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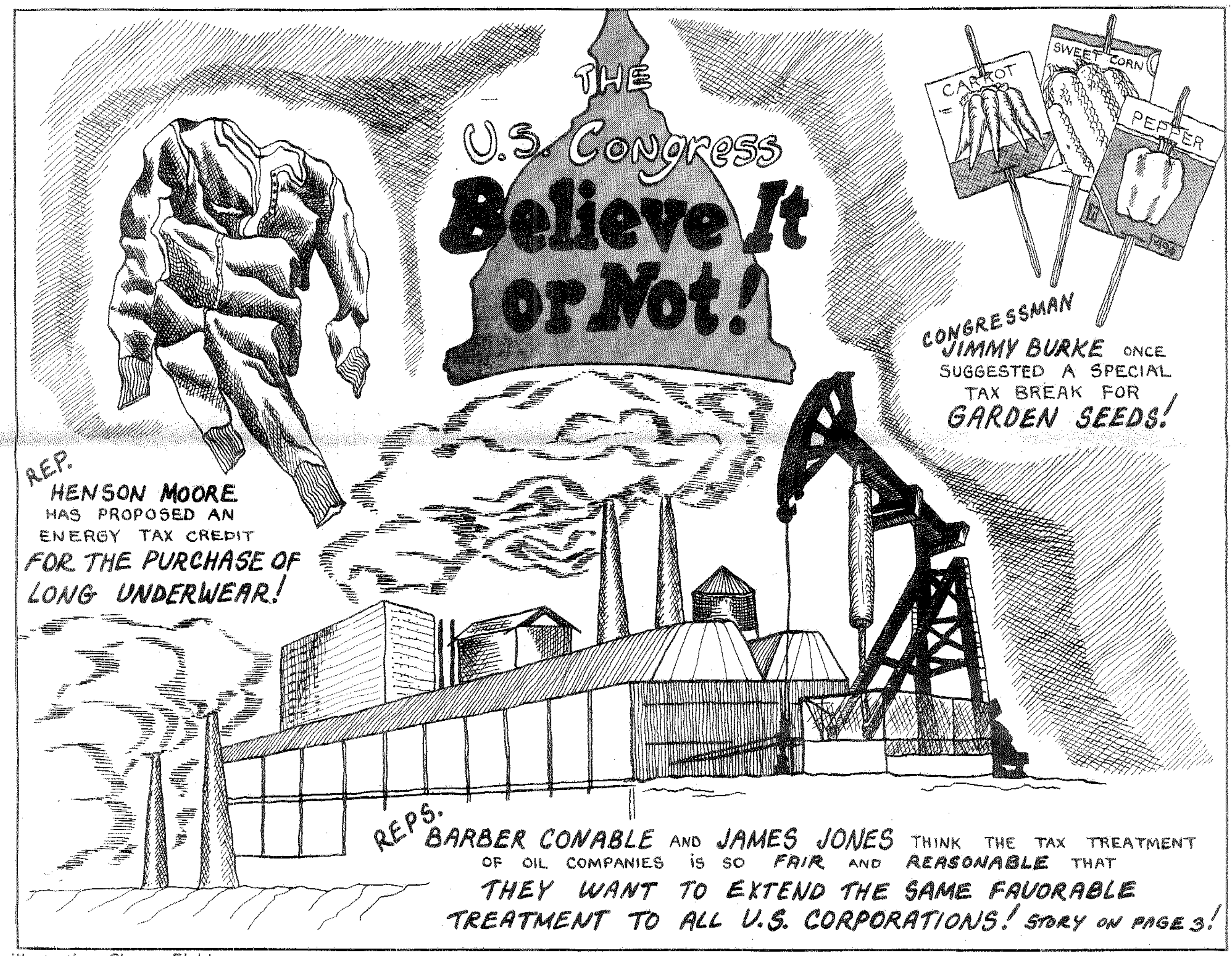

illustration: Sharon Fields

In this issue:

People & Taxes
P.O. Box 14198
Washington, D.C. 20044

Letters

The property tax and renters' relief

To the editor:

In a recent letter to the editor (*People & Taxes*, August 1979), a reader commented that one of the major failings of the homestead exemption as a vehicle for reform of the property tax is the fact that the homestead exemption only provides relief to homeowners and not to renters who pay property taxes indirectly through their rental payments. To my dismay the editor's note completely ignored this valid criticism. Although I have a number of other reservations about the June 1979 article, "The Property tax: Probing Some of the More Difficult Issues," I feel somewhat constrained because the manner in which these ideas were set forth did not suggest that the staff of the TRRG had in mind a comprehensive analysis of of the real property tax and a thorough discussion of the pros and cons of the various methods of decreasing the regressivity or increasing the progressivity of the real property tax. However, the issue regarding tax relief for renters is so compelling it should be addressed.

Approximately one-half of the poverty population in the United States is housed in rental units. Any property tax relief program that fails to provide relief to renters cannot be considered a serious tax reform program and certainly will not make the property tax "progressive" either as the editors have defined it in their note or as generally defined in economic literature. Eighteen states presently provide homestead exemptions to homeowners and do not have a circuit-breaker program as well. Of these eighteen states, only one, Hawaii, also provides some property tax relief to renters through a different program. On the other hand, of the thirty states that have circuit-breaker programs, twenty-four also provide relief to renters. In nearly all cases, the renters receive their benefits under the same program with a percentage of rent being used as a proxy for property taxes paid. Circuit-breaker programs facilitate the inclusion of renters in a state-wide program of property tax relief, whereas the homestead program necessitates the passage of a completely unique program targeted solely at renters. In theory this is certainly possible, but in practice it precludes serious consideration of a renter relief program in most states.

It is not clear from either the June 1979 article or the editor's note whether the TRRG is seriously considering adopting as a policy position preference for the homestead exemption over the circuit-breaker. I hope that before that decision is made a more serious analysis of the two programs is performed and that the TRRG reaches out to the "tax reform community," especially poverty organizations, for their counsel.

Russell G. Murray
Economist, Research Institute
Legal Services Corporation

An essential question in the rentor's relief issue is whether the property tax is actually passed on. There doesn't seem to be much agreement on the answer. Joseph Pechman, in Who Bears the Property Tax Burden, *maintains that the tax is paid by the* holders of capital. *Howard Jarvis has said that "not one nickle of the property tax is paid by landlords." But then, does Jarvis represent the interests of the renter or the landlord? Anyway, given a choice between Jarvis and Pechman, we tend to side with Pechman on most points.*

This is not to say that we shouldn't provide some kind of direct relief to renters for housing costs. It's also not to say that the whole question of how to provide property tax relief is black and white. Our purpose right now is to stimulate some careful thinking on the subject. —*Ed.*

"Crystal clear" oil tax policy

To the editor:

Along with my renewal, I wish to request that you provide more publicity on the tax reducing policies for the oil companies. Since most individuals pay from 20% to 35% of their gross income in federal, state and local income taxes, it would be interesting reading to expose the following:

- That most oil companies only pay 10 to 15% maximum federal tax on their *net increase* in worth each year; and that this net increase is profit realized after all other expenses are paid from their gross intake.
- That it is only 15% in part because the federal government allows the oil companies to deduct from their tax obligation, the amount of foreign "taxes" paid on the oil that is imported.
- That our oil tax policy is encouraging oil companies to import oil rather than use domestic oil because of this foreign tax treatment, in effect subsidizing the oil exporting nations.
- That other tax reductions like depletion allowances and investment credits also reduce the federal tax obligation.
- And finally, that the oil companies use this favored tax position to pay for lobbyists that in turn pay for favorable legislation from the Congress!

It is time for this mess to be made crystal clear.

Robert L. Schmidt
Silver Spring, MD

Actually, we are trying to keep our readers informed on the outrageous tax schemes that are available for the oil industry. Check out our May and August 1979 issues, which covered the debate on the windfall profits tax.

And for the latest on that fiasco, see the Issues section of this paper. —*Ed.*

We welcome letters of response from our readers. Letters may have to be edited to fit our space availability. Unfortunately, we can't handle individual tax problems.

Please address letters to the Editor, P.O. Box 14198, Washington, D.C. 20044.

People & Taxes

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Moving?

We'd like to be one of the first to know!

We have to pay a pretty penny each month for newspapers that are returned to us. Please help us out by letting us know if you will be moving soon – and you won't miss a single issue of P&T. Use the address change form on the back cover.

Coming up in October

Debate between Howard Jarvis and Ralph Nader: "The Tax Revolt—for Business or the People?" October 12, 1979, at the Mayflower Hotel in Washington, D.C. The debate is part of a two-day Institute on State and Local Taxation of Business, sponsored by the Washington College of Law of the American University and the Multistate Tax Commission. Other topics to be covered at the institute include business taxation and public opinion, natural resources taxation, and auditing multinational firms.

For more information and reservations, contact Francis Hadbavny at 202-686-2632.

A **National Day of Protest** to fight "sky-rocketing fuel prices and the tightening grip of oil monopolies." Sponsored by the Citizen/Labor Energy Coalition and the Progressive Alliance, October 17 and throughout the fall. Citizens' groups and labor unions are asked to join in the events which will include petitioning and lobbying for a citizens' energy program—including oil tax reforms.

For information on what your group can do to join, contact the Campaign for Lower Energy Prices, 1300 Connecticut Ave., N.W., Room 401, Washington, D.C. 20036.

The Beginning of the End of the Corporate Income Tax?

by Robert S. McIntyre

Ripley's "Believe It Or Not" series in the comic pages appears to be running into hard times. A few Sundays ago, it ran an item about a fellow who wrote a check for $875 on his check number 875. The strip has also come up recently with such gems as "Kris Kristofferson was a Rhodes Scholar!" and "Cary Grant is so shy he sometimes performed better with a hangover!"

If Ripley's is in need of better sources of material, its writers could do worse than to look at some of the tax bills introduced in the U.S. Congress. How about "Rep. Henson Moore (R-La.) has proposed an energy tax credit for the purchase of long underwear!" Or "Congressman Jimmy Burke of Massachusetts once suggested a special tax break for garden seeds!" Or better still, "Congressional Republicans and oil-state Democrats think the tax treatment of oil companies is so fair and reasonable that they would like to extend the same favorable treatment to all U.S. corporations!"

The *real* "believe it or not" is that this last proposal is currently gaining momentum in Congress, and the first step toward achieving it may well be approved by Congress next year unless individual taxpayers start protesting now.

The concept is embodied in a bill called the "Capital Cost Recovery Act of 1979," sponsored by Reps. Barber Conable (R-N.Y.) and James Jones (D-Okla.) in the House and Lloyd Bentsen (D-Tex.) in the Senate. The proposal would scrap the current depreciation laws, which generally require that business assets be written off only as they wear out, in favor of much faster write-off rules. Under the bill, investments in non-residential buildings could be written off in 10 years—with about 75% of the deductions in the first five years—and most equipment purchases could be written off over five years—with 84% of the deductions in the first three years. (Investments in cars and small trucks could be written off over three years—with 89% of the deductions in the first two years.) In contrast, under current tax rules and standard financial accounting procedures, 25—50 year write-off periods are typically assigned to buildings and 5—35 year periods are used for various kinds of equipment.

The Capital Cost Recovery Act is not quite as good a deal as the oil industry currently gets: The "intangible drilling costs" deduction allows about 70% of the cost of drilling oil wells to be written off *immediately*. But supporters of the "Capital Cost Recovery Act" make no bones about their intention to press for immediate write-offs for all business investments "once the link between actual lives and tax depreciation lives is broken."

And, since expensing capital investments is the functional equivalent of eliminating the taxes on all but windfall income from such investments, the direction of the Capital Cost Recovery Act is toward scrapping the corporate income tax entirely—at least as it applies to big, capital-intensive companies.

Predictably, then, the major advocates for the bill are the country's largest firms. One of their principal lobbying arms is the same organization which successfully orchestrated last year's slashes

Some of the corporate members of the American Council for Capital Formation—banding together for more business tax breaks.

in capital gains taxes—a tax-exempt business league called the "American Council for Capital Formation." Members include Exxon, Mobil, and five other major oil companies, enormous conglomerates such as TRW and Tenneco, and dozens of other giant companies, such as AT&T, General Electric, IBM, U.S. Steel, and Chase Manhattan Bank. The association is dedicated, according to its statement of objectives, to virtually every means of lowering taxes on corporations and wealthy individuals, ranging from corporate rate cuts to reduced estate and gift taxes.

The Council members' battle plan on the Capital Cost Recovery Act is similar to that used in connection with the 1978 tax bill. Besides judiciously using campaign contributions, they are conducting a publicity blitz designed to shift attention away from the tax equity issues by putting forward extraordinary claims about the beneficial economic effects of faster write-offs.

As any advertising executive knows, the public—not to mention Congress—love things that are "new and improved." So the trade association has enlisted the aid of its members' writing and publicity staffs to promote the idea that the Capital Cost Recovery Act rep-

CAPITAL, see page 4

Why business doesn't like current write-off rules

It's easy to understand why big business wants to scrap what Rep. Barber Conable calls the "old and archaic concept" which underlies the current depreciation rules. The basic structure of the current approach is generally designed to lead to a reasonably accurate reflection of taxable income for businesses which make capital investments.

If someone puts $100 in the bank, for example, and at the end of the year has earned $5 in interest, it wouldn't be plausible to say he or she has had a $95 loss. Similarly, if a business buys a machine for $100 which generates $20 in gross income and at the end of the year the machine is worth $90, the company's income would be $10, not minus $80.

In order to simplify accounting and avoid requiring annual reappraisals of every piece of equipment, the tax code requires businesses to estimate the "useful life" of an asset and then write it off over that period.

For financial accounting purposes and in their annual reports to stockholders, most businesses depreciate their equipment using what is called the "straight line" method, writing off assets in equal installments over their expected life. For example, if a machine is expected to last 20 years, 5% of its cost (minus what its junk value at the end of the period is expected to be) would be subtracted from income each year: if it were expected to last 12 years, about 8% a year would be written off.

For tax purposes, depreciation is more rapid. The ADR system enacted in 1971 lets businesses use tax "lives" 20% shorter than the actual estimated lives, and other accelerated depreciation provisions allow a larger portion of the write-offs to be concentrated in the early years.

The depreciation tax breaks already in the tax code are costly—at least $4 billion per year—but the depreciation system is still linked strongly to the concept of "useful lives." The Capital Cost Recovery Act would break this link, and add close to $20 billion to the existing price tag on accelerated depreciation when fully phased in. Since corporate taxes total only about $70 billion, the bill would mean a corporate tax cut of over 25%.

Once the link between real and tax depreciation is broken, big business's long-run goal is immediate expensing of capital investments. This step would come close to eliminating the corporate income tax entirely. As economists have long noted, expensing of capital investments is the functional equivalent of taxing the profits from such investments, unless the yield is substantially in excess of what was reasonably expected. Thus, the corporate income tax would degenerate into what might be called an "excess profits tax," hitting only companies which, because of technological breakthroughs or unforeseen events, have returns on investment well in excess of the corporate average.

Reps. Barber Conable and James Jones

CAPITAL, from page 3

resents a "new wave" of economic thought, a "new" concentration on "supply-side" economics, as opposed to the "old" approach of most economists, who allegedly focus exclusively on aggregate demand.

Leading the charge are two Council members with long experience in propagandizing. The first is Mobil Corp., whose chief lobbyist chairs the Council's "Economic Education Committee," a subgroup whose mission is "to communicate a greater understanding of the American economic system and the importance of capital formation." Mobil's contribution has been to devote several of its famous newspaper ads to essays and "fables" on the need to be nicer to big business, especially as far as taxes are concerned.

The second is Time, Inc., also represented on the "education" committee. (An early endorser of capital gains cuts last year, Time, Inc. was rewarded with a provision in the 1978 tax bill lowering the income taxes on its timber subsidiary.) Beginning with a glowing account of the Conable-Jones bill in its June 4 issue ("Pressing A Capital Idea"), complete with a box paying tribute to Congressman Jones, *Time* magazine has offered its readers a hard sell for the Council's economic ideas. The August 27 issue followed up with a cover story puff piece in praise of the "new economists" whose "bold new ideas" will "set the economy right."

Quoting extensively from the business-oriented views of conservative economists like Martin Feldstein, Arthur Laffer, and Michael Boskin, *Time* uncritically endorsed virtually every tax measure designed to reduce taxes on investment income, including the value-added tax (coupled with lower taxes on corporate profits), tax exemptions for interest income, and of course, increased tax incentives for business investment. The article concluded by claiming that the "investment-boosting, regulation-cutting, supply-expanding recommendations of incentive economics are gaining more support every day," and that their adoption by Congress could make the 1980s a great improvement over the dismal 1970s.

Time's claim that a policy of corporate tax slashing would distinguish the 1980s from the 1970s is more than a little disingenuous. In fact, starting the 1980s with business demands for increased "capital formation" subsidies—and, in particular, for more accelerated depreciation—is startlingly reminiscent of the events of the past decade. The 1970s have been characterized by a series of stunning corporate tax cuts, beginning, coincidentally enough, with sharp increases in depreciation write-offs. In 1971, the Nixon administration—one of whose advisors included "incentive economist" Arthur Laffer—sought and obtained enactment of the ADR system of accelerated depreciation, which shortened depreciation lives—and upped depreciation write-offs—by 20% (for those corporations large enough to be able to take advantage of it). The Nixon package also included a 7% investment tax credit for purchases of new equipment (a similar credit had been repealed in 1969), and the export subsidy, DISC, which exempted from taxation half the profits from exporting.

When these "supply-side" tax cuts failed to revitalize the economy sufficiently, further attempts followed. In 1975, depreciation deductions were further liberalized and the investment credit was increased to 10%. Last year, the top corporate rate was cut, the lower rates graduated, and the investment credit expanded and made permanent. The result has been to cut effective corporate rates by about 30%, and to reduce the share of Treasury revenues supplied by corporate taxes from 19.5% in fiscal 1969 to an estimated 14.1% in fiscal 1980. At the same time, of course, individual rates have remained about constant, supplying about 45% of budget receipts, and social security taxes have increased enormously, from 21% of receipts in fiscal 1969 to 32% in fiscal 1980.

This enormous shift in the tax burden from businesses to individuals, from capital to labor, has not satiated the appetites of the corporate lobbyists, nor has it diminished the capital investment "problem" they bemoan. Instead, the exact opposite has occurred: Appetites have been whetted and the "need" for further business tax cuts has allegedly increased.

Old-fashioned believers in learning by trial and error might think that the failure of business tax breaks to solve our economic problems in the 1970s argues for a different approach in the 1980s. But the "new wave" economists advocate a bolder plan: Start the next decade exactly as the last, with further increases in depreciation write-offs. There *is* one difference this time: As already noted, many supporters of the Capital Cost Recovery Act see it as the first step toward complete elimination of the corporate income tax, and potentially *all* taxes on investment income.

Many of the academic advocates of cutting taxes on investment income summarily dismiss complaints about the likely damage to tax fairness. Economist Michael Boskin of Stanford, for example, maintains that "we can set the rates in an expenditure tax as progressively, or more progressively, than in the current tax." The business and political supporters of lower investment income taxes are not so naive; they recognize that the practical result of their programs would be a serious reduction in the progressivity of the tax system. But curbing what Barber Conable calls the "redistribution of income and wealth from the productive segments of our society to the non-productive" is a goal to which the backers of the Capital Cost Recovery Act are enthusiastically and unabashedly devoted.

They don't hide their views on progressivity, but the lobbyists for Conable-Jones much prefer to concentrate their sales pitch on the economic

Inflation and depreciation

One of big business's favorite arguments in support of faster tax write-offs is that inflation has made the current depreciation rules unfair. In support of their claim, they point to analyses done by some of the "new economists," in particular Martin Feldstein, President of the National Bureau of Economic Research. In a recent study, Feldstein maintains that companies are paying taxes on $40 billion a year in "phantom profits" that really represent understated depreciation. Is there anything to this contention?

That inflation can hurt investors is obvious to anyone who has a savings account. A rising price level also reduces the value of depreciation deductions, since an asset is purchased with "real" dollars, while the write-offs in later years can be in deflated ones. But counterbalancing the damage caused by inflation are the many tax breaks in the Internal Revenue Code for capital investments.

Feldstein's approach in his study, however, is to ignore the tax expenditures for business investment. It's reminiscent of the method he used last year in a study purporting to show that inflation was causing the overtaxation of capital gains. His major premise for his conclusion was that the inflation-offsetting effects of the (then) 50% capital gains exclusion should not be considered! If the tax savings from the exclusion were taken into account, his data showed that inflation was far more than offset, especially for the high income people to whom the capital gains cuts were targeted.

Similarly, a close look at the current tax breaks for capital investments shows that Feldstein's conclusions in his more recent study aren't supported by the data either. The combination of the ADR system of shortened depreciation lives, accelerated depreciation formulas, and the investment tax credit yields tax benefits for corporations well in excess of what would result from correcting book depreciation of equipment for inflation. And as Feldstein himself admits, for real estate the tax benefits (and inflation offsets) are even greater. Unlike most of us, business has been able to stay ahead of inflation.

wonders which their bill will allegedly produce. In spite of the fact that the current level of business investment is close to its all-time high as a percentage of GNP (even not counting investments in pollution control equipment), supporters of faster write-offs argue that their measure is needed to spur even more investment. They point to the decline in labor productivity gains in the 1970s, and maintain that only a surge in capital spending to higher levels than ever before can revitalize our economy. Without this intensified investment, they contend, our future standard of living will be too low.

There's no question that replacement of workers with more efficient machines has historically been one of the major factors in boosting labor productivity—along with improvements in "soft" technology and advancements in worker skills. But the other side of the coin is that worker productivity *suffers* when machines become *less* efficient, and that is exactly what happened as energy prices shot up in the 1970s. And unfortunately, the recent OPEC price increases and the decontrol of domestic oil prices are going to reduce the efficiency of machines even further (at least in the short run), and labor productivity will again suffer.

In the face of higher energy prices, it is, of course, necessary for businesses to become more energy-efficient. Quite rationally, they have already moved quite far in this direction—using machines that require less energy and placing greater reliance on labor. This has mitigated the effects of higher energy prices, but the fact remains: We are less rich because of the OPEC cartel than we otherwise would be.

The Capital Cost Recovery Act operates on the premise that changes in the tax laws can reverse the effects of higher energy costs. In fact, however, although most of the tax breaks it would grant would go to reward companies for doing what they would have done anyway, any economic effects the bill did have would be harmful to our need for greater efficiency and less waste.

For example, the bill would tilt business spending decisions in favor of equipment purchases even where the labor, materials, and energy necessary to construct and operate the machine utilize more of society's resources than would hiring workers. Excessively costly durable machines would be favored over less sturdy, more cost-effective ones, because the bill's flat 5-year write-off period favors machines with long actual lives. And perhaps most significantly, real estate would attract more capital, and equipment purchases less, because the bill grants its largest breaks to investments in commercial buildings.

Even the proponents of the bill admit the problem with faster write-offs for real estate. *Business Week* notes that it "could be the best tax shelter opportunity to come along in years..., a tax bonanza for real estate speculators." Since *nobody* claims there's currently a shortage of tax incentives for putting up commercial buildings, why were faster write-offs for buildings included in the bill? Why indeed, since real estate subsidies are fundamentally inconsistent with the sponsors' putative goal of encouraging investments in equipment? The answer, backers of the bill admit, was that the real estate break was necessary to win the support of retailing and service industries—companies like Sears, Roebuck. "Politically, everybody had to get something," a tax lobbyist for a major corporation who helped draft the bill admitted to *Business Week*.

The willingness of the proponents of the Capital Cost Recovery Act to include real estate within the bill indicates how little they really care about or believe in the alleged economic benefits of their plan. Their main goal is simply to reduce taxes on large corporations and high income investors, that is, on themselves.

The Capital Cost Recovery Act represents the latest of several attempts to form a conservative-business alliance around a major structural change in the system of corporate taxation. Previous efforts to confront Congress with a unified front have either failed to come together or have quickly fallen apart.

One campaign was to end the so-called "double taxation" of dividends, under schemes loosely lumped in the category of "integration" of the corporate and personal income taxes. Begun in the Ford administration as simply a tax break for funds distributed to shareholders, this effort was essentially co-opted by liberal reformers, who saw integration as potentially a tax *reform* rather than just a tax *reduction* move. When reformers—including the Carter Treasury—began detailing how they would structure their integration plan, the business community quickly withdrew its support, much to the chagrin of Ways and Means Chairman Al Ullman (D-Ore.), a devotee of the concept.

Another plan—replacement of part of the corporate income tax with a value-added tax (the equivalent of a national sales tax)—has been favored for several years by Rep. Ullman, and more recently gained the endorsement of Senate Finance Chairman Russell Long (D-La.). It has run into trouble, however, with those, such as Rep. Conable, who fear its inflationary effects and its potential to be an addition to, rather than a substitute for, the corporate tax. Although Ullman is insisting on holding hearings on VAT this fall, and has promised to use the revenues from his tax to fund everything from social security cuts to faster depreciation write-offs, few observers give the measure much chance of congressional approval.

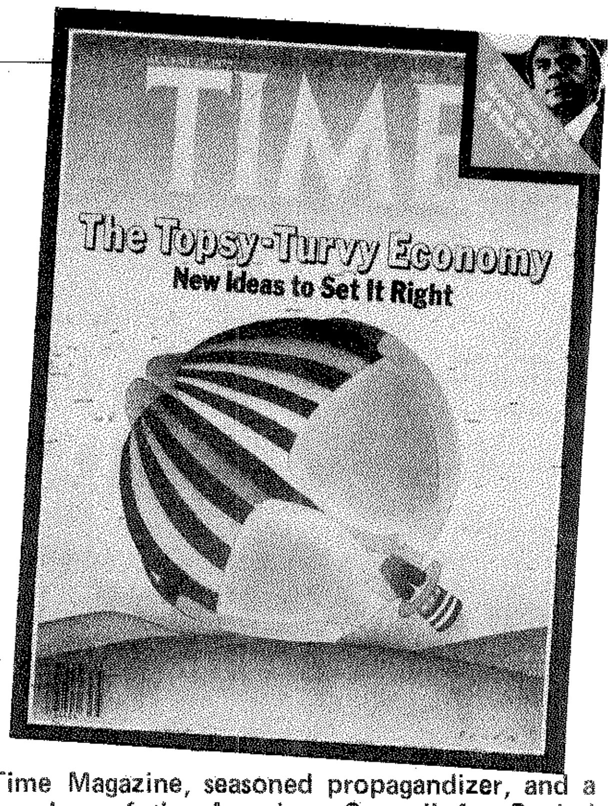
With these unsuccessful efforts in mind, Rep. Conable recently reminded a group of corporate lobbyists of the "significant amount of time [which] has been spent bringing together a Balkanized business community in support of" his bill. And he warned them that "any capital formation device on which the business community divides will fail in the existing Congress."

Whither productivity?

If the Capital Cost Recovery Act is approved by Congress, one reason will be that the lobbyists for the bill have convinced the legislators that their proposal holds out some hope for reversing the discouraging decline in labor productivity gains over the past six years. This will be in spite of the fact that most economists have little faith that the bill even addresses the real problem.

Since 1973, labor productivity gains have fallen to a fraction of the 2.4% per year they averaged in the previous quarter century. Some of the causes are obvious. OPEC's quadrupling of oil prices in 1973-74 is one. Another is a flaw in the measurement of productivity. In this decade, the U.S. finally started to pay attention to protecting the public's health, the environment, and worker safety. The *cost* of the laws and regulations implementing these overwhelmingly popular goals shows up on business balance sheets, but the benefits to society don't. The result —because of the GNP myopia of the Commerce Department's economic statistics—has been to make things look worse than they really are.

But energy and the environment fail to explain the whole plunge in productivity, and a recent study by the associate director of the Commerce Department's Bureau of Economic Analysis, Edward F. Denison, concludes that other factors sometimes cited don't add much to furthering the explanation. Denison looked at two dozen potential causes—ranging from government paperwork requirements to the effects of taxes on working and investing—and concluded that all of them put together did not come close to answering the riddle. While some other economists think that Denison underestimated the effects of higher energy costs, they agree that the cause of a large part of the slump is still unknown.



Time Magazine, seasoned propagandizer, and a member of the American Council for Capital Formation's "Economic Education Committee"

Whether the coalition can hang together this time is unclear. One big potential advantage for business is that new Treasury Secretary William Miller was pushing an approach similar to the Capital Cost Recovery Act back when he was at the Federal Reserve. In fact, Miller's suggestion would have gone even further, allowing investments in government-required equipment to be written off in *one* year—a feature even the supporters of Conable-Jones couldn't justify, since it would have allowed everything from pollution control equipment to elevators to indoor plumbing to have been written off immediately.

It's likely that Miller's enthusiasm for faster write-offs will wane after he has a chance to talk to Treasury tax policy experts. But if Treasury's natural opposition to the Capital Cost Recovery Act is muted, the business lobbyists will have only the slings and arrows of a few public interest organizations like the Tax Reform Research Group with which to contend.

Internal dissension within the Conable-Jones coalition could become the main stumbling block for the bill. Big business supporters of the plan scored a major early coup by getting the endorsement of the National Federation of Independent Businesses, and obtaining self-styled "small business advocate" Gaylord Nelson (D-Wis.) as a Senatorial sponsor. But the rest of the small business community is reportedly annoyed by the NFIB's action, and the *Wall Street Journal* has reported that the Federation is starting to hedge on its endorsement. Small business is not pleased that virtually all the benefits of the faster write-offs would go to large companies (perhaps 80% to the top 1/10 of 1% of all corporations), since they feel this disparity could increase big business's competitive advantage. And, even worse, the cost of the Capital Cost Recovery Act could jeopardize the kind of tax cut small business would prefer, a reduction in payroll taxes.

Furthermore, the apparent willingness of many proponents of the bill to jettison the real estate sections—for which no one has yet conceived even a sophistic justification—may antagonize the retail and service industries for whom the building rules were included. Senator Nelson has already expressed reservations about the 10-year life for structures, and Conable admits that some changes might have to be made.

Still, for the moment the momentum is all on the side of big business. Unless citizens make their voices heard and members of Congress are willing to stand up to the money-backed pressure of the giant companies, 1980 may be the beginning of the end for the corporate income tax. □

Corporate Giveaway

In trying to outdo each other with "favorable business clima

largest corporations –

and sending the taxp

and the federal gove

the bill.

Editor's note: The following is adapted from a Public Interest Research Group study, "Bidding for Business: Corporate Auctions and the 50 Disunited States." For a copy of the full 50-page report, write to PIRG, P.O. Box 19312, Washington, D.C. 20036. Individuals $5.00. Businesses and institutions $10.00.

by Jerry Jacobs

Last fall, the Missouri state Director of Commerce and Industrial Development made a trip to Michigan. His wasn't a particularly friendly visit: he was there to try to coax a number of Michigan firms to pack up and relocate in Missouri. With him he had a set of statistics comparing the two states, including information on their murder rates, frequencies of rapes, numbers of doctors per capita, and finally, the states' tax rates and prevailing wage standards.

Missouri's tactic is hardly unusual. Competition among states and localities for new industry is becoming increasingly widespread, and with it two devices used to attract industry, tax breaks and tax-exempt financing, are proliferating.

Since the mid-60's, almost every state has passed business tax subsidy measures, including income tax exemptions, investment tax credits, and state authority to localities to grant property tax abatements. Meanwhile, tax-free financing for industry has increased from less than a half billion dollars in bonds released in 1969 to *$3.5* billion issued in 1977. The problem is that, in spite of their growth, there is no indication that these schemes are actually working to attract new firms. And while the *costs* to states and localities—and, in the case of tax free revenue bonds, to the federal government and low- and middle-income taxpayers—are rising, the *benefits* accrue to the nation's largest corporations.

How this happens is easy to see in the example of tax-free financing, or industrial development bonds.

States and localities frequently borrow to finance the construction of schools, public buildings, roads, and other capital projects. The interest on their bonds is exempt from federal income taxes, and usually state and local income taxes as well. The tax-free nature of these securities allows states and cities to borrow more cheaply than they otherwise could, because investors are willing to accept a lower rate of interest in exchange for avoiding taxes on the income they receive. Tax-free securities are most attractive to the wealthiest investors, those in the highest tax brackets, who stand to gain the most by avoiding federal income taxes.

In 1939, the state of Mississippi significantly broadened the accepted application of the bonds by authorizing their use to finance the construction of industrial facilities. This way a municipality was allowed to offer its tax-free borrowing privileges as a lure to industry, in effect becoming a middleman between investors and corporations. Businesses saved a couple of percentage points in interest costs, while the cost to the locality was limited mostly to administrative expenses. Meanwhile the federal government effectively subsidized banks and high income investors who purchased these securities because of their tax-free status.

After the Mississippi move, it was, of course, only a matter of time before other states followed suit. By the mid-1960's, the use of industrial development bonds was increasing at an exponential rate. The federal government was concerned about the drain on the treasury: the growing amount of tax-free financing increased the availability of tax shelters for the wealthy and imposed substantial costs in lost federal revenues. Bond specialists worried about the intrusion of government in an increasingly large share of industrial financing decisions. The Investment Securities Association urged the curtailment of the industrial development bond tax exemption. Others suggested the complete elimination of tax-free status for all municipal bonds.

In late 1968, Congress finally acted, restricting the tax exemption on industrial development bonds to $1 million per issue. The limitation was designed to allow depressed areas to channel venture capital to small companies. But at the urging of E.F. Hutton, a seemingly minor exemption was made for pollution control bonds, which received tax-exempt status no matter how large the issue. And, in true loophole fashion, in 1971, an amendment was passed to increase the $1 million limit on all other issues to $5 million—and in 1978 the limit was increased once more, to $10 million per project.

Currently, 47 states issue industrial development bonds. Of course, since almost all states and localities now have more to offer industry, none is put in a stronger position, and the only clear-cut winners are corporations—especially large corporations. In fact, of the over $18 billion in tax-free bonds issued over the past 20 years listed in *Moody's Municipal Manual*, a hefty $12 billion or 67% in tax-free financing has been issued to corporations employing more than 5,000 people. The amount issued to companies with annual sales in excess of $1 billion totals nearly $10 billion, or 53% (see chart). If 1978 bond issues were included, these figures would each increase by over $1 billion. In addition, thirty-three companies each have received over $100 million in industrial development bond financing (see box, page 8). The list includes well-known companies, such as Dow Chemical, Monsanto, American Airlines and U.S. Steel, as well as large companies perhaps less familiar to the general public such as Union Camp and the Mead Corporation. The amount issued to these 33 companies totaled over $6.3 billion, about one-third of the total in our sample.

Large corporations seem to be able to exploit both geographic diversity and geographic concentration to their own advantage. Corporate giants, such as Boise Cascade, International Paper, DuPont, and Union Carbide, are able to use their numerous branch locations without any single government agency informed of the full extent of the subsidy. Many other companies—Armco Steel in Ohio, Scott Paper in Maine and Alabama, Stauffer Chemicals in Tennessee, Georgia Pacific in Arkansas and Louisiana—are able to obtain dramatic amounts of governmental assistance from a single state.

Besides unfairly benefiting large corporations, tax-free financing is inefficient. Of the current $1 billion in annual revenue loss to the Treasury, only about $714 million is translated into lower interest rates. Put another way, the federal government loses about $1.40 in tax revenues for every dollar in interest reductions received by corporations. The rest is a windfall for the purchasers of the bonds. The reason for this inefficiency is as follows: with a market rate for

and the Fifty States

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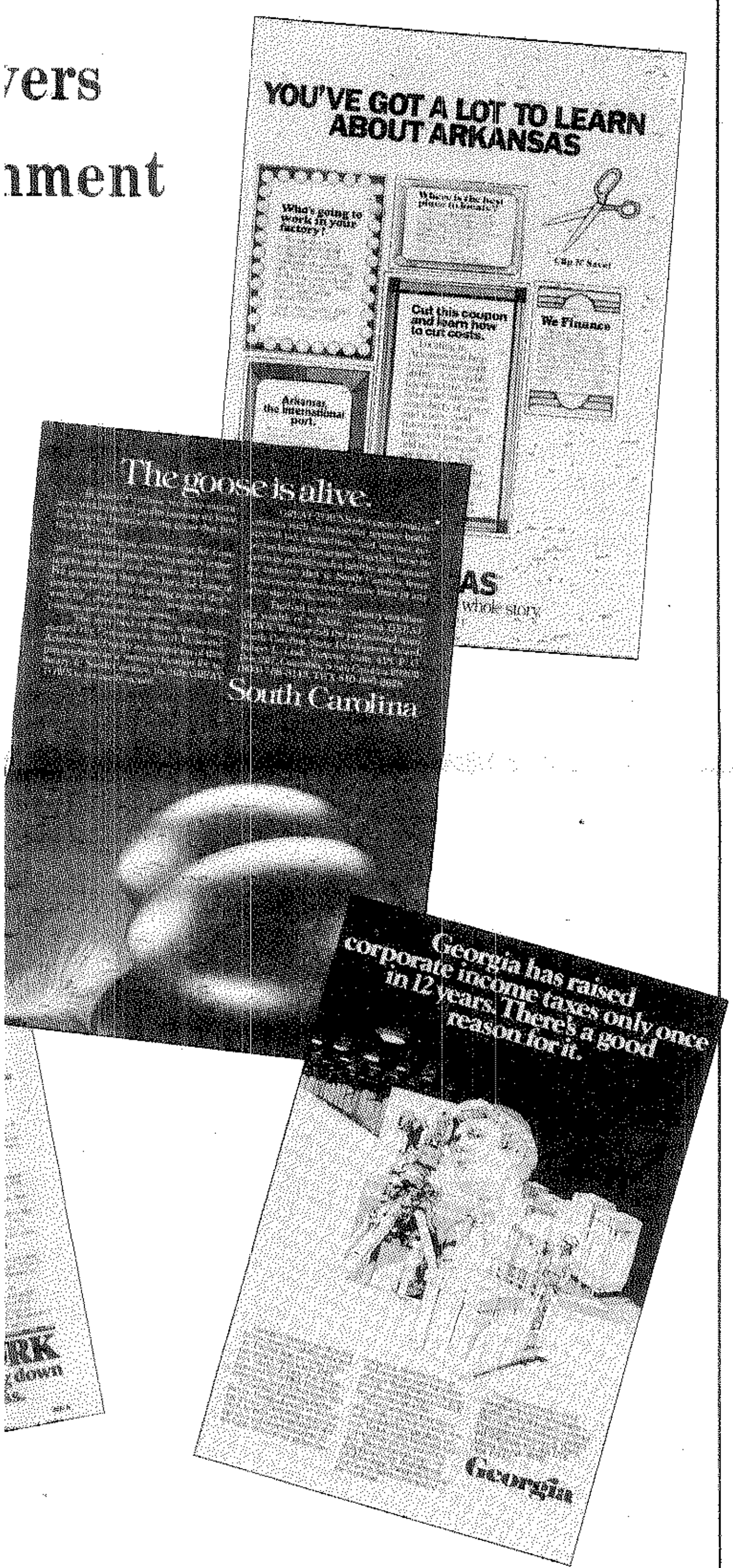


taxable bonds of 10%, a taxpayer in the 50% bracket would be willing to buy a tax-free bond paying only 5%, since this will yield the same after-tax gain as if he or she received 10% and paid a 50% tax. A person in the 70% tax bracket would accept a tax-free yield of only 3%. In order to attract a wide range of lenders, however, interest rates on industrial development bonds are set to appeal to taxpayers in the 30% bracket and up. This means the bonds currently yield about 7%, tax free. Investors whose marginal tax rates exceed 30%—and the average bond purchaser is in the 42% bracket—receive a windfall,

FINANCING, see page 8

Which companies benefit from tax free financing? Why, the very biggest.

Tax-free financing issued to nation's largest corporations, by state (in $ millions)

	total issued	issued to corporations w/ 5,000+ employees	% of total	issued to corporations w/ $1 billion+ sales	% of total
Alabama	$1450	$1154	80%	$752	52%
Alaska	1263	1263	100	1263	100
Arizona	277	109	39	8	46
Arkansas	511	329	64	256	50
California	336	321	96	280	83
Colorado	207	135	65	31	15
Connecticut	72	21	29	12	17
Delaware	77	33	43	33	43
Florida	677	485	72	319	47
Georgia	560	524	94	441	79
Hawaii	0	0	0	0	0
Idaho	0	0	0	0	0
Illinois	557	296	53	272	49
Indiana	584	328	56	251	43
Iowa	442	247	56	229	52
Kansas	256	65	25	39	15
Kentucky	819	528	64	349	43
Louisiana	980	711	73	672	69
Maine	104	102	98	81	78
Maryland	262	230	88	125	48
Massachusetts	36	33	92	22	61
Michigan	658	569	86	495	75
Minnesota	216	27	13	23	11
Mississippi	247	98	40	83	34
Missouri	388	240	62	163	42
Montana	172	95	55	91	53
Nebraska	66	48	73	43	65
Nevada	49	9	18	4	8
New Hampshire	47	14	30	0	0
New Jersey	201	195	97	178	85
New Mexico	241	37	15	37	15
New York	307	207	67	147	48
North Carolina	1	1	100	0	0
North Dakota	113	1	1	1	1
Ohio	910	612	67	483	53
Oklahoma	297	186	63	175	59
Oregon	98	80	82	80	82
Pennsylvania	1024	624	61	469	46
Rhode Island	21	13	62	1	5
South Carolina	270	185	69	125	46
South Dakota	46	5	11	9	11
Tennessee	409	304	76	250	61
Texas	1059	793	75	729	69
Utah	165	87	53	0	0
Vermont	2	1	50	0	0
Virginia	441	301	68	261	59
Washington	37	37	100	37	100
West Virginia	522	178	34	118	23
Wisconsin	290	175	60	141	49
Wyoming	252	57	23	57	23
Puerto Rico	0	0	0	0	0
Virgin Islands	0	0	0	0	0
Total	$18,019	12,093	67%	9,635	53%

The federal government loses about $1.40 in tax revenues for every dollar in interest reductions received by corporations. The rest is a windfall for the purchasers of the bonds.

FINANCING, from page 7

a windfall paid for by the federal government and ultimately, the rest of us.

The question remains whether or not these subsidies are effective in promoting economic development. The answer is clear: industrial development bonds do not increase the stock of capital available for investment. The tax-exempt status of an industrial development bond makes it more attractive than an alternative investment: it is purchased by banks and other traditional investors who would have invested in other firms had the tax exemption not been available. In other words, industrial development bonds divert funds from other uses; they do not increase the total amount available for investment. As economist William Morgan of the University of Wyoming puts it, "From the national point of view, none of these things makes any sense at all. . . . You're not creating any new industry, just moving it someplace different."

Another problem, of course, is that financing subsidies cannot be effective inducements to locate in one particular place if they are practically universally available. The economic rationale behind incentives is that they tend to make location X more profitable and so more attractive than location Y. But industrial development bonds are so widely available now that no single place stands out as uniquely attractive to industry.

That the bonds do little to alter the companies' strategic decisions is actually borne out by statements of the business executives themselves. Robert Gulian, financial officer for Union Carbide, was asked if pollution control bonds had enabled Union Carbide to initiate additional projects that might not have otherwise been undertaken. "No," he answered. "I can say very positively that has not been the case. We always identify the project first and then go to the municipality." Similarly, Arthur Harrigan, Executive Vice-President for Finance with the International Paper Company, said, "I am not aware of any attempt to locate in a state where the lack of pollution control financing altered our investment plans." As Walt Muhall of Monsanto Corporations's Treasury Office explained, "You put on pollution control equipment for one of two reasons—you have to in order to meet government regulations or because you want to in order to meet your responsibility to keep the environment clean."

For these large corporations, then, it seems clear that the financing subsidies they are receiving have not profoundly influenced their investment decisions. Yet Union Carbide had received over $170 million in tax-free financing; International Paper, $145 million; and Monsanto, $130 million.

At least one state economic development official agrees that the subsidy programs have little effect. The economic development specialist for the Idaho Division of Tourism and Industrial Development responded to our questionnaire on corporate subsidies: "You will quickly notice that most of the questions receive negative responses, as Idaho has no tax abatements and issues no industrial revenue bonds. Furthermore, it is our opinion that we have not been hurt by not having these programs. We are still able to compete with most Western states."

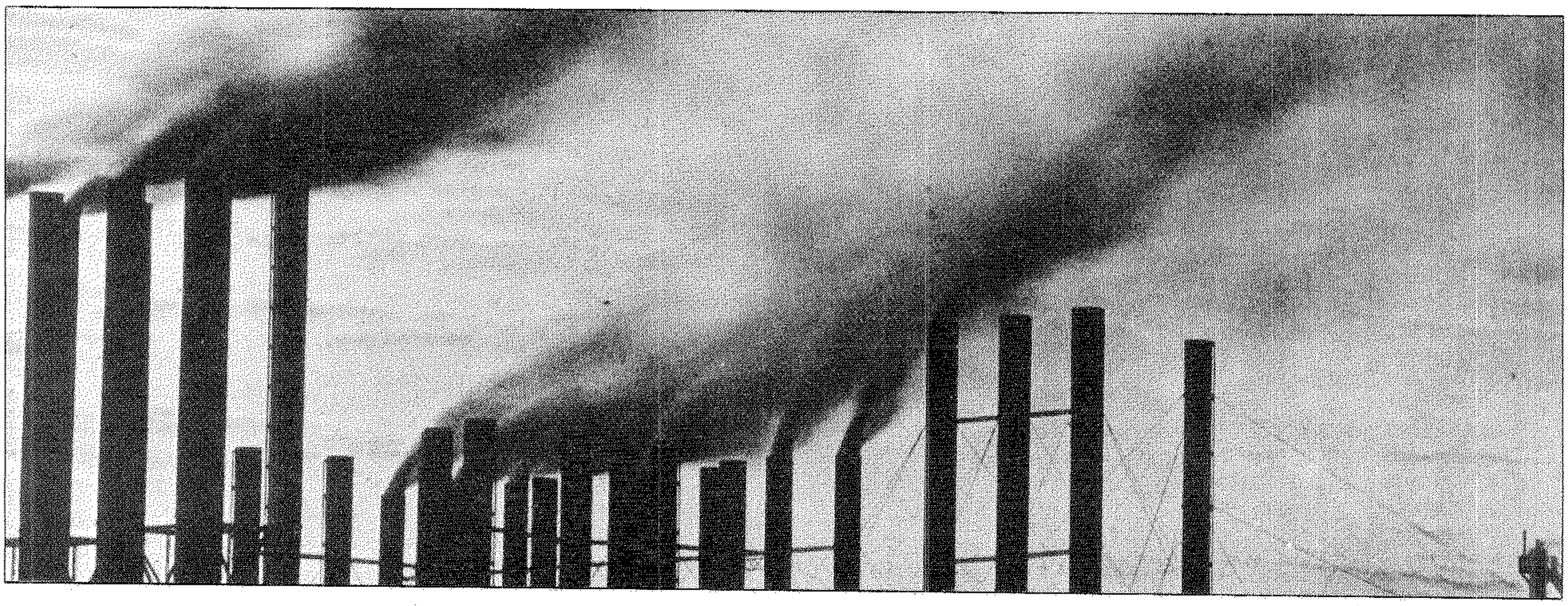
Who benefits?

33 companies receiving $100 million or more in industrial development bonds

Corporation	Amount received (in $ thousands)
Alabama Power	147,800
Allied Chemical	173,110
American Airlines	132,425
Armco Steel	250,220
Atlantic Richfield	388,060
Bethlehem Steel	100,000
Boise Cascade	161,185
Champion International	191,400
Commonwealth Edison (Illinois)	135,000
Container Corp. of America	109,790
Detroit Edison	194,455
Dow Chemical	127,025
Eastern Airlines	101,500
Georgia-Pacific	242,710
Georgia Power	150,000
Hercules	115,000
Inland Steel	115,000
International Paper	145,000
ITT	105,250
Mead	142,425
Monsanto	132,020
Northern States Power	108,650
Ohio Edison	105,000
Phelps-Dodge	121,400
Public Service Co. of New Mexico	124,045
Republic Steel	122,300
Reynolds Metals	125,100
Shell	164,950
Standard Oil of Ohio*	674,000
TWA	158,290
Union Carbide	172,500
Union Camp	123,070
U.S. Steel	412,500

* jointly with British Petroleum

Below: Business executives themselves admit that tax-free financing has nothing to do with their decisions to invest in pollution control bonds.



Capital Gains Tax Cut Fever

The states are catching it from the federal government

by Frank Domurad and Marvin Shapiro

Last November when Congress passed what many observers consider the most anti-reform tax legislation in recent years—lowering the already preferential tax rate on capital gains (gains from sales of stocks, bonds, or other assets, ordinary taxpayers were told that the measure would encourage new investment, raise stock prices, reduce the cost of capital, and create jobs.

It hasn't happened. Standard and Poor's stocks have grown by only one percent in the last two quarters. Because of inflation and economic uncertainty, there has also been no surge in new investments and new jobs. In the meantime, 95% of the windfalls created by last year's legislation are being realized by the top 20% of the nation's taxpayers, while the rest of us are left to pick up the tab. According to the *New York Times*, "The only clear winners from the tax cut appear to be the people who are actually taking capital gains and paying less tax."

In fact, the federal tax windfalls for recipients of capital gains have been so enormous that they are now attempting to extend their victory to the states. Mouthing familiar phrases about economic prosperity and jobs, business leaders and wealthy investors have invaded state capitals *en masse*. And just to make certain that their message is heard, they threaten to leave in the same way, warning state officials and state legislators that a failure to adopt the new federal preferential rate will induce a dramatic outflow of capital to more favorable climes.

In eighteen states and the District of Columbia (see box), wealthy taxpayers have already won, without lifting a finger. These states have "federalized" their income taxes by accepting the IRS definition of adjusted gross income and automatically implementing any changes Congress makes in that definition. The advantage of states federalizing their systems is obvious since the returns filing process is much less painful for the taxpayer. But the *dis*advantage is that whatever regressive measures that pass in the U. S. Congress are automatically adopted by the states. Thus, when Congress raised the capital gains exclusion from 50% to 60% last fall the tax break was simply passed through to the federalized states, without legislative discussion or vote.

In states that don't federalize their tax system, the adoption of the new preferential rate is being hotly contested. In California, for example, a recently defeated piece of legislation called for an increase in the exclusion of capital gains income from 50% to 60%, thereby matching the federal level. Capital gains loopholes already cost the state $303 million annually and the proposed bill would have raised the tab another $60 million. But the real clincher in the debate was the regressive effect that further preferences would have had on an already weakened progressive income tax. As the California Tax Reform Association testified, "Sixty-eight percent of the benefits from this bill will go to the wealthiest 7% of the people, while only 9% of the benefits go to the bottom 66% of the taxpayers."

The fiercest struggles over capital gains, however, are not occurring in states that already provide some preferential treatment, but in those where capital gains are taxed fully as income. Here the legislative battle being waged in Wisconsin is of special note.

Wisconsin was the first state in the union to introduce an income tax, even preceding the federal government by two years. Ever since, the tax has been a thorn in the side of wealthy taxpayers. Until early this year when the maximum personal income tax rate was lowered from 11.4% to 10%, the state levied the heaviest effective tax on capital gains in the nation. Unfortunately, this step merely whetted the appetite of rich investors for more. In recent weeks, legislation to federalize the state's treatment of capital gains has sprouted like crabgrass.

The business community has assumed the lead in the fight. In testimony before a senate subcommittee on tax reform, one business spokesman argued that it was unfair to tax capital gains fully as income because in today's economy such profits were "caused solely by inflation." Such a tax amounted to a levy on capital and cut "deep into the hard-earned savings of Wisconsin residents." Pity, for instance, the unfortunate wealthy persons who would have to "leave the state prior to disposing of substantial investments to escape the tax." *Their* misery would rebound on everyone else, for they would take with them to more comfortable surroundings potential income and inheritance taxes.

In response to these charges, tax reformers have refused to give ground or be stampeded. Their rebuttal has been simple and direct: Wisconsin has a satisfactory progressive income tax which it should not weaken for the sake of the well-to-do. The wealthiest 2% of the state's population possess 50% of all capital gains accrued. Observed one state representative, "Windfalls for the rich do not result in relief for the rest of us." □

States which treat capital gains as income:

Alabama, Alaska, Arkansas, Colorado, Illinois, Indiana, Louisiana, Massachusetts, Mississippi, Missouri, New Jersey, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, and Wisconsin.

States which federalize their tax systems:

District of Columbia, Delaware, Georgia, Iowa, Kansas, Kentucky, Maine, Maryland, Michigan, Montana, Nebraska, New Mexico, Oklahoma, Rhode Island, South Dakota, Utah, Vermont, Virginia, and West Virginia.

States which give their own preferential treatment to capital gains:

Arizona	50% preferential rate
California	50% preferential rate
Connecticut	60% preferential rate
Hawaii	50% preferential rate
Idaho	60% preferential rate
Minnesota	50% preferential rate
New York	40% preferential rate

States with no broad-based income tax:

Florida, Nevada, New Hampshire, Tennessee, Texas, Washington, Wyoming.

Source: Commercial Clearinghouse, State Tax Departments.

State & local briefs

Massachusetts and development

Massachusetts needs jobs, and over the past few years it has run through one futile tax scheme after another in order to generate employment. The lastest venture in this series is the Massachusetts Industrial Finance Agency (MIFA)—a state agency whose sole purpose is to issue tax-exampt industrial revenue or pollution control bonds, thereby providing business with cheap capital financing.

The scheme works like this. MIFA issues federally sanctioned tax-exempt bonds for industrial expansion or pollution control and loans the proceeds to eligible businesses at a low interest rate. In turn, the business assumes the responsibility for paying back the loan to the creditors.

Everyone except the federal treasury and taxpayers who must foot the bill comes out ahead. Business is happy because it can save money on loans it probably would have taken out anyway. Investors are happy because they have yet another tax loophole to exploit. And the state's politicians are pleased to have another "job creation" program they can parade before anxious voters.

Over its one year's existence MIFA has handed out some $110 million in tax-exempt bonds and claims 850 new jobs as a result. It even hopes in the future to use tax-exempt financing "for all industrial expansion" in the state.

But before MIFA can reach such an ambitious goal, it has to clear up a few problems, the most important of which is the justified suspicion of business, banking, and real estate leaders that all this is a bit too good to be true. "Surely the delays, the high bond counsel fees, underwriters' fees, printing expenses, and bureaucratic red tape which seem to accompany every government benefit must make MIFA yet another in the long list of government programs to be avoided by all but the desperate," according to one agency brochure. "Only experience and hard work will completely dispel this suspicion, but the truth is that tax-exempt loans have gone primarily to anyone *but* the desperate. Indeed, nationally it has been the larger corporations with the established credit ratings which have received the most benefits from this program."

MIFA's assurance that it isn't the needy firms that receive tax-free financing has been more than substantiated by its actions. Of the $110 million handed out to business over the past year, $96.5 million went to New England Power Company to convert its Brayton Point electrical generating station from oil to coal. In all, the company will save $78 million in interest over 27 years or about $3 million per year. As for the jobs created through this massive tax give-away, besides the temporary work to be done on the conversion itself, not one long-lasting position can be expected from the project. □

On surpluses, deficits, and tax cuts

When states were sporting fat budgetary surpluses last year, tax cuts for big business and the rich became all the rage. Governors and state legislators all but fell over themselves in the rush to lower maximum corporate and personal income tax rates, exempt machinery and equipment from the sales tax, and increase the capital gains preference rate.

Now with a recession in the works, the bill for such ill-considered tax breaks has come due. Not only is one state after another seeing its revenues decline while the demand on services soars, but many others are also confronted with statutory or constitutional mandates forbidding deficit spending.

Commerce Department figures reveal the full extent of the budgetary turn-around, described by one private analyst as "the sharpest ever recorded." From a surplus of $8.4 billion in the first quarter of 1978, the combined operating balances of states and localities has sunk to a deficit of $6.1 billion in this year's second quarter. Even worse are current predictions that this deficit will exceed $9 billion by the end of 1979 and linger near $12 billion during much of 1980.

Among the hardest hit states is California, where Proposition 13 slashed property tax revenues by 50%. The once massive $4 billion surplus of June 1978 dropped to $2.5 billion this year and is expected to decline another $1 billion by next. This means far less "bail-out" money for hard-pressed localities than was previously anticipated. According to one high official in the state Finance Department, "we'll have to reorder priorities and say no to a lot of different things" to balance the budget.

Other severely affected regions are the industrial Northeast and Midwest, where state governments are already on the brink of deficits. In New York State Budget Director Howard F. Miller foresees a small surplus for this year, "but our projections for 1980–81, starting next April, are grim" with perhaps a deficit in the hundreds of millions.

What accounts for the squeeze in New York now that the recession has come? "We did a large tax-reduction program, and we've got to pay for it," said Miller. The reduction consisted in lowering the maximum income tax rates from 12% to 10%, a move that will cost the state $190 million a year in benefits to taxpayers with net taxable incomes over $17,000. A manufacturing exemption cutting the sales tax on tools, supplies and some parts used in producing consumer goods in half, will save businesses some $48 million a year.

To make matters worse, states can expect little or no assistance from the federal government. General revenue sharing may be allowed to expire in fiscal 1981, costing a state like New York some $245 million. It seems that the lawmakers are a bit miffed over certain governors' efforts to force a balanced federal budget amendment into the Constitution, while expecting Washington to help them balance their own state budgets. □

The scramble for Alaskan windfalls

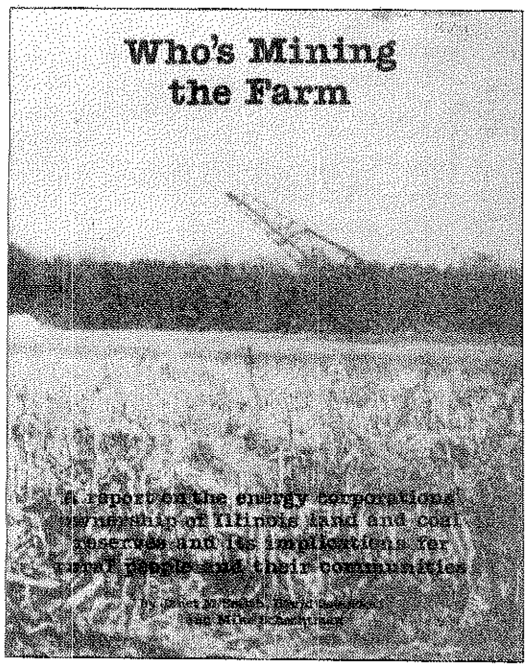
While most other states are confronted with declining fiscal fortunes due to the recession, Alaska finds itself in the midst of a financial boom—but ironically one that, if

BRIEFS, see page 11

Left: The "What's good for business is good for America" thinking that leads to huge corporate loopholes and subsidies.
photo: Library of Congress

Resources

The August 1979 issue of P&T featured an article on taxing the coal industry. Below are some useful resources covering the topic.



Who's Mining the Farm
by Janet M. Smith, David Ostendorf, and Mike Schechtman

When people think about coal mining they don't often think of Illinois. But Illinois currently ranks fourth among the nation's coal producing states. Who owns that coal wealth and what effect coal exploitation will have on farming in the state forms the major subjects of this detailed study.

Available from:

The Illinois South Project, Inc.
101 1/2 North Park
Herrin, Illinois 62948

$4, individuals
$8, institutions and organizations
$25, corporations and their representatives (include $1 for handling)

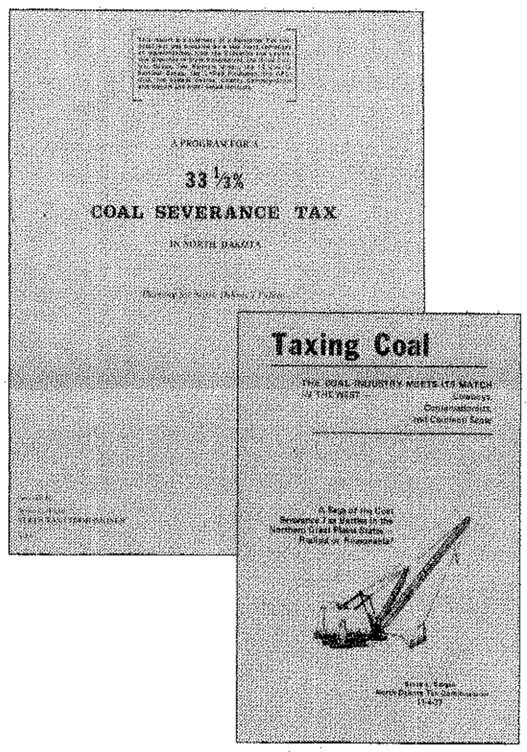
A Landless People in a Rural Region: A Reader on Land Ownership and Property Taxation in Appalachia
edited by Steve Fisher

The myth of Appalachia as a mountainous region in the eastern United States which somehow stumbled into poverty is effectively exploded in this collection of essays. In one article after another it is demonstrated that poverty in the region is not a quirk of nature or an accident, but the result of unjust landholding patterns, the failure of state and local governments to tax mineral wealth, and the destructive and insensitive role of the federal government.

Available from:

Highlander Center
Rt. 3, Box 370
New Market, Tennessee 37820

$7.50 (extensive bibliography available for $1 extra)

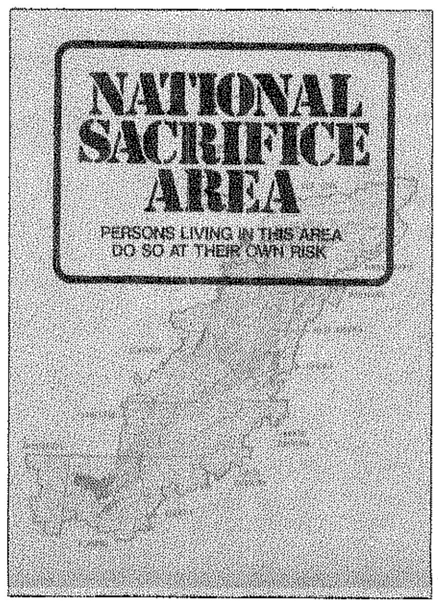


Taxing Coal, and A Program for a 33 1/3% Coal Severance Tax in North Dakota
by Byron L. Dorgan

These two pamphlets are must reading for those concerned with reforming coal taxation. As Tax Commissioner of North Dakota, Dorgan effectively debunks business' arguments against a reasonable severance tax that will cover all the costs, including health and environmental, involved in mining coal for profit.

Available from:
North Dakota State Tax Department
State Capitol
Bismarck, North Dakota 58505

Free of charge



National Sacrifice Area
by the Appalachian Alliance

How is it that one of the richest coal mining regions in the world is the scene of such human suffering and poverty? This publication from the Appalachian Alliance shows how the region is drained of its resources by outside corporate interests and receive little in return in the way of taxes.

Available from:

Appalachian Alliance
c/o Beth Spence
515 Harvey Street
Williamson, West Virginia 25661

$1 □

BRIEFS, from page 10

coupled with demands for massive tax cuts, could leave the state close to bankruptcy by the next decade.

Alaska's financial good fortune derives from oil. Now that the North Slope is in full production, the state treasury in Juneau is awash in money. Just recently the state raised royalty payments from producing companies, and current estimates predict that over ten years some $6 billion annually will be collected as a result. Already oil revenue has pushed the state's once anemic budget into the black. By next July the budgetary surplus will amount to $600 million, with some observers setting the actual figure in the neighborhood of $1 billion.

Needless to say, such public riches have spawned numerous schemes on how to use them. The business community in particular is pushing for improvements in Alaska's "backward" road system as well as the construction of new docks and harbors for an expanding fishing industry. It is also promoting tourism and the resorts that go along with it.

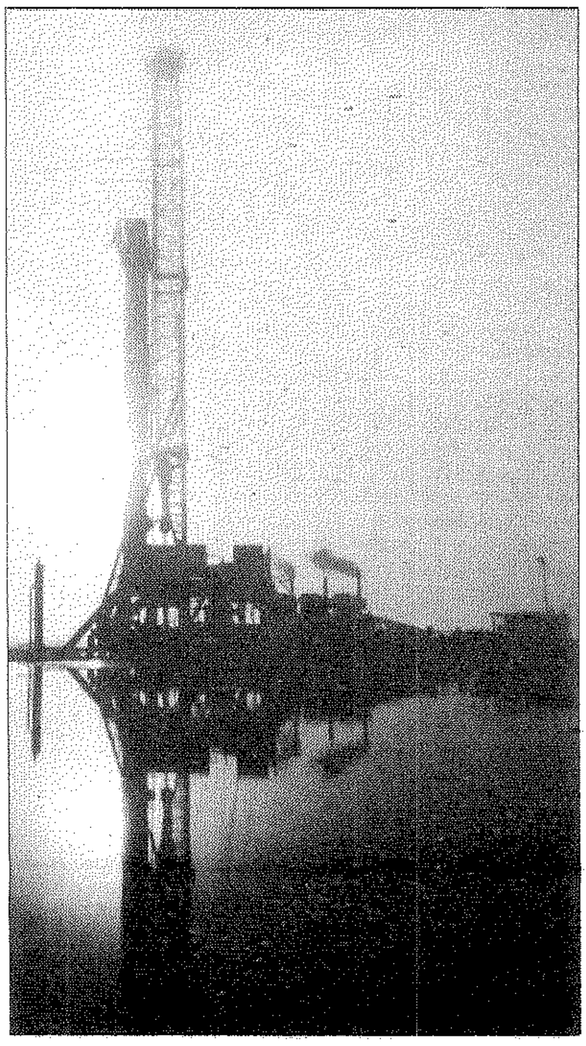
But for an even quicker fix, business has proposed simply eliminating the state's income tax, a move that would cost $150 million a year in lost revenues. Much, if not most, of this money would be immediately taken out of the state by corporations and wealthy individuals sticking around only as long as the oil holds out. Commented an obviously piqued Governor Jay Hammond about the business proposal, "Do we really want to see the fellow who made $90,000 in pipeline construction on the North Slope and drew Alaskan unemployment in Hawaii leave no tax money in his wake for the privilege of coming up here and depriving some Alaskan of a job?"

By way of a counterproposal, Hammond has called for a state income tax credit that would increase with each year of a person's residence in the state. He insisted that such a tax credit would spread around the oil money and be fairer to the elderly, the young, the poor, and to native Alaskans than simply repealing the income tax.

Meanwhile, liberal legislators are attempting to use current oil revenues to insure Alaska's economic future without manipulating the tax system. The state already places an automatic 25% of well-head income in a permanent fund, and they would like to see this percentage increased. In this way, they contend, the state's tax base would not be eroded, while avoiding the prospect of economic disaster once the oil wells stopped pumping. □

Issues

Windfall Profits Tax: When President Carter linked the tax on decontrol profits to his massive synfuel program, he hoped that this would encourage supposed synfuel supporters on the Senate Finance Committee not to gut the tax. Instead, the strategy backfired. The environmentalists, who had been providing most of the lobbying support for the tax, lost much of their enthusiasm. And big oil, to whom the Finance Committee members are responsive, quickly reversed its position on synfuels, suddenly noticing the many problems involved. The result has been to remove any real pressure for the Finance Committee to approve a serious tax, and so far the merry buccaneers on the Committee have approved so many exemptions to the tax and so many tax credits that their current proposal actually *loses* money, leaving nothing for low-income relief or mass transit.



Carryover Basis: As predicted, the Finance Committee has tacked repeal of this 1976 income tax reform onto the windfall profits tax bill, by a unanimous 18—0 vote. On the House side, Republicans apparently have at least 227 members (more than half) lined up to approve the non-germane amendment. It's a disaster for tax reform.

Bigger Write-Offs for Big Business: Momentum is growing for proposals to gut the corporate income tax by speeding up depreciation write-offs. But some chinks in the business coalition are also appearing, especially on the part of small business and retailers. See page 3.

Mortgage Bonds, Exemptions for "Small Savers": A vote should be coming up relatively soon in the House as to whether additional subsidies for homeownership are needed. Ways and Means has approved a bill allowing, within limits, the use of tax exempt financing to provide cut-rate mortgages. The costs of this plan exceed its benefits by a 2-to-1 margin, but some members feel this is too efficient, and would prefer to provide a tax exemption for $100 in savings per taxpayer to encourage people to put money in the bank. This is expected to provide about a dollar in new mortgage money for every ten dollars in revenue loss. Which alternative the House will choose is still unclear.

Independent Contractors: A few years ago the IRS began cracking down on businesses which were characterizing as "independent contractors" workers whom the Service thought should have been treated as employees. The IRS's concern was that, because the "independents" don't have taxes withheld, they weren't paying income and social security taxes. The affected industries—real estate, insurance, lumbering, direct sales, and so on—ran to Congress and got a temporary reprieve pending Congressional review. Since then, IRS has done a study of the tax compliance of the individuals involved and found that 47% of them don't report any of their independent contractor income.

Treasury would like to institute a low-level withholding system on the workers in this class, but Senator Bob Dole and Rep. Dick Gephardt have proposed an alternative. Their bill could create what they call "safe harbor" rules, under which certain workers would be considered independent contractors. The problem is that their "safe harbor" is so generous that it would exempt a wide range of workers who unquestionably should be treated as employees for withholding purposes—including certain federal bureaucrats and U.S. Senators and Representatives, to mention just a few!

Rep. Dan Rostenkowski, whose Ways and Means Select Revenue Measures subcommittee recently held hearings on the issue, is trying to put together a bill to combine elements of both the Treasury and Gephardt/Dole proposals. But lobbyists for Gephardt/Dole are so taken with the more lenient proposal that they're working on their own plan: attaching the measure to the windfall profits tax bill. ☐