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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

July 24, 1981

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Attached is a comparison of HR 3849, Senate Tax Bill, House Ways & Means and House Bipartisan Substitute for your information. Also included is an itemization of the Small Business Provisions of the Bipartisan House Substitute Bill.

Small Business Provisions of the Bipartisan House Substitute Bill

In addition to the broad benefits of individual rate reductions and accelerated cost recovery for all small businesses and their owners, the Bipartisan House Substitute Bill has a number of provisions of special interest to small businesses. It provides rate reductions for small corporations, reduces or eliminates estate and gift taxes on transfers of family-owned businesses, allows for limited expensing of machinery and equipment purchases, increases tax-deductible retirement savings for the self-employed, and includes a number of other tax-reduction measures. Altogether, the provisions total about $3.3 billion of small business tax relief in 1982 and $12.0 billion by 1984. The specific provisions are:

- Estate and gift tax relief. Transfers of up to $600,000 will be free from tax and the top estate tax rate will be reduced from 50 to 70 percent. No transfer tax will be imposed on gifts and bequests between spouses. Special use valuation will be applied to more farms, small businesses, and woodlands and may reduce taxable estates by up to $1 million. These changes will greatly reduce the hindrance of the transfer taxes to the building and maintaining of small family businesses.

- Increase in Keogh plans. The limits on deductions for contributions by the self-employed to a retirement plan will be increased from $7,500 to $15,000.

- Expensing of capital investment. Expenditures for machinery and equipment may be written off in the first year up to an amount of $5,000 for investment in 1982 and 1983, $7,500 in 1984 and 1985, and $10,000 thereafter. This provision will further simplify tax accounting for small businesses and provide immediately the additional incentive and cash flow for their modernization and expansion.

- Accelerated cost recovery for rental housing. Those who invest in rental housing, many of whom are individuals or small businesses, will be allowed deductions for cost recovery over 15 years using the 200 percent declining balance method. These new rules will apply whether the housing is new or used.

- Increased investment credit for used property. Many small businesses conserve scarce capital by purchasing used machinery and equipment. The amount of these purchases eligible for the investment credit will be raised from $100,000 to $125,000 for 1981-84 and $150,000 thereafter.

- Liberalized accumulated earnings tax. Earnings may be retained in a corporation up to at least $250,000 without incurring an accumulated earnings tax. The bill raises this minimum amount from $150,000.

- Write-off of operating rights for motor carriers. Deregulation of the motor carrier industry dramatically reduced the value of certificates of operating rights which had been an important asset for many small trucking companies. As partial compensation, the bill allows these losses to be deducted over a 60-month period.

- Reduction of the Windfall Profits Tax. The tax burden will be eliminated or reduced for small royalty owners and oil production incentives will be restored for independent oil producers by changes in the windfall profits tax. These changes include a credit of $2,500 for royalty owners for 1981, to be replaced by exemption of two barrels per day in 1982-84 and exemption of four barrels per day thereafter. For independent producers, the percentage depletion rate will be frozen at 22 percent and stripper oil production will be exempted from tax beginning in 1983.

o <u>Liberalized Subchapter S</u>. The maximum number of shareholders allowable in a corporation whose owners choose to be taxed as individuals under Subchapter S will be increased from 15 to 25. In addition, certain kinds of trust will be allowed as shareholders in such corporations.

o <u>Incentive stock options</u>. Start-up businesses will be aided by a provision to allow employees to be taxed at capital gains rates upon sale of stocks acquired through incentive stock options. This provision will help such businesses to attract key employees who might otherwise be too costly.

o <u>Simplification of LIFO</u>. The bill makes changes, and authorizes regulations to make further changes, to simplify and remove impediments to the use of the LIFO inventory method by small businesses. These changes will help to remove a tax on overstated profits due to inflation and thereby provide needed cash for growth of small businesses.

Tax Reductions for Small Business
in the Bipartisan House Substitute Bill

($ billions)

| | Fiscal Year | | | | | |
|---|---|---|---|---|---|---|
| | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 |
| Estate and gift tax provisions | - | -0.2 | -2.2 | -3.3 | -4.3 | -5.6 |
| Increase Keogh plan limit to $15,000 (January 1, 1982) | - | * | -0.1 | -0.2 | -0.2 | -0.2 |
| Write off rental housing over 15 years at 200% declining balance | -0.1 | -0.5 | -0.9 | -1.3 | -1.7 | -2.1 |
| Phased-in expensing of assets: $5,000 in 1982 increasing to $10,000 by 1986 | - | -0.5 | -1.0 | -0.9 | -0.8 | -0.3 |
| Small business corporate tax rate reduction (January 1, 1982) | - | -0.1 | -0.3 | -0.4 | -0.5 | -0.5 |
| Increase used property limit for the investment tax credit to $125,000 for 1981-1984 and $150,000 thereafter | * | -0.1 | -0.1 | -0.1 | -0.1 | -0.2 |
| Increase accumulated earnings test to $250,000 (January 1, 1982) | - | * | -0.1 | -0.1 | -0.1 | -0.1 |
| $2,500 windfall profit tax credit for royalty owners for 1981, replaced by exemption of 2 barrels per day in 1982 through 1984 and 4 barrels per day in 1985 and thereafter | - | -1.2 | -0.8 | -0.9 | -1.2 | -1.2 |
| Freeze percentage depletion rate at 22% (January 1, 1981) | * | -0.5 | -0.6 | -0.9 | -1.1 | -1.3 |
| Exempt stripper oil production by independent producers (January 1, 1983) | - | - | -0.3 | -0.4 | -0.4 | -0.4 |
| Write-off of motor carrier operating rights | * | -0.1 | -0.1 | -0.1 | -0.1 | * |
| Stock options | * | * | * | * | * | * |
| LIFO inventory simplification | - | -0.1 | -0.2 | -0.2 | -0.1 | -0.1 |
| Totals | -0.1 | -3.3 | -6.7 | -8.8 | -10.6 | -12.0 |

Office of the Secretary of the Treasury
Office of Tax Analysis

July 23, 1981

* Less than $50 million.

THE REAGAN BIPARTISAN TAX PROPOSAL:

A Comparison

1. Remarks by Treasury Secretary Donald Regan
2. Comparison of the Senate Finance Committee Tax Bill and the Proposal of House Ways and Means Committee Democrats
3. How the Reagan Supply-side Tax Plan Differs from Traditional Tax Cuts
4. Tax Cut History: It Worked Before

EXCERPTS FROM REMARKS BY 7/14/81

SECRETARY DONALD T. REGAN
Before Women in Governmental Relations

THERE HAVE BEEN SOME WHO HAVE TRIED TO CAST DOUBT ABOUT THE MEANING OF THE LAST ELECTION, SAYING THAT THE ORDINARY VOTER DIDN'T MAKE A DETERMINATION BASED ON ECONOMIC PRINCIPLES. TO THE DEGREE THAT THE ORDINARY VOTER DOESN'T HOLD A GRADUATE DEGREE IN ECONOMICS, THAT IS TRUE.

BUT WHEN YOU KICK A STONE YOU DON'T HAVE TO BE A PHYSIOLOGIST TO KNOW THAT IT HURTS.

EVEN THE ELECTION OF 1932 WAS NO COMPARISON, FOR YOU WILL SEARCH FRANKLIN ROOSEVELT'S CAMPAIGN SPEECHES IN VAIN FOR A VISION OF ECONOMIC RECOVERY THAT MATCHES IN CLARITY AND COMPREHENSIVENESS THAT PROVIDED BY CANDIDATE REAGAN. FROM ONE END OF THIS COUNTRY TO ANOTHER, HE DISCUSSED THE NEED FOR INCENTIVES TO ENCOURAGE THE FREE ENTERPRISE GENIUS OF THE NATION.

THAT IS WHY THE PRESIDENT IS WILLING TO FIGHT FOR A 25 PERCENT, THREE-YEAR TAX CUT AND WHY, THOUGH HE HAS AGREED TO SOME SIGNIFICANT ACCOMMODATIONS, HE SIMPLY WILL NOT TAKE THE EXPEDIENT WAY AND YIELD ON A PRINCIPLE THAT IS ABSOLUTELY FUNDAMENTAL TO RESTORING INCENTIVE.

THE OPPOSITION HAS TRIED TO UNDERMINE THE DRIVE FOR RESTORING INCENTIVE BY A VARIETY OF TACTICS. IN REGARD TO TAXES, THERE ARE THREE MAIN LINES OF ATTACK: THE BLUNTLY ABSURD, THE SUBTLY ABSURD, AND THE IMITATION.

FOR THE BLUNTLY ABSURD, THE OPPOSITION IS CLAIMING THAT THIS IS A RADICAL PROGRAM THAT MAY DESTROY AMERICA.

ONE EXAMPLE IS THE EDITORIAL A FEW WEEKS AGO THAT SAID THE TAX-CUT PACKAGE IS TOO LONG, TOO INFLATIONARY, TOO LOOSE, TOO LOPSIDED, AND TOO THEORETICAL. FORTUNATELY, THE BLUNTLY ABSURD ARE TOO SHALLOW, TOO OBVIOUS, AND TOO WRONG TO BE TAKEN SERIOUSLY.

THE SUBTLY ABSURD ARGUMENT ASKS THAT WE WAIT UNTIL THERE IS A BUDGET SURPLUS BEFORE THERE IS A TAX CUT. ON THE SURFACE THIS SEEMS REASONABLE AND LOGICAL -- BECAUSE WE'VE ALL BECOME SO ACCUSTOMED TO THE KEYNESIAN DEMAND-MANAGEMENT APPROACH TO THE RELATIONSHIP BETWEEN INCOME AND EXPENDITURE. THE BLUNT TRUTH IS THAT THIS APPROACH DOESN'T WORK. IT DOESN'T WORK BECAUSE IT IS AN EXTENSION OF THE APPROACH THAT ASSERTS GOVERNMENT'S PRIOR CLAIM ON EARNINGS. IF MORE FLOWS INTO THE TREASURY, MORE WILL BE SPENT, MORE WILL BE COMMITTED, MORE NEW WAYS WILL BE DEVISED FOR GOVERNMENT INTERVENTION IN OUR LIVES AND IN THE ECONOMY, SO THAT THE DELICATE BALANCE WE ALL SEEK WILL NEVER BE ACHIEVED.

WHAT IS NEEDED IS THE OPPOSITE APPROACH, ONE THAT PLACES PRIME PRIORITY ON THOSE WHO ARE ACTUALLY DOING THE EARNING AND THE PRODUCING AND THE SAVING. THIS IS THE KEY TO WHY WE NEED A 25 PERCENT TAX CUT, FOR WHAT WE AIM AT IS A FUNDAMENTAL CHANGE, SO THAT GOVERNMENT'S CHARACTERISTIC DRIVE FOR EVER GREATER LARGESSE DOES NOT DRAIN OFF REVENUE THAT BELONGS TO THE PEOPLE.

FINALLY, THERE IS THE <u>IMITATION</u> TACTIC. THIS CONSISTS IN ADOPTING ENOUGH OF THE PRESIDENT'S BASIC IDEAS IN AN EFFORT TO SPLIT OFF SOME SUPPORT NECESSARY FOR PASSAGE OF THE FUNDAMENTAL, 25 PERCENT TAX CUTS.

OUR OPPOSITION HAS BROUGHT THE IMITATION TACTIC TO A FINE ART, WITH TAX CUTS THAT PARALLEL THOSE CONTAINED IN THE ADMINISTRATION BILL AND WITH NEW PROVISIONS THAT ARE PULLED OUT LIKE LIFEBOATS WHENEVER THEIR PROGRAM FACES STORMY WEATHER. SOME OF THEIR CUTS APPEAR ON THE SURFACE AT LEAST, TO BE EVEN MORE ATTRACTIVE THAN OURS. BUT THEY WANT TO TRADE A FEW EXTRA TAX CUT DOLLARS IN THE SHORT TERM FOR A LOT OF EXTRA DOLLARS IN THE LONG TERM. THEIR PROGRAM MAY LOOK GOOD IN '82 BUT IT OFFERS LITTLE OR NOTHING FOR THE FOLLOWING YEARS.

THE FACT IS THAT THE DEMOCRATIC ALTERNATIVE WILL RESULT IN HIGHER TAX RATES FOR FAMILIES AT VIRTUALLY EVERY INCOME LEVEL BY 1984.

TO INCREASE CAPITAL FORMATION AND PRODUCTIVITY IN PRIVATE INDUSTRY, OUR BILL PROVIDES A SYSTEM OF CAPITAL COST RECOVERY TO REPLACE THE COMPLEX DEPRECIATION PROVISIONS OF CURRENT LAW.

THE WAYS AND MEANS PLAN FOR BUSINESS RETAINS PRESENT LAW FOR FIVE MORE YEARS WHILE PHASING OUT THE INVESTMENT TAX CREDIT AND MOVING TO AN EXPENSING SYSTEM. WHETHER THIS SCHEME IS AS BENEFICIAL TO BUSINESS AS IS THE IMMEDIATE MOVE TO ACRS DEPENDS UPON CUTS IN CORPORATE TAX RATES PROMISED FOR FUTURE YEARS. ONCE AGAIN WE ARE ASKED TO RELY ON PROMISES.

THE WAYS AND MEANS DEMOCRATS HAVE PROPOSED TO AID CERTAIN "DISTRESSED INDUSTRIES" BY PROVIDING REFUNDS OF UNUSED INVESTMENT TAX CREDITS AGAINST TAXES PAID AS FAR BACK AS 1962. FOR THIS PURPOSE, THEY HAVE DEFINED A VERY EXCLUSIVE CLUB CONSISTING OF SIX MAJOR INDUSTRIES -- AUTO, STEEL, RAILROADS, MINING, PAPER AND AIRLINES. COMPANIES IN THESE SIX INDUSTRIES, AND ONLY THESE,

COULD RECEIVE REBATES BASED ON THE AMOUNT OF UNUSED INVESTMENT CREDITS FOR PAST INVESTMENT. ONLY ABOUT ONE-FOURTH OF ALL UNUSED CREDITS ARE IN THESE SIX INDUSTRIES.

UNLIKE THE WAYS AND MEANS REBATES, THE TAX INCENTIVES IN OUR BILL WOULD BE BROADLY AVAILABLE TO DEAL WITH CASES OF LOCALIZED DISTRESS, TO HELP SMALLER INDUSTRIES WITH LESS PUBLICIZED ECONOMIC PROBLEMS, AND TO AID TEMPORARILY TROUBLED COMPANIES IN OTHERWISE HEALTHY INDUSTRIES. IN EVERY CASE, HOWEVER, THIS "AID" WOULD TAKE THE FORM OF REDUCED TAX BURDENS ON NEW INVESTMENT OPPORTUNITIES, NOT A PAYMENT FOR PAST LOSSES.

SO, DESPITE THESE IMITATION PROVISIONS THAT MAKE THE OPPOSITION PLAN <u>APPEAR</u> TO RESEMBLE THE ADMINISTRATION BILL, THE RESEMBLANCE IS MERELY SUPERFICIAL, SOMEWHAT LIKE THE RESEMBLANCE BETWEEN LIGHTNING AND A LIGHTNING BUG.

THE 25 PERCENT, THREE-YEAR TAX CUT IS ESSENTIAL TO THE ENTIRE ECONOMIC RECOVERY PACKAGE. NO AMOUNT OF IMITATION, OR TINKERING WITH LIGHTNING BUGS, IS GOING TO DO THE JOB. WE MUST HAVE A BILL THAT INVOLVES A TOTAL REORIENTATION AWAY FROM THE OLD DEMAND-MANAGEMENT APPROACH, A BILL THAT ASSURES AMERICA'S BUSINESS COMMUNITY THAT THEY CAN BEGIN PLANNING FOR THE LONG PULL, AND NOT HAVE TO START WORRYING ABOUT THE PROMISE OF STILL ANOTHER TAX BILL IN A YEAR OR SO.

THE OPPOSITION PLAN IS AN IMAGINATIVE, ~~THOROUGH-GOING, SINCERE EFFORT -- TO REARRANGE~~ THE DECK CHAIRS ON THE TITANIC. WE ARE SEEKING A CHANGE IN THE SHIP'S COURSE. THAT'S THE DIFFERENCE.

ONE FINAL WORD. THE CUTS IN GOVERNMENT SPENDING DID NOT COME AUTOMATICALLY. THEY DID NOT COME ONLY BECAUSE THE PRESIDENT PERSONALLY INTERVENED, ALTHOUGH AT ONE POINT HIS EFFORTS WERE VITAL. THEY REALLY CAME ABOUT BECAUSE INFORMED AND CONCERNED AMERICANS EXPRESSED THEIR SUPPORT OF THE ECONOMIC RECOVERY PROGRAM. WE ARE GOING TO NEED THOSE EXPRESSIONS OF SUPPORT AGAIN, PERHAPS EVEN MORE SO THAN WITH REGARD TO THE BUDGET.

SO I URGE YOU, IF YOU WANT TO SEE OUR AMERICAN ECONOMY BOUNDING AHEAD RATHER THAN STUMBLING ALONG ON ITS TAIL, BY ALL MEANS LET YOUR VOICES BE HEARD!

JULY 15, 1981

# Comparison of H.R. 3849, Senate Finance Committee Tax Bill, and Proposal of House Ways and Means Committee Democrats

| H.R. 3849 | Senate Finance Committee | Ways & Means Democrats |
|---|---|---|
| **I. Individual Rate Reduction** | | |
| Across-the-Board | Same | Rate cuts targeted to $15,000-$50,000 income class |
| 5% October 1, 1981<br>10% July 1, 1982<br>10% July 1, 1983 | | Cuts "average"<br>5% October 1, 1981<br>10% July 1, 1982<br>No cut in third year |
| Top marginal rate lowered to 50%, effective January 1, 1982 | Same, but for individuals a maximum capital gains rate of 20% will apply to transactions occurring after June 10, 1981 | Top marginal rate lowered to 60% effective January 1, 1982, and to 50% effective January 1, 1983 |
| Top rate on individual capital gains lowered to 20% by January 1, 1982 | | Top rate on individual capital gains 24% by January 1, 1982, 20% by January 1, 1983. Committee to study earlier effective date for capital gains transactions. |
| No provision for indexing | Indexing to be offered on Senate Floor as separate Committee amendment. Would be effective January 1, 1985. | No provision for indexing |
| No provision | No provision | Increase Zero Bracket Amount by $200 for single, $400 for married taxpayers. Earned Income Credit increased to 11% of $5,000, and phases out between $8-$12,000 (up from $6-$10,000). |

## II. Capital Cost Recovery

| H.R. 3849 | Senate Finance Committee | Ways & Means Democrats |
|---|---|---|
| Basic 10-5-3 starting in 1981 with rates approximating 150% declining balance, increased to 175% in 1985 and 200% after 1985. | Same with following modifications: | Expensing of personal property other than long-lived public utility property to be phased in by 1990. No investment credit for expensed assets. |
| | Expensing election<br>1982 $5,000<br>1983 $5,000<br>1984 $7,500<br>1985 $7,500<br>1986 $10,000 | Expensing election $25,000 annually, effective in 1981. |
| Real property recovered over 15 years with 200% declining balance. Section 1245 recapture (ordinary income) for nonresidential buildings unless straight line is elected. | Same | Real property 15-year recovery period.<br>Residential rental-150% declining balance, with Section 1250 recapture<br>Low income housing-200% declining balance, with Section 1250 recapture<br>All other real property 150% declining balance, with 1245 recapture |
| | | For targeted "economically distressed" areas, 200% declining balance with 1245 recapture for industrial and commercial property. |
| | Utility property with current ADR midpoint of 18-25 years would remain 10-year property; over 25 years would be 15-year property, but still eligible for the 10% investment credit. | Utility property with current ADR midpoint of 18.5 to 25 years would be written off over 10 years with 150% declining balance method; greater than 25 year midpoint would be written off over 15 years. 10% investment credit applies. |
| Flexibility allowed with two alternatives--recovery period straight line or extended earnings profits recovery period, straight line. | Additional flexibility -- taxpayer may elect earnings and profits period of the next longest class for capital recovery purposes. | |

| H.R. 3849 | Senate Finance Committee | Ways & Means Democrats |
| --- | --- | --- |
| Current IRS leasing rules liberalized. | Leasing provisions slightly liberalized. | |
| "At risk" rules extended to investment credit. | "At risk" rules slightly modified. | |
| NOL and investment credit carryovers extended from 7 to 10 years. | 10-year NOL carryforward for transportation companies (up from 9). | NOL carryforward 10 years. |
| | Investment credit recapture rules changed to be based on sales proceeds instead of period property is held. $100,000 limitation on used property repealed. | |
| | Special purpose agricultural structures 5-year property. | |
| | Petroleum storage facilities 5-year property. | |
| | Staff authorized to include technical amendments. | |
| | Railroad tank cars in 10-year class. | |
| | | "Distressed industries" could carry back to 1962 unused investment credits against 100% of tax liability. One-quarter to be claimed in each of next 4 years. Credit available only to extent funds are "reinvested." |

| H.R. 3849 | Senate Finance Committee | Ways & Means Democrats |
|---|---|---|
| | | Corporate rate reduction |

| Year | Bracket | Rate |
|---|---|---|
| 1982: | $0 - 37,500 | 17% |
| | 37,500 - 75,000 | 20% |
| | 75,000 -112,500 | 30% |
| | 112,500 -150,000 | 40% |
| | Over 150,000 | 46% |
| 1983: | $0 - 50,000 | 17% |
| | 50,000 -100,000 | 20% |
| | 100,000 -150,000 | 30% |
| | 150,000 -200,000 | 40% |
| | Over 200,000 | 46% |
| 1984 and after: | $0-50,000 | 15% |
| | 50-100,000 | 20% |
| | 100-150,000 | 25% |
| | 150-200,000 | 30% |
| | Over 200,000 | 43% |

Top rate 1984 -- 43%
1985 -- 40%
1986 -- 37%
1987 -- 34%

| H.R. 3849 | Senate Finance Committee | Ways and Means Democrats |
|---|---|---|
| **III. R&D Tax Credit** | | |
| Nonrefundable 25% incremental credit for wages paid in conducting R&D, effective July 1, 1981. | Same | Nonrefundable 25% incremental credit for qualifying R&D, effective July 1, 1981. Definition includes all expenses except overhead and indirect expenses, and depreciation.<br><br>Provision expires January 1, 1986.<br><br>Also creditable: Basic research performed under written agreement with university, and grants to tax-exempt research organizations and research funds. These amounts not in base. |
| | Increased charitable deduction for donation of certain research equipment to universities. | Same as Senate Finance. |
| **IV. Investment Tax Credit for Rehabilitated Buildings** | | |
| 15% for industrial and commercial buildings at least 30 years old; 20% for 40-year or more industrial and commercial buildings; 25% for all income-producing certified historic structures | Same, with retention of current law penalty on demolition of historic structures of straight line capital recovery for replacement | Same as H.R. 3849 |
| **V. Marriage Penalty** | | |
| 5% in 1982, 10% in 1983 for the first $30,000 of earnings of lower-earning spouse. Maximum deduction $1,500 in 1982; $3,000 thereafter. | Same | 10% in 1982 of the first $50,000 of earnings of lower-earnings spouse. Maximum deduction $5,000. |

| H.R. 3849 | Senate Finance Committee | Ways & Means Democrats |
|---|---|---|
| **VI. Individual Retirement Accounts** | | |
| Annual IRA contribution raised to lesser of $2,000 or 100% of earned income ($2,250 for spousal IRA). | Same | Same, with additional nondeductible contributions of up to $2,000 per year permitted. |
| Participants in employer-sponsored plans could contribute $1,000 to separate IRA ($1,125 for spousal IRA). | Contribution raised to $1,500; deduction also permitted for voluntary contribution to employer plan, with IRA rules to apply to withdrawals. | Participants in employer-sponsored plans could contribute $1,000 to separate IRA or could deduct $1,000 for voluntary contribution to employer plan. Additional nondeductible contributions of up to $1,000 would be permitted. |
| **VII. Self-Employed Retirement Savings (Keogh plans)** | | |
| Annual deduction limit increased from $7,500 to $15,000. Prohibition on borrowing from the plan extended to all partners. | Same, but with compensation taken into account raised from $100,000 to $150,000. | Same as H.R. 3849. |
| **VIII. $200/$400 Interest and Dividend Exclusion** | | |
| Made permanent. | Interest portion repealed as of December 31, 1981. As of January 1, 1982, dividend exclusion of $100 single, $200 joint return. | Same as Senate Finance bill. |
| **IX. Tax Exempt Savings Certificate** | | |
| No provision. | $1,000/$2,000 interest exclusion on one year certificates established at financial institutions between October 1, 1981 and September 30, 1982. Interest rate on certificates 70% of Treasury bill rate. | Same as Finance Committee except that issuance of certificates would be linked to financial institution's investment in residential mortgages. |

| H.R. 3849 | Senate Finance Committee | Ways & Means Democrats |
|---|---|---|
| **X. Foreign Earned Income** | | |
| $50,000 exclusion, plus one-half of next $50,000. Housing exclusion. Physical presence shortened to 11 out of 12 months. | Same | $75,000 exclusion. Same housing exclusion and physical presence provision. |
| **XI. Estate and Gift** | | |
| 4-year phased-in increase in unified estate and gift tax credit; unlimited marital deduction; annual gift tax exclusion increased from $3,000 to $10,000. When fully effective, estates under $600,000 not subject to tax. | Same, but with 5-year phase-in and several additional technical changes.<br><br>Modifications to special use valuation for farms and other business property.<br><br>Woodlands would be considered part of qualified real property, but with recapture upon severance or disposition of the timber. | "Undecided" but some proposal likely |
| **XII. Crude Oil Windfall Profit Tax Credit For Royalty Owners** | | |
| Permanent $2,500 credit | Same, with modification to permit Secretary to provide regulations modifying withholding. | "Undecided" |
| **XIII. Windfall Profit Tax** | | |
| No provision. | Reduce the rate on newly discovered oil from 30 to 15%, beginning January 1, 1983.<br>1/1/83 25%<br>1/1/85 20%<br>1/1/86 15% | No provision. |

| H.R. 3849 | Senate Finance Committee | Ways & Means Democrats |
|---|---|---|
| OTHER ITEMS | | |
| No provisions. | 1. Incentive Stock Options | |
| | Employee receiving option would be taxed at long-term capital gains rate at time of sale of stock obtained from exercise. ISO's must be exercised in the order granted | "Will be discussed" |
| | 2. Commodity straddles | |
| | Rules adopted to prevent the conversion of ordinary income into capital gains and the deferral of income. | Similar rules on conversion but commodities losses, including straddle losses, could be used to offset commodities gains. |
| | 3. ESOP's | |
| | Beginning January 1, 1983, a tax credit equal to a percent of payroll will be allowed for contributions to employee stock ownership plans. | No provision |
| | 4. Small business | |
| | Maximum number of Subchapter S shareholders increased from 15 to 25. | Same as Senate Finance |
| | Under certain limited circumstances, trust to be permitted as Subchapter S shareholder. | Same as Senate Finance |
| | Minimum accumulated earnings credit would increase from $100,000 to $250,000. | Same as Senate Finance. In addition, corporation may accumulate earnings during year prior to death without accumulated earnings liability. |
| | | Treasury to prepare study of LIFO and cash accounting by June 30, 1982. |

| H.R. 3849 | Senate Finance Committee | Ways and Means Democrats |
|---|---|---|
| | 5. Motor carrier operating authorities<br><br>Ratable deduction over 60-month period for adjusted basis of motor carrier operating authorities held on July 1, 1980, which have decreased in value due to deregulation. | Some provision anticipated |
| | | 6. Tax treatment of state legislators<br><br>Extension of expiring provision of current law possible. |
| | | 7. Child care credit<br><br>Increased from 20 to 25%. Maximum expenses increased to $2,400 for one dependent, $4,800 for two (up from $2,000/$4,000). |
| | | 8. Dividend reinvestment<br><br>Effective January 1, 1982, shareholders in public utilities could exclude up to $1,500/$3,000 of stock dividends. |
| | | 9. Interest and penalty provisions<br><br>Interest on overpayments and deficiencies to be adjusted semi-annually or at least annually to 100% of prime rate.<br><br>Civil penalty for false W-4s increased from $50 to $1,000; criminal penalty from $500 to $1,000.<br><br>Penalty for failure to file information return increased from $1 per return ($1,000 per year maximum) to $10 per return ($25,000 maximum).<br><br>New 25% penalty on overstated amounts withheld by employer. |

| H.R. 3849 | Senate Finance Committee | Ways and Means Democrats |
|---|---|---|
| | | 10. Cash management<br><br>Corporate current estimated tax payment increased from 60 to 80% where corporation had income over $1 million in any of 3 preceding taxable years. |
| | | 11. Railroad retirement taxes<br><br>Provides adjustments in tier-II taxes and borrowing authority for the railroad retirement account against amounts to be transferred under the social security financial interchange. |

# HOW THE REAGAN SUPPLY-SIDE TAX RATE REDUCTION PLAN DIFFERS FROM TRADITIONAL TAX CUTS

President Reagan's plan cuts marginal tax rates for individuals. Marginal rates are the rates at which the next dollar earned will be taxed. The Reagan plan is designed to increase individual incentives to work, save, and invest.

Most tax cuts in the past decreased average tax rates, leaving marginal rates unaffected. These were designed to stimulate demand by increasing spending for consumer goods.

The present system reduces the incentive to earn more, save, and invest:

--under current law, middle income families are taxed at rates applied to the affluent fifteen years ago.

-a family of four earning the median income this year is in the 28 percent bracket; a similar family in 1965, earning twice the median that year, was in only the 22 percent bracket.

--at a high marginal rate like 28 percent, the incentive to work harder to earn the "next dollar" is reduced because the extra dollar's worth of work only nets the worker 72 cents.

--income from savings and investing is also taxed at the marginal rate so the incentive to do either is also reduced.

--these disincentives will only grow as incomes rise to meet inflation unless tax rates are reduced.

A traditional tax cut can't solve the disincentives problem because it doesn't even address it:

--it cuts average tax rates on current earnings by such methods as increasing the standard deduction or personal exemption amounts. It leaves marginal rates on "next dollar" earnings in place at same high levels.

--the disincentive to increase earnings, save, or invest would be the same after such a tax cut as it would be before.

The Reagan tax cut plan will stimulate the growth of the economy by restoring incentives:

--marginal rate reduction will increase the rewards for extra work by allowing workers to keep more of the extra income that results.

-in 1984, without the Reagan cuts, a median income family will be in the 32 percent bracket; with the Reagan cuts, that family will be in the 23 percent bracket (approximately where a median income family was in 1965).

--it will encourage savings and investment by lowering the tax rate on the income they produce and by increasing after-tax income so there's more money available to save or invest.

# TAX CUT HISTORY: It Worked Before

History supports it: Tax cuts can stimulate the economy without causing inflation and actually increase the amount of money the IRS collects.

## The Mellon Tax Cuts

Andrew Mellon, Treasury Secretary for Presidents Harding and Coolidge, authored three significant tax rate reductions. The three tax cuts ultimately reduced the highest marginal income tax rates from 73% to 25% by calendar year 1925.

* The nominal GNP grew from $69.6 billion to roughly $103.1 billion as a result. Because prices were falling, real GNP rose by much more, 54% over the period.

* Output per man hour increased by 66.5% while the index of industrial production doubled.

* Increased prosperity meant that total revenue increased. The overall tax base grew, and the share of taxes paid by those with incomes under $20,000 declined from 35% to 11% during the four-year period.

## The Kennedy Tax Cuts

At President Kennedy's recommendation, individual income tax rates were cut an average of 20% in 1964 and 1965; corporate tax rates were reduced; depreciation rules were liberalized; and a 7% investment tax credit was enacted.

* Unemployment rates dropped by almost half between 1961 and 1969.

* In 1965, though the IRS predicted a revenue loss of $8.4 billion due to the personal tax cuts, there was an actual revenue gain of $13.1 billion.

* The Chairman of the Council of Economic Advisers under the Johnson Administration noted: "The tax cuts of 1964 are credited with a $25 billion contribution to our GNP by mid-1965, a $30 billion effect by the end of 1965, and an ultimate $36 billion increment."

Changes:

Page 4: Last line, "provide real, permanent jobs for our people."

Page 5: Add to last line of first paragraph: "great hopes. In short, the best way to have a strong foreign policy abroad is to have a strong economy at home."

Page 8: Insert new paragraph after third full paragraph:

"been met by 1983.

But by holding the people's tax reduction hostage to future economic events, they will eliminate people's
1 ability to plan ahead. Shopkeepers, farmers and individuals will be denied the certainty they must have to begin saving or investing more of their money. And encouraging more savings and investment is precisely what we need most to rebuild our economy."

Page 8: 4th full paragraph, Keep the first line "But there is . . . mechanism." Delete last 2 lines. Insert instead: "The
2 committee bill ensures that the 1983 deficit will be $6.5 billion greater than their own trigger requires. As it stands now the design of their own bill will not meet the trigger they have put in. Therefore, the 3rd cut year and will automatically never take place."

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LEVEL 1 - 1 OF 1 STORY



December 19, 1980, Friday, Final Edition

SECTION: Business & Finance; C1

LENGTH: 610 words

HEADLINE: Rostenkowski: No Obstruction But 'Healthy' Discussion

BYLINE: By Caroline Atkinson, Washington Post Staff Writer

BODY:

Rep. Dan Rostenkowski (D-Ill.), the chairman-to-be of the key House Ways and Means Committee, said yesterday he expects "extensive" and "healthy" discussions in the House of any spending cuts proposed by the new, Republican administration.

In an interview, Rostenkowski emphasized that he and his Democrat-controlled committee would "in no way play an obstructive role," but he indicated it would be difficult to cut the budget significantly.

"I am not about to see programs which have been successful be dissected," Rostenkowski said, citing the Social Security program as an example.

The Chicago Democrat refused to go into detail on his views of tax and spending policy for next year, saying that he intended to wait until President-elect Ronald Reagan makes specific recommendations.

However, Rostenkowski pointed out that President Carter also had come to Washington hoping to cut spending and balance the budget. The prospective Ways and Means chairman said he did not want his comments to be interpreted in any way as being uncooperative, and he said that he would not discourage a proposal to initiate swift spending and tax-cut measures if "the solutions to our problems are not too drastic."

"What we're really talking about, although no one wants to admit it, is sacrifice. And I want to know whether that same majority of the American people who voted for a new president and Senate are really going to want sacrifice," he asserted.

The new administration will have to look at things such as price supports for farmers and the automatic increases in Social Security payments in line with inflation, Rostenkowski said, as "these are things that with the limited amount of tax money collected are not sustainable." He added, "I hope they bring a magic wand."

The congressmen fully supported an early tax cut next year to stimulate the economy and "work climate." He said Reagan "has a full wind in the sails of tax reduction" and should use it, "and we should too." Although House Democrats opposed enactment of a tax cut before the election, there was "always a unified feeling that a tax cut is necessary," he said.

Asked whether his committee would oppose the controversial Kemp-Roth plan for a 10 percent cut in tax rates for three successive years, Rostenkowski replied that he did not want to say "no Kemp-Roth." But he indicated that he thought Reagan may not push this measure. "I wasn't aware of any great eagerness on the part of Republicans on the committee to push Kemp-Roth," he said.

There will be a "sweet aroma" of cooperation to get a tax bill to the floor of the House, he said, at least until after testimony is taken from economists, the panel has discussed whatever proposals are made and he has tried to get a consensus from the Democrats on Ways and Means.

On a proposal from the director-designate of the Office of Management and Budget, David Stockman, that Reagan should declare a national emergency on taking office, Rostenkowski said, "Sure, they should take advantage of their momentum. . .

There is a glistening aura of the presidency for the first six months or so."

But he warned that governors and outsiders coming to Washington often overestimate the awesomeness of the presidency and think that they can rush Congress into action much faster than is possible. On the spending side "there will be extensive discussions, I'm sure," he said.

Stockman has warned that, unless the new administration quickly pushes for a program of significant spending and tax cuts, it could be engulfed in economic problems brought on by high interest rates and inflation.

GRAPHIC: Picture, Dan Rostenkowski . . . will they sacrifice?

# Rostenkowski Agrees to Tax Cut In 3rd Year, Tied to Economy

TAXES, From A1

targeting the cuts to the poor and middle class, the Democrats are encouraging inflationary consumption instead of savings and investment, both of which Republicans contend will increase more through their bill because it provides larger cuts to the rich.

While not responding directly to Rostenkowski, Treasury Secretary Donald T. Regan, appearing on the Cable News Network show "Newsmaker-Sunday," attacked the triggering concept for a third-year tax cut as a mechanism to "hold the American people hostage for some event to occur."

The two key elements of the Rostenkowski proposal are that the third-year cuts are targeted toward persons making from $15,000 to $50,000, as in the Democratic bill for the first two years, and that the third year be contingent on achievement of three administration economic goals.

These goals are a $23 billion deficit in 1983, lowering of the average inflation rate from 1981 through mid-1983 to 7.5 percent and reduction of the rate of interest on three-month Treasury bills to 7.5 percent in 1983. (Last week the average yield was 14.558 percent.)

Pointing out that these figures are based on the administration's own targets contained in the midyear economic review, Rostenkowski said, "If this administration is committed to their economic forcasts, to what they see as the need for a third year, Dan Rostenkowski would try to use his influence" to get the House leadership to back his proposal.

Just as Democrats are moving to solidify support among southern colleagues and possibly some Republicans, administration sources said there is a growing likelihood the GOP bill on the Senate floor will be sweetened with additional tax breaks for oil producers.

The Senate bill already calls for progressive reduction of the rate of the windfall profits tax on "new" oil from 30 percent to 15 percent by 1986. Sources said this is likely to be lowered even further to either 10 percent or down to zero. Lowering the rate from 15 percent to zero would cost, according to rough estimates, another $1.5 billion.

Administration sources are nowhere near as confident of winning on the House floor on the tax bill as they were at parallel points in the two previous budget fights and, they are quick to acknowledge, the margin of victory in the last major House floor vote was only 7 votes, 217 to 210.

Adding the larger oil tax break, a move expected early this week on the Senate floor, is expected to attract Democrats from oil states. In the last budget vote, 29 Democrats defected to the Reagan administration, and nine were from Texas.

House Democrats have not yet agreed on oil tax provisions in their bill, although they have considered exempting up to 1,000 barrels of oil, old and new, from the windfall profits tax. The exemption would be phased in, but when fully in place would be very expensive, costing in the range of $4 billion in lost revenues annually.

Rostenkowski admits being in a bidding war with the Reagan administration on the tax bill, but, largely because of the cost, the likelihood that the Democratic bill would go farther in the area of breaks for oil than the Senate GOP bill has declined significantly.

Ways and Means Committee aides said yesterday that in accepting a third year of tax cuts, Rostenkowski raised the danger of losing support for his bill from House liberals, many of whom argue that the administration's tax package is a back-door way to force a steady reduction of federal revenues and consequently increase pressure to cut social programs.

In terms of developing a trigger mechanism for the third year of the tax cut starting July 1, 1983, committee aides said there would be no problem determining the rate of interest on Treasury bills and the average inflation rate, but they acknowledged that the deficit figure for 1983 would be impossible to obtain, because the fiscal year does not end until Sept. 30, 1983.

DAN ROSTENKO…
…bidding to gain Hou…

## *Ohio Reinstates the Death Penal…*

DAYTON, Ohio, July 19 (AP)—Ohio reinstated the death penalty today with a law that will replace one ruled unconstitutional by the U.S. Supreme Court.

Gov. James A. Rhodes signed the measure before about 250 law enforcement officers and said he would not pardon anyone sentenced to death under the new law.

The measure gives t… its first capital punishn… since July 3, 1978, whe… vious measure was rule… stitutional.

The new law, which … effective Oct. 19, all… death penalty in certain … aggravated murder, inclu… slaying of a peace offi… slayings committed duri… mission of a felony.

# wski Agrees to Tax Cut ear, Tied to Economy

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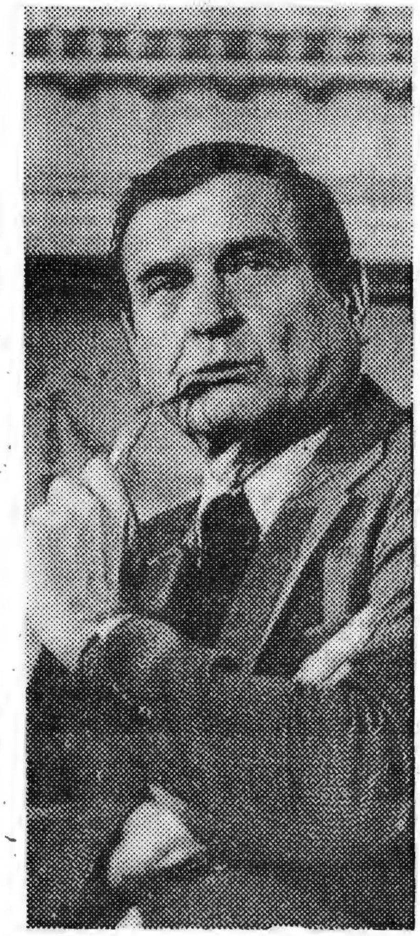

DAN ROSTENKOWSKI
...bidding to gain House votes

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Gov. James A. Rhodes signed the measure before about 250 law enforcement officers and said he would not pardon anyone sentenced to death under the new law.

The measure gives the state its first capital punishment law since July 3, 1978, when a previous measure was ruled unconstitutional.

The new law, which becomes effective Oct. 19, allows the death penalty in certain cases of aggravated murder, including the slaying of a peace officer and slayings committed during commission of a felony.

# Postal U Little P

By Warren Br
Washington Post Staff

Union leaders repre of the Postal Service workers reported "n progress" late last night tract talks with postal r

The negotiators the working against a dea night tonight, when th vice's current three-y with four unions expire

However, leaders of Postal Workers Union the National Associat Carriers (NALC), wh about 500,000 of nearl ionized postal employ have sent signals that ing to bargain beyond a settlement seems im

Talks reportedly we thly with the two sma Mail Handlers Divisi borers' International National Rural Lette sociation, meeting in separate bargaining se

Only noneconomic cussed over the we "main table" talks wi and NALC, who, un vision of federal i meeting with posta L'Enfant Plaza Hotel

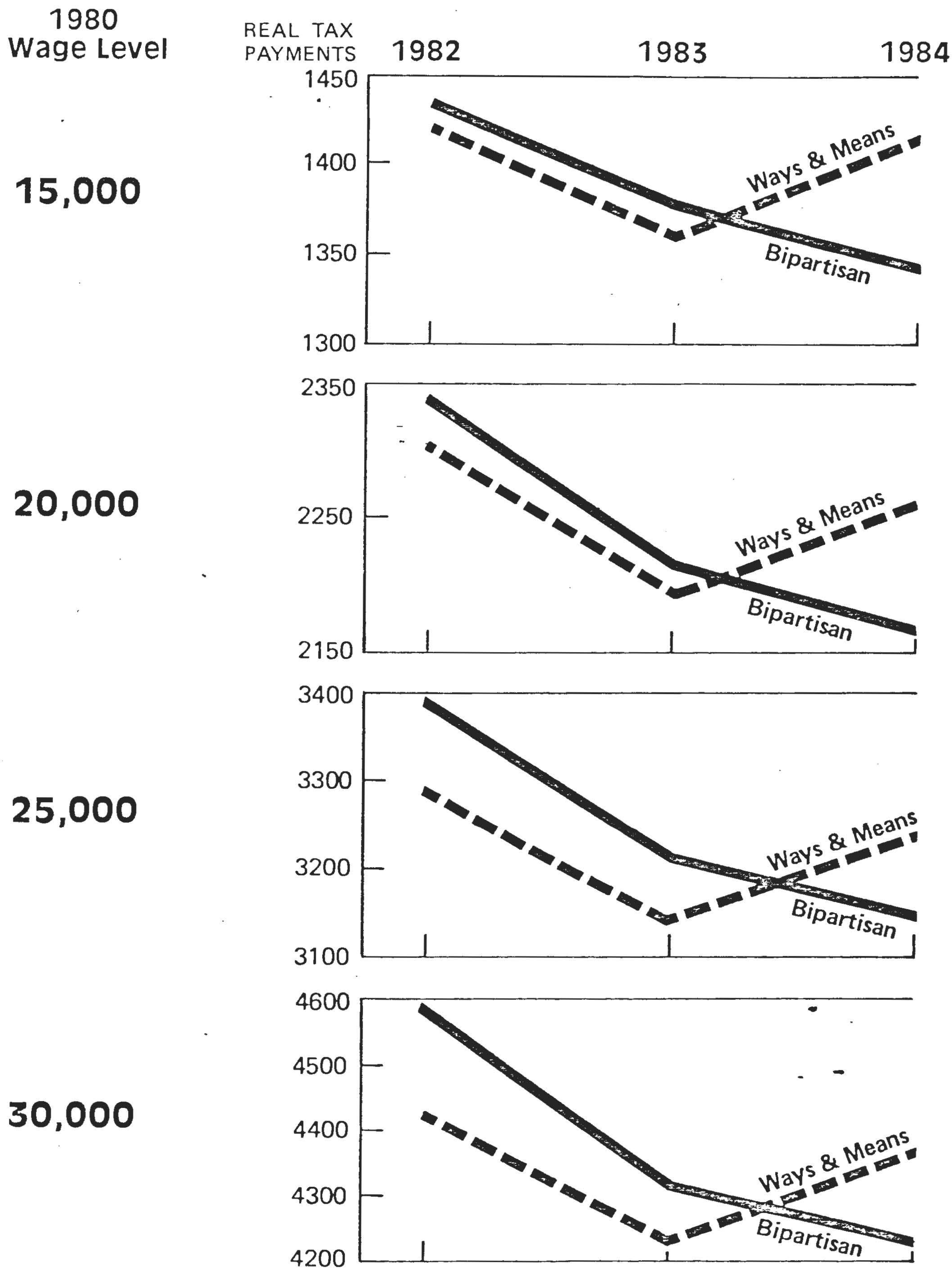
"We have made progress... in those President Morris (M NALC President Vi brotto said in a joint regret to report that to an agreement tha negotiations started ago."

However, the sta



(Bill)

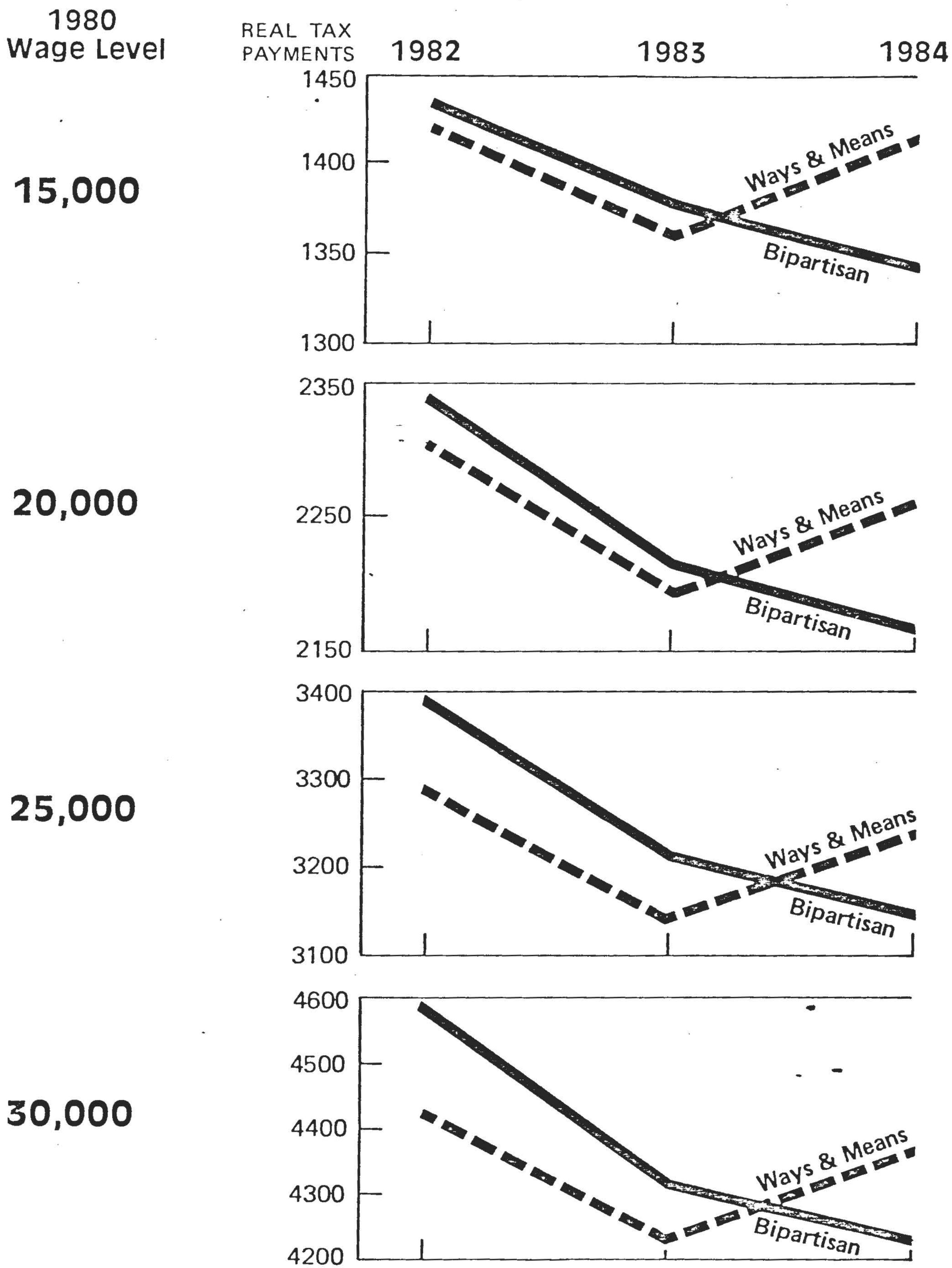
# Bipartisan Benefits All



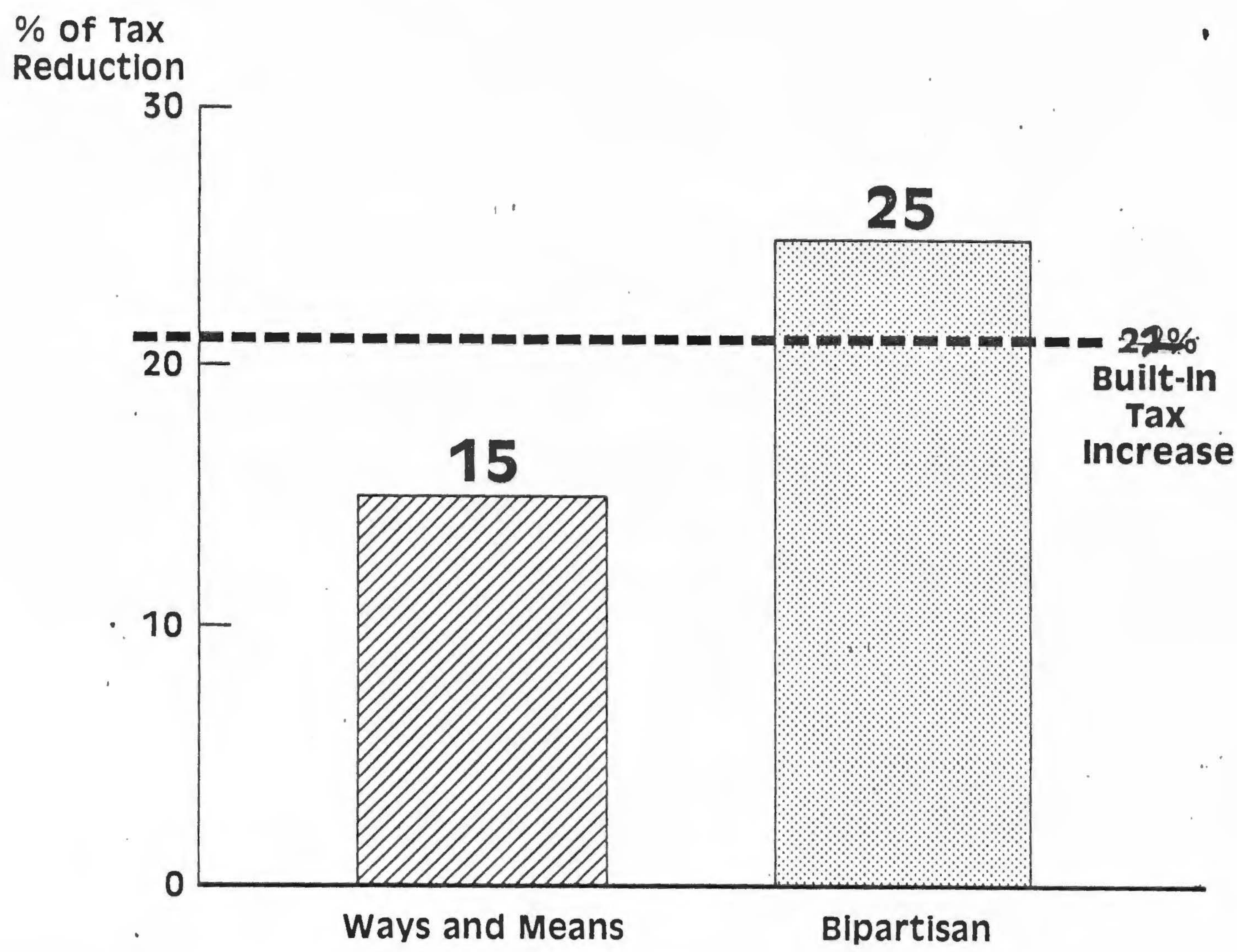

TREASURY 7/20/8

Bill

# Bipartisan Benefits All



# Tax Increase vs Tax Cut



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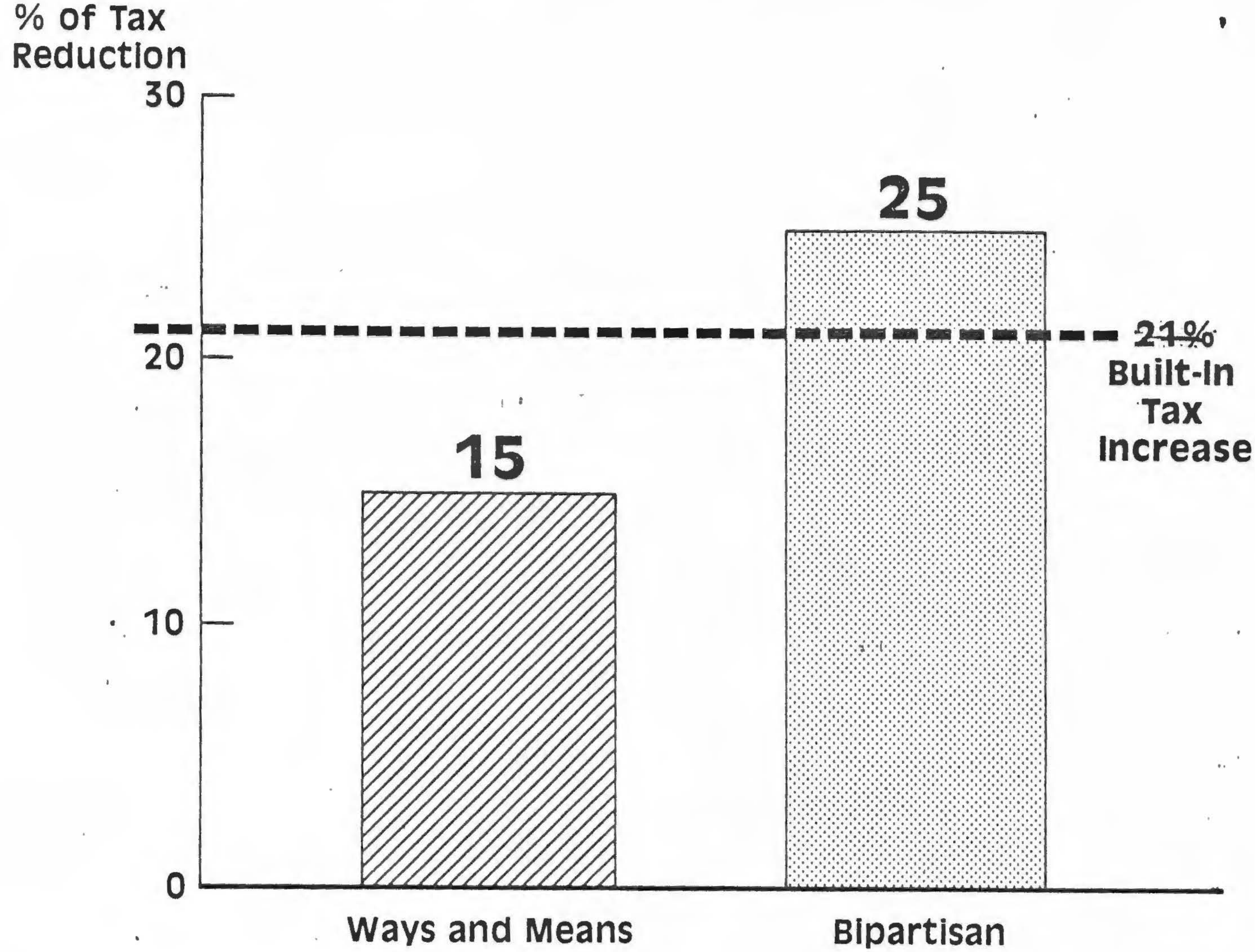


TREASURY NEWS
Department of the Treasury • Washington, D.C. • Telephone 566-204

FOR IMMEDIATE RELEASE
Thursday, July 23, 1981

Contact: Marlin Fitzwater
(202)566-5252

STATEMENT BY
SECRETARY OF THE TREASURY DONALD T. REGAN

The tax bill approved by the House Ways and Means Committee today can be described in one word -- misleading.

Rather than helping working people, as Speaker O'Neill claims, his bill has a shock in store for working people.

Just as they have done so often in the past, the Democratic leadership is trying to give the American people a temporary tax cut which will evaporate into higher taxes for working people.

Throughout the 1970's, the Democratic leadership promised working people tax cuts which they never saw. They are promising the same again.

In the last ten years, the Democratic leadership gave the American people five "tax cuts." Over the same ten year period, taxes increased by more than $400 billion.

Tip O'Neill's tax bill promises more of the same -- higher taxes for the working people of this country.

The President's Tax Bill is the only one to give the American people a real and dependable tax cut.

o 0 o

to: Ben Elliot

room: date: 5/4/81

Department of the Treasury

Office of the Secretary

I have enclosed the material you requested during your conversation with Dr. Roberts this morning.

Patsy, Ofc. of

Paul Craig Roberts
Assistant Secretary
for Economic Policy

room 3452
phone 566-2551

566-5561

John Ch

THE PROBLEM: PAST POLICIES

The attempt to fine-tune the economy by manipulating the federal budget deficit has left a track record over the past 15 years of rising rates of inflation and unemployment. For the budget deficits to provide the intended stimulus to demand, the Federal Reserve had to accommodate them with a monetary expansion. The growth in money fueled inflation, and the inflation pushed taxpayers into higher brackets and also eroded the depreciation allowances of businesses.

The combination of excessive demand with weak incentives to work, save and invest has resulted in "stagflation." Stagflation has put the federal budget into a deficit mode. Entitlements and transfer payments like Social Security automatically rise with the rate of inflation, and income-support programs automatically pay out more as the unemployment rate rises. It is practically impossible to balance the budget without improving the real economic performance of the economy.

THE CURE: NEW POLICIES

I have proposed an integrated economic policy package designed to lower the rate of inflation, raise the rate of real economic growth and productivity, create more and better jobs, and balance the budget.

The policy consists of (1) lower marginal tax rates in order to increase incentives and accelerated capital cost recovery in order to increase business investment, (2) restraints on the growth of Federal spending, (3) a non-inflationary monetary policy, and (4) a reduction in regulations in order to reduce production costs.

The personal income tax rate reductions will encourage better work attitudes, a higher saving rate, and the willingness to assume risks. Since the purpose of the tax cut is to increase incentives and not demand, there will be no pressure on the Federal Reserve to accommodate an expansionary fiscal policy by expanding the money supply. For the first time in 15 years the Federal Reserve will be free to keep the growth of the money supply on a stable and non-inflationary course.

The reductions in federal spending will prevent the increase in private savings from being borrowed by the government to finance growth in government spending. Instead, the savings will remain in the private capital markets where they will help lower the interest rate and where they will be available for for new plant and equipment.

The accelerated capital cost recovery will help firms generate internally more resources for the long-term investments that the new business climate will make attractive.

The reduction in regulation will lower business costs and increase production. It will also reduce feelings of animosity toward the federal government.

As the economy improves, both inflation and unemployment related budget expenditures will decline, and the budget will come into balance.

If the Federal Reserve fails to keep money growth on a slow, steady and predictable path, the tax and budget cuts will be offset by the rise in inflation, and the economy will be denied the incentives that we are trying to provide.

Tax cuts and inflation: Under the old policy, the purpose of cutting personal income taxes was to create a budget deficit in order to increase spending in the economy. This pressured the Federal Reserve to increase the money supply. Otherwise, the Treasury would borrow back with one hand the tax cut it gave with the other, and there would be no increase in spending--just a rise in the interest rates as Treasury bonds "crowded out" private investment. In effect, it was a policy of trying to stimulate production by printing money.

Not all tax cuts, however, result in inflationary deficits. There are three non-inflationary ways to pay for a tax cut, and our policy relies on all three: (1) offsetting spending cuts, (2) revenue feedbacks from a better performing economy, and (3) increased private saving.

Although it will be 1984 before our program balances the budget, the deficits that will occur in the meantime will not have the adverse effects that past deficits have had, because our policy will provide a larger pool of private savings out of which the government's bonds can be purchased.

Chart I shows the effect of the Kennedy tax cuts on revenues and saving. In the first year of the tax cut revenue growth slowed, then grew sharply on a new higher trend.

The savings response was also substantial. In the four years prior to the tax cut, the personal savings rate averaged 5.8 percent. In the next four years it averaged 7.2 percent, rising to 8.1 percent in 1967. In real terms, the increase in saving above the previous trend was about 75% of the size of the tax cut.

The importance of marginal tax rates: The marginal tax rate is the rate at which new or additional income is taxed. The higher the marginal tax rate, the less the incentive to earn additional income. Since income from saving and investment is added on top of wage or salary income, it is always taxed at the top rate. The same applies to overtime income or any income from additional effort.

In 1965 the top bracket encountered by a median income family of four was 17 percent. A family with twice the median income had a top bracket of 22 percent. Unless tax rates are cut, in 1981 the median income family will be in the 28 percent federal bracket, rising to 32 percent in 1984. A family with twice the median income will face a 43 percent bracket, rising to 49 percent in 1984. When Social Security and state income taxes are included, the disincentives are even harsher with average families this year facing 40-44 percent marginal tax rates.

As inflation has pushed people higher in the progressive income tax system, the personal saving rate has fallen. Today, for the majority of the population the incentive to produce additional income is the lowest in our history and falling. Under our proposals, the median income family will be in the 23 percent federal bracket in 1984. A family with twice the median income will be in the 36 percent bracket.

"Supply-side" effects: For our policy to work, taxpayers do not have to respond to lower marginal tax rates by giving up vacations, going on a double-shift and saving all of their income. With a work force of more than 100 million people, small individual responses result in a large aggregate effect.

For examples, if the average number of hours worked per week rises by half an hour, GNP rises by $25 billion. If the absentee rate declines by one-half percentage point, GNP rises by $10 billion. If the personal savings rate rises by two percentage points, as it did after the Kennedy tax rate reductions, private savings increase by $42 billion annually at current income levels.

The reduction in marginal income tax rates is a business tax cut too. It automarically reduces the maximum capital gains tax from 28 percent to 20 percent. It increases the rate of return to investment income across the board. It lowers the tax rates on partnerships and unincorporated business income. It increases savings available to business and lowers interest rates. It improves work attitudes by providing more reward for effort and lowers wage demands by providing larger take-home pay, thereby contributing to better labor productivity.

The program is fair: Our policy treats taxpayers equally. Each receives taxes back in proportion to the taxes each pays. More importantly, at the end of three years, each has a substantially greater incentive to earn additional income and to save more. We believe that if people have better incentives, more income will be produced, and the whole country will be better off.

THE EFFECTS ON OUR TRADING PARTNERS

The success of our policy in restoring the economy will blunt the mounting protectionist pressures and allow the United States to continue to lead the world in the direction of free trade. It will also show that with adequate incentives and a stable currency, individual initiative can meet economic needs better than can a growing welfare state, which "crowds out" individual responsibility and creates a new and growing welfare-dependent class.

ECONOMIC OUTLOOK WITH ENACTMENT OF THE NEW POLICY

With the enactment of our policy and the cooperation of the Federal Reserve in providing a slow, steady and predictable rate of growth in the money supply, we expect a higher rate of real economic growth, lower inflation rates and lower interest rates. Better performance from the economy will reduce the rate of growth in federal budget pay-outs and bring the budget into balance.

ECONOMIC OUTLOOK WITHOUT ENACTMENT OF THE NEW POLICY

In the absence of our policy change, the question is what policy would be in effect. Judging by the empirical record, a continuation of demand-management means we must accept progressively worsening economic performance (see Chart II).

Furthermore, demand-management, which relies on budget deficits to stimulate spending and the economy, is out of tune with the growing emphasis on a balanced budget. We conclude that the policy of the past 15 years is not a viable alternative to our proposed policy.

Our approach to a balanced budget is to increase the rate of real economic growth through better incentives, higher rates of return after tax, and a higher savings rate. The improved performance of the economy will reduce both inflation- and unemployment-related budget pay-outs.

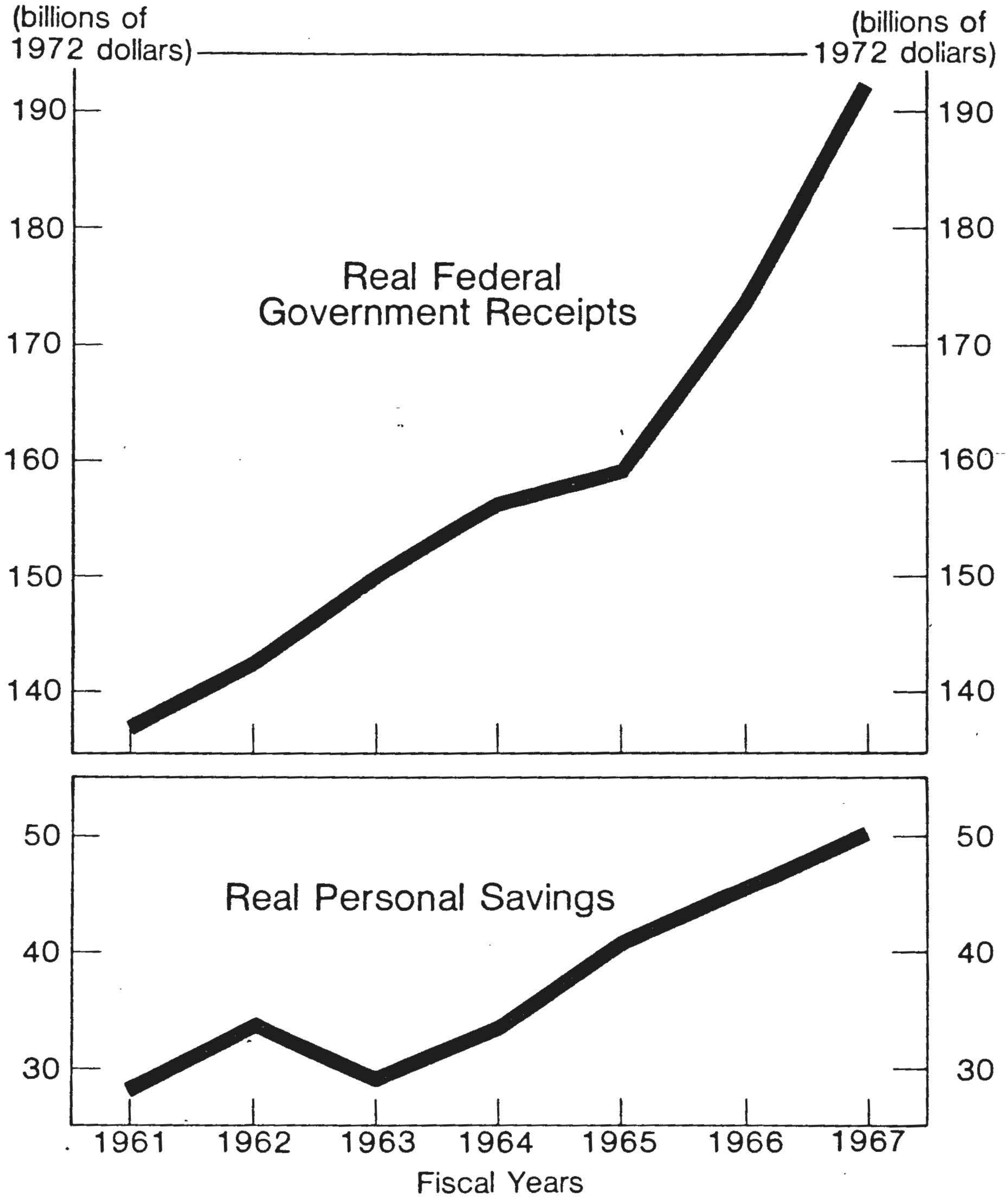
Alternative paths to a balanced budget would require either higher taxes or deeper cuts in social spending. Deeper cuts in social spending would require Congress to re-write some of the social legislation of the last 15 years. Higher taxes might further depress the economy, thus leading to more budget pay-outs and a continuation of the budget deficit.

Once it was possible to use inflation to balance the budget by driving taxpayers into higher tax brackets. Now, however, half of the budget expenditures are indexed to inflation, and another 25 percent is taken up by the defense budget to which we are committed to real increases. Therefore, at least three-fourths of the budget expenditures would rise with the inflation rate. higher
The bottom line is that using inflation to balance the budget is not acceptable and would not work even if it were.

Once it was possible to lower interest rates by easing monetary policy. This no longer works, because people connect more money with more inflation, and interest rates rise. During the first few days of May it became clear that money supply growth had substantially increased over what it had been from mid-November until February. The prime rate immediately moved up, and the Federal Reserve followed by raising the discount rate. We now have easy money and high interest rates--yet another reason why we must implement a new policy.

CHART I

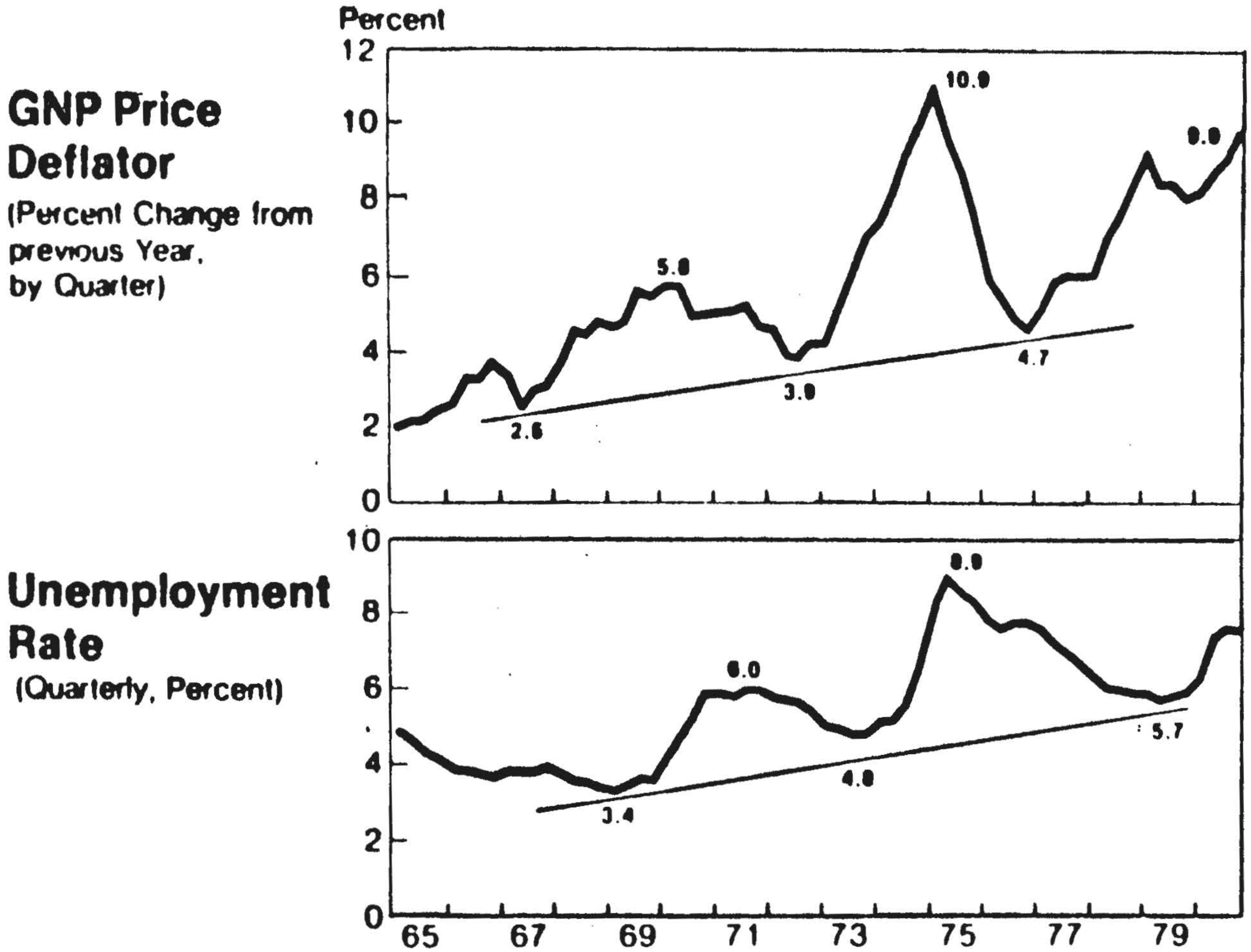
# Federal Receipts and Personal Savings in the Kennedy Tax Cut Years




Source: The Budget of the United States Government and Bureau of Economic Analysis, U.S. Department of Commerce.

CHART II

## INFLATION AND UNEMPLOYMENT RATES




THE RECORD OF KEYNESIAN, FINE-TUNING, DEMAND-MANAGEMENT POLICY: EVERY YEAR THE BEST THE ECONOMY CAN DO IS WORSE.

ESTIMATED GAINS IN REAL PERSONAL SAVING
AS A RESULT OF 1964 PERSONAL INCOME TAX RATE REDUCTIONS

| Year | (Bil. $) Real Disposable Income Without Tax Cut[1] | (Bil. $) Real Personal Saving Without Tax Cut[2] | (Bil. $) Actual Real Personal Saving | (Bil. $) Gain in Real Personal Saving With Tax Cut[3] | Gain in Real Personal Saving as Percent of Tax Cut | Change in Actual Real Personal Saving as Percent of Tax Cut[4] |
|---|---|---|---|---|---|---|
| 1964 | $559.1 | $32.4 | $39.0 | $6.6 | 74% | 109% |
| 1965 | 576.4 | 33.4 | 43.6 | 10.2 | 72% | 101% |
| 1966 | 594.3 | 34.5 | 45.3 | 10.8 | 72% | 106% |
| 1967 | 612.7 | 35.5 | 54.5 | 19.0 | 121% | 161% |

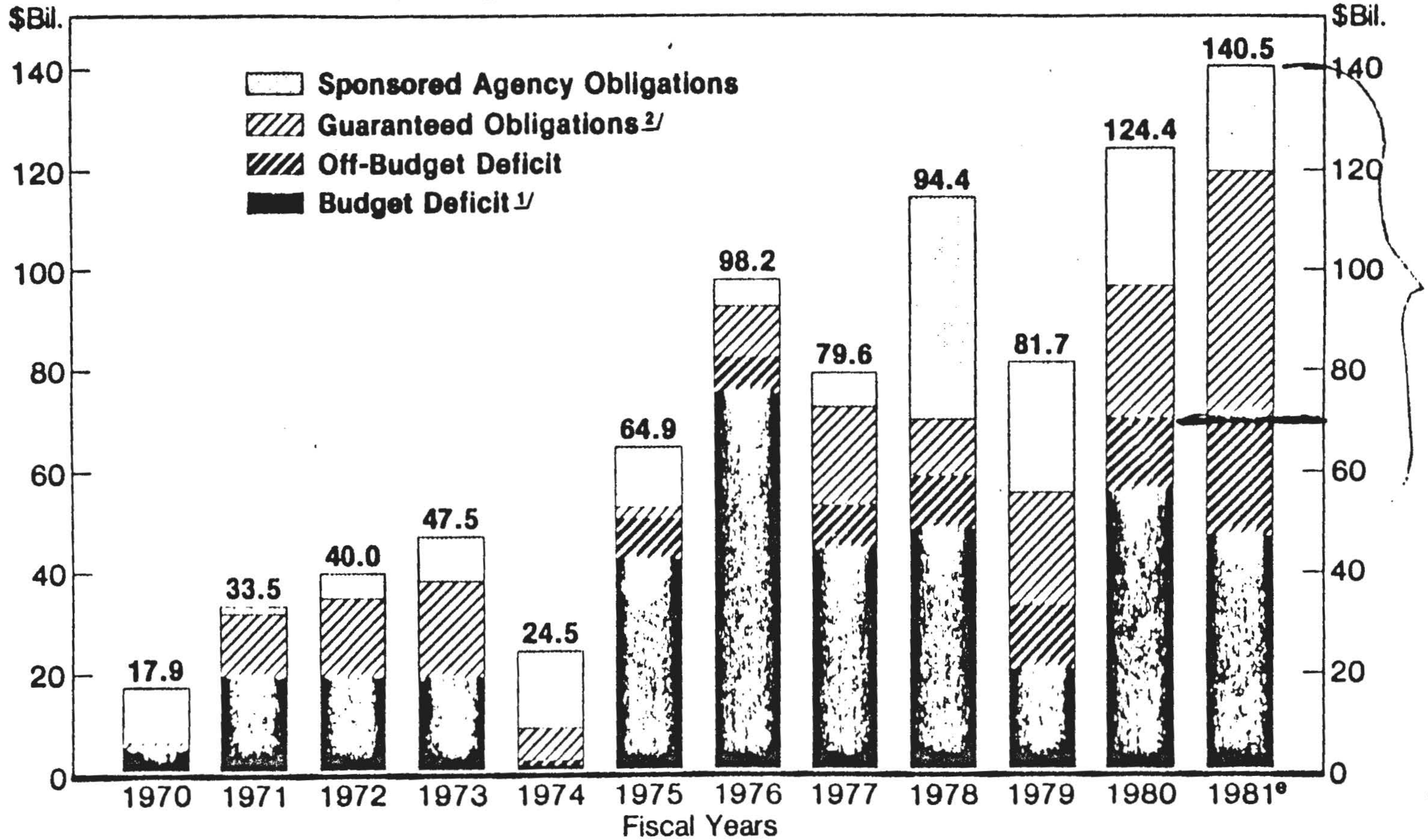
[1] Based on 3.1% growth trend for period 1959-1963

[2] Based on 5.8% average rate for period 1960-1963

[3] Difference between actual real personal saving and estimated real personal saving without tax cut, column (4) minus column (3).

[4] Change in actual real saving from its 1963 level as a percent of the reduction in real personal taxes.

# FEDERAL AND FEDERALLY-ASSISTED BORROWING FROM THE PUBLIC




1/ Adjusted for other means of financing.

2/ Adjusted for federal and sponsored agency purchases of guaranteed obligations.

e estimate

Office of the Secretary of the Treasury
Office of Government Financing

April 28, 1981-16

THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release July 27, 1981

THE PRESIDENT'S ADDRESS
TO THE NATION

Press Release
Rm. 111 1/2
3 copies

The Oval Office

8:01 P.M. EDT

THE PRESIDENT: Good evening. I'd intended to make some remarks about the problem of Social Security tonight, but the immediacy of Congressional action on the tax program, a key component of our economic package, has to take priority. Let me just say, however, I've been deeply disturbed by the way those of you who are dependent on Social Security have been needlessly frightened by some of the inaccuracies which have been given wide circulation. It's true that the Social Security system has financial problems. It's also true that these financial problems have been building for more than twenty years, and nothing has been done.

I hope to address you on this entire subject in the near future. In the meantime, let me just say this: I stated during the campaign and I repeat now, I will not stand by and see those of you who are dependent on Social Security deprived of the benefits you've worked so hard to earn. I make that pledge to you as your President. You have no reason to be frightened. You will continue to receive your checks in the full amount due you. In any plan to restore fiscal integrity of Social Security, I personally will see that the plan will not be at the expense of you who are now dependent on your monthly Social Security checks.

Now, let us turn to the business at hand. It's been nearly six months since I first reported to you on the state of the nation's economy. I'm afraid my message that night was grim and disturbing. I remember telling you we were in the worst economic mess since the Great Depression. Prices were continuing to spiral upward, unemployment was reaching intolerable levels, and all because government was too big, and spent too much of our money.

We're still not out of the woods, but we've made a start. And we've certainly surprised those long-time and somewhat cynical observers of the Washington scene, who looked, listened, and said, "It can never be done, Washington will never change its spending habits". Well, something very exciting has been happening here in Washington, and you're responsible.

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Your voices have been heard. Millions of you, Democrats, Republicans, and Independents from every profession, trade and line of work, and from every part of this land. You sent a message that you wanted a new beginning. You wanted to change one little two little word -- two letter word, I should say. It doesn't sound like much but it sure can make a difference -- changing "by government" -- "control by government" to "control of government."

In that earlier broadcast you'll recall I proposed a program to drastically cut back government spending in the 1982 budget which begins October 1st and to continue cutting in '83 and '84. Along with this I suggested an across-the-board tax cut spread over those same three years and the elimination of unnecessary regulations which were adding billions to the cost of things we buy.

All the lobbying, the organized demonstrations and the cries of protest by those whose way of life depends on maintaining government's wasteful ways were no match for your voices which were heard loud and clear in these marble halls of government.

And you made history with your telegrams, your letters, your phone calls and yes, personal visits to talk to your elected representatives. You reaffirmed the mandate you delivered in the election last November -- a mandate that called for an end to government policies that sent prices and mortgage rates skyrocketing while millions of Americans went jobless.

Because of what you did, Republicans and Democrats in the Congress came together and passed the most sweeping cutbacks in the history of the federal budget. Right now, Members of the House and Senate are meeting in a conference committee to reconcile the differences between the two budget cutting bills passed by the House and the Senate. When they finish, all Americans will benefit from savings of approximately $140 billion in reduced government costs over just the next three years. And that doesn't include the additional savings from the hundreds of burdensome regulations already cancelled or facing cancellation.

For 19 out of the last 20 years, the federal government has spent more than it took in. There will be another large deficit in this present year which ends September 30th. But with our program in place, it won't be quite as big as it might have been and starting next year, the deficits will get smaller until in just a few years the budget can be balanced. And we hope we can begin whittling at that almost $1 trillion debt that hangs over the future of our children.

Now, so far, I've been talking about only one part of our program for economic recovery -- the budget cutting part. I don't minimize its importance. Just the fact that Democrats and Republicans could work together as they have, proving the strength of our system, has created an optimism in our land. The rate of inflation is no longer in double-digit figures. The dollar has regained strength in the international money markets and businessmen and investors are making decisions with regard to industrial development, modernization and expansion,

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all of this based on anticipation of our program being adopted and put into operation.

A recent poll shows that where a year and a half ago only 24 percent of our people believed things would get better, today 46 percent believe they will. To justify their faith, we must deliver the other part of our program. Our economic package is a closely knit, carefully constructed plan to restore America's economic strength and put our nation back on the road to prosperity.

Each part of this package is vital. It cannot be considered piecemeal. It was proposed as a package and it has been supported as such by the American people. Only if the Congress passes all of its major components does it have any real chance of success. This is absolutely essential if we are to provide incentives and make capital available for the increased productivity required to provide real, permanent jobs for our people.

Let me not forget that the rest of the world is watching America carefully to see how we'll act at this critical moment.

I have recently returned from a summit meeting with world leaders in Ottawa, Canada, and the message I heard from them was quite clear. Our allies depend on a strong and economically sound America and they're watching events in this country, particularly those surrounding our program for economic recovery, with close attention and great hopes.

In short, the best way to have a strong foreign policy abroad is to have a strong economy at home.

The day after tomorrow, Wednesday, the House of Representatives will begin debate on two tax bills and once again they need to hear from you. I know that doesn't give you much time but a great deal is at stake. A few days ago I was visited here in the office by a Democratic Congressman from one of our southern states. He'd been back in his district and one day one of his constituents asked him where he stood on our economic recovery program. I outlined that program in an earlier broadcast, particularly the tax cut. Well, the Congressman, who happens to be a strong leader in support of our program, replied at some length with a discussion of the technical points involved, but he also mentioned a few reservations that he had on certain points. The constituent, a farmer, listened politely until he had finished, and then he said, "Don't give me an essay. What I want to know is are you for him or agin' him?"

Well, I appreciate the gentleman's support and suggest his question is a message your own representative should hear.

Let me add, those representatives honestly and sincerely want to know your feelings. They get plenty of input from the special interest groups. They'd like to hear from their home folks.

Now, let me explain what the situation is and what's at issue. With our budget cuts we've presented a complete program of reduction in tax rates. Again, our purpose was to provide incentive for the individual, incentives for business to encourage production and hiring of the unemployed, and to free up money for investment.

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Our bill calls for a five percent reduction in the income tax rate by October 1st, a 10 percent reduction beginning July 1st, 1982, and another 10 percent cut a year later, a 25 percent total reduction over three years.

But then to ensure the tax cut is permanent, we call for indexing the tax rates in 1985 which means adjusting them for inflation. As it is now, if you get a cost-of-living raise that's intended to keep you even with inflation, you find that the increase in the number of dollars you get may very likely move you into a higher tax bracket and you wind up poorer than you would. This is called bracket creep.

Bracket creep is an insidious tax. Let me give an example. If you earned $10,000 a year in 1972, by 1980 you had to earn $19,700 just to stay even with inflation. But that's before taxes. Come April 15th, you'll find your tax rates have increased 30 percent. Now, if you've been wondering why you don't seem as well-off as you were a few years back, it's because government makes a profit on inflation. It gets an automatic tax increase without having to vote on it. We intend to stop that.

Time won't allow me to explain every detail. But our bill includes just about everything to help the economy. We reduce the marriage penalty, that unfair tax that has a working husband and wife pay more tax than if they were single. We increase the exemption on the inheritance or estate tax to $600,000 so that farmers and family-owned businesses don't have to sell the farm or store in the event of death just to pay the taxes.

Most important, we wipe out the tax entirely for a surviving spouse. No longer, for example, will a widow have to sell the family source of income to pay a tax on her husband's death. There are deductions to encourage investment and savings. Business gets realistic depreciation on equipment and machinery. And there are tax breaks for small and independent businesses which create 80 percent of all new jobs.

This bill also provides major credits to the research and development industry. These credits will help spark the high technology breakthroughs that are so critical to America's economic leadership in the world.

There are also added incentives for small businesses, including a provision that will lift much of the burden of costly paperwork that government has imposed on small business.

In addition, a short-term but substantial assistance for the hard pressed thrift industry, as well as reductions in oil taxes that will benefit new or independent oil producers and move our nation a step closer to energy self-sufficiency.

Our bill is, in short, the first real tax cut for everyone in almost 20 years. Now, when I first proposed this, incidentally, it has now become a bipartisan measure co-authored by Republican Barber Conable and Democrat Kent Hance, the Democratic leadership said a tax cut was out of the question. It would be widely inflationary. And that was before my inauguration.

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And then your voices began to be heard and suddenly the leadership discovered that, well, the one-year tax cut was feasible. We kept on pushing our three-year tax cut and by June the opposition found that a two-year tax cut might work. Now it's July and they find they could even go for a third year cut provided there was a trigger arrangement that would only allow it to go into effect if certain economic goals had been met by 1983.

But by holding the peoples' tax reduction hostage to future economic events they will eliminate the peoples' ability to plan ahead. Shopkeepers, farmers, and individuals will be denied the certainty they must have to begin saving or investing more of their money, and encouraging more savings and investment is precisely what we need now to rebuild our economy.

There's also a little sleight of hand in that trigger mechanism. You see, their bill, the Committee bill, ensures that the 1983 deficit will be $6-1/2 billion greater than their own trigger requires. As it stands now, the design of their own bill will not meet the trigger they've put in. Therefore, the third year tax cut will automatically never take place.

If I could paraphrase a well-known statement by Will Rogers that he had never met a man he didn't like, I'm afraid we have some people around here who never met a tax they didn't hike. Their tax proposal, similar in a number of ways to ours, but differing in some very vital parts, was passed out of the House Ways and Means Committee and from now on I'll refer to it as the Committee bill and ours as the bipartisan bill. They'll be the bills taken up Wednesday. The majority leadership claims theirs gives a greater break to the worker than ours, and it does. That is, if you're only planning to live two more years. The plain truth is our choice is not between two plans to reduce taxes; it's between a tax cut or a tax increase. There is now built into our present system, including payroll, Social Security taxes, and the bracket creep I've mentioned, a 22 percent tax increase over the next three years.

The Committee bill offers a 15 percent cut over two years. Our bipartisan bill gives a 25 percent reduction over three years. Now, as you can see by this chart, there is the 22 percent tax increase. Their cut is below that line. But ours wipes out that increase and with a little to spare, and there it is, as you can see. The red column. That is the 15 percent tax cut and it still leaves you with an increase. The green column is our bipartisan bill which wipes out the tax increase and gives you an on-going cut.

Incidentally, their claim that cutting taxes for individuals for as much as three years ahead is risky rings a little hollow when you realize that their bill calls for business tax cuts each year for seven years ahead.

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It rings even more hollow when you consider the fact the Majority leadership will keenly endorse its federal spending bills that project years into the future, but objects to a tax bill that will return your money over a three year period.

Now, here is another chart which illustrates what I said about their giving a better break if you only intend to live for two more years. Their tax cut, so called, is the dotted line. Ours is the solid line. As you can see, in an earning bracket of $20,000, their tax cut is slightly more generous than ours for the first two years. Then as you can see, their tax bill, the dotted line, starts going up and up and up. On the other hand, in our bipartisan tax bill, the solid line, our tax cut keeps on going down, and then stays down permanently.

This is true of all earning brackets, not just the $20,000 level I've used as an example, from the lowest to the highest. This red space between the two lines is the tax money that will remain in your pockets if our bill passes. And its the amount that will leave your pockets if their tax bill is passed.

I take no pleasure in saying this, but those who will seek to defeat our Conable-Hance bipartisan bill, as debate begins Wednesday, are the ones who have given us "five" tax cuts in the last ten years. But, our taxes went up $400 billion in those same ten years. The lines on these charts say a lot about who is really fighting for whom. On the one hand, you see a genuine and lasting commitment to the future of working Americans, on the other, just another empty promise.

Those of us in the bipartisan coalition want to give this economy, and the future of this nation, back to the people. Because putting people first has always been America's secret weapon. The House Majority leadership seems less concerned about protecting your family budget, than with spending more on the federal budget.

Our bipartisan tax bill targets three-quarters of its tax relief to middle-income wage earners who presently pay almost three-quarters of the total income tax. It also indexes the tax bracket to insure that you can keep that tax reduction in the years ahead. There also is, as I said, estate tax relief that will keep family farms and family-owned businesses in the family, and there are provisions for personal retirement plans and individual savings accounts.

Because our bipartisan bill is so clearly drawn and broadly based, it provides the kind of predictability and certainty that the financial segments of our society need to make investment decisons that stimulate productivity and make our economy grow.

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Even more important, if the tax cut goes to you, the American people, in the third year, that money returned to you won't be available to the Congress to spend, and that, in my view, is what this whole controversy comes down to. Are you entitled to the fruits of your own labor or does government have some presumptive right to spend and spend and spend?

I'm also convinced our business tax cut is superior to theirs because it's more equitable and it will do a much better job promoting the surge in investment we so badly need to rebuild our industrial base.

There is something else I want to tell you. Our bipartisan coalition worked out a tax bill we felt would provide incentive and stimulate productivity, thus reducing inflation and providing jobs for the unemployed. That was our only goal. Our opponents in the beginning didn't want a tax bill at all. So what is the purpose behind their change of heart? They've put a tax program together for one reason only, to provide themselves with a political victory. Never mind that it won't solve the economic problems confronting our country. Never mind that it won't get the wheels of industry turning again or eliminate the inflation which is eating us alive. This is not the time for political fun and games. This is the time for a new beginning.

I ask you now to put aside any feelings of frustration or helplessness about our political institutions and join me in this dramatic but responsible plan to reduce the enormous burden of federal taxation on you and your family.

During recent months many of you have asked what can you do to help make America strong again. I urge you again to contact your senators and congressmen. Tell them of your support for this bipartisan proposal. Tell them you believe this is an unequalled opportunity to help return America to prosperity and make government again the servant of the people.

In a few days the Congress will stand at the fork of two roads. One road is all too familiar to us. It leads ultimately to higher taxes. It merely brings us full circle back to the source of our economic problems, where the government decides that it knows better than you what should be done with your earnings and, in fact, how you should conduct your life. The other road promises to renew the American spirit. It's a road of hope and opportunity. It places the direction of your life back in your hands where it belongs.

I'm not taking your time this evening merely to ask you to trust me. Instead, I ask you to trust yourselves. That's what America is all about. Our struggle for nationhood, our unrelenting fight for freedom, our very existence, these have all rested on the assurance that you must be free to shape your life as you are best able to, that no one can stop you from reaching higher or take from you the creativity that has made America the envy of mankind. One road is timid and fearful. The other bold and hopeful.

In these six months we've done so much and have come so far. It's been the power of millions of people like you who have determined that we will make America great again. You have made the difference up to now. You will make the difference again. Let us not stop now.

Thank you. God bless you. Good night.

END 8:23 P.M. EDT