reduce the cost of capital bring about an increase in capital investment, which, in turn, improves labor productivity and raises labor's income," he said.

Robert S. McIntyre, director of Citizens for Tax Justice, a labor-backed research organization, said the old capital-gains tax break was worth an average tax saving of $41,683 a year for people making more than $200,000. "In contrast, the break was worth less than $50 a year to families earning under $50,000."

The Oregonian
Portland, Oregon
Thursday, October 5, 1989
Business section, page D11

Packwood's Switch on Capital Gains Tax Fans Fire

by Foster Church

Washington, D.C.—Sen. Bob Packwood, father of the sweeping 1986 Tax Reform Act that eliminated the tax break on capital gains, has provoked the anger of some tax reformists by advocating a cut in the capital gains tax in 1989.

Three years ago, the Oregon Republican was one of the sharpest critics of the capital gains tax differential; he now leads the drive among Senate Republicans to put the differential back into the tax code.

The switch has angered many of his tax reform backers, who say he has walked away from a key element of the act.

During Senate debate over the tax reform bill in 1986, Packwood described the capital gains tax break as "the biggest loophole for the rich." He added, "It is the biggest single loophole for the income class above $200,000."

Packwood also said at the time that if an effort to include a capital gains differential in the reform package were successful, "We will be starting right back up the stairstep of escalating rates and increased privileges."

But early Wednesday in the Senate Finance Committee, Packwood proposed a reduction in the capital gains tax as an amendment to a massive budget cutting bill on which the committee was working.

The proposed change was defeated 10 to 10, and the committee instead voted to liberalize Individual Retirement Accounts as a way to encourage savings.

But Packwood now is recruiting Republicans and Democrats to vote for his plan—or at least to construct a new capital gains tax cut that could pull together the 60 votes needed for the proposal to be approved on the Senate floor.

Ordinarily, a bill requires only 51 votes to pass. But since the Finance Committee decided to adopt the IRA approach, the capital gains tax cut would have to be offered as an amendment on the Senate floor. And under Senate rules, any amendment that could cause a budget loss requires 60 votes.

Packwood said Wednesday that he liked neither the IRA nor the capital gains provision. But he added that the capital gains cut would offer more tax relief to persons who make less than $50,000 than liberalizing IRAs. By contrast, he said, the IRA deduction already is available to persons with individual incomes of $35,000 or to joint incomes of $50,000, so that plan helps mostly those of higher incomes.

Packwood said that he liked neither the IRA nor the capital gains provision. He also said the capital gains differential was not a critical part of the tax reform package.

He also said the capital gains differential was not a critical part of the tax reform package and noted that elimination of the investment tax credit, for example, saved $120 billion.

But some of those who strongly supported Packwood when the controversial package was being put together say they are disappointed in him.

Citizens for Tax Justice, a tax policy research and lobbying group financed by foundations and labor unions, actively worked for the tax reform act and provided some of the early research that pushed it forward.

Bruce Fisher, the group's research director, said, "We have no animus toward Sen. Packwood, but it is tremendously disappointing to us that the senator . . . would walk away from the tremendous achievement for which he was in large part responsible in 1986, just because of a revival of a discredited economic theory."

. . .

The Oregonian
Portland, Oregon
Sunday, October 22, 1989
Forum, page K1

Architect Also Knows How To Disassemble

by Steven Duin

Senator Bob Packwood has a chilling response to those who believe the 1986 Tax Reform Act is going down the tubes:

Right on.

The Oregon Republican agrees that the sweeping tax reforms he helped package three years ago are under constant, ominous assault.

"Everyone is trying to chip away at it. Everyone said we went in the right direction except when it affected them," Packwood said Thursday. "Everyone wants their deduction. There is a continual desire to use the tax code for your favorite gewgaw. That fight will go on forever."

But the senator refuses to concede that President Bush's favorite gewgaw—a cut in the capital gains rate—may reopen the loophole that sinks tax reform for good.

Neither does Packwood grant that a lower capital gains rate will primarily benefit the wealthy, a class quite prominent in the list of those who will support him for re-election in 1992.

Of the 12 highest-paid executives of publicly held companies in the Portland metro area, 10 are already safely aboard the Packwood bandwagon. They include Don Frisbee, Peter Pope, Gerard Drummond and Bruce Engel.

Their salaries and compensation in fiscal 1988 ranged from $400,000 to more than $1.5 million. From where I sit that sounds like capital-gains country.

Packwood has a different view. He brushes aside the Democrats' argument that 80 percent of capital gains benefits go to people making at least $100,000.

That figure is warped, he said, by the addition of the capital gain. If the capital gains on the sale of a home or a large block of stock don't count as income, Packwood said 47 percent of the beneficiaries make less than $50,000 a year.

Even so, he will now grant the wealthy their tax break. What Packwood once described as "the biggest loophole for the rich" now looks like a tidy way to generate additional tax revenue. Thursday he introduced separate legislation that would cut the capital gains tax—and expand IRAs.

While shaping tax reform, Packwood always expected that Congress would revisit capital gains. The election of George Bush hastened the reunion. Reagan fought for tax reform. Bush "is fighting to undo it," said Bob McIntyre, a former Ralph Nader disciple and the director of Citizens for Tax Justice.

Bush's first offensive is the capital gains cut. "The president," Packwood reminds us, "won big in an election in which capital gains was one of the four or five issues he hammered on. This was not just an off-the-cuff remark in Houston in midsummer."

Packwood is less vocal in his support of Bush's only other campaign issues: the pledge of allegiance, Willie Horton and the no-new-taxes lip. That's why McIntyre wonders if the senator is pledging allegiance to the president instead of to tax reform.

"Packwood has the role if he wants to be the president's point man," McIntyre said. "He's certainly doing it on capital gains. The administration has a laundry list of things it wants to do to undo tax reform. If Packwood takes that side on things, he will be undoing the best thing he ever did in Congress."

Packwood is clearly annoyed by some of the baubles that have been attached to the Budget Reconciliation Bill. Democrats on the Senate Finance Committee have created two gaping loopholes in the estate tax. "I regard them both as invasions of what we did," Packwood said. "Had I been chairman, they would not have been in the bill."

And nine days ago, Packwood helped strip the bill of $28 billion in gewgaws, ranging from tax-exempt bonds for sports stadiums to tax breaks for rental tuxedos.

But even Packwood can't resist tinkering with the 1986 act that lowered the individual tax rate by plugging corporate loopholes and dynamiting most tax shelters.

Not only has he flopped on capital gains, but Packwood has been pushing tax breaks for timber industries. Thus, he is chipping away at the foundation of tax reform. Reform was only possible when politicians moved beyond, "You can keep your deduction if I can keep mine," to, "I'll get rid of mine if you'll get rid of yours."

Packwood knew that in 1986. He is wavering as we head into the '90s. If capital gains deserve a second look, maybe we had better re-evaluate whether rental tuxedos should be depreciated over two years instead of five.

Regardless of how they feel about capital gains, Packwood's comrades in the Senate must be thinking that if the father of tax reform is abandoning his child, they need not provide the child shelter.

Especially when tax shelters spark many more cash contributions and votes.

Chafee scored on capital-gains tax

He, others accused of partisan action in support of Bush

By JOHN E. MULLIGAN
Journal-Bulletin Washington Bureau

WASHINGTON — Tax reformers and Senate Democrats are turning up the political heat on GOP champions of tax breaks, such as Sen. John H. Chafee, who now back the President's effort to repeal a lynchpin of the historic 1986 reform bill.

Robert S. McIntyre, director of Citizens for Tax Justice, charged yesterday that Chafee, Sen. Bob Packwood, R-Ore., and other architects of the Tax Reform Act of 1986 are backing off their principles to support President Bush's bid to cut taxes on capital gains.

McIntyre called their actions "understandable if reprehensible," and argued that cutting capital gains taxes could begin the unraveling of an unprecedented tax reform achieved by trading away special tax breaks in return for lower rates across-the-board for all.

Chafee acknowledged yesterday that he backs Mr. Bush in part out of party loyalty. "I didn't embark on this with any great enthusiasm," he said of his support for the President's effort.

"This is no time to be retreating on tax reform," McIntyre said at a press conference called to trumpet what he portrayed as the successes of the sweeping tax reform bill — both in spurring investments and in collecting fair tax shares from wealthy companies and individuals.

Chafee has voted for a committee bill that would cut the capital gains tax rate from 33 percent — the same as on ordinary income — to 19.6 percent when assets are held for six years before they are sold.

Senate Democratic leader George J. Mitchell of Maine has charged that the GOP is willing to endanger such unrelated matters as deficit reduction and aid to Soviet-orbit nations in Europe in order to chase "the holy grail" of a tax break.

In 1986, Chafee spoke often in favor of taxing capital gains — profits from the sale of stock, property and other assets — at the same rate as other personal income. Special rates for capital gains, he said in June that year, is "shelter for the rich."

Chafee said at the time, during a successful effort to beat back amendments to add capital gains tax breaks to the reform bill, that they would "lead us into that old quagmire" of "artful dodging."

He said if lower capital gains rates were allowed, "deal after deal will be structured to be a capital gain." He quoted statistics to the effect that the very rich got most of the benefit from the special rate.

But Chafee said yesterday, "This is not something to do with the rich." He asserted that "average" taxpayers, such as old people selling a home for profit, benefit from reductions in the capital gains tax.

McIntyre said such examples of "average" taxpayers needing capital gains tax relief make up a tiny proportion of potential beneficiaries of a preference that would overwhelmingly go to wealthy people. "And John Chafee knows it," he said.

Chafee echoed the administration line that the capital gains tax break would help everyone by spurring freer investment in risky enterprises. "I'm willing to give it a chance," he said. But he would not say that he believes the administration's argument is correct.

Sen. Claiborne Pell generally supports lower capital gains taxes as an investment incentive but has not been active in tax writing. He said yesterday, however, that he opposed the Republican tactic of tacking the capital gains matter onto a pending bill to give aid to promote democracy in Poland and Hungary.

McIntyre yesterday released a detailed study showing among other things that only seven major, profitable companies paid no tax in 1988, compared with 41 companies that won an aggregate of $1.9 billion in refunds between 1981 and 1985, before tax reform.

For example, General Dynamics, corporate parent of Electirc Boat, was generally on the Citizens for Tax Justice list of "Top Freeloaders" during the years before tax reform, reaping $37.6 million in refunds between 1981 and 1985, despite profits of $2.3 billion. Its effective tax rate was minus 1.6 percent.

But last year, according to the survey, General Dynamics paid $136.5 million in taxes on profits of $455 million, for a rate of 30 percent.

Among other local corporations listed, Textron paid $42.6 million on profits of $244.2 million last year, for a rate of 17.4 percent, not significantly different from its rate of 16.1 percent in the pre-reform period.

Massachusetts-based Raytheon, generally among the higher-rate corporate taxpayers in previous Citizens for Tax Justice surveys, paid $377.8 million in taxes last year on $688.7 million in profits, a rate of 54.9 percent.

On Sept. 30 a coalition of Democratic defectors and nearly unbroken GOP support killed a House effort to replace the administration's capital gains tax cut with full deductibility for Individual Retirement Accounts, combined with higher tax rates on the wealthiest Americans.

Rep. Claudine Schneider, a supporter of the 1986 tax reform bill, and Rep. Ron Machtley, voted to support the President. Rep. Barney Frank voted on the losing side, against Mr. Bush.