TAX FOUNDATION'S VOL. 33, NO. 7 DECEMBER 1989

TAX·FEATURES

Bentsen Pushes Savings Incentives as Key to 1990 Tax Package; Capital Gains Tax Cut a Possibility

Front Burner

by Wayne Gable
President, Tax Foundation

The Burden of Corporate Tax Compliance

When major tax reform surfaced in the early 1980s, one of its primary objectives was simplification. Unfortunately, that intention dropped by the wayside when Congress finally produced the mammoth Tax Reform Act of 1986. What taxpayers are left with is the most complex tax code ever and the onerous burden of tax compliance.

According to data derived from a study prepared for the Internal Revenue Service, the equivalent of one percent of the total U.S. civilian workforce is devoted to determining just the corporate income tax liability. This tremendous amount of manpower dedicated to tax compliance comes at a huge cost. For example, in 1983 it cost the U.S. economy $35 billion to raise $37 billion in corporate income taxes. This is an outrageous cost contrasted with the revenue collected. One percent of the nation's gross national product was consumed by the cost of complying with the corporate income tax. Clearly this effort does not represent the most efficient use of the nation's economic resources.

The study prepared by the A.D. Little Company for the IRS indicates that 2.7 billion hours were spent in reporting the various tax liabilities of business. This is the equivalent of a year's work from 1,350,000 persons and is more manpower than our total U.S. military establishment. Individuals devote the time of an additional 797,000 persons for a year to comply with the personal income tax.

To get a clearer perspective on just what these numbers mean, it is useful to note what percent of our national effort goes toward more

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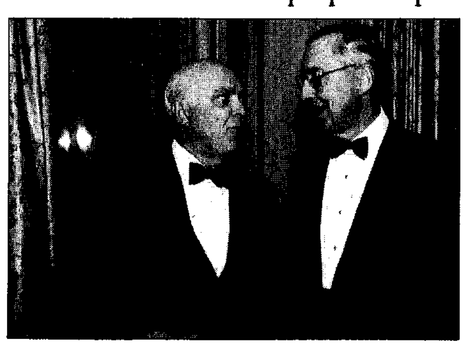
"We must do a better job of encouraging savings and investment in this country," Senator Lloyd Bentsen told the Tax Foundation's 52nd annual dinner in New York November 29th. "My goal will be to develop a bipartisan package of cost-effective savings and investment incentives. Will capital gains be on the table?" he asked. "No doubt."

The assembled crowd of corporate executives applauded this sign that the Senate Finance Committee Chairman would not exclude a capital gains tax cut from the tax bill he will offer in the next congress. Senator Bentsen's speech followed the Tax Foundation's presentation to him of a Distinguished Service Award for contributions in the public sector and to David Roderick, director and former chairman and chief executive officer of USX for contributions in the private sector.

The Texas Democrat did make it clear, however, that he sees an enhanced IRA proposal as a critical part of any tax package the Senate Finance Committee puts together. He ascribed an improvement in Canada's savings rate to broadened IRA measures and pointed to new studies in the U.S. that show an increase in savings of three dollars for every one dollar of tax revenue lost through IRA deductions. "I believe that the figures would be even better for the IRA proposal I put forth this year, which allows a 50 percent rather than a 100 percent deduction," Senator Bentsen continued. "In short, the IRA is a retirement plan that never should have been retired."



From left, the recipients of Tax Foundation's Distinguished Service Awards: David M. Roderick, director and former chairman and chief executive officer, USX Corporation, for contributions in the private sector; and The Honorable Lloyd Bentsen, senior senator from Texas, for contributions in the public sector.

He also tempered his endorsement of a capital gains tax cut with cautionary remarks about the revenue neutrality of such a measure. "The biggest problem for capital gains relief is the one

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that proponents of a capital gains tax cut refused to face this year: How do you pay for it? . . . We would have to

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answer the virtually unanimous verdict of economists that after that first year such a cut drains the treasury."

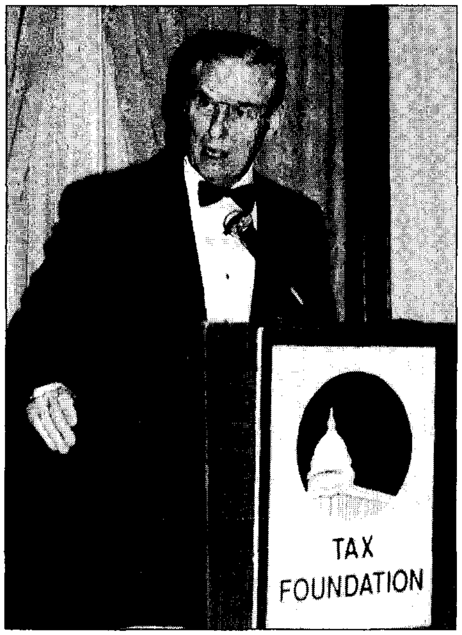
The price the U.S. will pay if it does not stimulate savings and investment is an eroded economy, according to Senator Bentsen, and he already sees symptoms of that erosion:

■ Excessive debt: With the national debt tripling during the decade of the 80s, the interest payments alone last year took the personal taxes of all taxpayers west of the Mississippi.

■ High interest rates: We now have a 10.5 percent prime rate compared to 9 percent in Germany and 4.875 percent in Japan.

■ Low productivity: It has averaged barely 1 percent, or less than half the rate in Germany and Japan.

"Why can't we do better?" Bentsen asked. "One key is capital accumulation. Having enough money



The Honorable Lloyd Bentsen addresses the Tax Foundation Annual Dinner.

to invest is what has sparked the U.S. standard of living — and helped spur the success of western democracy. Now we don't have enough. And the main reason is our emergence as the world's leading debtor economy."

He dismissed the notion that the national debt is just money we owe to ourselves and therefore not a serious problem. While emphasizing that foreign money invested in the U.S. brings benefits to the nation's economy, he pointed to our high interest rate as the primary reason for heavy foreign investment here. Expanding on this theme, he gave examples of different kinds of foreign investment.

"Foreign investment [could be] a source of strength. In the 19th century English investment helped build much of the railroad that first connected the east and west coasts. But today that foreign investment is

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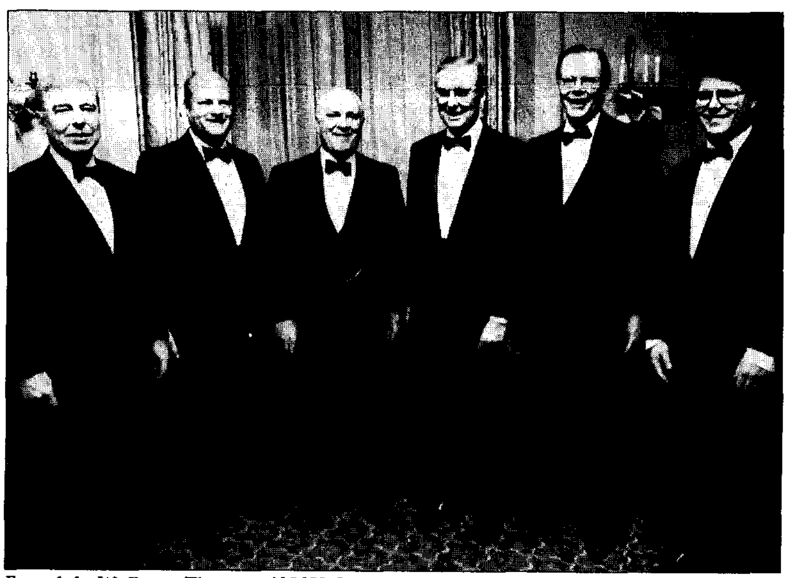
not being used to finance America's future. It's being used to buy Rockefeller Center. . . . and to finance consumption."

Senator Bentsen closed his remarks with an appeal to all Americans to make whatever sacrifices are necessary to save and invest more. Moreover, he challenged legislators to exercise strong leadership, to take the often unpopular actions that will encourage Americans to save and invest, making the country economically stronger.

Senator Lloyd Bentsen talks at the head table with Tax Foundation President, Wayne Gable.



From left: W. Bruce Thomas of USX; James C. Miller III, Co-Chairman, Tax Foundation; Distinguished Service Award winners David M. Roderick of USX, and Sen. Lloyd Bentsen; James Q. Riordan, Co-Chairman, Tax Foundation; and Wayne Gable, President, Tax Foundation.

Tax Features

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Tax Foundation's 42 Annual Conference Addresses Revenue Estimation and International Taxation

The Tax Foundation held its 41st Annual Conference in New York City the afternoon of November 29. Corporate executives, professors and students of economics and public finance, and members of the business press heard presentations from experts in the fields of revenue estimation and international taxation.

"Revenue Estimating: Evolving Toward Conflict or Consensus?" served as the theme of the first panel discussion. The subject was addressed by Kathleen O'Connell, Deputy Assistant Director for Tax Analysis at the Congressional Budget Office; Bernard Schmitt, Associate Chief of Staff, Revenue Analysis, at the Joint Committee on Taxation; John Wilkins, Senior Economic Advisor, Department of the Treasury; and Gail Fosler, Chief Economist at The Conference Board.

Kendyl K. Monroe, Partner, Sullivan & Cromwell, moderated the panel and highlighted the importance of revenue estimating in his introduction. "There is a strong view, in the private sector at least, that much of modern tax legislation has been driven by revenue estimates as distinguished from tax policy. That does open the question of just what

At left, David R. Milton, retired, formerly of Shell Oil, moderated the international taxation panel, here speaking with two of the panelists, William Modahl (center) and Alan Reynolds at right.

tax policy is . . . and gets into some fundamental discussions about tax legislation altogether."

Kathleen O'Connell was first to address the assembled corporate tax executives. She clearly stated her view that consensus prevails among professional estimators to a much greater degree than observers and pundits seem to think. Even the words controversy and conflict are terms that she sees as being borrowed from politics and having little place in the technical field of "econometric modeling and fiscalization of payment patterns."

Ms. O'Connell ascribes the appearance of conflict to three factors: So many groups are generating revenue estimates, or what they call revenue estimates, that "you can't tell the players without a scorecard." Second, some estimators, though not CBO, are guarded about the sources of their estimates, and this confidentiality has created the impression of a mysterious process at work. Third, users of revenue estimates discuss them out of context and without reference to their real purpose.

Bernard Schmitt of the Joint Committee on Taxation followed Ms. O'Connell with remarks on many aspects of revenue estimation. He also traced the events that have made estimators more visible on the fiscal policy scene.

"Going back to the Budget Act of 1974," the gears were set in motion. The "budget deficits of the 1980s . . . and the change in the indexing system" speeded the process, according to Mr. Schmitt. Gramm-Rudman contributed to the increased importance of revenue estimates but even more so the Tax Reform Act of 1986, "which, in fact, dictated absolute neutrality within tax provisions and tax proposals, . . . Anybody that wants to spend some money has to come up with a way to pay for it."

John Wilkins of Treasury concentrated his remarks on the issue of static vs. dynamic estimates, and asserted that contrary to the frequent criticism that official revenue estimates are not sufficiently dynamic, they do in fact take adequate account

Revenue estimating panel from left: Bernard Schmitt of the Joint Committee on Taxation, Kathleen O'Connell of the Congressional Budget Office, Gail Fosler from The Conference Board, and John Wilkins from the Department of the Treasury.

of behavioral changes in the economy that result from proposed tax provisions.

The panel's presentations were completed with remarks by Gail Fosler of The Conference Board. One of the points she made was that regarding some new targets of taxation, pools of public data that estimators have traditionally relied on do not exist. She cited LBO activity, the tax contained in the reconciliation bill on ozone-depleting chemicals, and the alternative minimum tax as areas where revenue

Phillip Morrison, International Tax Counsel, Department of the Treasury

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productive pursuits.

Three percent of the nation's employment is devoted to agricultural production, but we devote over one-third as much time to filling out corporate tax reports as we do to feeding ourselves. Total annual housing production costs about five percent of GNP whereas managing the corporate income tax costs fully a fifth as much.

What is lacking in our tax system is the efficiency that comes with simplicity. The tax system should be as simple as possible, easy to understand, and easy to comply with. The complexity of our current tax code continues to impose a tremendous cost on society.

The staggering increase in the complexity and the administrative burden of our tax code must stop. During the past decade alone, over fourteen major tax bills have been enacted. A tax code that changes continually destroys the stability needed for business investment and planning. Simplicity is critical in fostering efficiency for both the tax collector and taxpayer. Compliance expense is a cost to society that should not be ignored. Without serious reform towards simplicity, compliance will become a heavier burden on our economy than the taxes themselves.

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estimation relies on difficult judgment calls. She called on the private sector and on non-profit groups like the Tax Foundation to provide more of the basic research needed for accurate revenue estimation.

David Milton, retired, formerly Vice President and Chief Tax Counsel of Shell Oil, led the afternoon's second panel on the topic: "Is International Taxation Becoming Backdoor Protectionism?" The three panelists were William Modahl, Director of Tax Affairs, Digital Equipment; Phillip Morrison, International Tax Counsel, Department of the Treasury; and Alan Reynolds, Chief Economist, Polyconomics, Inc.

Mr. Modahl opened by saying that although there are protectionist trends in international tax policy, he concentrated his criticism on the tax code provisions that hinder U.S. investment abroad. He focused particularly on the Tax Reform Act of 1986 and urged that, "Today we need to complete the process of tax reform with a major overhaul of corporate taxation in the direction of a border adjustable system that eliminates both domestic double taxation of capital and international double taxation of earnings."

Phillip Morrison, just recently installed as International Tax Counsel at Treasury, looked at a variety of international tax issues. He finds "Capital export neutrality and capital import neutrality [to be] increasingly irrelevant in the increasingly globalized economy." Mr. Morrison hypothesized that a harmonized international tax system would tax no income twice but allow none to escape untaxed. If other nations adopted our tax system, the areas where such double- or non-taxation occurred should be studied for possible unilateral change by the United States.

Alan Reynolds of Polyconomics, Inc. finished the second panel discussion by ridiculing those in the U.S. who oppose the globalization of the U.S. economy and try to keep American investment in the U.S. by creating tax incentives for domestic investment. "There has always been a group in Congress that wanted to isolate the U.S. economy from foreign competitive pressure — goods, assets, anything. They want to isolate us in a way that successful economies such as Albania and North Korea have always done."

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