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American Council of Life Insurance

1850 K Street, N.W.
Washington, D.C. 20006
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Richard S. Schweiker
President

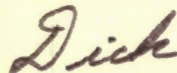
December 27, 1984

The Honorable James A. Baker III
Chief of Staff and Assistant to
the President
The White House
Washington, D.C. 20500

Dear Jim:

I thought you would be interested in seeing a copy of the attached letter I have sent to President Reagan. This is an issue which is very important to the insurance industry and which, we believe, could have a profound negative impact on the nation.

Sincerely,



Richard S. Schweiker

Enclosure

American Council of Life Insurance

1850 K Street, N.W.
Washington, D.C. 20006
(202) 862-4300

Richard S. Schweiker
President

December 27, 1984

The President
The White House
1600 Pennsylvania Avenue, N.W.
Washington, D.C. 20500

Dear Mr. President:

I am writing to express my concern over the suggestions contained in the Treasury Department's report on "Tax Reform," that would increase the taxes Americans pay by adding to their tax base the increase in the value of individual life insurance policies and annuities as well as the value of group life insurance and health insurance provided by their employers.

America's existing employee benefit system provides the American worker with the finest protection in the world. Employer-sponsored life and health insurance are almost universal and a large and increasing percentage of workers is being covered by private pensions. One key to the success of our system is a favorable tax policy -- the current one has encouraged both business and labor to support the establishment and expansion of employee benefit plans. If we change our current tax policy, we could do serious, perhaps irreparable, harm to the system.

Taxing employee benefits would mean raising their cost to the employee. Many employees -- primarily low and middle income wage earners -- would ultimately have less protection than under the current tax system because they would be unable or unwilling to pay the additional taxes. Since the basic needs these benefits meet would still be there, I am convinced it would fall to government -- primarily the federal government -- to make up the shortfall.

Current employee benefit plans, together with Social Security and related programs, allow the American worker to enjoy an unprecedented degree of financial security. For example, a 1983 U.S. Labor Department survey found that 96 percent of all workers in medium and large firms were covered by group life insurance. For many workers this coverage was a substantial portion of their life insurance.

Similarly, about 8 in 10 Americans under age 65 are covered by employer-sponsored group health insurance policies. Here again it is the employer-sponsored group mechanism that provides these workers with access to life and health protection that might otherwise be unaffordable or unavailable.

To dismantle our private benefits system at this point in history and ultimately be forced to replace it with a government program strikes me as both bad social policy and bad economics. It also seems to run counter to your long-standing philosophy of encouraging the private sector to take a major role in helping to meet our country's needs.

The Treasury's proposal to tax the "inside buildup" -- the increase each year in the value of an individual life insurance policy or annuity contract -- would have serious negative consequences. Large numbers of people -- again, primarily low and middle income workers -- would ultimately have less life insurance or annuities than they would if current tax policy were continued. As would be the case with employee benefits, the need these individuals and families have for protection would not be lessened and lesser coverage would put the government at risk to bear more of the burden.

Furthermore, the very nature of the annual increase in the value of an insurance policy makes the idea of taxing it, as the Treasury has proposed, unfair. The increases in value of the policies cannot be realized unless the policy is surrendered for cash. To tax this annual appreciation before the policy is cashed in would be like taxing a homeowner on the appreciation of his residence each year even though he may never sell it.

Another point I wish to call to your attention has to do with the vital role the life insurance industry plays in capital formation in our country. Two of the chief sources of investment funds in America today are life insurance policies and pensions, including annuities. Discouraging people from buying these products for their own financial security by changing the tax treatment of such products would reduce the amount of investment capital available in the land. The country will need more capital for the foreseeable future than we are currently accumulating. Changing tax policy in such a way as to reduce the growth of capital formation through life insurance companies could affect the economy seriously.

Mr. President, the life insurance business understands full well the pressures for changing the tax system and the reasons advanced by the Treasury for its proposed changes. However, we disagree very strongly with the idea of taxing employee benefits or life insurance

or annuity contracts that individuals own. Such a change would be counter-productive and it would cost the government and the taxpayer far more in long-run expenditures than it would raise in taxes in the short run.

I sincerely hope you will give consideration to our views.

With all good wishes,

Sincerely,

A handwritten signature in cursive script that reads "Dick Schweiker".

Richard S. Schweiker
President
American Council of
Life Insurance

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THIS FORM MARKS THE FILE LOCATION OF ITEM NUMBER 1 LISTED ON THE
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Vice Chairman (Chemicals), Vincent L. Gregory, Jr., Chairman, Rohm and Haas Company
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**COMMITTEE
FOR
EFFECTIVE
CAPITAL
RECOVERY**

*(formerly
Ad Hoc Committee
For An Effective
Investment Tax Credit)*

December 28, 1984

Mr. James A. Baker, III
Chief of Staff and Assistant
to the President
The White House
1600 Pennsylvania Avenue, N.W.
Washington, D.C. 20500

Dear Mr. Baker:

I am writing to you on behalf of the Committee for Effective Capital Recovery, a group representing over 600 businesses around the country, which have been working for more than a decade to improve the incentives for savings and investment in our current tax system and thus to improve economic growth and employment in the United States.

As you know, the Treasury Department recently made public its long-anticipated tax reform plan. The Committee has carefully reviewed the various proposals contained in the Treasury report, and has studied the interaction and impact of these provisions. In so doing, full consideration was given to the positive aspects of the proposal, such as rate reduction and indexation for inflation. However, on balance, we are of the opinion that the recommendations to eliminate the investment tax credit, and to replace the Accelerated Cost Recovery System (ACRS) with a severely scaled-back system of depreciation, would be extremely detrimental to the nation's economy.

In analyzing the Treasury proposal, its effect on economic growth, not on a particular company or industry's taxes, is a paramount concern. Speaking now as the Chairman of Colt Industries Inc., a company that currently pays a high effective tax rate, I would like to point out that Colt's taxes would actually decrease under the Treasury proposal. However, we anticipate that the overall impact of the proposal on the nation's economic growth generally, and on Colt's ability to market its products, specifically, will be highly negative. Thus, the potential positive impact of the proposed lower tax rates will be negated by the reduced growth resulting from the elimination of investment incentives -- and reduced income, even if taxed at a lower rate, does nothing to increase profits.

We have reached the conclusion that the Treasury proposal will be harmful to the economy based on a number of factors. First, history has already taught us much in this area. As the attached excerpt from the Committee's testimony to Congress in the mid-1970's pointed out,*/ the last two times Congress negatively changed the investment tax credit, there was a consequent severely damaging effect on the economy. Not only was there a sharp drop in new orders for machine tools and producer's capital goods, and a slowdown in employment in these industries, but there was also a decrease in total corporate federal tax revenues each time the credit was suspended or repealed. (See charts attached to excerpt of earlier Congressional Committee testimony.) This history provides an important lesson that should not be ignored in the rush to reform our tax system.

Second, from the information available to us, it appears that the very suggestion that the investment tax credit and ACRS might be repealed has already resulted in some contraction in business plans for investment. While Treasury has recommended a supposedly revenue-neutral tax plan, the fact is that cautious business managers cannot depend upon the tax rates actually decreasing to 33 percent. They will, however, take into consideration the negative proposals relating to capital investment incentives when planning future investments. Thus, the tax reform debate itself may freeze corporate spending plans.

The importance of stability in tax policy for the economy cannot be overstated. Back in the mid-1970's when a flexible investment credit was being proposed to respond to a changing economy, a serious analytical study**/ found that it was nearly impossible to optimally time the changes in the credit with the needs of the economy. Each of the historical changes in the credit was badly mistimed, coming about 10 quarters after the period during which they would have been most beneficial. It concluded that a fixed rate investment tax credit would have been much preferable to the changes actually made. A fluctuating credit is less efficient and, at times,

*/ Statement of Committee for Effective Capital Recovery (formerly Ad Hoc Committee For An Effective Investment Tax Credit) before Senate Finance Committee, March 10, 1975, and House Ways and Means Committee, July 28, 1975.

**/ Policy Alternatives for the Investment Tax Credit by Roger H. Gordon, Princeton University and Dale W. Jorgensen, Harvard University (1975).

will be greater in amount and therefore more costly in the short run, than is necessary with a constant 10-percent credit.

After many years of this on-again, off-again tax policy, Congress finally realized the importance of stability when dealing with plant and equipment expenditures and adopted a "permanent" investment tax credit. Subsequently, ACRS was added as the centerpiece of our current system of corporate taxation in this area.

Studies of the impact of tax changes on the economy found that these capital investment incentives were among the most significant factors leading to the recent economic recovery. Since the depth of the 1981-82 recession, the rate of growth in fixed business investment has been the highest of any post-war recovery period. And productivity has increased for the ninth consecutive quarter, the longest period of productivity growth since 1966-68. In fact, 1984 is now expected to produce the largest real gain in economic growth since 1955, confirming the prediction of many economists that the country is in a period of sustained prosperity.

Despite this evidence of the enormous importance of the investment tax credit and ACRS, the Treasury Department concluded that these provisions were of limited value and that their elimination, combined with rate reductions, would more effectively lead to increased economic growth. Yet every independent study of the impact of the Treasury tax plan has reached the opposite conclusion.

Wharton Econometrics, a national forecasting firm, concluded that implementation of the Treasury tax reform proposal would result in higher consumption, lower capital stock, and, ultimately, decreased productivity. According to Wharton's senior economists, "[i]n 10 years, U.S. workers will be 0.6% less productive . . . [a]nd the gap will widen over time." The increased cost of capital and consequent decrease in productivity would result directly from the elimination of the investment tax credit and ACRS. Capital costs would increase by 15 percent in 1986, rising to 20 percent for manufacturing industries after 10 years.

The Wharton study concluded that the proposed rate reduction in the corporate tax could not offset this negative effect. It also found that the Treasury study would place the United States in a less competitive posture overseas. This finding was confirmed by a preliminary analysis of the plan by the National Association of Manufacturers which concluded that the Treasury plan will most likely have adverse effects on the international competitiveness of American industry because

depreciation schedules would once again be less favorable than those available in other industrial countries.

In a similar vein, Data Resources, Inc. (DRI), also a major economic forecasting firm, predicts slower economic growth in the short run resulting from the Treasury Department's tax reform proposal. Cited as one of the major reasons for the slowdown was the elimination of the investment tax credit and accelerated depreciation. According to DRI, investment in equipment and structures would decline and not recover to their current baseline level until 1995. While total real spending would eventually increase slightly, DRI seriously questions whether the present economic climate is an appropriate one for making such drastic tax changes. The major risk of reducing per capita living standards due to sagging investments suggests to DRI that Congress should deal with the deficit before addressing tax reform.

These recent studies simply confirm some previous studies which lead to the same conclusion. For instance, a Washington University econometric analysis of the leading Congressional tax proposals, which also called for eliminating or changing the investment tax credit and ACRS (Bradley-Gephardt FAIR tax and Kemp-Roth FAST tax), found that the impact on the economy would be extremely adverse, despite the fact that each plan proposed a 16 point reduction in the corporate tax rate.

In a more general study of the impact of tax proposals on capital investment, the well-known economist, Allen Sinai, found that the current capital recovery provisions in the tax code provide a much greater "bang for the buck" than would a reduction in the corporate tax rate, that is, for each dollar of revenue lost in the short run, ACRS and the credit provide a greater economic benefit than a tax cut. For example, ACRS provides \$0.81 in business fixed investment for every dollar of corporate tax lost, the investment tax credit provides \$0.76, but a reduction in the corporate tax rate provides only \$0.19.

All of these various economic studies lead to the same, inevitable conclusion -- ACRS and the investment tax credit are vital and necessary components of any tax plan intended to foster long-term, stable economic growth for this nation. A precipitous move to eliminate these incentives to capital investment could have a severely detrimental impact on productivity, employment, and balance of trade, and thus on the overall economic health of the country.

Mr. Baker
December 28, 1984
Page 5

Thus, the Committee strongly urges that any proposal for tax reform maintain these crucial capital investment incentives.

Sincerely,

George A. Strichman

George A. Strichman
Chairman
Committee for Effective
Capital Recovery

Chairman of the Board
Colt Industries Inc.

EXCERPT FROM TESTIMONY OF
COMMITTEE FOR EFFECTIVE CAPITAL RECOVERY
(FORMERLY AD HOC COMMITTEE FOR AN
EFFECTIVE INVESTMENT TAX CREDIT)
BEFORE SENATE FINANCE COMMITTEE MARCH 10, 1975
AND HOUSE WAYS AND MEANS COMMITTEE JULY 28, 1975

HISTORIC EFFECTS OF CHANGES IN DEPRECIATION
PROVISIONS AND THE INVESTMENT CREDIT

There is no question that liberalized depreciation provisions and the investment credit have proven in the past to be effective in increasing employment and productivity, thus combating inflation and enhancing real growth. This fact can be illustrated in terms of capital investments, employment and Federal revenues.

1. Effects of Changes in Capital Recovery Provisions on Investment in Capital Facilities, 1962-1972

Following enactment of the original investment credit and adoption of the reduced guideline lives for depreciation in 1962, new orders for machine tools increased rapidly by 251 percent--from \$144 million in the last quarter of 1961 to \$514 million in the first quarter of 1966. New orders for producers capital goods increased by 82 percent--from \$3.9 billion in the fourth quarter of 1961 to \$16.2 billion in the third quarter of 1966.

The suspension of the investment credit in the third quarter of 1966 was followed in the next two quarters by a sharp drop in new orders for machine tools and

producers capital goods--\$130 million and \$2.8 billion, respectively.

Restoration of the credit in the second quarter of 1967 led to a rapid build up in orders--producers capital goods increased 36 percent from \$13.8 billion in the first quarter of 1967 to \$18.8 billion in the second quarter of 1969. Machine tool orders in the same period increased 70 percent from \$328 million to \$558 million.

The repeal of the credit in 1969 resulted in a drop of \$2.7 billion in new orders for producers capital goods through the second quarter of 1970. Machine tool orders were off \$417 million, almost 75 percent, from the second quarter of 1969 through the end of 1970.

Following enactment of the new investment credit and the Asset Depreciation Range (ADR) System in 1971, orders for producers capital goods increased by \$4.5 billion from the second quarter of 1971 through the third quarter of 1972. Machine tool orders rose by \$103 million--almost 60 percent--in the same period, from \$182 million to \$285 million. The pattern is unmistakable.

2. Employment Effects, 1962-1972

Employment in capital goods and machine tool manufacturing industries in 1962-1972 also parallels changes in capital recovery tax provisions. Following enactment of the investment credit and adoption of the shorter guideline

lives for depreciation in 1962, the number of employees in producers durable goods industries increased rapidly by 23 percent from 6.1 million in 1962 to 7.5 million in 1966. Suspension of the credit in the third quarter of 1966 slowed employment increases to only 2 2/3 percent in 1967. Following restoration of the credit in the second quarter of 1967, employment increased to about 8 million in 1969.

With the repeal of the credit in 1969, employment dropped by about 900,000 jobs--roughly 11 1/4 percent--in 1971. After enactment of the new credit and the ADR in 1971, employment increased from 7.1 million to 7.8 million--about 10 percent--in 1973.

The number of employees in machine tool manufacturing rose by 41 percent or 34,000 from 1962 through 1967. Output and employment in this industry was adversely affected by the cutback in the space program in 1968; between 1967 and 1969, employment dropped by 5 percent or 5,800 jobs. Repeal of the investment credit in 1969 resulted in a much steeper drop in jobs, from 110,600 in 1969 to 78,400 in 1971, a decline of 29 percent. After enactment of the new credit and the ADR in 1971, machine tool employment increased by 3,700 jobs or by 4.7 percent in 1972.

The above discussion covers the capital goods sector only. Through the multiplier effect, the beneficial impact

of the credit on employment in the capital goods sector was also reflected in higher employment throughout the economy.

3. Revenue Effects of Changes in Capital Recovery Allowances, 1962-1972

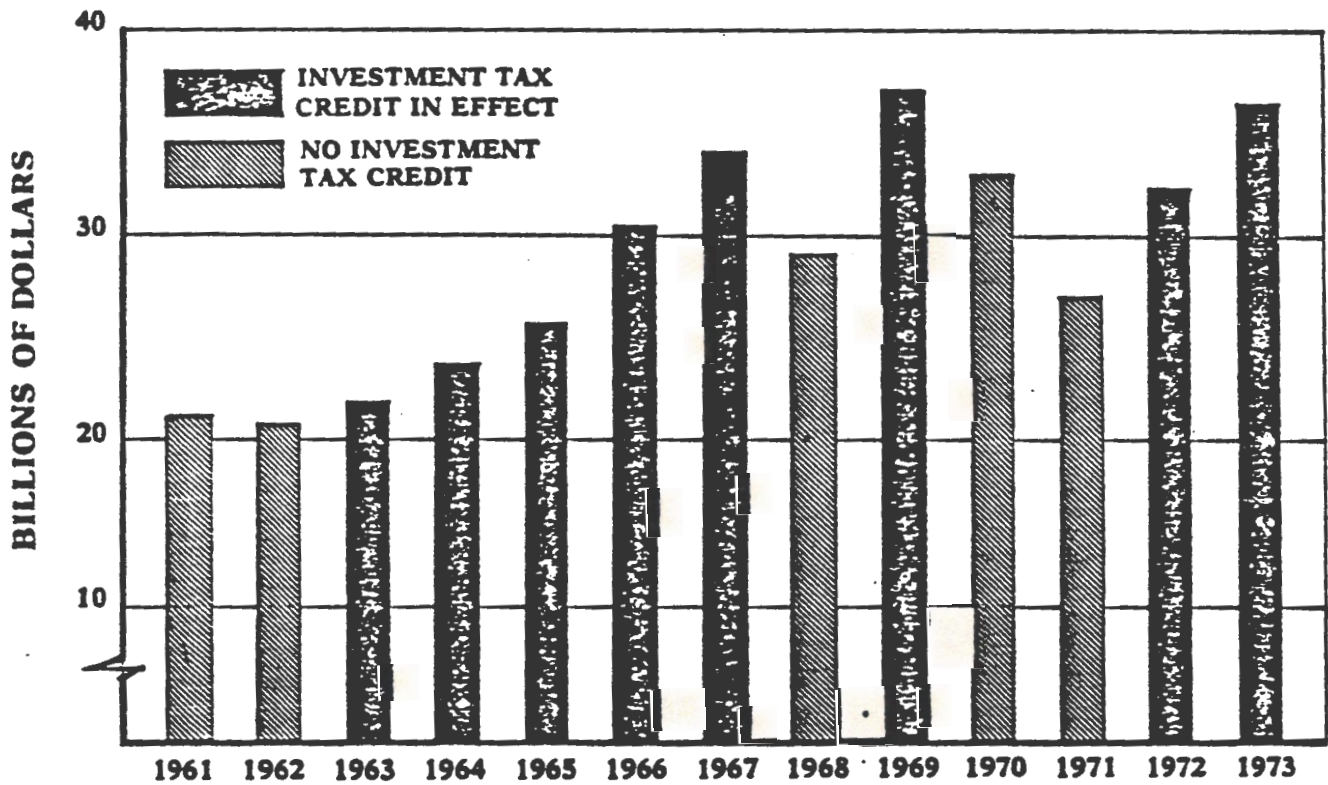
The investment tax credit and the shortening of tax lives have added an estimated \$2.6 billion to Federal tax collections from all sources since 1962. In every year that the investment tax credit was in effect, Federal revenues were above the level they would otherwise have been, amounting to approximately \$1 billion in 1972 alone.

Conversely, tax receipts fell each time the credit was removed. Suspension of the credit in 1966-67 and its repeal from 1969 until 1971 resulted in a \$760 million decrease in Federal tax revenues below what would otherwise have been collected had the credit remained in effect.

These estimates follow from a calculation of the amount by which tax changes altered the cost of capital outlays resulting from enactment of the credit and issuance of the guideline lives in 1962, removal of the basis adjustment in 1964, suspension of the tax credit for two quarters in 1966 and 1967, its restoration in 1967, repeal in 1969 and reinstatement and approval of the Asset Depreciation Range in 1971. Each favorable change raised output, wages and profits, thereby expanding the Federal tax base. Conversely, each tax law

change which increased the cost of capital outlays resulted in a lower level of output, wages and profits than would otherwise have occurred.

CORPORATION INCOME TAXES: FISCAL YEARS 1961-1973



SOURCE: NORMAN B. TURE, INC.

Table A. Estimated Change in Federal Revenues Resulting From Tax Credit and Shorter Tax Lives, 1962-72 (Calendar Years)

<u>Year</u>	<u>Revenue Change</u> <u>(Millions of dollars)</u>	
1962	160	
1963	330	
1964	50	
1965	110	
1966		- 50
1967	140	
1968	390	
1969		-230
1970		-480
1971	440	
1972	<u>1,000</u>	<u> </u>
Total	2,620	-760
	Net Change*	1870

*Note: Net change differs from sum of individual changes shown due to rounding.

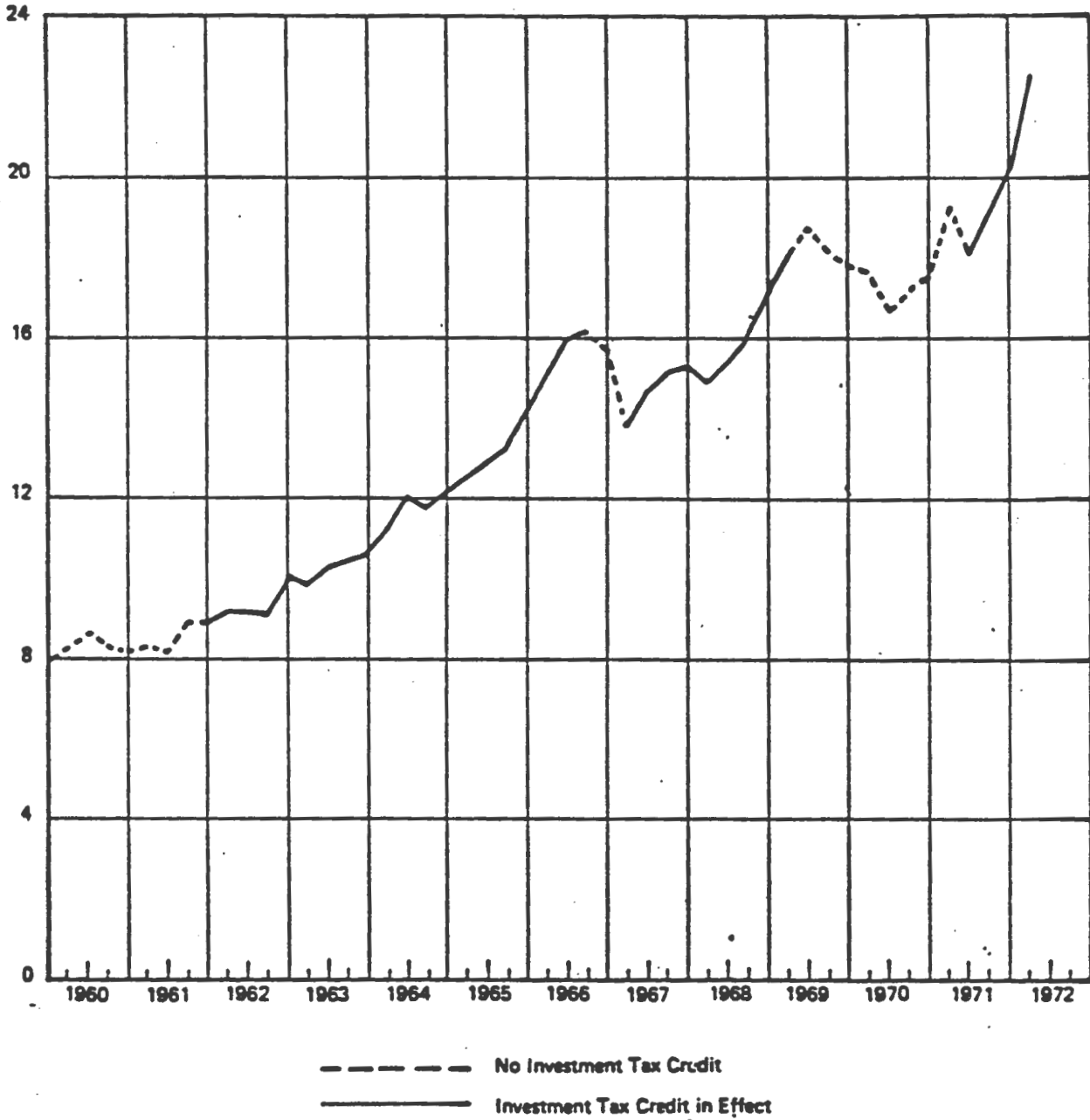
Source: Norman B. Ture, Inc.

The patterns of fluctuations in these key areas demonstrate:

1. that the investment credit accomplishes what its original proponents intended; and
2. that it can be fully effective in stimulating needed, long-term growth only if its basic provisions (particularly the rate of the credit) are permanent features of the tax code.

Chart 1.

PRODUCER'S CAPITAL GOODS: NET NEW ORDERS
(Quarterly in Billions of Dollars)





NATIONAL CONSTRUCTION INDUSTRY COUNCIL

2100 M Street, N.W. • Suite 600 • Washington, D.C. 20037 • (202) 296-7019

MAILING ADDRESS: Post Office Box 19268 • Washington, D.C. 20036

December 27, 1984

Mr. James A. Baker III
Chief of Staff
The White House
Washington, D.C. 20500

Dear Mr. Baker:

I am writing to express the deep concern of the nation's construction industry over certain portions of the Treasury Department Report on Tax Reform for Fairness, Simplicity, and Economic Growth.

The National Construction Industry Council (NCIC), which I have the privilege of chairing, consists of the 25 major trade associations and professional societies that together make up America's construction industry. The combined membership of these various NCIC groups and organizations includes more than 100,000 contractor firms and 150,000 design professionals. A listing of NCIC member organizations is attached.

The construction industry's immense diversity, which is a major part of its strength, can at times prevent recognition of the tremendous contribution which it makes to our national economy. Indeed, it is difficult to overstate the importance of the construction industry for this country. The Commerce Department estimates that total industry receipts in 1982 exceeded \$312 billion, accounting for nearly 10% of the gross national product. This compares to other industry contributions of: 1) transportation and communication, 6.5%; 2) petro-chemical, 6%; and 3) banking, 5%. The total average industry employment that year was over 4,360,000, which means that approximately one out of every 20 jobs, ranging from design professionals and managers to craftsmen and unskilled labor, both union and non-union, is involved in construction.

Members of NCIC: Air Conditioning Contractors of America - American Concrete Pavement Association - American Consulting Engineers Council - American Rental Association - American Road and Transportation Builders Association - American Society of Civil Engineers - American Subcontractors Association - Associated Builders and Contractors - Associated Equipment Distributors - Associated General Contractors of America - Associated Landscape Contractors of America - Association of the Wall & Ceiling Industries-International - Construction Industry Manufacturers Association - Door and Hardware Institute - Mechanical Contractors Association of America - Metal Building Dealers Association - National Asphalt Pavement Association - National Association of Minority Contractors - National Association of Plumbing-Heating-Cooling Contractors - National Association of Surety Bond Producers - National Association of Women In Construction - National Constructors Association - National Electrical Contractors Association - National Society of Professional Engineers - Portland Cement Association - Prestressed Concrete Institute - Sheet Metal and Air Conditioning Contractors National Association

The impact of America's construction industry is felt by each and every citizen. Its health is a prerequisite to a vital national economy. NCIC members, however, have raised the concern that portions of the Treasury Proposal would so depress construction markets in this country that the very health and stability of the industry itself would be jeopardized. Furthermore, certain provisions of the Proposal would have a significant adverse impact on the industry directly, forcing sweeping changes in the way its companies do business that would affect not only their economic viability at home but also their ability to compete successfully overseas.

The following discussion of issues raised by the Treasury Proposal is designed to convey the significance of specific tax policies, both existing and proposed, for the construction industry. This document was recently drafted by the NCIC Committee on Taxes and will be reviewed by the entire Council in late January when it will be offered for industry-wide adoption.

It is our hope that this information will be useful to you over the next weeks and months as discussions continue within the Administration and on Capitol Hill concerning reform of the nation's tax system. NCIC is pleased to offer its further assistance to you in any way that it can.

Despite our concerns over the sweeping changes proposed to our nation's tax system we recognize that, as a major sector of the U.S. business community, we must accept certain responsibilities, even sacrifices, as this nation comes to grips with its economic ills.

On behalf of the National Construction Industry Council, I offer you our resources, as well as those of our membership, in helping to review and analyze the issues raised in this letter in greater detail. To this end, we are of course prepared and available to meet with you or members of your staff at any time that would be convenient for you. It is my sincere hope that we can be of real assistance to you as we all work together toward a stronger national economy.

Sincerely yours,



G. Paul Jones, Jr.
Chairman



NATIONAL CONSTRUCTION INDUSTRY COUNCIL

2100 M Street, N.W. • Suite 600 • Washington, D.C. 20037 • (202) 296-7019

MAILING ADDRESS: Post Office Box 19268 • Washington, D.C. 20036

SUMMARY OF PROVISIONS AFFECTING CONSTRUCTION

ACCELERATED COST RECOVERY SYSTEM/INVESTMENT TAX CREDIT

The construction industry is deeply concerned about the Treasury Proposal to substitute its Real Cost Recovery System (RCRS) for the present combination of the Accelerated Cost Recovery System (ACRS) and Investment Tax Credit (ITC). The ITC and ACRS provisions in the Economic Recovery Tax Act of 1981 were the cornerstone of the capital formation policy of the Act, enacted after years of Congressional review. This policy recognizes the importance of fixed assets to the national economy. The initial purchase of an asset is specifically recognized by the ITC and the importance of recovering costs over realistic periods in order to allow further capital asset acquisition is reflected in ACRS. In addition, the technical implementation of the provisions was carefully drafted to create an easily administered system. The RCRS proposal does not recognize the importance of capital formation and is significantly more burdensome to administer than the present ACRS and ITC provisions.

The RCRS proposal essentially eliminates the capital formation policy which led to the enactment of the present ITC and ACRS provisions. We do not believe this is in the public interest. Changes of this magnitude will have long range effects which are difficult to assess and cannot be easily reversed. It is virtually impossible for the construction industry to make long range plans while such proposals are under serious consideration.

Most importantly there is a general fear in the construction industry that short term transitional rules on this and other changes in the Treasury proposal could lead to wide scale cancellation of infant projects. These cancellations would be crippling to an already depressed domestic construction market.

The RCRS proposal is significantly more complicated than present law and far more uncertain. Annual depreciation adjustments for inflation will have to be made for all assets. The limited ability of businesses to project inflation will make planning a far more speculative process. Neither of these problems is present under the ITC/ACRS structure, inasmuch as

Members of NCIC: Air Conditioning Contractors of America - American Concrete Pavement Association - American Consulting Engineers Council - American Rental Association - American Road and Transportation Builders Association - American Society of Civil Engineers - American Subcontractors Association - Associated Builders and Contractors - Associated Equipment Distributors - Associated General Contractors of America - Associated Landscape Contractors of America - Association of the Wall & Ceiling Industries-International - Construction Industry Manufacturers Association - Door and Hardware Institute - Mechanical Contractors Association of America - Metal Building Dealers Association - National Asphalt Pavement Association - National Association of Minority Contractors - National Association of Plumbing-Heating-Cooling Contractors - National Association of Surety Bond Producers - National Association of Women In Construction - National Constructors Association - National Electrical Contractors Association - National Society of Professional Engineers - Portland Cement Association - Prestressed Concrete Institute - Sheet Metal and Air Conditioning Contractors National Association

credits and depreciation amounts are relatively simple to compute and track during the entire recovery period.

COMPLETED CONTRACT METHOD OF ACCOUNTING

An issue of special concern to the construction industry in the Treasury Proposal is the completed contract method of accounting. The Treasury Department has proposed changing the method as part of its treatment of multi-year production activities. As part of the Department's new tax neutrality policy, the method would be altered to match new changes in basis computations for persons constructing their own structures. We believe that this proposal carries the Treasury's neutrality theory beyond an acceptable limit. The tax reporting method of an on-going business should not be made contingent on the tax computation of a taxpayer building an asset by himself. Whatever neutrality justification there may be for tax rules applying to self-construction as opposed to contracting out to acquire an asset, it does not apply to on-going businesses which never own the assets they are building.

The completed contract method was last revised by Congress in the Tax Equity and Fiscal Responsibility Act of 1982. The Act set out specific directions for the Treasury to publish regulations for modifying the method in order to better reflect income where changes were deemed necessary. The proposed changes to the completed contract method in the current Treasury Proposal are virtually identical to those made in 1982. Congress addressed many of Treasury's proposals at that time after lengthy hearings, and provided a practical set of rules in response to the theoretical proposals made by the Department. The resubmission of this proposal as part of a new tax theory for other types of taxpayers is, we feel, unjustified.

The construction industry has presented detailed testimony concerning proposed changes in the completed contract method of accounting on many occasions in the past, including statements before Congressional panels and the Treasury Department. NCIC would be pleased to make these statements available to you if a more lengthy and specific discussion of the issue and its impact on the construction industry would be useful.

ENERGY TAX CREDITS

Members of NCIC believe strongly that energy tax credits must be retained in order to ensure a viable construction industry, especially in the industrial, commercial, and residential markets. Indeed, they may be essential if energy conservation and avoidance of future energy shortages are to remain national priorities.

The increased demand resulting from energy tax credits, particularly in the form of new commercial and industrial construction, has led to economic and technological innovations which will have a strong impact on our nation's energy independence. One has only to look at strides being made in the field of solar energy to appreciate this progress. These innovations, and the assurance of their continued application, have been boosted immeasurably by energy tax credits. The construction industry feels that it would be a short-sighted error in national policy to eliminate them at this time.

INTEREST ON TAX-EXEMPT BONDS

The proposed elimination of the tax-exempt status of interest earned on bonds issued by state and local governments for so-called "private purposes" poses a serious threat to the construction industry as well as to the nation's current economic recovery.

Under this proposal, "privatization," which has been used to privately fund design, construction and, in some cases, initial operation of such public facilities as jails, schools, airports, hydropower plants, parking garages, stadia and numerous other public facilities, would virtually disappear. While there were certainly some tax abuses of the privatization concept, the fact is that private risk capital has produced, and is producing, needed local facilities, often with the added feature of stimulating revenues to service the debt. Without exemption from paying taxes until the local government becomes owner of the project, there would no longer be an incentive for "privatization."

An even more serious problem exists in public housing. In 1983, tax exempt bonds financed \$5.3 billion worth of apartment buildings and \$12.7 billion worth of houses. These figures are estimated to represent habitation for a quarter million families. As recently as last November's election, voters clearly supported (to the tune of \$4.64 billion) bond issues which, among other things, financed farm and home purchases, neighborhood schools, local hazardous waste cleanup and senior citizens' centers. For example, by a 3-to-1 margin Alaskan voters agreed to back \$700 million in revenue bonds to subsidize veterans' home mortgages. State legislatures, the U.S. Congress, and the Administration have recognized housing as "public purpose." NCIC questions whether it is time to reverse that position.

Further, repeal of the tax exemption on "nongovernmental-purpose" municipal bonds interest will eliminate the Industrial Development Bond (IDB) concept which has aided hundreds of

municipal economic enhancement programs. IDB's have generated industrial parks, office buildings, and manufacturing/processing plants which expand the tax base and create employment. In fact, IDB's presently constitute 75% of the municipal bond market. A recent Heller/Roper Poll found that 24% of 1000 manufacturers contacted are planning to increase their borrowing and 44% anticipate increasing their payrolls in 1985. It would be interesting to know how these same manufacturers might now respond to that poll in the face of the Treasury Department's proposed repeal of the tax-exempt status of interest on industrial development bonds.

REHABILITATION AND PRESERVATION INCENTIVES

The preservation industry is an important part of the U.S. economy and the construction industry. Approximately \$21 billion per year is reinvested in privately owned buildings which are more than 50 years old. Older and historic commercial properties are particularly important investments, capturing almost half of all the reinvestment money in this country. Combined with the over \$2.2 billion in certified rehabilitation, construction firms are involved in at least \$5.1 billion in commercial rehab annually. However, residential rehabilitation is also a booming business: In some areas of the country, the amount invested each year in existing buildings is 25% greater than the amount spent on new housing construction.

Approximately 11,600 preservation projects have been certified by the National Park Service alone since the tax incentives were approved in 1977, over 85% of which have been in response to the 1981 tax incentives. According to a National Trust survey, more than 60% of smaller construction firms are involved in rehabilitation work, almost half of which are general or subcontractors. The average certified rehab project size is in excess of \$850,000. More than three-fifths of all firms (more than 35,000 firms) with an annual volume up to \$500,000 did rehabilitative work according to a National Trust survey. NCIC believes that we should not retreat from the commitment to preservation and rehabilitation which has been strongly supported by the nation since the 1976 tax act.

REAL ESTATE INVESTMENTS

From a purely real estate perspective, the Treasury proposal would affect property values, financing opportunities, and investment opportunities for many Americans -- and thus have a direct and immediate negative impact on the construction industry.

For example, several proposals in the Treasury plan affect the taxation of partnerships, a major avenue of real estate investment in recent years. Since real estate, especially for less affluent people, is often a low-yielding investment, many real estate partnerships attract investors by offering the opportunity to write off losses, rather than earn income. Treasury's plan to limit the amount of losses a partnership could claim for tax purposes and to limit to 35 members the size of a partnership that could pass on its losses to its partners, would effectively kill a large chunk of the tax-sheltered, limited partnership business and place a severe clamp on future growth in the construction industry.

The Treasury proposal would also diminish the value of various tax deductions to homeowners and thus reduce the number of new houses built. By diluting the value of home mortgage interest deductions and the federal tax deduction for state and local property taxes, the proposal could substantially increase the annual cost of owning a typical single family home. Again, this would have a direct and immediate negative effect on the construction industry.

Other Treasury proposals would also negatively impact real estate and the construction industry. The proposal to eliminate all tax-exempt financing for first-time home buyers would affect 200,000 mortgages a year; and the elimination of such tax-exempt financing for modest-rent apartments could affect \$6 billion to \$8 billion worth of construction. In addition, if the Treasury plan were implemented, the \$6 billion to \$7 billion worth of new home mortgages currently financed via builder bonds would have to come from somewhere else.

Each of these proposals alone could severely cripple the real estate industry; together the effect could be devastating.

TAXATION OF FRINGE BENEFITS

Present law excludes certain statutory fringe benefits from gross income, and generally beginning in 1985 taxes all other fringe benefits at the excess of the fair market value over any amounts paid by the employee for the benefits. These statutory fringes were intended by Congress as tax incentives for employers to provide compensation in particular ways, and their use has substantially increased over the past ten years.

The Treasury Department Proposal would repeal the tax exclusion of most statutory fringe benefits, and impose new limits on the current exclusion of employer-provided health care. The construction industry has consistently opposed similar proposals in legislation before the House and Senate in recent years, and reaffirms its support for retention of existing statutory fringe benefits.

Construction is a labor-intensive industry, and accordingly is more vulnerable to changes in the tax treatment of employer-provided benefits than many other business sectors. The impact of proposed changes on workers themselves is immediate and obvious -- the Bureau of Labor Statistics estimates that 82% of full-time workers in the U.S. participate in employer-provided pension programs, with fully 96% enjoying health and life insurance protection through similar programs. Construction employers must be concerned about any reduction in these basic tax benefits which exist under current policy.

The proposed changes would affect construction firms in a more direct manner as well. For example, new rules for calculating the value of self-funded health care benefits for the purpose of determining taxable income for employees are not only cumbersome, but must also be computed in advance of the payroll period. The liabilities faced by employers who underestimate those costs are of understandable concern to an industry which relies on an often temporary, constantly changing labor force. Employee relations groups within the various NCIC member organizations are currently studying the impact of these and other proposed changes, including the elimination of 401 (k) plans and IRC Section 125 (cafeteria plans), in greater detail, and the Council will forward their conclusions to you as soon as possible.

INDEXING OF INTEREST INCOME

The Proposal indexes both business and personal interest for tax purposes, excluding a fractional amount of interest receipts from income and denying a deduction for a corresponding fraction of interest payments. The construction industry would feel these changes very quickly.

In the construction industry, particularly in the commercial and industrial fields, financing during times of high interest rates is often available only if the investor is able to defer some portion of the tax on interest during the construction period until the property's cash flow improves or the property is sold. This has a direct impact on the number of construction starts in this country, and has quite literally helped the construction industry survive. Indexing interest expense and income would clearly discourage the construction investor, and result in an immediate slowdown in construction starts. At a time when the construction industry is beginning to rebound from years of economic hardship, NCIC feels that even a program of partial indexing is counterproductive and ill-advised.

INTERNATIONAL TAX ISSUES

While construction in the United States has declined on average by 3.4% per year since 1973 in real terms, construction in foreign markets has expanded. To a great extent, the U.S. construction industry has turned to the growing foreign market to offset the decrease in domestic project awards. In fact, the 400 largest U.S. firms have secured an average of 30% of their total contract volume overseas in recent years. This trend is expected to continue.

The success of the construction industry in foreign markets has a direct impact on U.S. producers of equipment and supplies, as well as on a wide variety of services. Construction industry surveys indicate that on foreign projects undertaken by U.S. companies and financed in the United States, approximately 50% of the contract value represents goods and services procured in this country. The U.S. export content is even higher on projects in lesser developed countries.

The importance of foreign markets is even more apparent when one realizes that, according to studies performed by the Bechtel Corporation, approximately 30,000 U.S. jobs are created for each \$1 billion of manufactured exports.

A number of questions are raised by Treasury Proposal which would directly affect the ability of the U.S. construction industry to compete abroad. I would also like to take the liberty of discussing several additional international tax issues which, although not specifically addressed in the Proposal, could well be raised at a later date.

IRC SECTION 911

Changes in Section 911 of the Internal Revenue Code establishing the current \$80,000 exclusion for income earned by Americans working overseas were put into place as part of the Economic Recovery Tax Act of 1981. Although they have been in use only a short time, the new 911 provisions seem to be having the intended effect of helping to put U.S. contractors on a more equal footing with their international competitors.

The U.S. construction industry, which has been struggling for years to maintain its market overseas, considers the 911 exclusion to be a vital element in its efforts to remain competitive in these markets. The exclusion provides no "windfall" earnings to U.S. personnel or their companies, but allows U.S. firms to keep their costs in line with those of its foreign counterparts.

IRC Section 911 has not been altered in the Treasury Proposal, although a future attempt to do so on Capitol Hill seems possible. Accordingly, it is appropriate to include it as part of this discussion of international tax issues in order to emphasize its importance to the construction industry as well as, we believe, a future improvement in the U.S. balance of trade in general.

Foreign Tax Credits

No single portion of the Treasury Proposal has caused as much concern among construction firms active in overseas markets as the institution of a per-country limit on the foreign tax credit.

A substantial number of the international projects undertaken by the U.S. construction industry occur in developing countries with which the United States does not have specific tax treaties. It is also within the developing world where competition between U.S. and non-U.S. firms is often most intense. Virtually all of our competitors operate under tax and regulatory arrangements which encourage their continued presence and success in these markets; American firms have few such advantages, which heightens their reliance on foreign tax credit provisions of the Internal Revenue Code for minimizing international double taxation and providing the necessary neutrality of treatment. The U.S. foreign tax credit mechanism is a crucial element in our financial calculations on international operations.

The construction industry has long argued that foreign tax credits constitute the very cornerstone of its ability to compete in the world marketplace. Given the enormous size of many international projects, and corresponding investment required, it is not unusual for construction firms to be heavily committed in only a few countries at any one time. Institution of a per-country limit on the amount of foreign-paid taxes which can be credited against the company's tax burden at home imposes a new and potentially crippling financial burden for those countries at a time when it is becoming more and more difficult to compete on the basis of project cost. Changes in the foreign tax credit as proposed do not further the cause of tax simplification or fairness, and could well eliminate many NCIC companies from some of the few remaining construction markets in the world that are continuing to grow and offer bright prospects for the future.

Foreign Sales Corporations

Since 1972, a growing number of large U.S. companies, including more and more construction firms, have been exporting through Domestic International Sales Corporation (DISC) subsidiaries. In response to pressure from abroad, Congress acted this summer to terminate DISCs and replace them with a new entity, the Foreign Sales Corporation (FSC). Although differing in several important aspects from the DISC, FSCs offer substantial tax benefits to U.S. exporters. Among the estimated 5,000 FSCs expected to be established by U.S. firms are many construction companies which regard the mechanism as a potentially invaluable tool for competing abroad.

The Treasury Proposal does not recommend changes in the FSC regulations, which are scheduled to go into effect on January 1, 1985. The construction industry considers the FSC to be vulnerable on Capitol Hill during the 99th Congress, however, and urges the support of the Administration in our efforts to preserve it until such time as its impact on the U.S. balance of trade can be evaluated.

Technical Assistance Tax

For years the construction industry has been fighting to eliminate the double taxation of technical assistance services performed by U.S. contractors on overseas projects. Legislation permitting U.S. construction firms to deduct foreign taxes on such services as a cost of doing business was introduced in both the House and Senate during the 98th Congress, with hearings held in both the Senate Finance and House Ways and Means Committees. Although the Deficit Reduction Act of 1984 did mandate a Treasury study on the double taxation of technical assistance services, that recently-completed study did not recommend a legislative remedy to the problem. The construction industry will be responding to that study and will continue to seek a legislative solution to this ongoing taxation problem for its projects overseas. No provisions dealing with the taxation of technical assistance services were included in the Treasury Proposal.

PRESENTING THE 1984 MEMBERS
OF THE NATIONAL CONSTRUCTION INDUSTRY COUNCIL

American Concrete Pavement Association
American Consulting Engineers Council
American Rental Association
American Road and Transportation Builders Association
American Society of Civil Engineers
American Subcontractors Association
Associated Builders and Contractors
Associated Equipment Distributors
Associated General Contractors of America
Associated Landscape Contractors of America
Association of the Wall and Ceiling Industries - International
Construction Industry Manufacturers Association
Door and Hardware Institute
Mechanical Contractors Association of America
National Asphalt Pavement Association
National Association of Minority Contractors
National Association of Plumbing, Heating, Cooling Contractors
National Association of Surety Bond Producers
National Association of Women in Construction
National Constructors Association
National Electrical Contractors Association
National Society of Professional Engineers
Portland Cement Association
Prestressed Concrete Institute
Sheet Metal and Air Conditioning Contractors National Association



Standard Oil Company (Indiana)

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202-857-5304

Rady A. Johnson
Vice President, Government Affairs

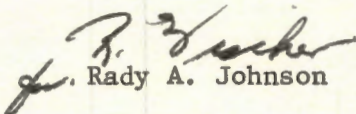
December 26, 1984

Mr. James A. Baker III
Chief of Staff and
Assistant to the President
The White House
Washington, DC 20500

Dear Mr. Baker:

We furnished Secretary Hodel the attached letter outlining our concerns with the Treasury tax reform proposal. I hope you will find the information useful.

Sincerely,


Rady A. Johnson

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Standard Oil Company (Indiana)

200 East Randolph Drive
Chicago, Illinois 60680

Richard M. Morrow
Chairman of the Board

December 21, 1984

Mr. Donald P. Hodel
Secretary of Energy
U.S. Department of Energy
1000 Independence Avenue, S.W.
Washington, D.C. 20585

Dear Mr. Secretary:

Thank you for the opportunity to provide our thoughts concerning the tax proposals contained in the Treasury report "Tax Reform for Fairness, Simplicity, and Economic Growth," and their potential effect on the oil and gas industry. While I commend the Treasury's goal of making the federal income tax system more equitable and less complex, I have serious reservations about the "price" the oil and gas industry, and ultimately the nation, will have to pay as a result of some of the tax code changes embodied in the Treasury tax report.

I know you were made aware of many of the generic concerns of the oil and gas industry at the recent National Petroleum Council meeting. I must echo those apprehensions. The country has been enjoying stable energy supplies and prices, which have helped bring inflation under control and bolster the economic recovery. Absent prudent foresight, however, tomorrow's energy picture could change dramatically.

In the longer-term, industry trends portend declining domestic reserves and increasing imports of crude oil and petroleum products, and thus, the reoccurrence of the economic and national security problems that we have worked so hard to overcome. The Treasury proposal would accelerate those trends. Government energy, environmental, and tax policies must reflect the national importance of a healthy and stable domestic energy industry.

The wide-sweeping nature of the Treasury tax plan has made it difficult to complete any comprehensive assessment of its effects to date, but preliminary analyses point to some very serious problems. My comments focus on two areas: 1) the consequences of the Treasury plan on the corporate sector generally, and 2) the effects on the petroleum industry specifically.

Mr. Donald P. Hodel

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The effect of the Treasury tax proposals would be to increase corporate taxes 25 percent in FY '86 to 37 percent in FY '90. That is, total corporate tax payments would increase from about \$87.9 billion to \$110.1 billion in FY '86, and from \$122.6 billion to \$167.4 billion in FY '90. This will have a profound adverse effect on job creation. Increased business taxes will stifle economic growth and ultimately result in fewer federal tax revenues and increased outlays -- continuing a dangerous cycle that we are just beginning to break.

Federal tax policy has traditionally been used not only to raise revenues for the government, but also to promote social and economic goals. The Economic Recovery Tax Act of 1981 provided powerful tax incentives such as the Accelerated Cost Recovery System (ACRS) which spurred investment in productive plant and equipment, and is responsible for much of the current economic growth the country is presently enjoying. The erosion or repeal of ACRS and/or the Investment Tax Credit (ITC) simply runs counter to the nation's objectives of continued job creation and long-term economic growth, and could prove a high "price" for small gains in tax equity and simplicity.

The goal of the National Energy Policy Plan -- assuring an adequate supply of energy at reasonable costs -- can only be realized through government policies which promote the rational development and use of our domestic energy resources. However, certain elements of the Treasury tax proposal run counter to our national energy objectives. Proposed changes in the treatment of intangible drilling costs (IDCs) and dry hole expenses would discourage domestic exploration, thereby exacerbating the divergence between domestic reserve additions and production. Repeal of the ITC and the ACRS will also increase the cost and decrease the availability of capital which would have a negative effect on capital-intensive industries.

Specifically, our preliminary analyses of the Treasury tax plan indicate that the internal cash flow of the oil and gas industry will be reduced by approximately \$81.2 billion over the 1986-90 period. If corporate tax rates are indeed lowered, and the cash dividend deductibility and Crude Oil Excise Tax phase-out provisions retained, oil and gas industry tax liabilities would be reduced by approximately \$43.7 billion over the five year period. Thus, the Treasury tax plan results in a net \$7.5 billion annual tax increase on the oil and gas industry, or \$37.5 billion over the 1986-90 period.

Internally-generated cash flows represent only part of the total capital generated by the oil and gas industry. Estimates indicate that for each dollar of funds the petroleum industry generates internally, it will

typically raise another 35 cents from external sources -- primarily through borrowings. If the industry is unable to generate the initial \$1.00 internally through earnings and capital consumption allowances, lenders are unlikely to advance the 35 cents of additional borrowed funds. Hence, the total impact of the Treasury tax plan on corporate capital availability to the oil and gas industry will be more in the order of \$10 billion per year. This decrease in capital availability will result in a reduction in 1990 domestic crude oil equivalent production in the order of 1.0 MMBD, thereby increasing dependence on imports to satisfy domestic demand.

The proposed tax changes will also negatively impact prospective internal rates of return from new investments in oil and gas projects. In a highly competitive market for investment capital, and a reduction in prospective investment profitability in the oil and gas industry accompanied by prospective improvements in after-tax investment returns in other lines of business, available capital will be diverted from marginal projects in the petroleum industry to other business investments. While not readily quantifiable, the expected deterioration in project rates of return will further decrease capital availability, depress domestic production and increase imports.

The decline in domestic production will worsen in the years beyond 1990 as the impact of reduced incentives and spending affect a greater and greater share of our domestic production base. Domestic oil and gas production would be expected to decrease by an oil equivalent of 1.5 MMBD by 1995 compared with production under current tax laws. Domestic net oil imports are expected to increase from about 5 MMBD in 1984 to about 8 MMBD in 1995 under current tax laws. With the Treasury proposal, U.S. oil imports by 1995 would be expected to increase to over 10 MMBD or 60 percent of domestic oil requirements. This doubling of imports from the current 30 percent to 60 percent of requirements would make the U.S. extremely vulnerable from both an economic and national security standpoint.

Estimated 1984 spending by the oil and gas industry (net of lease bonus payments to government) is roughly \$50 billion, 80 percent of which will be in upstream spending to find and produce new oil and gas supplies. Industry spending commitments of this magnitude simply cannot be sustained in the face of a prospective cut of 25 percent or more in available capital and a sharp reduction in investment profitability.

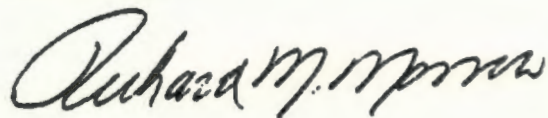
Mr. Donald P. Hodel
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The proposed reduction in the corporate tax rate, the treatment of dividends and phasing-out the ill-conceived Crude Oil Excise Tax represent significant steps toward long-term economic growth. I am concerned, however, that many of the favorable corporate tax provisions promised down the road in exchange for increasing business' tax burden in the short-term, will fall prey to changes in the political landscape. Without implementation of these tax reductions, oil and gas industry internal cash generation would be decremented by some \$25 billion per year and U.S oil and gas production would be reduced by an oil equivalent of 1.8 MMBD in 1990 and 3.5 MMBD in 1995.

As evidenced above, the present Treasury tax package would be severely disruptive to the domestic energy industry, particularly in terms of domestic exploration. In the longer-term, it is not difficult to envision the adverse consequences of declining domestic energy supplies, increasing crude and petroleum product imports, and the implications for the nation's economic vitality and security.

Given the potential consequences of such broad changes in the Internal Revenue Code, I think it only prudent that the Administration proceed slowly and deliberately in assessing the ramifications. We must be sure that we are not establishing policies that will plunge the nation into serious energy supply problems.

Sincerely,





DRILLING AND SERVICE
SPUDDERS / ROTARY DRILLING

**LES
WILSON
INC.**

President Ronald Reagan
The White House
Washington, D.C. 20500

December 20, 1984

Dear President Reagan:

As a CPA who recently left a "Big Eight" public accounting firm in St. Louis, Missouri to move to Southern Illinois and enter the petroleum industry, I would like to convey to you that I believe the implementation of the Treasury reform proposal for the petroleum industry would bring irrevocable negative consequences to the entire economy of Southern Illinois.

While living only 120 miles away in St. Louis, Missouri, although I knew the oil industry was a significant industry, I had no idea just how many businesses are interrelated to the industry. Starting at the oil producer who puts together the oil lease and sells the joint interest, to the drilling contractor, to the related service companies and all the way to the car and truck dealers who sell and repair the many vehicles used in the industry, the number of businesses that would be negatively effected by an industry slump is too numerous to estimate. Similarly, while in St. Louis, I assumed a majority of the drilling was done by major oil companies in search of new reserves to replenish old fields. However, in reality a majority of the oil wells drilled in Southern Illinois are for independent producers who are selling their deals to higher income individuals locally. In short, the loss of the major tax incentives would put a significant damper on the sale of such investments and drilling activity would be dramatically slowed down and the economy would come to a screeching halt. The number of unemployed would climb to staggering numbers and the lost revenue on individual income tax alone would not equal the amount hoped to be gained by the Treasury with these new policies. The Company I work for alone has a \$2,000,000 annual payroll.

I readily understand the need for increased taxes for the Treasury and feel that a rate increase would be a better vehicle. I personally am not in the 50% tax bracket but would be glad to have the problem of paying 70% of my income in taxes as was done before the tax change in 1982. I know that all the political pressure of increasing the rates of the higher income brackets is a tough bullet to bite, but its high time someone starts biting. All this happy bull about not raising the rates but instead taking away the deductions is just a facade. A 20% increase in rates on income over \$100,000 would alone bring a substantial increase in Treasury revenue not to mention an increase in the rates for lower brackets.

In summary, the 1982 changes put a significant damper on the oil industry, but the proposed changes for 1985 would put the nail in the coffin and I assure you, the consequences of such changes cannot be fully understood or quantified in Washington, (I could not even see it only 120 miles away), and I urge you to look at alternative means of increased revenue. I urge you to study this problem as I am sure Southern Illinois is not alone in my feelings, and I seek your support to publicly reject such provisions and seek alternative means of increasing the revenue. I will pay my fair share to help, but I would not like to see an industry which has supported the economy for so many years, go down the tubes so quick in one short swipe of the Treasury's hand.

Very truly yours,

LES WILSON, INC.

David G. Watkins, CPA
Vice President/Controller