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# REDUCING THE TAX BURDEN

## HEARINGS

BEFORE THE

## COMMITTEE ON WAYS AND MEANS
## HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTH CONGRESS

SECOND SESSION

JANUARY 28, FEBRUARY 4 AND 12, 1998

**Serial 105–97**

Printed for the use of the Committee on Ways and Means

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# REDUCING THE TAX BURDEN

**WEDNESDAY, JANUARY 28, 1998**

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
*Washington, DC.*

The Committee met, pursuant to notice, at 11:35 a.m., in room 1100, Longworth House Office Building, Hon. Bill Archer (Chairman of the Committee) presiding.

[The advisories announcing the hearings follow:]

# *ADVISORY*

## FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE CONTACT: (202) 225–1721
January 21, 1998
No. FC–10

# Archer Announces Hearing Series on Reducing the Tax Burden

Congressman Bill Archer (R–TX), Chairman of the Committee on Ways and Means, today announced that the Committee will hold a hearing series on proposals to reduce the Federal tax burden on the American public. The hearing will begin on Wednesday, January 28, and be continued on Wednesday, February 4, and Thursday, February 12, 1998, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m. each day. The first hearing day will address proposals intended to correct perceived unfairness in the tax code, focusing on the "marriage tax penalty," and the estate and gift tax (or "death tax").

Oral testimony for January 28th will be from invited witnesses only. Both invited and public witnesses will have the opportunity to testify on Feb 4th and 12th. Any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee or for inclusion in the printed record of the hearing.

**BACKGROUND:**

The Federal tax burden, as a percentage of Gross Domestic Product, has been rising in recent years. It is currently 19.9 percent, a height not reached since World War II. The annual Federal budget deficit has declined greatly over the past several years, and current projections show years of budget surpluses. The rising tax burden and improved fiscal outlook have elicited various tax reduction proposals. This hearing series is designed to explore some of these proposals.

In announcing the hearing, Chairman Archer stated: "If the politicians in Washington exercise restraint, we soon may find ourselves in a post-deficit era, where our greatest challenges will be social and moral, not economic. I believe the era we're entering will test how big a government the people want, or whether they want a smaller, less taxing government that enhances individual power, freedom, and opportunity, strengthening our moral fabric, freeing families to provide more for themselves, their neighbors and their communities. We must care for each other more, and tax each other less."

**FOCUS OF THE HEARING:**

The first hearing day will address proposals intended to rectify perceived unfair provisions in the tax code. It will focus on the "marriage tax penalty" and the estate and gift tax (or "death tax"). The second day (February 4th) will consider tax rates: What are they and what should they be? That session also will address alternative minimum tax relief for individuals, proposals to reduce Federal income or payroll taxes, and provisions in the tax code that operate as "hidden rates" and which cause effective tax rates to exceed statutory rates. The third day (February 12th) will review new savings incentives and likely will address modifications to the new capital gains law, such as eliminating the 18-month holding period for the new 10 and 20 percent capital gain rates, and proposals to provide an exclusion for interest and dividend income. The hearing may be continued on additional days on other tax reduction topics.

**DETAILS FOR SUBMISSIONS OF REQUESTS TO BE HEARD:**

Requests to be heard on February 4th and February 12th must be made by telephone to Traci Altman or Bradley Schreiber at (202) 225–1721 no later than the close of business, Thursday, January 29, 1998. The telephone request should be followed by a formal written request to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. The staff of the Committee will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the Committee staff at (202) 225–1721.

In view of the limited time available to hear witnesses, the Committee may not be able to accommodate all requests to be heard. Those persons and organizations not scheduled for an oral appearance are encouraged to submit written statements for the record of the hearing. All persons requesting to be heard, whether or not they are scheduled for oral testimony, will be notified as soon as possible after the filing deadline.

Witnesses scheduled to present oral testimony are required to summarize briefly their written statements in no more than five minutes. THE FIVE-MINUTE RULE WILL BE STRICTLY ENFORCED. The full written statement of each witness will be included in the printed record, in accordance with House Rules.

In order to assure the most productive use of the limited amount of time available to question witnesses, all witnesses scheduled to appear before the Committee are required to submit 300 copies of their prepared statement and an IBM compatible 3.5-inch diskette in ASCII DOS Text or WordPerfect 5.1 format, for review by Members prior to the hearing. Testimony should arrive at the Committee office, room 1102 Longworth House Office Building, 48 hours prior to each hearing day (no later than 10:00 a.m.).

**WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE:**

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit at least six (6) single-space legal-size copies of their statement, along with an IBM compatible 3.5-inch diskette in ASCII DOS Text or WordPerfect 5.1 format only, with their name, address, and hearing date noted on a label, by the close of business, Wednesday, March 11, 1998, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Committee office, room 1102 Longworth House Office Building, at least one hour before the hearing begins.

**FORMATTING REQUIREMENTS:**

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages including attachments. At the same time written statements are submitted to the Committee, witnesses are now requested to submit their statements on an IBM compatible 3.5-inch diskette in ASCII DOS Text or WordPerfect 5.1 format. Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments

by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at 'HTTP://WWW.HOUSE.GOV/WAYS__MEANS/'.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

*****NOTICE—CHANGE IN TIME*****

# *ADVISORY*

**FROM THE COMMITTEE ON WAYS AND MEANS**

FOR IMMEDIATE RELEASE CONTACT: (202) 225–1721
January 23, 1998
No. FC–10-Revised

## Time Change for Full Committee Hearing on Wednesday, January 28, 1998, on Reducing the Tax Burden

Congressman Bill Archer (R–TX), Chairman of the Committee on Ways and Means, today announced that the full Committee hearing on reducing the tax burden, previously scheduled for Wednesday, January 28, 1998, at 10:00 a.m., in the main Committee hearing room, 1100 Longworth House Office Building, will begin instead at 11:30 a.m.

All other details for the hearing remain the same. (See full Committee press release No. FC–10, dated January 21, 1998.)

Chairman ARCHER. The Committee will come to order. I would like our guests and staff to take seats as quickly as possible so that we can commence.

Today is the first in a series of hearings to examine proposals to reduce the tax burden on individuals while correcting perceived unfairness in the Tax Code. This will probably be a neverending task

as long as we have the income tax, but we must proceed to do the best that we can.

The tax burden on the American people is the highest in our Nation's peacetime history. The social and moral consequences of high taxation on America's families are devastating. Families are struggling today because the government is taking their money before they have a chance to invest it in themselves, their children, and their communities. It's money that is denied to workers, diminishing their ability to pay for their own childcare needs, healthcare needs, or to prepare for their retirement years in comfort and security. American workers are caught in a tax trap. The harder they work, the longer they work, the more they pay.

Can the people in the back of the room hear me? This is very important. I want everyone to be able to hear.

Mr. MCDERMOTT. There's nothing wrong with the speakers down here.

Chairman ARCHER. I can hear you very well.

Be sure that the PA system works the same for Charlie Rangel when it's his turn. [Laughter.]

American workers are truly caught in a tax trap today in the United States because the longer they work, the harder they work, the more they pay. That is wrong. It shouldn't be that way. I personally believe that we must care for each other more and tax each other less. That is why, to strengthen families and children while protecting against big government, we must reduce the debt and the record high tax burden on the American people. We must remember that when we pay down the debt, that helps preserve Social Security without forcing Americans to pay record high taxes.

There is room both to save Social Security and to protect Americans from high taxes. Yes, Congress must shore up Social Security, and we will do so. But we must also look at the ways our existing Tax Code unfairly prevents individuals from saving more of their income to reach their retirement goals. If we agree to the President's request to maintain the high tax status quo, we will perpetuate a marriage penalty on 21 million couples. We will force more than 25 million Americans, many of whom make as little as $26,000 a year, into higher tax brackets.

The first focus of this morning's hearing will be the marriage tax penalty. Based on a recent CBO study, matrimony translates into an average of $1,400 in additional taxes for some 42 percent of American couples. The marriage tax penalty is a well-known topic on Capitol Hill. As many will recall, the Contract With America and the Balanced Budget Act of 1995 contained provisions to lessen the tax bite on working married couples. This relief suffered under the veto pen of the President, so it is important that we turn our attention once again to what 21 million married couples perceive as unfair. I am pleased that we are joined this morning by Sharon Mallory and Darryl Pierce of Indiana, who will share with the Committee their personal experience with the marriage penalty.

Today's hearing will also focus on the death tax, which with its estate, gift, and generation-skipping components, can cause the tax collector to compound the tragedy of a family death by taking over half of the deceased person's lifetime savings. I must add, that's only the beginning. As you get into the later years of your life, if

you continue to produce and to earn more, you will have up to 44 percent in income tax taken out of your earnings. The remaining amount will be taxed at 55 percent, so that your heirs, your children, will receive only 25 percent of what you have worked very hard in your later years to be able to accomplish. The death tax forces the sale or reorganization of family-owned businesses and it costs jobs. It creates development pressure on farm and ranch land, and contributes to the loss of open space.

Last year we were able to take a first step to providing relief from the death tax. We convinced the Clinton administration to support death tax relief after they initially accused those who sought such reductions as being "selfish."

As I said earlier, taxes are at a record high level. I hope no one will defend the high tax status quo. The purpose of these hearings is to listen to various tax relief proposals so the Committee can determine which taxes should be reduced. I intend to be conservative in my approach. I will resist the temptation to over promise. We are still within the constraints of reducing the deficit and keeping a balanced budget. Yes, there is room to pay down the debt and to cut taxes. But no, we must never let the budget be tipped out of balance again.

Before we begin, I would like to recognize Mr. Rangel for any comments that he might like to make.

Mr. RANGEL. That's very kind of you, Mr. Chairman. Welcome back. As the Committee starts to work, I think the better we can understand the agenda, the more closely we can work together as Democrats and Republicans. I gather from what I have heard over the airwaves and read in the paper that your top priority is going to be rooting up or pulling out the IRS and bringing a flat tax, consumption tax or some kind of tax that would be even-handed across the board. If that is your priority, since I have been waiting for it for 3 years, do you have any idea whether we might get a chance to vote for that in this Committee? I hate to be against something when I haven't the slightest idea what it's going to be. Will we have a chance to vote on any of these simplified taxes this year?

Chairman ARCHER. We would be happy to have the outward expressed support, Mr. Rangel, of you and the Minority on the Committee. I am sure we could move the bill rather rapidly when that occurs. The President has not seen fit to make any proposal for structural tax reform. So perhaps it will be left up totally to the Congress. It needs to be bipartisan. It can not be driven just by one party. It's too important to the lives of all the people in this country.

Mr. RANGEL. But it's hard to know which idea we're supporting. There are so many different ideas. You have some and Mr. Armey has some. They were all in the closet. So if someone could get organized and bring something to us, then we can see whether or not the bill with its simplification and its cost would warrant us joining together to pass it. So would that be done this year or are we just going to just air it out and let people be educated about the possibility of changing the system?

Chairman ARCHER. I think it's very hard to predict what we will do in that regard this year. I do know that we will continue to have hearings on this issue, where all Members will be able to become

better versed on the various reform plans and be able to crystallize their own opinion as to what vehicle they believe is the best. But at this point, I cannot anticipate whether we will have a markup of a bill. But I can anticipate this: we will have a tax relief bill within the current income tax of some kind this year.

Mr. RANGEL. I think then my Democratic colleagues on the Committee won't have to worry about the flat tax this year. We can concentrate on some of the ideas that the President has. You might have noticed, Mr. Chairman, that the President had any number of ideas that fell within the jurisdiction of this Committee. Certainly Social Security, low-income housing credits, expansion of Medicare, educational zones, childcare, school construction, and the African trade bill. My God, it looked like a program just designed for us.

Now I share your concern about the marriage tax penalty and the death taxes and the other reduction in taxes that you have, but so that we might be able to plan and work more closely together, could you give me any idea of when you intend to see whether or not the President's agenda would be able to get on the Ways and Means calendar?

Chairman ARCHER. As we move through the various items that are before the Committee, particularly with each individual Subcommittee, there will be plenty of opportunity to flush out all proposals and consider all options this year.

Mr. RANGEL. Welcome back, Mr. Chairman. I'm glad I won't have much time to deal with the flat tax, but there's so many other things that we could work on, I look forward to working with you.

Chairman ARCHER. You are most welcome, Mr. Rangel. Should you wish to submit any proposal on your own as to what is the appropriate way to restructure the income tax, we would be pleased to have that in the hopper too.

Mr. MCDERMOTT. Mr. Chairman.

Chairman ARCHER. Yes.

Mr. McDermott.

Mr. MCDERMOTT. Mr. Chairman, I would like to ask unanimous consent to enter my statement in the record. I offered to eliminate the marriage tax penalty last year. I want the record to show that all the Republicans voted against my repeal proposal last year which was the same as your 1995 tax proposal. So it will be interesting to hear the rhetoric today about this whole issue as we come back to it.

Chairman ARCHER. Without objection, all Members will be able to insert any written statement into the record at this point.

[The opening statements follow:]

**Opening Statement of Hon. Jim McDermott, a Representative in Congress from the State of Washington**

I applaud the Chairman for choosing to hold a hearing on the problem of the marriage penalty. This is an issue which I tried to address during last year's Balanced Budget debate.

The proposal I offered last year, which I would like to mention today, would have eliminated the marriage penalty for many taxpayers by adjusting the standard deduction. It was not a new idea. The proposal I advocate was included in the 1995 Budget Conference report passed by Congress. To be fair, you could characterize this as a bipartisan fix to the marriage penalty.

The marriage penalty fix I support simply would increase the standard deduction for joint filers so that it equals twice that of single filers. The standard deduction

in tax year 1997 is $6,900 for joint returns and $4,150 for single returns. Two singles get a combined standard deduction of $8,300 compared to $6,900 for a couple—thus penalizing the couple for getting married. In my view, increasing the standard deduction for joint filers is the simplest, fairest, easiest, and most fiscally responsible way in which to address the structural marriage tax penalties within the code.

As you can see from the attached charts to be inserted into the record, the fix I proposed last Congress would have eliminated virtually all marriage penalties, and, it even provides a modest bonus for one-earner families.

The McDermott plan is progressive: Since most high-income taxpayers do not use the standard deduction, the Congressional Budget Office (CBO) has found that only 36% of the benefits from this type of change goes to taxpayers earning $50,000 or more—meaning—64% of the benefits go to couples earning less than $50,000/year. CBO found that other leading repeal proposals direct at least 65% of the benefits to those taxpayers earning more than $50,000/year.

The McDermott plan is comparatively affordable: CBO estimates that increasing the standard deduction for joint filers costs roughly $4 billion/year. Estimates prepared by the Joint Committee on Taxation verify this finding. Meanwhile, CBO found other leading repeal proposals cost as much as $29 billion/year.

The McDermott plan is family friendly: In addition to eliminating the marriage penalty, the standard deduction fix *slightly* increases the marriage bonus (see charts)—making it more affordable for the spouses of single earners who prefer to have a parent stay at home to care for their child or children. This bonus provides a small incentive without creating a new program and is not excessive so that it overly penalizes individuals for being unmarried.

The McDermott plan is simple compared to the problems raised by other repeal proposals which will force taxpayers to do their taxes twice in order to figure out which is the best choice for their family.

In 1997, repeal of the marriage penalty was pushed aside by the Republican Majority. Inexplicably, in the W&M Committee, where roughly 20 members signed the Contract with America, my amendment failed. Most likely, the Majority preferred cutting taxes for corporations (not mentioned in their contract). In my view, a tactical decision was made that it was more important to provide tax cuts preferred by the business community (such as reducing the corporate AMT and corporate capital gains tax cuts) than it was to address the marriage penalty.

In fact, no legislation was introduced during the 105th Congress to repeal the marriage penalty until after the budget agreement passed Congress last August.

Now that repeal of the marriage penalty is finally being addressed and if it sincerely is a priority of this Congress, I would urge my colleagues to take a second look at my proposal before they rush to advocate an alternative.

Structural Marriage Tax Penalties and Bonuses in 1997 Dollar and Percentage Amounts by which Joint Income Tax Liabilities Exceed those of Two Singles (Marriage Tax Bonus Shown in Parenthesis)

| Income Levels ($000s) | Joint Income Tax Liability | 50/50 | 60/40 | 70/30 | 100/0 |
|---|---|---|---|---|---|
| $20 | $1,170 | $210 22% | $345 42% | $378 48% | ($810) (41%) |
| $25 | $1,920 | $210 12% | $210 12% | $384 25% | ($810) (30%) |
| $30 | $2,670 | $210 9% | $210 9% | $269 11% | ($810) (23%) |
| $35 | $3,420 | $210 7% | $210 7% | $210 7% | ($1,272) (27%) |
| $40 | $4,170 | $210 5% | $210 5% | $210 5% | ($1,922) (32%) |
| $50 | $5,670 | $210 4% | $210 4% | (252) (4%) | ($3,222) (36%) |
| $60 | $8,028 | $1,068 15% | $1,476 6% | (304) (4%) | ($3,664) (31%) |
| $75 | $12,228 | $1,444 13% | $1,256 11% | $281 2% | ($3,918) (24%) |
| $100 | $19,228 | $1,444 8% | $1,444 8% | $1,152 6% | ($4,668) (19%) |

Source: CRS

McDermott Amendment Changes the Structural Marriage Tax Penalties and Bonuses: Dollar and Percentage Amounts by which Joint Income Tax Liabilities Exceed those of Two Singles (Marriage Tax Bonus Shown in Parenthesis)

| Income Levels ($000s) | Joint Income Tax Liability | 50/50 | 60/40 | 70/30 | 100/0 |
|---|---|---|---|---|---|
| $20 | $960 | $0 — | $135 16% | $108 13% | ($1,020) (52%) |
| $25 | $1,710 | $0 — | $0 — | $174 11% | ($1,020) (37%) |
| $30 | $2,460 | $0 — | $0 — | $59 2% | ($1,020) (29%) |
| $35 | $3,210 | $0 — | $0 — | $0 — | ($1,482) (32%) |
| $40 | $3,960 | $0 — | $0 — | $0 — | ($2,132) (35%) |
| $50 | $5,460 | $0 — | $0 — | ($462) (8%) | ($3,432) (39%) |
| $60 | $7,636 | $676 10% | $84 1% | ($696) (8%) | ($4,058) (35%) |
| $75 | $11,836 | $1,052 10% | $864 8% | ($111) (1%) | ($4,310) (27%) |
| $100 | $18,836 | $1,052 6% | $1,052 6% | $760 4% | ($5,060) (21%) |

Source: CRS

**Statement of Hon. Barbara B. Kennelly, a Representative in Congress from the State of Connecticut**

Thank you, Mr. Chairman, for the opportunity to testify here today. As you well know, I have worked on the marriage penalty for many years. In fact, CBO recently completed an excellent report on the topic for me. For those of you who may not have seen it, it is entitled "For Better or for Worse: Marriage and the Federal Income Tax." I commend it to your attention. Copies are available by calling CBO or my office.

First, let me briefly summarize the problem. According to CBO, based on sheer numbers of returns, an estimated 42% of couples incurred marriage penalties in 1996, 51% received bonuses, and 6% paid taxes unaffected by their marital status. That distribution varies markedly across the income distribution. Only 12% of couples with incomes below $20,000 sustained penalties and 63% received bonuses. Couples with incomes between $20,000 and $50,000 were somewhat more likely to receive bonuses than to incur penalties, whereas couples with incomes above $50,000 were somewhat more likely to incur penalties than to receive bonuses. Couples with just one earner never incur a marriage penalty and receive a bonus at all but the lowest income levels.

Three factors have the greatest influence on whether a couple bears a marriage penalty or receives a marriage bonus: the couple's total income, the division of the income between husband and wife, and the presence and number of children that determine the filing status of unmarried individuals and qualify taxpayers for the EITC and personal exemption.

The largest bonuses, measured as a percentage of income, occur in two cases. First, two-earner couples with one child and very low incomes split equally between spouses receive a larger EITC as the credit phases in and thus receive a bonus of up to 13% of their income. Second, low-income single-earner couples in which each spouse has one child, and for whom combining children into one tax unit increases the size of the EITC, receive bonuses of up to 11% of income. The largest bonuses in dollar terms—more than $5,600—go to childless one-earner couples with incomes between $180,000 and $190,000.

The largest penalties, measured as a percentage of income, are greatest for low-income couples who have several children and an equal division of income between spouses; the loss of EITC on joint returns can cost such families up to 18% of income. In dollar terms, the penalty resulting from difference in tax brackets, limitations on itemized deductions, and the phaseout of personal exemptions combine to impose the maximum penalty—more than $21, 599—on couples whose income is equally divided between spouses and whose taxable income exceeds $527,500.

Although the prevalence of marriage penalties and bonuses indicates that the tax code fails to provide marriage neutrality, it more successful in achieving equal treatment of married couples with similar incomes. If couples were required to file individual tax returns, those with one earner would face substantially higher tax rates than those with two earners who have roughly equal incomes. Because the tax code generally requires couples to file jointly, those with different divisions of earnings between spouses incur more nearly equal tax rates. Marriage penalties and bonuses

arise from this equalization of tax rates for couples with different divisions of earnings.

Marriage penalties and bonuses are not deliberately intended to reward or punish marriage. Rather, they are the result of a delicate balance of disparate goals of the federal income tax system. The principal goals are equal treatment of married couples, marriage neutrality and progressive taxation and they are in fundamental conflict.

Nonetheless, as two-earner couples become more prevalent, more and more Americans will incur marriage penalties. For this reason, I think it is important that we move to provide more equitable treatment for these working couples, consistent of course, with our other goals.

Therefore, I am pleased to be here today with my friend and colleague, Representative Herger and support H.R. 2593. This bill would simply restore the pre–1986 law—the two-earner deduction. It would allow couples a 10% deduction for up to $30,000 of the lower-earning spouse's income. I offered a version of this as an amendment in Committee during the markup of the Republican Contract with America. I think it is a reasonable solution to a very difficult problem and would urge my colleagues to support H.R. 2593.

Thank you.

STATEMENT OF REP. JERRY KLECZKA
PRESENTED TO THE WAYS & MEANS COMMITTEE
JANUARY 28, 1998

Thank you Mr. Chairman and members of the Committee for this opportunity to speak on a matter of great importance to me -- eliminating the marriage penalty. I think the marriage penalty is one of the most biased and unfair provisions in the tax code. This hearing will provide us with some insight as how to best address this inequity, and I look forward to hearing from our witnesses.

In recent years, we have seen families working harder than ever before to make ends meet. Twenty years ago, two-earner families were few and far between. Today, I hardly know of a family where one parent has the luxury of staying at home. Unfortunately, the decision for most spouses to work is not based just on career advancement. Instead, it is based on economic reality. But as more and more spouses head into the workforce, they find themselves caught in a Catch-22. The harder they work, the more taxes they pay. Why? Because the second job has put them into a higher tax bracket. The tax code provides no remedy to that family for their extra taxes.

Moreover, the tax code is biased in favor of single taxpayers as compared to married families. For example, single taxpayers filing a tax return for their 1997 taxes will have a standard deduction of $4,150 However, the standard deduction for a married couple is $6,900. This means that married taxpayers can only get 60% of what single taxpayers are able to deduct from their taxes. I am not saying we need to eliminate the marriage penalty through the pocketbooks of single taxpayers. But I am saying we need to have a sense of fairness and balance in the tax code.

More than 21 million families find themselves caught by this penalty each year. With an average penalty of $1,400 per family we are talking about real money. Instead of having extra money to buy a new car, pay for a child's education or take an family vacation, families are finding themselves with a steeper tax bill than they had imagined.

I think all of us realize this injustice is caused by a glitch in the tax code put in by Congress. In 1981, Congress gave married taxpayers a special deduction designed to reduce the marriage penalty. Unfortunately, the Tax Reform Act of 1986 eliminated that deduction. However, we have been working on a bipartisan basis to eliminate the marriage penalty from the tax code. An attempt was made during this Committee's consideration of the Taxpayer Relief Act of 1997 to address this issue. Unfortunately, that effort was defeated. I am proud to be a cosponsor of two bills that enjoy broad, bipartisan support to reduce or eliminate the marriage penalty. And I am hopeful they will acted upon this year.

Mr. Chairman, I again thank you for holding this hearing today. I hope it will give us renewed vigor to eliminate this burdensome and unfair provision from the tax code before the end of the 105th Congress.

Chairman ARCHER. We are fortunate to have with us today Members of our own body, Mr. Weller, Mr. McIntosh, and Mr. Herger. We are happy to have you here. We would be pleased to hear your

testimony. I have already spoken about Sharon Mallory and Darryl Pierce, who are coming with Congressman McIntosh.

You might wish to further introduce them. We'll be pleased to receive their testimony.

But first, Mr. Weller, we would be happy to have your testimony.

**STATEMENT OF HON. JERRY WELLER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS**

Mr. WELLER. Thank you, Mr. Chairman. First, I want to commend you and this Committee for conducting these hearings on inequities in the Tax Code, and thank you for inviting our colleagues to testify on clearly what is arguably our Tax Code's most unfair provision, the marriage tax penalty. I know from my conversations with you, Mr. Chairman, this has been an area of great concern to you over the years. I really appreciate your leadership in working on this issue.

Last night, President Clinton gave his State of the Union address outlining many of the things he wants to do with the budget surplus. The surplus provided by the bipartisan budget agreement which cut waste, put America's fiscal house in order, and held Washington's feet to the fire to balance the budget for the first time in 28 years. While President Clinton paraded a long list of new spending items totalling at least $46 to $48 billion in 30 new programs and proposals, we believe that a top priority should be returning the budget surplus to America's families as additional middle-class tax relief. This Congress has given more tax relief to the middle class and the working poor than any Congress in the last half century.

I think the issue of the marriage tax penalty can best be framed by asking these questions. Do Americans feel it's fair that our Tax Code imposes a higher tax penalty on marriage? Do Americans feel it's fair that the average married working couple pays almost $1,400 more in taxes than a couple with almost identical income living together outside of marriage? Is it right that our Tax Code provides an incentive to get divorced? In fact, today the only form one can file to avoid the marriage tax penalty is paperwork for divorce. That's just wrong.

Since 1969, our tax laws have punished married couples when both spouses work. For no other reason than the decision to be joined in holy matrimony, more than 21 million couples a year are penalized. They pay more in taxes than they would if they were single. Not only is the marriage tax penalty unfair, it's wrong that our Tax Code punishes society's most basic institution. The marriage tax penalty exacts a disproportionate toll on working women and low-income couples with children. In many cases, it's a working woman's issue.

Let me give you an example, and there's a chart to my right, an example of how the marriage tax penalty unfairly affects middle-class, married, working couples. For example, in my district, I'll use an example of a machinist at the local Caterpillar manufacturing plant in Joliet, who makes $30,500 a year in salary. His wife is a tenured elementary schoolteacher, also bringing home an identical income of $30,500 a year in salary. If they both filed their taxes as singles, after standard deductions and exemptions, as indi-

viduals they would pay in the 15 percent tax bracket. But if they choose to live their lives in holy matrimony and now file jointly, their combined income is $61,000, and pushes them into a higher tax bracket of 28 percent, producing a marriage tax penalty of $1,400 in higher taxes.

On average, America's married working couples pay $1,400 more a year in taxes than individuals with the same incomes. That's serious money. Every day we get closer to April 15, more married, working couples will be realizing that they are suffering the marriage tax penalty, and will be looking to us to do something about it. Why? Because if you think of it in terms that mean something to the folks back home, $1,400 is a downpayment on a house, several months worth of car payments, 1 year's tuition at a local community college, or several months worth of quality childcare at a local daycare center.

To that end, Congressman David McIntosh and I have authored the Marriage Tax Elimination Act. It would allow married couples a choice in filing their income taxes, either jointly or as individuals, whichever way lets them keep more of their money. Our bill already has the bipartisan cosponsorship of 232 Members of the House, and a similar bill in the Senate also enjoys widespread support.

It isn't enough for President Clinton to suggest tax breaks for childcare. The President's childcare proposal would help a working couple afford on average 3 weeks of daycare. Elimination of the marriage tax penalty would give the same couple the choice of paying for 3 months of childcare or addressing other family priorities. After all, parents know best, in fact better than Washington what their family needs.

We fondly remember the 1996 State of the Union address when the President declared emphatically that "the era of big government is over." We must stick to our guns and stay the course. There never was an American appetite for big government, but there certainly is for reforming the way the existing way government does business. What better way to show the American people that our government will continue along the path to reform prosperity than by eliminating the marriage tax penalty.

Ladies and gentlemen, we are on the verge of running a surplus. It's basic math. It means Americans are already paying more than is needed for government to do the job we expect of it. What better way to give back than to give mom and dad and the American family, the backbone of our society, what they have earned. We ask President Clinton to join with Congress and make elimination of the marriage tax penalty a bipartisan priority.

Of all the challenges facing married couples today in providing home and hearth for America's children, the U.S. Tax Code should not be one of them. Let's eliminate the marriage tax penalty, and do it now.

Again, thank you, Mr. Chairman.

[The prepared statement follows:]

**Statement of Hon. Jerry Weller, a Representative in Congress from the State of Illinois**

Mr. Chairman:

I want to commend you for holding these hearings on inequities in the tax code and thank you for inviting my colleagues and I to testify on what is arguably the most immoral provision in our tax code...the marriage tax penalty

Last night, President Clinton gave his State of the Union Address outlining many of the things he wants to do with the budget surplus.

A surplus provided by the bipartisan budget agreement which:

- cut waste,
- put America's fiscal house in order, and
- held Washington's feet to the fire to balance the budget.

While President Clinton paraded a long list of new spending proposals—without mentioning the accompanying increase in bureaucracy and red tape—we believe that a top priority should be returning the budget surplus to America's families as additional middle-class tax relief.

This Congress has given more tax relief to the middle class and working poor than any Congress of the last half century.

I think the issue of the marriage tax penalty can best be framed by asking these questions: Do Americans feel its fair that our tax code imposes a higher tax penalty on marriage? Do Americans feel its fair that the average married working couple pays almost $1,400 more in taxes than a couple with almost identical income living together outside of marriage—is it right that our tax code provides an incentive to get divorced?

In fact, today the only form one can file to avoid the marriage tax penalty is paperwork for divorce.

Since 1969, our tax laws have punished married couples when both spouses work. For no other reason than the decision to be joined in holy matrimony, more than 21 million couples a year are penalized. They pay more in taxes than they would if they were single. Not only is the marriage penalty unfair, it's immoral that our tax code punishes society's most basic institution. The marriage tax penalty exacts a disproportionate toll on working women and lower income couples with children.

Let me give you an example of how the marriage tax penalty unfairly affects middle class married working couples.

For example, a machinist, at a Caterpillar manufacturing plant in my home district of Joliet, makes $30,500 a year in salary. His wife is a tenured elementary school teacher, also bringing home $30,500 a year in salary. If they would both file their taxes as singles, as individuals, they would pay 15%.

But if they chose to live their lives in holy matrimony, and now file jointly, their combined income of $61,000 pushes them into a higher tax bracket of 28 percent, producing a tax penalty of $1400 in higher taxes.

On average, America's married working couples pay $1,400 more a year in taxes than individuals with the same incomes. That's serious money.

Particularly if you think of it in terms of:

- a down payment on a house or a car,
- one years tuition at a local community college, or
- several months worth of quality child care at a local day care center.

To that end, Congressman David McIntosh and I have authored the Marriage Tax Elimination Act.

It would allow married couples a choice in filing their income taxes, either jointly or as individuals—which ever way lets them keep more of their own money.

Our bill already has the support of 232 Members of the House and a similar bill in the Senate also enjoys widespread support.

It isn't enough for President Clinton to suggest tax breaks for child care. The President's child care proposal would help a working couple afford, on average, three to four weeks of day care. Elimination of the marriage tax penalty would give the same couple the choice of paying for three to four months of child care—or addressing other family priorities. After all, parents know better than Washington what their family needs.

We fondly remember the 1996 State of the Union address when the President declared emphatically that, quote "the era of big government is over."

We must stick to our guns, and stay the course.

There never was an American appetite for big government.

But there certainly is for reforming the existing way government does business.

And what better way to show the American people that our government will continue along the path to reform and prosperity than by eliminating the marriage tax penalty.

Ladies and Gentleman, we are on the verge of running a surplus. It's basic math. It means Americans are already paying more than is needed for government to do the job we expect of it.

What better way to give back than to begin with mom and dad and the American family—the backbone of our society.

We ask that President Clinton join with Congress and make elimination of the marriage tax penalty... a bipartisan priority.

Of all the challenges married couples face in providing home and hearth to America's children, the U.S. tax code should not be one of them.

Lets eliminate The Marriage Tax Penalty and do it now!

Thank you, Mr. Chairman.

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Chairman ARCHER. Thank you, Congressman Weller. Now, Congressman Wally Herger.

**STATEMENT OF HON. WALLY HERGER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA**

Mr. HERGER. Thank you, Mr. Chairman and Members of the Committee for the opportunity to testify today about a serious inequity in the Tax Code. When a couple stands at the altar and says "I do," they are not agreeing to higher taxes. Yet under our current tax law, that is precisely what is happening to millions of married couples each year. According to a recent report by the Congressional Budget Office, an estimated 42 percent of all married couples, some 21 million couples nationwide, incurred marriage penalties in 1996. The average marriage penalty that year approached an astonishing $1,400. I believe that addressing this inequity in our tax law should be a top priority for this Committee as we work to provide the American people further tax relief in 1998.

Mr. Chairman, as financial pressures push more and more nonworking spouses into the labor force, an increasing number of families will fall prey to this marriage tax. A major reason why so many of these joint filers face this added tax burden is that the very first dollar earned by the low-earning spouse is taxed at the marginal rate of the high-earning spouse, not necessarily at the lower 15-percent rate faced by single filers. This problem was exacerbated in 1993 when the number of tax brackets was increased from three to five. That change created even more opportunities for dual-income, married couples to be bumped into higher brackets, and to face even larger marriage penalties.

To address this problem, I have introduced legislation along with Mrs. Kennelly to restore the two-earner deduction. As many of you may remember, between 1982 and 1986, dual-income couples were entitled to a significant tax benefit to help offset the marriage penalties built into the Internal Revenue Code. The two-earner deduction, once fully phased in, entitled married couples to a 10-percent deduction on up to $30,000 of the low-earning spouse's income. However, for a variety of reasons, Congress eliminated this tax benefit in 1986. My bill, H.R. 2593, the Marriage Penalty Relief Act, would simply restore the two-earner deduction. I am pleased to report that this legislation has attracted a broad bipartisan group of 155 cosponsors in the House so far, including 35 Democrats. I am particularly gratified that 27 Members of this Commit-

tee, 21 Republicans and 6 Democrats, have thus far signed onto this legislation.

I should make it clear for the record, Mr. Chairman, that I strongly support a complete elimination of the marriage penalty. I am an original cosponsor to the bill introduced by Mr. Weller and Mr. McIntosh. I am encouraged to learn that the Congressional Budget Office is now projecting a $660 billion surplus over the next 10 years. I sincerely hope that this fiscal dividend can be used in part to ensure that our Tax Code no longer punishes married couples. However, I also recognize that Members of this body and of this Committee have a variety of ideas about where to dedicate this projected surplus. If budgetary and political conditions prevent us from completely eliminating the marriage penalty in this year's tax bill, I would certainly hope that we can at least take a significant step toward achieving that objective.

Mr. Chairman, restoring the two-earner deduction would enable us to make meaningful progress toward that goal in a way that provides targeted relief to those couples who are particularly hard hit by this inequity. When a couple stands at the altar and says "I do," they are not agreeing to higher taxes. Congress should act this year to address the fact that in too many cases, they will be paying higher taxes.

I want to again thank Chairman Archer for the opportunity to testify. I look forward to working with all interested Members on this issue as the Committee works to provide the American people further tax relief this year. I would also like to ask that Mrs. Kennelly's statement in support of my legislation, which she had hoped to deliver today in person, be included in the record following my testimony. Thank you.

[The prepared statements follow:]

**Statement of Hon. Wally Herger, a Representative in Congress from the State of California**

Thank you Mr. Chairman and Members of the Committee for the opportunity to testify today about a serious inequity in the tax code. When a couple stands at the altar and says "I do," they are not agreeing to higher taxes. Yet under our current tax law, that is precisely what is happening to millions of married couples each year.

According to a recent report by the Congressional Budget Office, an estimated 42 percent of all married couples—some 21 million couples nationwide—incurred marriage penalties in 1996. The average marriage penalty that year approached an astonishing $1,400. I believe that addressing this inequity in our tax law should be a top priority for this Committee as we work to provide the American people further tax relief in 1998.

Mr. Chairman, as financial pressures push more and more non-working spouses into the labor force, an increasing number of families fall prey to this marriage tax. A major reason why so many of these joint filers face this added tax burden is that the very first dollar earned by the lower-earning spouse is taxed at the marginal rate of the higher-earning spouse, not necessarily at the lower 15-percent rate faced by single filers. This problem was exacerbated in 1993 when the number of tax brackets was increased from three to five. That change created even more opportunities for dual-income married couples to be bumped into higher brackets and to face even larger marriage penalties.

To address this problem, I have introduced legislation—along with Mrs. Kennelly—to restore the two-earner deduction. As many of you may remember, between 1982 and 1986, dual-income couples were entitled to a significant tax benefit to help offset the marriage penalties built into the Internal Revenue Code. The two-earner deduction, once fully phased in, entitled married couples to a 10-percent deduction on up to $30,000 of the lower-earning spouse's income. However, for a variety of reasons, Congress eliminated this tax benefit in 1986.

My bill, H.R. 2593—"The Marriage Penalty Relief Act"—would simply restore the two-earner deduction. I am pleased to report that this legislation has attracted a broad, bipartisan group of 155 cosponsors in the House so far, including 35 Democrats. I am particularly gratified that 27 members of this Committee—21 Republicans and 6 Democrats—have thus far signed on to this legislation.

I should make it clear for the record, Mr. Chairman, that I strongly support a complete elimination of the marriage penalty and am an original cosponsor of the bill introduced by Mr. Weller and Mr. McIntosh. I am encouraged to learn that the Congressional Budget Office is now projecting a $660 billion surplus over the next 10 years, and I sincerely hope that this fiscal dividend can be used, in part, to insure that our tax code no longer punishes married couples.

However, I also recognize that members of this body—and of this Committee—have a variety of ideas about where to dedicate this projected surplus. If budgetary and political conditions prevent us from completely eliminating the marriage penalty in this year's tax bill, I would certainly hope that we can at least take a significant step toward achieving that objective.

Mr. Chairman, restoring the two-earner deduction would enable us to make meaningful progress toward that goal in a way that provides targeted relief to those couples who are particularly hard-hit by this inequity. When a couple stands at the altar and says "I do," they are not agreeing to higher taxes. Congress should act this year to address the fact that in too many cases, they will be paying higher taxes. I want to again thank Chairman Archer for the opportunity to testify today, and I look forward to working with all interested members on this issue as the Committee works to provide the American people further tax relief this year.

Wally
Herger
Congressman
2nd District • California

NEWS

FOR IMMEDIATE RELEASE
JANUARY 28, 1998

CONTACT: RON SHINN
(202) 225-3076

HERGER TESTIFIES BEFORE WAYS & MEANS COMMITTEE ON "MARRIAGE PENALTY RELIEF ACT"

(WASHINGTON, DC) Rep. Wally Herger testified before the House Committee on Ways and Means today, speaking in favor of a piece of his legislation, H.R. 2593, "The Marriage Penalty Relief Act." Herger is a member of the Committee on Ways and Means. "The Marriage Penalty Relief Act" has garnered a broad, bipartisan group of 155 cosponsors, including 35 Democrats and 27 Ways and Means members.

"When a couple stands a the altar and says 'I do,' they are not agreeing to higher taxes," Herger testified. "Congress should act this year to address the fact that in too many cases, [married couples] will be paying higher taxes."

Herger's legislation provides relief from the marriage penalty by restoring the two-earner deduction. It would allow a ten-percent deduction on up to $30,000 of the lower-earning spouse's income. Between 1982 and 1986, dual-income couples were entitled to this tax benefit to help offset the marriage penalties built into the tax code. However, joint filers are no longer permitted to take advantage of this deduction.

Herger noted that the recently enacted 1997 tax cut brought tax relief to investors, home owners, owners of small businesses and farms, families with children, and students, but had no specific provision to assist those families victimized by the marriage penalty.

A copy of Herger's testimony follows this release.

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Chairman ARCHER. Thank you, Congressman Herger.

Congressman McIntosh, you may proceed in any way you see fit. If you wish to give a statement and then introduce Ms. Mallory and Mr. Pierce, that's fine. If you want them to speak first, that's fine. The floor is yours. You may proceed.

## STATEMENT OF HON. DAVID M. MCINTOSH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF INDIANA

Mr. MCINTOSH. Thank you, Chairman Archer, Mr. Chairman, excuse me. I want to say I appreciate the Committee hearing this issue today, and more importantly, the spotlight that you are able to shed on this important issue.

Let me first introduce Sharon and Darryl. The Committee can hear from them directly. Then I would like to add a statement

about the importance of this issue. Sharon and Darryl are two constituents of mine. Sharon wrote me a letter last February that really moved me to find out what is at stake in this marriage penalty issue. She explained that she and Darryl both work at the Ford Motor plant in Connersville. They live in a small rural community in my district, make about $10 an hour. Darryl does a little farming on the side. They wanted to get married. They went to H&R Block to find out what would be the consequences, if they got married, on their tax form. Well, as Sharon put it in her letter, not only would she have to give up her $900 refund, she found out that together they would pay $2,800 in taxes. Quite frankly, they couldn't afford it, Mr. Chairman, and wrote to me that they can't afford to get married, and wanted Congress to do something about this unfair marriage penalty in the Tax Code. It broke their hearts.

Well, it broke my heart when I heard their story. They have been kind enough to tell their story to others and to come here today. So why don't I now turn it over to Sharon Mallory. Sharon and Darryl, if you want to share your thoughts about this penalty and how it affects you, and then I'll have a statement at the end of that, Mr. Chairman.

**STATEMENT OF SHARON MALLORY AND DARRYL PIERCE, STRAUGHN, INDIANA**

Ms. MALLORY. My name is Sharon Mallory, of Straughn, Indiana.

Mr. THOMAS. Sharon, excuse me. These microphones are horrible today, worse than usual. If you speak directly into it, you might have a better chance. We do want to hear your message. Thank you.

Ms. MALLORY. My boyfriend Darryl Pierce and I are constituents of Congressman David McIntosh. Darryl and I love each other very much and want to be married, but the IRS won't let us. We are victims of the marriage penalty. We traveled here from Indiana today to tell the Committee how the marriage penalty affects us, and to urge the Committee to adopt legislation introduced by Congressman David McIntosh and Congressman Jerry Weller to eliminate the marriage penalty.

Darryl and I both work at the former Ford Electronics Plant in Connersville, southeast of Indianapolis near the Indiana/Ohio border. We make less than $10 and work overtime whenever it is available. Darryl does some farming on the side to supplement our income. Last year Darryl and I decided we wanted to get married. However, when we went to our accountant in an H&R Block office in New Castle, Indiana, she said that not only would I forfeit my $900 refund, but that we would also have to write a check to the IRS for $2,800. To us, this is real money. It's food on our table and clothes on our backs. For Darryl and me, the marriage penalty was large enough that we were forced to put off our marriage.

Last February, I wrote to Congressman McIntosh about our situation. In my letter, I wrote, "Darryl and I would very much like to be married. I must say it broke our hearts when we found out we can't afford it. We hope some day the government will allow us to get married by not penalizing us."

I know that Congress and the President wouldn't purposely single out married couples for higher taxes, but that is the effect of

this tax. I understand the Committee and the Congress may have different ideas about how to cut people's taxes this year. Let me urge you to include eliminating the marriage penalty on the top of your list. It is too important an issue for too many families to ignore. According to the Congressional Budget Office, 21 million families pay an average of $1,400 more in Federal taxes just because they are married. This cannot be allowed to continue. Strong families are the backbones of strong communities and the heart of a strong country. I don't know how many other couples postpone or cancel their marriages because of the marriage penalty, but one family is one too many. By approving legislation to eliminate the marriage penalty, this Congress can do something that will help millions of families in a real and tangible way. I urge you to approve this legislation as soon as possible. Thank you.

[The prepared statement follows:]

**Statement of Sharon Mallory and Darryl Pierce, Straughn, Indiana**

My name is Sharon Mallory of Straughn, Indiana. My boyfriend, Darryl Pierce, and I are constituents of Congressman David McIntosh.

Darryl and I love each other and very much want to be married. But the IRS won't let us. We're are victims of the marriage penalty.

We traveled here from Indiana today to tell the committee how the marriage penalty affects us—and to urge the committee to adopt legislation introduced by Congressmen David McIntosh and Congressman Jerry Weller to eliminate the marriage penalty.

Darryl and I both work at the former Ford Electronics plant in Connersville, southwest of Indianapolis near the Indiana-Ohio border. We make less than $10 and work overtime whenever it is available. Darryl does some farming on the side to supplement our income.

Last year, Darryl and I decided we wanted to get married. However, when we went to our accountant in an H & R Block office in New Castle, Indiana, she said that not only would I forfeit my $900 refund but that we also would have to write a check to the IRS for $2800.

To us, this is real money. It's food on our table and clothes on our children's backs. For Darryl and me, the marriage penalty was large enough that we were forced to put off our marriage.

Last February I wrote to Congressman McIntosh about our situation. In my letter, I wrote: "Darryl and I would very much like to be married and I must say it broke our hearts when we found out we can't afford it. We hope someday the government will allow us to get married by not penalizing us."

I know that Congress and the President wouldn't purposefully single out married couples for higher taxes. But that's the effect of this tax.

I understand that the committee and the Congress may have different ideas about how to cut people's taxes this year. Let me urge you to include eliminating the marriage penalty at the top of your list. It's too important an issue for too many families to ignore.

According to the Congressional Budget Office, 21 million families pay on average $1,400 more in federal taxes just because they're married.

This cannot be allowed to continue. Strong families are the backbones of strong communities—and the heart of a strong country. I don't know how many other couples postpone or cancel their marriages because of the marriage penalty. But one family is too many.

By approving legislation to eliminate the marriage penalty, this Congress can do something that will help millions of families in a real and tangible way. I urge you to approve this legislation as soon as possible.

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Chairman ARCHER. Thank you, Ms. Mallory.

Mr. MCINTOSH. Mr. Chairman, is there still time available for my statement or do you need to move on?

Chairman ARCHER. If you can make it as brief as possible, yes. Your entire written statement, without objection, will be inserted in the record.

Mr. MCINTOSH. Thank you, Mr. Chairman. I would also ask, Jerry and I have received numerous correspondence and e-mails from people like Sharon and Darryl about the marriage penalty, if we could also ask permission to submit those as part of the record as well.

Chairman ARCHER. Without objection.

Mr. MCINTOSH. I would just make two points to the Committee. One, this marriage penalty disproportionately discriminates against women. When the Tax Code was written in the sixties with the married filing jointly, most families in this country had one wage earner, traditionally the husband. Today, that has changed. Seventy-five percent of the families have both spouses working. When the wife decides to go to work, perhaps she has been out of the job force raising children and goes back to finish her career, she gets hit with all of that penalty, as much as a 50 percent marginal tax on her income. So some have said that Jerry Weller and David McIntosh's bill would be the Working Women's Tax Relief Act of 1998, because they are hit disproportionately and unfairly by this marriage penalty.

The second point that has come out in research recently by a professor at the University of Cincinnati Law School, is that minority families are also disproportionately discriminated against by this penalty. That is because oftentimes the woman's income in those families is of a greater percentage than traditional families in the whole of the population in the United States. Therefore, they suffer a larger penalty when you look at minority families as compared to typical families in the United States. That's because oftentimes they have to have two people working in order to earn enough money to get ahead and have a chance to survive in our economy.

So this bill to eliminate the marriage penalty not only would strengthen families, but it would eliminate a policy that discriminates against women and discriminates against minorities as well. I wanted to make sure that that point was in the record, and will submit my testimony, the complete testimony for the Committee.

Thank you, Mr. Chairman, very much. I know you care a great deal about this issue. I appreciate this hearing.

[The prepared statement and attachments follow:]

**Statement of Hon. David M. McIntosh, a Representative in Congress from the State of Indiana**

Mr. Chairman, fellow members of the Committee, I want to thank you for inviting here before this prestigious body to speak about the Marriage Penalty, but much more importantly, you have my profound gratitude for shining the public spotlight on this insidious tax.

As Sharon and Darryl's testimony makes so heart-breakingly clear, the marriage tax is immoral. There's no more adequate way to describe a designed government policy which undermines the traditional institution of the family and, most tellingly, discriminates against women and minorities.

The marriage penalty entered our tax code thirty years ago and has systematically undermined the family ever since. The trend in our nation has seen a decrease in marriage and increase in divorce. Many people, like Sharon and Darryl, want to marry but cannot afford it. Divorce is reaching epidemic levels. There are twice as many single parent households in America today since the marriage penalty came

into effect.[1] The terrible financial strain caused by the marriage penalty contributes to this. Simply put, the marriage penalty is doing great harm to our society by frustrating family cohesion.

The devastating consequences of divorce on parents and children are well documented. When parents divorce, they are likely to die earlier, their general health is worse, and sadly, many divorced adults, particularly young mothers, are thrown into poverty.[2] The effects on children are no less devastating. The National Fatherhood Initiative has shown that where there is a divorce, the children are more prone to violence, illegal drugs, suicide, and drop out of school. Over Ninety percent, Ninety percent!, of children on welfare are from homes with only one parent.[3]

And by the way, don't interpret these facts as an attack on single mothers. I was raised by a single mom. I know the sacrifices she made for us. Single moms are heroes born out of necessity.

Let us simply get rid of the government penalties that push these moms toward divorce and illegitimacy. Big government in Washington and its marriage penalty tax have become the number one enemy of the American family and its affects on working women and minorities are particularly devastating.

The marriage penalty could equally be known as "The Tax on Working Women." When the marriage penalty was proposed America was a far different place and large numbers of women were not yet in the workforce. Today, 75 percent of married couples have two incomes.[4] The marriage penalty almost always hits the second-earner the hardest. Therefore, this tax clearly discriminates against women who may chose to enter the workforce to provide a better life for their family. These women can be taxed at an astounding 50% marginal rate.[5] The Weller-McIntosh Tax on Working Women Elimination Act is the ultimate piece of legislation in the women's liberation movement. If our bill passes, women—and men—will have much greater freedom to choose to work without having to worry about the taxman.

African-Americans are particularly devastated by the marriage tax. The marriage penalty occurs when both spouses work and make roughly the same income and black women historically have entered the workforce in larger numbers and make comparatively more money than whites. 73% of married back women are breadwinners and black women contribute approximately 40% of their household's income.[6] Our legislation brings fairness back into the tax code so that African-American women and families can keep more of their hard earned money to provide for their children.

I know you agree with me that we must completely rid our tax code of this bill that hurts families, working women, and minorities. Therefore, I categorically reject those who have said that the federal government can't afford it. No one in Congress asked married people if they could afford it when they passed it. It's time for the federal government to tighten its belt to help families. I say we cannot afford to allow it to continue because of its pernicious effects on families. I will work with this committee to ensure adequate funding to eliminate the marriage penalty is included in the budget resolution. To guarantee support from those who favor eliminating the marriage penalty, the budget resolution must include enough resources to abolish the marriage penalty.

Mr. Chairman, we in Congress must be held accountable for failing to respond to the American people when we defy the traditional values of the American people. We have a choice. We can continue down the path of destroying the family, penalizing marriage in our tax code, the path of high crime, drug use, divorce, and children being brought up without knowing the difference between right and wrong.

Or we can choose a different path: a path based on the firm conviction that the family must be the foundation of our society. We can choose a path where families are lifted up—not punished by government. It is the way by which young people like Sharon and Darryl can find happiness and finally be married. I believe most strongly that for our nations' future, we must choose to lift up the family. I joined Jerry Weller in introducing legislation to eliminate the marriage penalty and remove one more obstacle in the recovery of the family. Even if some in Washington scoff at this idea, the American people have a special wisdom in these matters. They will support our efforts to succeed in this effort to eliminate the marriage penalty. It is

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[1] The Statistical Abstract of the United States, Department of Commerce, Table No. 146, "Marriages and Divorces," p. 104: 1996.

[2] Dr. Wade Horn, The National Fatherhood Initiative, "Father Facts 2," p.10: 1997.

[3] Ibid.

[4] The Congressional Budget Office, "For Better of for Worse: Marriage and the Federal Income Tax," (June 1997), Table 10, p.39.

[5] The Greater Washington Societies of Certified Public Accountants, Sept. 1997

[6] Dorothy Brown, "The Marriage Bonus/Penalty in Black and White," University of Cincinnati Law Review (Spring 1997), p.5.

crucial that we succeed because the success of the family and the success of America are inseparable.

Thank you, Mr. Chairman.

I would ask that I could submit a speech I gave on the marriage penalty as well as a marriage penalty paper prepared by my office for the record.

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**TO RENEW THE AMERICAN FAMILY by David McIntosh, R–IN**

**Speech to Christian Coalition, September 13, 1997**

Some say that it takes a village to raise a child. No! It takes a family and it will take a family to rebuild our nation and once again make it the guiding moral light for this world. These are two competing visions for America's future. One is right. One is wrong. Putting the family first, builds a great nation. But putting the village—that is the government—first, tears down the family and the nation crumbles.

We, as a nation, must learn from history that societies which rely on government, instead of families,to solve their problems never prosper. 500 years before Christ, the prophet Nehemiah returned to Jerusalem, the city of his forefathers and found it in ruins. The City wall had broken down and thieves and marauders preyed upon the people. Even worse, the Bible says that the Israelites were forced to pay excessively high taxes, to a remote government in a far off capital. Families had to sell their property and give up on their inheritance just to pay what the King of Persia's tax collectors extorted from them. We know Nehemiah set about rebuilding the walls of Jerusalem using the strength of the family. He assigned each family a piece of the wall to rebuild. When his enemies threaten to kill the Israelites, Nehemiah mounted a family defense. "Don't be afraid. Remember the Lord, who is great and awesome, and fight for your brothers, your sons and your daughters, your wives and your homes." With each family defending a portion of the wall, Nehemiah defeated his enemies. 500 years before Christ the people of Israel followed God's plan, employed a family defense, rebuilt the walls of a new Jerusalem, and were blessed with a society that was moral and just.

History repeats itself. Let us fast forward to today, nearly 2000 years after the death of Christ, and ask ourselves: What is happening in America? America that for 200 years was founded on the principle that God has blessed every man and woman in this nation with certain inalienable rights, among them, life, liberty, and the pursuit of happiness. America that has become for most of the world a shinning city on the hill in which truth, justice, and freedom are hallmarks of everything we do.

For the last thirty-years, America has turned away from the commandment to entrust the family with the well-being of our society. Indeed, America's government has begun to systematically punish the family. Starting in 1969, America has taxed married couples more than if they are divorced or single. That is the year the marriage penalty entered into our tax code. Today, 21 million couples in America suffer and strain under a marriage penalty tax. The average cost to the family is $1,400 a year.

Here is how the marriage penalty works. First, when a young couple decide to get married they pay higher rates and lose some of their deductions. Second, when the couple has children they are penalized once again. Under the budget we passed, many families only receive a portion of the $500 tax child credit because they are married and earn too much money. Third, when their children go to college the family is punished by paying higher taxes on savings they use to pay tuition. Fourth, when they retire, they are penalized in Social Security and Veterans benefits, if they remarry. The worst part of the marriage penalty is that it discriminates against women who, when their children are old enough, want to go back into the workforce to provide an even better life for their family. These women can be taxed at an astounding 50% marginal rate.

This is wrong. Washington should not punish families that need two incomes to make ends meet. A constituent of mine, Sharon Mallory, wrote me an anguished letter about how this marriage tax hurt her. Let me read to you from her letter. "Dear Congressman McIntosh, My boyfriend, Darryl Pierce, and I would very much like to get married....We both work at Ford Electronics and make less than $10.00 an hour; however, we do work overtime whenever it is available....I can't tell you how disgusted we both are over this tax issue....If we get married not only would I forfeit my $900 refund check, we would be writing a check to the IRS for $2,800....Darryl and I would very much like to be married and I must say it broke our hearts when we found out we can't afford it."

Sadly, Darryl and Sharon's story is not unique. One of my staff in Muncie, Indiana told me of a young couple, who asked not to be named, that has a terrible problem in their family. They were driving home one evening and were struck by an on-coming car. The couple's 6 year-old daughter suffered severe brain damage. She is now having to learn to walk and talk all over again. Our government, out of compassion for people like this, has programs to assist families and allow them to pay for their medical bills. This family went to a government case-worker to seek help for their little girl's therapy. The devastated parents were told that the husband makes 10 dollars more a year than the government will allow in order to qualify for any assistance. What did the case worker say to the family? That they have two choices. One, the father can quit his job and go on welfare. And if that's not bad enough, The second choice was that they can get a *divorce*! The mother can take the child and qualify for government assistance.

Once again, I say this tax is wrong and immoral. Our government should not force 21 million families to choose between divorce and economic prosperity, on the one hand, or staying married and financial hardship, on the other. In the Gospel of St. Matthew, Christ said about the family "What therefore God hath joined together, let not man put asunder." Our government has ignored this warning. What are the consequences of such folly? Look at what has happened to America during these last thirty years? Each of us, as we look around in our neighborhoods and our streets and our cities, know that the family is under assault. In Hollywood, on the Internet, and in Washington, the family is a favorite and familiar target. This barrage has weakened the family as the foundation of our society.

In our inner cities, in our small towns across America, and in our neighborhoods, the walls of our communities, built up by the American family, are crumbling. We face a crisis in our country. In the last thirty years, since the marriage penalty began, 9 million couples decided not to get married in the United States. Many of these young people are like Sharon and Darryl who want to marry but cannot afford it. 2 million more marriages ended in divorce, And there are twice as many single parent households.

What does this breakdown of the family mean for mothers and fathers, and most importantly, for the children of broken families? Studies show that when parents divorce, they are four times as likely to die early,e more respiratory and digestive illnesses. And sadly, many divorced adults, particularly young mothers, are thrown into poverty. The effects on children are no less devastating.

The National Fatherhood Initiative has shown that where there is a divorce, the children are prone to violence. 72 percent of juvenile murderers and 60 percent of America's rapists grew up in homes without fathers. They are 4 times more likely to use illegal drugs; 3 times more likely to commit suicide, and twice as likely to drop out of school. When they join the workforce, their pay is lower, with less of a chance to be promoted. These poor children, who are not responsible for their fate, are even more likely to be trapped in a cycle of poverty. Over Ninety percent, Ninety percent!, of children on welfare are from homes with only one parent.

And by the way, don't interpret these facts as an attack on single mothers. I was raised by a single mom. I know the sacrifices she made for us. Single moms are heroes born out of necessity. Let us simply get rid of the government penalties that push these moms toward divorce and illegitimacy.

Big government in Washington and its marriage penalty tax have become the number one enemy of the American family.

My friends, we cannot let this stand. We must pass a bill that Jerry Weller and I have introduced into Congress that eliminates the marriage penalty from the tax code. Our bill is simple—It says families may choose. If they pay less taxes filing jointly as a normal couple, they may do so. If they pay lower taxes by filing as individuals, they may choose to do that instead of having to file for a divorce to get this tax break.

The prophet Jeremiah says: "Stand at the crossroads and look. Ask for the ancient paths. Ask where the good way is. And walk in it." My friends, as the 20th century draws to an end,America indeed stands at a crossroad.

We have a choice. We can continue down the path of destroying the family, penalizing marriage in our tax code, the path of high crime, drug use, divorce, and children being brought up without knowing the difference between right and wrong.

Or we can choose a different path: a path that is based on the ancient ways of Nehemiah where we recognize that the family must be the foundation of our society. We can choose a path where families are lifted up—not punished by government. It is the way by which young people like Sharon and Darryl can find happiness and finally be married. It is the path that allows Americans to provide for their children without the government pressuring them to divorce.

Again, the choice is ours. For the sake of America, and freedom, and the young boys and girls who are our nations' future, we must choose to lift up the family. I feel it is my personal calling to begin by fighting with every ounce of my being to end the marriage penalty tax once and for all. I ask you in the Christian Coalition to join me in this calling. Let us act boldly, with the courage of our convictions, to link arm and arm and march to Washington with the goal of unconditional surrender.

Let us never stop praying that our nation's leaders will understand that the laws of this land must not try to "put asunder what God has brought together." let us call on our nation's leaders, our leaders in Congress, and the President to: Demand that families are put at the head of our national agenda. Demand that America once again has a government that respects the sanctity of marriage. We will be silent no longer. Tonight, we say to Sharon and Darryl and to all those facing marriage penalties: No more broken promises. No more broken hearts.

In our crusade, I urge you to: Support your leaders here in the Christian Coalition—Pat Robertson, Don Hodell, Randy Tate—as they fight across this great land on behalf of the American family. As they fight in Washington to rid our tax code of the penalties against marriage and the family. If the Christian Coalition makes repeal of the marriage penalty tax your number one priority, we cannot fail. This is crucial because the success of the family and the success of America are inseparable. I am confident, that with the help of God, we will succeed.

And when we do, America will once again be on the path of righteousness. And when we have restored the family, we can re-fortify the walls of this great country with the building blocks of freedom, faith, and virtue. Then, and only then, as we enter the 21st century, will America be that shining city on the hill.

Thank you, God bless you and God bless America.

## Congressman David M. McIntosh, Second District, Indiana

DO YOU PAY MORE IN TAXES JUST BECAUSE YOU'RE MARRIED?

*What is the marriage penalty?*

The IRS punishes millions of married couples who file their income taxes jointly by pushing them into higher tax brackets. The marriage penalty taxes the income of a family's second wage earner—often the wife's salary—at a much higher rate than if that salary were taxed only as an individual.

For example, consider a couple whose husband and wife each earn $30,500 for a total household income of $61,000. Subtracting their personal exemptions and standard deductions of $11,800, this couple's taxable income is $49,200. At this income level, the couple is taxed at the *28 percent* marginal rate for a total tax bill of $8,563.

However, if this couple were divorced or living together but not married, they would get a better tax break from Uncle Sam. For example, with each earning $30,500 and subtracting their individual exemptions and deductions of $6,550 each, their taxable income would be $23,950 each. That means their incomes would each be taxed at the lower *15 percent* marginal rate for a tax bill of $3,592 each.

*So the married couple pays more in taxes just because they're married*. That's a marriage penalty of $1,378. Overall, according to a recent report by the Congressional Budget Office, more than 21 million couples suffer a marriage penalty averaging $1,400.

| Marriage Penalty Example | Individual | Individual | Couple |
|---|---|---|---|
| Adjusted gross income: | 430,500 | 430,500 | 461,000 |
| Minus personal exemption and standard deduction: | 46,550 | 46,550 | 411,800 |
| Taxable income: | 423,950 | 423,950 | 449,200 |
| Tax liability: | 43,592 | 43,592 | 48,563 |
| Marriage Penalty: | | | 41,378 |

Incidentally, there's also a marriage penalty for the personal exemption and standard deduction. In the above example, the exemptions and deductions for an individual total $6,550. Common sense says that for a married couple the exemptions and deductions should be double that of an individual, or $13,100. Unfortunately, common sense doesn't apply to the IRS. The family's personal exemptions and

standard deductions total $11,800—that's $1,300 less that what two individuals living together receive.

*Consequences of marriage penalty?*

Families today are under assault. Broken homes. Fatherless children. Single moms struggling to raise their children while also ensuring there's food on the table.

When Washington taxes couples more just because they're married that hurts working families who are playing by the rules. Rather than helping families stay together, the marriage penalty contributes to the breakdown of the family.

What does this breakdown mean for mothers and fathers? Studies show that when parents divorce, they are four times as likely to die at an earlier age,[1] their health is worse[2] and sadly many divorced adults, particularly young mothers, are thrown into poverty.[3]

The effects on children are also devastating: 72 percent of juvenile murders[4] and 60 percent of rapists[5] grew up in broken homes. They are more likely to use drugs, more likely to commit suicide and more likely to drop out of school.[6] And today 75 percent of children living in single-parent families will experience poverty before they turn 11 years old.[7]

*What's the solution to the marriage penalty?*

In September Reps. David McIntosh, R-Ind., and Jerry Weller, R-Ill. introduced H.R. 2456, the "Marriage Tax Elimination Act of 1997." The bill would benefit married couples regardless of whether they have children. Its idea is simple: It allows families to decide how they file their income taxes—either individually or jointly, whichever gives them the greatest tax benefit. Ending the marriage penalty will allow 21 million families to keep more of the money they earn, rather than paying more in taxes to Uncle Sam.

*In Congress who supports the Marriage Tax Elimination Act?*

Over 226 House co-sponsors—including Speaker Newt Gingrich, Majority Leader Dick Armey, Majority Whip Tom DeLay, Conference Chairman John Boehner, Conference Vice Chairman Jennifer Dunn and Conference Secretary Deborah Pryce.

*Who else supports McIntosh's bill?*

"Government, by taxing married couples at higher rates than singles, has for too long been a part of the problem. At a time when family breakups are so common, Congress should pass legislation to encourage marriage and ease the burden of families trying to form and stay together. This legislation places government on the side of families."

*The Christian Coalition, Don Hodel, president*

"David McIntosh has touched a nerve—his bill to eliminate the marriage penalty will help put an end to Washington's punishment of families. Washington should be supporting families, not undermining them. McIntosh's bill is a bold step in the right direction to make the tax code more family-friendly."

*Americans for Hope, Growth and Opportunity, Steve Forbes, chairman*

"American's for Tax Reform supports the efforts of the Sophomore Republican Class in leading the march toward tax relief for working American couples. We support efforts to enact the 'Marriage Tax Elimination Act' for America's working couples. We would like to thank David McIntosh in particular for his efforts."

*Americans For Tax Reform, Grover Norquist, president*

"Current law forces many married Americans to pay a higher tax bill than if they remained single and had the same combined income. Such a double standard is

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[1] Joseph E. Schwartz. "Sociodemographic and Physchosocial Factors in Childhood as Predictors of Adult Mortality." American Journal of Public Health 85 (1995):1237–1245.

[2] L. Remez. "Children who Don't Live with Both Parents Face Behavioral Problems." Family Planning Perspectives. (January/February 1992).

[3] Jeanne Woodward. "Housing America's Children in 1991." U.S. Bureau of the Census, Current Housing Reports H121/93–6. U.S. Government Printing Office, Washington, D.C., 1993.

[4] Dewey Cornell. "Characteristics of Adolescents Charged with Homicide." Behavioral Sciences and the Law 5 (1987):11–23.

[5] Nicholas Davidson. "Life Without Father." Policy Review (1990); see also Karl Zinsmeister. "Crime is Terrorizing Our Nation's Kids." Citizen (August 20, 199): 12.

[6] Wade F. Horn. "The National Fatherhood Initiative." Father Facts II.

[7] National Commission on Children. "Just the Facts: A Summary of Recent Information on America's Children and Their Families." Washington, D.C., 1993.

wholly at odds with the American ideal that taxes should not be a primary consideration in any individual's economic or social choices."

*National Taxpayers Union, Al Cors, director*

"We welcome the 'Marriage Tax Elimination Act' introduced today by representatives Dave McIntosh and Jerry Weller. This bill can be a first step in recognizing in law that the family is the first church, the first school, the first government, the first hospital, the first economy, and the first and most vital mediating institution in our culture. In order to encourage stable two-parent, marriage-bound households we can no longer support a tax code that penalizes them."

*The Catholic Alliance, Keith Fournier, president*

"By eliminating the marriage penalty, Congress will send a strong message to couples across America that the institution of marriage is important and that the government should work to strengthen, not weaken it. With the passage of the 'Marriage Tax Elimination Act,' couples and families will no longer be robbed of their hard-earned money, and it will enable them to work towards their own financial independence at retirement."

*Traditional Values Coalition, Rev. Louis P. Sheldon, chairman*

"We urge Congress to put the tax code where its rhetoric is and eliminate marriage penalties. Serious steps to reform tax laws would mean real liberation for women, those who work and those who may have to in the future."

*National Independent Women's Forum, Barbara Ledeen, executive director*

Chris Jones, Communications Director
(202) 225-3021

For Immediate Release
January 28, 1998
010-8

# McINTOSH URGES WAYS AND MEANS PANEL TO HELP FAMILIES BY ENDING MARRIAGE TAX

*Henry County couple also testify before key tax-writing committee*

**(NOTE: For the complete text of Congressman McIntosh, Sharon Mallory and Darryl Pierce's opening statements before the House Ways and Means Committee, please visit McIntosh's web site at www.house.gov/mcintosh.)**

WASHINGTON -- Rep. David McIntosh, R-Ind., and two of his Indiana constituents told Congress' chief tax-writing committee on Wednesday that American families are struggling under the weight of the marriage penalty, and they urged repeal of the penalty that forces millions of couples to pay more in taxes solely because they are married.

McIntosh and Sharon Mallory and Darryl Pierce, of Straughn, Ind., testified and answered questions before the House Ways and Means Committee. The committee is considering various tax cuts plans -- including McIntosh's bill to eliminate the marriage penalty.

Mallory and Pierce, who both work at an electronics plants in Connersville, Ind., wrote to McIntosh in February 1997 that the marriage penalty forced them to delay their marriage. Mallory wrote that a New Castle accountant reported that if they married she would give up her $900 refund and together the couple would pay $2,800 more in federal taxes just because they would be married.

"Darryl and I love each other and very much want to be married -- but the IRS won't let us," Mallory said in opening remarks to the committee. "We're victims of the marriage penalty. This cannot be allowed to continue. Strong families are the backbones of strong communities -- and the heart of a strong country. I don't know how many other couples postpone or cancel their marriages because of the marriage penalty. But one family is too many."

McIntosh highlighted the impact of the marriage penalty on millions of families like Mallory and Pierce. According to a June 1997 study by the Congressional Budget Office, more than 21 million families pay on average $1,400 more in taxes just because they are married.

"As Sharon and Darryl's testimony makes so heart-breakingly clear, the marriage tax is immoral because it punishes our most cherished institution -- families," McIntosh told the committee. "While some may say Washington can't afford to eliminate the marriage penalty, I say families can't afford to continue suffering from it."

**(MORE)**

The Congressional Budget Office study found that the marriage tax forces 42 percent of American families -- 21 million married couples -- to pay more in income taxes than if they were divorced or lived together unmarried.

When the marriage penalty first appeared in the tax code in 1969, most families had only one breadwinner, and the tax provision was actually designed to give a tax cut -- a so-called "marriage bonus" -- to one-income families. But the tax failed to envision the growing number of women in the workforce. Today in nearly 75 percent of all families, both the husband and wife work either because they want to or must to make ends meet.

It is these two-income families -- and especially working women -- that the marriage penalty targets for higher taxes. That is because the marriage penalty taxes the income of a family's second wage earner -- often the wife's salary -- at a much higher rate than if that salary were taxed only as an individual.

"The marriage penalty is a slap in the face to working women who still are striving for equality of pay with men in the workforce," McIntosh said. "This kind of economic discrimination against working women is immoral, and this Congress must stand up and defend working women."

McIntosh and Rep. Jerry Weller, R-Ill., introduced the "Marriage Tax Elimination Act" in September 1997. The legislation, H.R. 2456, ends the marriage penalty by allowing married couples to file either jointly or as individuals, whichever gives them the greatest tax benefit.
More than 240 House lawmakers -- Republicans and Democrats -- have co-sponsored McIntosh's bill. Last fall Speaker Newt Gingrich, who also is a co-sponsor, pledged that marriage penalty reform would be the centerpiece of the 1998 tax relief bill considered by Congress.

"I know that Congress and the President wouldn't purposefully single out married couples for higher taxes, but that's the effect of this tax," Mallory told the Ways and Means Committee. "I understand that the committee and the Congress may have different ideas about how to cut people's taxes this year. Let me urge you to include eliminating the marriage penalty at the top of your list. It's too important an issue for too many families to ignore."

For more information on the marriage penalty and the Weller-McIntosh bill, visit McIntosh's web site at www.house.gov/mcintosh.

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4906 East County Line Road
Straughn, IN 47387
February 17, 1997

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Taxes

The Hon. David McIntosh
2900 W. Jackson St., Suite 101
Muncie, IN 47303

Dear Representative McIntosh,

My boyfriend, Darryl Pierce, and I have been living together for quite some time. We would very much like to get married.

We both work at Ford Electronics in Connersvil Indiana. We both make less than 10.00 an hour; however, we do work overtime whenever it is available. Also, Darryl does some farming on the side.

I can't tell you how disgusted we both are over this tax issue. If we get married not only would I forfeit my $900.00 refund check, we would be writing a check to the IRS for $2,800.00. This amount was figured for us by an accountant at the local H+R Block office in New Castle.

Now there is nothing right about this. After we continually hear the government preach to us about "family values."

Nothing new about the hypocrites in Washington. Why don't we do away with the

current tax system? It is old and outdated. Antiquated. The flat tax is the most sensible method to use and no one is being penalized. Everyone would be treated the same.

I don't understand how the government can ask such questions as: single? married? dependents? Employers, bankers, realators, and creditors are forbidden by law to ask these questions. The same should apply to the government.

Darryl and I would very much like to be married and I must say it broke our hearts when we found out we can't afford it.

We hope someday the government will allow us to get married by not penalizing us.

Yours Very Truly,
Sharon Mallory and Darryl Pierce

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Chairman ARCHER. Mr. Pierce, do you have anything to add to what Ms. Mallory said?

Mr. PIERCE. No. She said it all.

Chairman ARCHER. We are happy to have you before us. You have graphically pointed out to the Committee the unfairness of this marriage penalty in the Code. I will say for myself that when

I came on this Committee in January 1973, coming from the State of Texas, our property laws automatically provide that a spouse that is not working has title to 50 percent of everything the spouse that is working earns. I was offended enormously by the marriage penalty because it totally disregards the property rights that are established by each State. This is a little bit different an issue than the one that Ms. Mallory and Mr. Pierce brought up, but it is another part of the inequity in the marriage penalty. I have fought against it my entire career on this Committee. So I welcome your testimony today.

I yield to Mr. Rangel for any inquiry that he might like to make.

Mr. RANGEL. Mr. Chairman, I pass my time.

Chairman ARCHER. Mr. Thomas.

Mr. THOMAS. Thank you, Mr. Chairman. I thank all of my colleagues, and especially those who came from Indiana. The old saying, love conquers all, apparently doesn't cover the IRS. Although Mr. Pierce, your willingness to defer to Ms. Mallory indicates that you are ready for marriage. [Laughter.]

Even though the IRS won't let you. I just found the opening exchange between the Chairman and the Ranking Member interesting since in the 103d Congress the Chairman of the Ways and Means Committee, Mr. Gibbons, and then in the 104th, the Ranking Member of the Committee, Mr. Gibbons, has long been an advocate for a system different than the current system, and went so far before he retired to actually write a bill to produce just such a different system. I am just a little surprised perhaps that there appears to be a newness to the subject of fundamentally reforming the tax system.

Mr. RANGEL. Will the gentleman yield? I assume you are referring to me.

Mr. THOMAS. Very briefly.

Mr. RANGEL. I am very anxious to see what document is coming out. I have just as much interest as Sam Gibbons or anyone else on this Committee. But we can't just keep educating people. We need a bill before us. Thank you.

Mr. THOMAS. I thought the road to a bill was education. I guess we're supposed to put the old cart before the horse.

Let me say that I'm a cosponsor of legislation dealing with this. I commend all of you for trying to get at the problem, although I believe the Chairman's comment, that as long as we have the current system, it's going to be a continual chase through the system. I don't think this is partisan. I do not think it's a vestigial remain from a previous era. Just let me make one point to illustrate that.

We just passed a tax package in the Balanced Budget Act. Because the administration insisted that we limit people's access to the new so-called Roth IRA, we in fact have perpetuated, reinforced and ingrained the marriage penalty in the Tax Code as recently as last year. If you are single, you can deal with an income up to $100,000 and a rollover into the new IRA. But if you are married, that married couple is limited to the $100,000, regardless of their income. It is something that is very difficult to root out, given the way in which the tax structure is created.

I commend you for your efforts. We will support your efforts. But I think what we need to do is look fundamentally at repealing

those sections that create limits, that produce choices such as we see here before us. There should be no penalty in the Code for marriage. I, for one, think I'm going to introduce legislation to repeal the cap, for example, on the Roth IRA, as my indication that at some point we have to say you can't play games with the numbers. You simply have to eliminate any reason for treating two people who happen to be married differently than two people who do not.

So I compliment you. I support your effort. Frankly, what we need to do, and Mr. McIntosh you indicated this creates a little bit of publicity on this issue. There are an awful lot of people who know about it. What we need to do is sensitize our Members to move on it. Thank you very much.

Chairman ARCHER. Ms. Dunn.

Ms. DUNN. Thank you very much, Mr. Chairman. I have a couple of questions. One I'll ask you, members of the panel. Have you had the scoring done on your two plans? Could I get the numbers if you have?

Mr. HERGER. The latest Congressional Budget Office number that I am aware of, Congresswoman Dunn, is about $9 billion a year on my approach, and about $29 billion for complete elimination.

Ms. DUNN. Is that over 5 years or is that over 1 year?

Mr. HERGER. That is per year, based on figures from 1996.

Mr. WELLER. If I might respond, Ms. Dunn. While the Marriage Tax Elimination Act, which allows a married working couple to choose to file jointly or as two singles has not been officially scored by Joint Tax yet this year, a similar bill in a previous Congress 2 years ago was scored roughly at about $18 billion in revenue loss to the Federal Government. But there is also a different way to say that. That is, that's an $18 billion tax on marriage that should not be being collected today.

Ms. DUNN. Thank you very much. I think we need to start with some background. I think this is a superb idea. I think I am on both your pieces of legislation. If I'm not, I certainly ought to be on your legislation because I think the points that were made, particularly by Mr. Weller and Mr. McIntosh about how working women are very concerned about this penalty that they are paying when they are married. It's not fair to them that this money is going to the IRS. We all know that it's not spent as well by the Federal Government as it would be by people who are able to keep this money in their pockets and decide where they want to put this money.

Mr. Chairman, my second question is one that I would like to ask you or somebody. I am wondering what the reason was for doing away with this obviously important part of the Tax Code in 1986. Is there justification that we ought to know as we are moving back into this area?

Chairman ARCHER. We'll be happy to have a presentation or a briefing on that for the Members of the Committee. I am reluctant to try to take the time now to explain what I know historically happened. But the marriage penalty has been in the Code beginning back in 1969. It was exacerbated to a degree in 1986, but it's been with us a very long time. It occurred initially because of the political pressure of the singles who came before this Committee and

said "it's cheaper for two people to live together than it is to live separately. Therefore, it is unfair to us to have everybody treated the same." That political pressure welled up and caused the Committee and the Congress to insert what we now term the marriage penalty. But that was the genesis of it originally.

Ms. DUNN. Thank you, Mr. Chairman. I suspect that the number of dollars included must have been very tempting for those people who believed the Federal Government's role should be expanded. These dollars certainly have been going the last few years until just recently to pay for lots of big government programs. I think it's time to turn that around.

Mr. WELLER. Will the gentlelady yield? You asked the question on the impact on the Federal Government if they lose the revenue that's currently collected with the marriage tax penalty. But if you think about what $1,400 means to a married working couple in Washington State or in Illinois or Indiana or California, $1,400 is 1 year's tuition at Joliet Junior College in my district. It's 3 months of childcare. In fact, I have a chart over here.

You know, the President has a politically attractive idea regarding expanding the childcare tax credit. Well, according to the President's own figures, that $360 that an average couple that would qualify for the President's childcare tax credit would be able to purchase 3 weeks of childcare. But with elimination of the marriage tax penalty, that extra $1,400 that the average married working couple would be able to keep as a result of the Marriage Tax Elimination Act would purchase 3 months. So you have 3 weeks versus 3 months of childcare in comparing the two proposals.

Ms. DUNN. And also the right of the parents to choose what they want to do in the area of childcare. Thank you very much.

Chairman ARCHER. Let's see who is here at this time. I guess on the list on the Minority side, Mrs. Thurman is.

Mrs. Thurman.

Mrs. THURMAN. Mr. Chairman, I actually don't have any questions at this time. I am looking forward to the debate as we get into this, and certainly any of the offsets. I know that Mr. McIntosh and I have talked about this on the floor. There are several proposals, I understand, that are being looked at in this area. Hopefully as this day goes on, we will have the opportunity to see how this all unfolds. But my heart does go out to folks that are here testifying before us today. It is unfortunate that we have a penalty in taking what many of us think is a wonderful part of our lives, of being married and having that opportunity. So I certainly think there are things that we need to look at. But let's see what happens as we go on.

Chairman ARCHER. Mr. English. Does any other Member of the Committee wish to inquire? If not, thank you very much.

Our next panel is scheduled to be three more of our colleagues. I don't know if they are here. Congressman Kasich, Congressman Salmon, and Congressman Riley. If one or more of those colleagues are here, they are invited to come and take a seat at the witness stand. I see Congressman Riley.

Congressman Riley, welcome. Congressman Salmon, welcome. If Congressman Kasich shows up, we'll be happy to receive his testimony also.

Congressman Salmon, just briefly, the rules of the Committee are that we would like for you to keep your oral testimony within 5 minutes. Without objection, your entire written statement will be inserted in the record. If you are ready, we are happy to have you here. You may proceed.

**STATEMENT OF HON. MATT SALMON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ARIZONA**

Mr. SALMON. Thank you very much, Mr. Chairman. I appreciate the opportunity to testify before the Ways and Means Committee in support of the Riley-Salmon Marriage Protection and Fairness Act. The Taxpayer Relief Act, now law, provided Americans with the first significant tax cut in almost a generation, but our work is not done. Mr. Chairman, as you so aptly pointed out, Americans were taxed at the post-World War II record of 19.9 percent of the Gross Domestic Product last year.

Lawmakers from both sides of the aisle have called for the next round of tax cuts, to revise the Tax Code as it pertains to married couples. One of the most indefensible aspects of our current Tax Code is that over 40 percent of married couples pay more in taxes filing jointly than they would if the husband and wife each filed individually. That's a crime.

This marriage penalty has been criticized by President Bill Clinton, Speaker Newt Gingrich, and Majority Leader Trent Lott. To ensure that the tax law would not punish married Americans, Representative Jerry Weller and Dave McIntosh introduced a bill, which I have cosponsored, and would eliminate the marriage penalty for some 40 percent for the 40-some odd percent of couples who pay tax filings jointly, pay more taxes filing jointly than they would as unmarried individuals. However, it would upset the principle embedded in our current law, that different families with the same total income should be treated equally for tax purposes. Consequently, it would place most couples in which both spouses work full time in a more favorable tax position than families in which one spouse remains at home or works part time.

Jerry Weller and Dave McIntosh have put this issue on the map. For that, we are deeply indebted. Taxpayers owe them a big debt of gratitude. I applaud their leadership on this issue. But income-splitting offers a better fix to this important problem.

The Riley-Salmon bill would permit married couples to use income-splitting on their tax returns and would increase the standard deduction for married couples. These changes would offer almost all married couples a tax cut, would eliminate the tax penalty on marriage that exists under current law, and would continue the current policy that different families with the same total income should be treated equally for tax purposes. Senator Lauch Faircloth has introduced virtually the same bill in the Senate, that's S. 1285.

Most importantly, the income-splitting legislation we have introduced treats equitably those families in which one parent stays at home. As the New York Post has editorialized, this approach would end the marriage penalty and benefit hard-pressed, one-income married families. Another attractive feature Maggie Gallagher noted in a Washington Times column on the marriage penalty, that income splitting would keep government from taking sides on the

mommy wars. Indeed, as the Congress and President contemplate proposals to improve daycare for young children, including the President's proposal to pour billions of dollars into daycare centers, while ignoring parents that raise their kids or have relatives who participate in child rearing, pursuing a marriage penalty fix that does not assist spouses who choose to stay at home or work part time should cause us to pause.

Profamily organizations such as the Family Research Council, Eagle Forum, and tax reform groups such as National Taxpayers Union, are aligning behind our approach because it benefits all married couples. Some will undoubtedly criticize our proposal as too difficult to achieve, given budgetary limitations. Indeed, the bill would likely require Washington to run on $30 billion less of tax money from America's families. But the preservation of security of the cornerstone of America, the smallest most important unit of government, the family, is too important to short-change with more economical but less effective proposals.

Additionally, Chairman Archer, you recently unveiled a proposal that would cap Federal taxation at 19 percent of Gross Domestic Product, which if enacted, could amount to an annual tax cut of up to $75 billion. A comprehensive marriage penalty fix would represent less than half of this amount.

I know that when we talk about the budget and numbers and the fact that this is probably double what the proposal from McIntosh and Weller is offering, I know it makes us a little bit queazy. But who would have ever thought 3 years ago that we would be where we are today in terms of balancing the budget. We are within a stone's throw of doing it.

I have a belief that if the American people can get energized about something, and if we representing them get energized about something, all things are possible to he that believes it. Let's go get it done. Thank you.

[The prepared statement follows:]

**Statement of Hon. Matt Salmon, a Representative in Congress from the State of Arizona**

I appreciate the opportunity to testify before the Ways and Means Committee in support of the "Riley-Salmon Marriage Protection and Fairness Act." The Taxpayer Relief Act (now law) provided Americans with the first significant tax cut in almost a generation. But our work is not done. As Chairman Bill Archer has pointed out, Americans were taxed at a post World War II record (19.9) percentage of Gross Domestic Product last year.

Lawmakers from both sides of the aisle have called for the next round of tax cuts to revise the tax code as it pertains to married couples. One of the most indefensible aspects of our current tax code is that over 40 percent of married couples pay more in taxes filing jointly than they would if husband and wife each filed individually. This "marriage penalty" has been criticized by President Bill Clinton, Speaker Newt Gingrich, and Majority Leader Trent Lott.

To ensure that tax law would not punish married Americans, Representatives Jerry Weller and Dave McIntosh introduced a bill, which I have cosponsored, that would eliminate the "marriage penalty" for the 40 some-odd percent of couples who pay more taxes filing jointly than they would if each spouse filed as an unmarried individual. However, it would upset the principle embedded in current law that different families with the same total income should be treated equally for tax purposes. Consequently, it would place *most* couples in which both spouses work full time in a more favorable tax position than families in which one spouse remains at home or works part time. Jerry Weller and Dave McIntosh have put this issue on the map. Taxpayers owe them a debt of gratitude, and I applaud their leadership on this issue. But "income splitting" offers a better fix to this important problem.

The Riley-Salmon bill would permit married couples to use "income splitting" on their tax returns, and would increase the standard deduction for married couples. These changes would offer almost all married couples a tax cut, would eliminate the tax penalty on marriage that exists under current law, and would continue the current policy that different families with the same total income should be treated equally for tax purposes. Senator Lauch Faircloth has introduced virtually the same bill in the Senate (S. 1285).

Most importantly, the income-splitting legislation we have introduced treats equitably those families in which one parent stays at home. As the *New York Post* has editorialized, this approach would end the marriage penalty and benefit "hard-pressed one-income married families." Another attractive feature: Maggie Gallagher noted in a *Washington Times* column on the marriage penalty that income-splitting would keep "the government from taking sides in the mommy wars." Indeed, as the Congress and President contemplate proposals to improve day care for young children—including the President's proposal to pour billions of dollars into day care centers, while ignoring parents that raise their kids or have relatives who participate in child-rearing—pursuing a marriage penalty fix that does not assist spouses who choose to remain at home or work part-time should cause us to pause.

Pro-family organizations such as the Family Research Council and Eagle Forum, and tax reform groups such as National Taxpayers Union are aligning behind our approach because it benefits all married couples. Some will undoubtedly criticize our proposal as too difficult to achieve given budgetary limitations. Indeed, the bill would likely require Washington to run on $30 billion less of tax money from America's families. But the preservation and security of the cornerstone of America, the smallest, yet most important unit of government—the family—is too important to shortchange with more economical, but less effective proposals. Additionally, Chairman Archer recently unveiled a proposal that would cap federal taxation at 19 percent of Gross Domestic Product, which if enacted, could amount to an annual tax cut of up to $75 billion. A comprehensive marriage penalty fix would represent less than half of this amount.

I look forward to working with the Committee on passing a marriage tax relief bill that benefits all families.

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Chairman ARCHER. Thank you for your testimony.

Congressman Riley, we would be happy to receive your testimony. Again, your entire written statement, without objection, will be inserted in the record. You are recognized to proceed on your oral testimony.

## STATEMENT OF HON. BOB RILEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ALABAMA

Mr. RILEY. Thank you, Mr. Chairman. Mr. Chairman, I want to thank you for holding this important hearing today. I appreciate the opportunity to come and speak before the Committee about the marriage tax penalty. I think that we can all agree that the marriage tax penalty is unfair and is misguided. According to the Joint Tax Committee in 1996, more than 21 million married couples paid a marriage penalty costing more than $28 billion a year. But as simply the average American couple will pay $1,400 more in income taxes simply because they are married. In my opinion, it is difficult to comprehend the devastating effect that the marriage penalty has had on our society. Instead of encouraging and helping families to stay together, our current Tax Code is forcing them apart.

Unfortunately, President Clinton's 1993 tax increase made the marriage penalty even more painful for married couples. For example, according to the National Center for Policy Analysis, the marriage penalty for couples earning $50,000 is $1,326 if they have no

children. However, if they have two children, the marriage penalty would be $4,348, a penalty of $1,500 per child.

Yesterday, I introduced the Marriage Protection and Fairness Act, that will once and for all eliminate this penalty. My proposal is unique because it allows couples to effectively split their combined incomes for tax purposes. That means that taxes for married couples would be figured by adding up the income of both spouses and dividing by two. Each would be taxed on half of their own total income. Furthermore, the bill also increases the basic standard deduction for married couples to twice the standard deduction. This would lower the tax burden for all families and would lower it regardless of how many children they have. Moreover, it would neutralize the tax incentive for two versus one income.

Mr. Chairman, there are many good marriage penalty relief proposals before Congress today. Like many of our colleagues, I am a cosponsor of the Weller-McIntosh Marriage Tax Elimination Act. But suppose one spouse earns $30,000 a year, and the family needs more income. If the other spouse takes a paid job, then the couple will benefit from the Weller-McIntosh proposal. But if the first spouse works harder to increase his own earnings by working overtime, by taking a second job, or by getting a promotion, the couple gets no benefit at all. Essentially, this means that two couples with the same family income, would pay a different Federal income tax. The couple where one spouse is a full-time homemaker would pay a higher tax than a couple in which both spouses work.

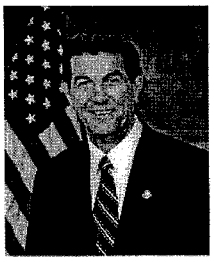
That is why I introduced the Marriage Protection and Fairness Act. I believe that my proposal is the fairest way to eliminate the marriage tax penalty. It is the one that makes the most sense. It will help millions of working couples who are simply trying to make ends meet, and will allow them to keep more of what they earn. Under this proposal, the tax burden would be the same if one spouse earned all the family income, or if both contributed to the family's earnings. It would allow millions of Americans to make a choice on how many breadwinners there should be, without incurring any penalties for that choice. It will also create incentives for families, that will allow one parent to stay at home to take care of and raise their children.

Mr. Chairman, we in Congress have a moral obligation to promote the family. If we are serious about giving working American families tax relief, if we are serious about reducing juvenile crime rates and keeping our children off drugs, if we are serious about solving our Nation's many other social problems, then we must promote legislation that promotes the family. I can think of no other more important profamily initiative that we in Congress can initiate than the repeal of the marriage tax.

Mr. Chairman, my bill is the same legislation that has been introduced by Senator Faircloth, Senator Hutchinson, and Senator Mack in the other body. Our proposal is not a revolutionary concept. In fact, it was the law until 1969. I urge this Committee to strongly consider the merits of the Marriage Protection and Fairness Act in its efforts to repeal the marriage penalty tax.

Thank you, Mr. Chairman.

[The prepared statement and attachments follow:]



**FOR IMMEDIATE RELEASE**

**Congressman Bob Riley**

Contact Name: Susan Dryden
202 - 225 - 3261
January 28, 1998

## CONGRESSMAN RILEY INTRODUCES LEGISLATION TO REPEAL THE MARRIAGE TAX PENALTY

WASHINGTON, D.C. -- Congressman Bob Riley has introduced major legislation, *The Marriage Protection and Fairness Act of 1998*, which would eliminate the marriage penalty for all married couples. Riley's legislation is unique because it will bring relief to married couples with two earners, and will provide tax relief to married couples where one spouse stays at home.

*The Marriage Protection and Fairness Act of 1998* will allow families to split their incomes for tax purposes. In other words, a married couple would add up their income, divide by two, and each spouse would be taxed on half. For example, one spouse earns $42,000 and the other spouse has a zero income, for a $42,000 total income. When divided by two, the couple would each pay taxes on an income of $21,000.

"We in Congress have a moral obligation to promote the family. If we are serious about giving working American families tax relief, if we are serious about reducing juvenile crime rates and keeping our children off drugs, then we must promote legislation that promotes the family. I can think of no more important initiative that we in Congress can initiate than the repeal of the marriage tax penalty," said Congressman Riley.

The Marriage Protection and Fairness Act of 1998 has been endorsed by such pro-family groups as the Family Research Council, the Christian Coalition, and Eagle Forum.

###

**Statement of Hon. Bob Riley, a Representative in Congress from the State of Alabama**

Mr. Chairman, I want to thank you for holding this important hearing today. I appreciate this opportunity to speak before the Committee about the marriage tax penalty.

I think we can all agree that the marriage tax penalty is unfair and misguided. According to the Joint Tax Committee, in 1996, more than 21 million married couples paid a marriage penalty, costing them an extra $28 billion a year in taxes. To put it simply, the average American couple will pay $1,400 more in income taxes simply because they are married. In my opinion, it is difficult to comprehend the devastating effect the marriage penalty has had on our society. Instead of encouraging and helping families to stay together, our current tax code is forcing them apart.

Unfortunately, President Clinton's 1993 tax increase made the marriage penalty even more painful for married couples with children. For example, according to the National Center for Policy Analysis, the marriage penalty for couples earning $50,000 is $1,326 if they have no children. However, if they have two children, the marriage penalty would be $4,348—a penalty of $1,511 per child.

Yesterday, I introduced the Riley-Faircloth Marriage Protection and Fairness Act that will once and for all eliminate the marriage tax penalty. My proposal is unique

because it allows couples to effectively split their combined incomes for tax purposes. That means that taxes for married couples would be figured by adding up the income of both spouses and dividing by two. Each would be taxed on half of the total income. Furthermore, the bill also increases the basic standard deduction for married couples to twice the standard deduction of single filers (totaling $8,300 for 1997). This would lower the tax burden for all families, regardless of how many children they have. Moreover, it would neutralize the tax incentives for two versus one income.

Mr. Chairman, there are many good marriage penalty relief proposals before Congress today. And like many of my colleagues, I am a cosponsor of the Weller-McIntosh Marriage Tax Elimination Act. But, suppose one spouse earns $30,000 and the family needs more income. If the other spouse takes a paid job, then the couple will benefit from the Weller-McIntosh proposal. But if the first spouse works harder to increase his own earnings by working overtime, by taking a second job, or by getting a promotion, the couple gets no benefit at all.

Essentially, this means that two couples with the same family income would pay a different federal income tax—the couple where one spouse is a *full-time homemaker would* pay a higher tax than a couple in which both spouses work.

That is why I introduced the Marriage Protection and Fairness Act. I believe that my proposal is the fairest way to eliminate the marriage tax penalty, and it is the one that makes the most sense. It will help millions of working couples—who are simply trying to make ends meet—and will allow them to keep more of what they earn. Under this proposal, the tax burden would be the same if one spouse earned all of the family income, or if both contributed to the family's earnings. It will allow millions of American families to make a choice on how many breadwinners there should be, without incurring any penalties for that choice. It will also create incentives for families that will allow one parent to stay at home to take care of and raise their children.

Mr. Chairman, we in Congress have a moral obligation to promote the family. If we are serious about giving working American families tax relief, if we are serious about reducing juvenile crime rates and keeping our children off drugs, if we are serious about solving our nation's many other social problems and living up to our obligations, then we must promote legislation that promotes the family. I can think of no more important pro-family initiative that we in Congress can initiate than the repeal of the marriage tax penalty.

This debate over the marriage tax penalty is about the survival of the American family. It's about correcting unintended consequences. And if, under my proposal, 1,000, 10,000, or 100,000 American families are able to keep one parent at home to care of the children, then I believe our nation will be better off. I cannot think of a more noble goal.

Mr. Chairman, this committee has the opportunity to once again reduce the tax burden on the American people. And like many of our colleagues, your work and the work of this committee is to be commended. As you begin preparing a tax relief package, I urge you to include the Marriage Protection and Fairness Act.

The time to pass this legislation is now. Working American families simply cannot wait any longer.

Thank you, Mr. Chairman.

**BOB RILEY**
3RD DISTRICT, ALABAMA
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MILITARY RESEARCH AND DEVELOPMENT
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# Fact Sheet
# Marriage Protection and Fairness Act

Riley Marriage Protection and Fairness Act

- Allows income splitting. Under the *Marriage Protection and Fairness Act* each spouse will be allowed to calculate their taxable income as **one-half** of the total income of the family.
- Increases the basic standard deduction for married couples to twice the standard deduction for single filers. (For 1997, single standard deduction = $4,250)
- Avoids an unintentional "homemaker penalty" for families where one spouse decides to stay at home to take care of the children.
- Same as S. 1285 introduced by Senator Lauch Faircloth.
- Supported by the Family Research Council and the Christian Coalition.

Weller-McIntosh

- Allows married couples to file their income taxes either individually or jointly, whichever gives them the greatest tax benefit.
- Increases the basic standard deduction for married couples to twice the standard deduction for single filers. (For 1997, single standard deduction = $4,250)
- Primarily benefits married couples where both spouses work and have roughly the same income.
- The Weller-McIntosh bill eliminates the marriage penalty and is a step in the right direction, but, we can do more.
- Inadvertently creates a "homemaker" penalty. For example, consider two families with the same income. Under Weller-McIntosh, the one-earner family will be taxed at a higher rate than the two-earner family.

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105TH CONGRESS
2D SESSION

# H. R. _____

IN THE HOUSE OF REPRESENTATIVES

Mr. RILEY (for himself, Mr. SALMON, Mr. BACHUS, Mr. MCINTOSH, Mr. CANNON, Mr. ISTOOK, Mr. PAUL, and Mr. KING) introduced the following bill; which was referred to the Committee on _____

# A BILL

To amend the Internal Revenue Code of 1986 to provide that married couples may file a combined return under which each spouse is taxed using the rates applicable to unmarried individuals.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

**SECTION 1. SHORT TITLE.**

This Act may be cited as the "Marriage Protection and Fairness Act of 1998".

1 **SEC. 2. COMBINED RETURN TO WHICH UNMARRIED RATES**
2 **APPLY.**
3 (a) IN GENERAL.—Subpart B of part II of sub-
4 chapter A of chapter 61 of the Internal Revenue Code of
5 1986 (relating to income tax returns) is amended by in-
6 serting after section 6013 the following new section:
7 **"SEC. 6013A. COMBINED RETURN WITH SEPARATE RATES.**
8 "(a) GENERAL RULE.—A husband and wife may
9 make a combined return of income taxes under subtitle
10 A under which—
11 "(1) a separate taxable income is determined
12 for each spouse by applying the rules provided in
13 this section, and
14 "(2) the tax imposed by section 1 is the aggre-
15 gate amount resulting from applying the separate
16 rates set forth in section 1(c) to each such taxable
17 income.
18 "(b) DETERMINATION OF TAXABLE INCOME.—
19 "(1) IN GENERAL.—For purposes of subsection
20 (a)(1), the taxable income for each spouse shall be
21 one-half of the taxable income computed as if the
22 spouses were filing a joint return.
23 "(2) NONITEMIZERS.—For purposes of para-
24 graph (1), if an election is made not to itemize de-
25 ductions for any taxable year, the basic standard de-
26 duction shall be equal to the amount which is twice

1 the basic standard deduction under section
2 63(c)(2)(C) for the taxable year.
3 "(c) TREATMENT OF CREDITS.—Credits shall be de-
4 termined (and applied against the joint liability of the cou-
5 ple for tax) as if the spouses had filed a joint return.
6 "(d) TREATMENT AS JOINT RETURN.—Except as
7 otherwise provided in this section or in the regulations
8 prescribed hereunder, for purposes of this title (other than
9 sections 1 and 63(c)) a combined return under this section
10 shall be treated as a joint return.
11 "(e) REGULATIONS.—The Secretary shall prescribe
12 such regulations as may be necessary or appropriate to
13 carry out this section."
14 (b) UNMARRIED RATE MADE APPLICABLE.—So
15 much of subsection (c) of section 1 of such Code as pre-
16 cedes the table is amended to read as follows:
17 "(c) SEPARATE OR UNMARRIED RETURN RATE.—
18 There is hereby imposed on the taxable income of every
19 individual (other than a married individual (as defined in
20 section 7703) filing a joint return or a separate return,
21 a surviving spouse as defined in section 2(a), or a head
22 of household as defined in section 2(b)) a tax determined
23 in accordance with the following table:".
24 (c) CLERICAL AMENDMENT.—The table of sections
25 for subpart B of part II of subchapter A of chapter 61

1 of such Code is amended by inserting after the item relat-

2 ing to section 6013 the following:

"Sec. 6013A. Combined return with separate rates."

3 (d) EFFECTIVE DATE.—The amendments made by

4 this section shall apply to taxable years beginning after

5 the date of the enactment of this Act.

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Chairman ARCHER. Thank you, Mr. Riley. You and Congressman Salmon are appearing together. Is there any difference in the proposals that each of you would make or are you basically behind the same proposal?

Mr. SALMON. It's the same bill, Mr. Chairman.

Mr. RILEY. Exactly.

Chairman ARCHER. That's very, very helpful. I must say that your approach is very appealing to me because again, coming from a community property State, the property laws require exactly what you are proposing. Half of each spouse's earnings belong legally to the other spouse.

Mr. RILEY. Yes, sir. That's exactly. What we can't do, Mr. Chairman, is codify into law something that differentiates between two working couples with the same income. That essentially is what the former proposal does. I want to compliment Congressman Weller for all the work and the attention that he has brought to it, but I think we do need to take it one step further. I think we need to go back and never penalize any spouse for making the decision to stay home and raise their family. Essentially, that's what we do. That is one thing that I don't believe this Congress believes in. I know it's certainly not something that I believe in.

Mr. SALMON. You know, Mr. Chairman, every politician just about that's here, when they get up, they talk about family values. I think it would be a real mixed message out of Congress that we would send if we are saying basically you mothers that decide to stay home or work part time so you can spend more time with your children, we are going to penalize you or continue the penalty for doing such. I think it sends the wrong message out of Congress. Some say "Can we afford to do it?" I say, "Can we afford not to do it?" I think that at a time when the message is and has been for parents to be more involved in their children's education, for parents to be more involved in raising their children, for parents to be more involved to make sure that their kids are off the streets, not causing mischief. When a couple decides the best way for them to address that issue is to have either mom or dad at home, I think it really sends a poor message from Congress that we disagree with you, that doesn't really add value.

Chairman ARCHER. Having said what I did, I also have to be a realist about the amount of revenue that we are going to be able to put into a tax package this year. We certainly will make an effort to move in the direction of ameliorating the negative impact of the marriage penalty. But how far we can go will depend upon how much revenue we will be able to put into the tax bill.

Does any other Member wish to inquire?

Mr. Shaw.

Mr. SHAW. Mr. Chairman, just very briefly I would like to compliment all the witnesses, and this panel particularly, who testified on the marriage penalty tax. It's certainly something that we should take down. We partially took down the barrier to marriage in the welfare reform bill, in which we paid people not to work, not to get married and to have kids. We have to take this last one down in the tax bill. It's absolutely ridiculous that it's this way.

To share with you an anecdote that we had in our own office. A young lady who works for me on my staff had a New Years Eve wedding. They waited for their license to be dated on the first of the year in order to avoid a marriage penalty. This is absolutely ridiculous, that we penalize people for being married. I compliment you for your work in this area, and am very hopeful that this will be the top priority of the Ways and Means Committee, to get rid of this unfair tax. Thank you. Thank you, Mr. Chairman.

Chairman ARCHER. Does anyone else wish to inquire?

Mr. Weller.

Mr. WELLER. Thank you, Mr. Chairman. I want to commend my friends, Mr. Riley and Mr. Salmon, for their interest in this issue. I have enjoyed talking with them and working with them. Of course whatever idea is the best idea, the bottom line is we want to eliminate the marriage tax penalty.

A couple questions I have. The Congressional Budget Office study highlighted not only the marriage tax penalty, but they also mentioned the so-called marriage bonus. In studying the CBO study, they pointed out that the single earner family, where one individual, the husband or wife works and the other one might stay at home or is not a wage earner, I was wondering, how does your legislation impact the so-called marriage bonus? Does that marriage bonus still exist or does it eliminate the marriage bonus for a married couple with one source of income?

Mr. RILEY. Congressman, it essentially does the same thing that your legislation does. It allows them an option to figure their tax liability in any one of three different forms, choose the lowest of the three and that's what they would do. If there is a bonus, I'm not too sure that that is a bad idea. If anything, I wish that we could encourage more spouses to stay home and raise their children. If that is an unintended asset to this bill, then I think it's one that I would encourage.

Mr. WELLER. Of course I am one who believes the bonus is a good thing. We certainly don't want to jeopardize that. But let me ask this. I was asked this question regarding our legislation. Have you had the legislation scored yet? Do you know the revenue impact?

Mr. RILEY. No. We haven't. We filed it yesterday. It is being scored. I think as Congressman Salmon said a moment ago, it's

going to be more expensive. We know that going in. Probably by $8 to $10 billion. That is no menial figure. But again, when you talk about codifying into law something that discriminates against a homemaker, I do not believe that we can allow that to happen in this country. Even though it may be another $8 or $10 billion, I think it is going to be well worth the price that we pay.

Mr. SALMON. If I might address that too. It will be significantly higher on an annual basis than the other one, even though as Congressman Riley mentioned, it hasn't been scored yet. But I would like to go back to what we have seen, Congressman Weller, since we have been in the Congress. The projections on revenues have vastly exceeded what we ever anticipated. There is a possibility in this next budget, we will already see a surplus.

I believe that it simply gets down to priorities. If this is our number one priority for the Congress, we can make it happen. We can figure out a way to make it happen and really not have any other aspect of government suffer for it.

Mr. WELLER. Thank you. I look forward to working with you. I share your goal, the number one must do as we look at this year's budget negotiations when it comes to the tax provision is eliminating the marriage tax penalty. So again, thank you.

Mr. RILEY. Let both of us compliment you on your leadership on this. We really appreciate it.

Mr. SALMON. If it wasn't for you, Congressman Weller, I don't think any of us would be here today. So we must both compliment you. I am a cosponsor of your bill as well.

Mr. RILEY. So am I.

Chairman ARCHER. Mr. Hayworth.

Mr. HAYWORTH. Thank you, Mr. Chairman. I have no real question other than just a commendation to my colleagues. Along with my seatmate here, the gentleman from Illinois, I am very pleased to see my colleague from Arizona, from the first district. I think this is intriguing. And one of the newcomers to the House of Representatives, the gentleman from Alabama. Thank you for bringing sound, logical thinking and a good dose of common sense here to the District of Columbia. I think you are both to be commended. This is a very intriguing proposal. We'll continue to study this as we also study the proposal by our colleagues from Illinois and Indiana. I just want to thank you again for your input into this debate and your solution.

Chairman ARCHER. Has the gentleman completed his inquiry.

Mr. HAYWORTH. Yes, sir. I know it's hard to believe.

Chairman ARCHER. Are there any other Members who wish to inquire? If not, thank you very much. I appreciate your input.

Our next panel is Michael Graetz, Daniel Feenberg, David Lifson, and Bruce Bartlett. Will you please come to the witness table?

If you gentlemen, when recognized, will state where you are employed and what you do for the record, and then proceed into your testimony. And, as I mentioned earlier, we would appreciate it if each of you would keep your oral presentation within 5 minutes, and your entire written statement, without objection, will be inserted in the record.

Mr. Graetz, we are delighted to have you back before the Committee. You're no stranger to the Committee over the years, and you go back to when the first marriage penalty was really inserted into the law. So we are really pleased to have you back before the Committee. And, again, if you'll tell the other Members what you are doing now, and whom, if anybody, you represent, we'd be pleased to hear your testimony.

**STATEMENT OF MICHAEL J. GRAETZ, PROFESSOR OF LAW, YALE LAW SCHOOL, NEW HAVEN, CONNECTICUT**

Mr. GRAETZ. Thank you, Mr. Chairman. I am currently a professor of law at the Yale Law School, and represent only myself, I fear.

I thank you for inviting me to testify. The last time I testified before this Committee on this subject was in May 1972 when we were considering the impact of legislation that had been enacted in 1969. Here we are 25 years later on the same topic.

I attached to my statement a chapter from my recently published book, "The Decline (and Fall?) of the Income Tax," which I've made available to the Members and to the staff. I can, therefore, just summarize a few of the key points I would like to make.

As you know, Mr. Chairman, in 1969 and shortly thereafter, the marriage penalty affected very few people. In 1972, when Treasury testified, it said that only 15 percent of married couples suffered a marriage penalty, while 85 percent received a bonus. In the last 25 years, the scale and scope of the marriage penalty have expanded dramatically. I think today somewhere between one-half and two-thirds of all married couples face a penalty because of some provisions that were omitted from the numbers that you have discussed earlier.

There are two causes of this vast expansion: one is the transformation of the Nation's work force and, in particular, the entry of married women into the labor market, as has been discussed earlier. The median income of those families is 40 percent greater than that of families with only 1 earner. Second, while the composition of the Nation's work force was changing so dramatically, Congress after 1969, was adding to the Tax Code a number of new marriage penalties. The earned income tax credit provisions have a very large marriage penalty in them, in some cases the tax can be as high as one-fourth of a combined couple's income. The 1993 changes requested by President Clinton and accepted by Congress added whopping marriage penalties at the top of the income scale and for Social Security recipients.

These new tax penalties on marriage, in my opinion, Mr. Chairman, have resulted from efforts by Congress to fit tax measures into straightjackets imposed by budgetary revenue constraints coupled with the desire to make distributional tables come out right. The fact that Congress now routinely enacts sizeable penalties on marriage for the sole purpose of conforming to distribution tables demonstrates the dangers of subordinating important tax and public policy goals to such constraints.

Second, because marriage penalties have been introduced to the Code through specific provisions as well as in the tax rates schedules, finding a solution to this problem is going to be extremely dif-

ficult. There are two general approaches before the Committee today, as you have heard, neither one of which, in my view, is entirely satisfactory. The first is to try and focus on specific tax penalties and to root them out wherever they appear; allowing deductions or credits for a portion of wages of the low-earning spouses, for example, would be such an approach. It would not affect, for example, Social Security recipients. And it's not clear to me why tax penalties for marriage are more important for citizens at one part of the income scale rather than at the other, or for workers rather than retirees.

The second approach, exemplified by Congressman Weller's bill and some others is to allow a married couple to file tax returns as if they were unmarried. As you pointed out, Mr. Chairman, this reintroduces distinctions between community property and common-law States and creates incentives to shift the ownership of assets. I think ultimately you have to base such an approach on the aggregate income of the couple in order to make it work.

In my book, I suggest that the marriage penalty is one of the major reasons the American public is now so dissatisfied with the income tax. It is one reason to take seriously restructuring of the tax system. To be sure, we've seen today people who have not married, and we know there are couples who have divorced because of this tax penalty on marriage. It is routine for couples to hold marriages in January rather than in December and put their families and friends to a bizarre inconvenience.

No one would design a tax system that penalized marriage. No broad reform of the tax system before the Congress should retain any tax penalty on marriage. The marriage penalty should be removed from our system, but I am, frankly, Mr. Chairman, skeptical about whether that can be done while retaining the current income tax in place.

When a tax system departs fundamentally from the values of the people it taxes, it cannot sustain public support. When people lose respect for a tax law, they will not obey it. Arbitrary and unfair tax distinctions of this sort instill disdain for the law and disrespect for those who write and enforce it.

Let me just end with this quote from an exchange between Senator Robert Dole—I report this in my book—and between a couple, Angela and David Boyter, in a Senate Finance Committee hearing in 1980 on this subject. Senator Dole says, "You are divorced now?" Mr. Boyter: "We are divorced now and have been for several years." Senator Dole: "You live together though." Mr. Boyter: "That is right. The IRS told us that that was preferable to getting remarried every year and then divorced." Mrs. Boyter: "My mother did not think so, but the IRS did."

Now is the time to conform the tax system to the values of America's mothers.

Thank you, Mr. Chairman.

[The prepared statement and attachment follow:]

**Statement of Michael J. Graetz, Professor of Law, Yale Law School, New Haven, Connecticut**

Mr. Chairman, and members of the Committee—

Thank you for inviting me to testify on this important issue. I first sat at this table at a hearing on this subject more than twenty five years ago in May, 1972, when I was serving at the Treasury Department.

My views on this issue are set forth in Chapter Two of my recently published book, The Decline (and Fall?) of the Income Tax, which I have attached to this statement. That chapter also reviews the history of the taxation of married and single persons under the income tax. Its history makes clear that this issue is no simple or straightforward matter. In this brief statement, I shall merely emphasize a few major points:

1. From the inception of the income tax in 1913 until 1969, there was no tax penalty for marriage. The marriage penalty originated in 1969 as a by-product of a well-intentioned Congressional effort to improve income tax equity for single people. In 1972, the Treasury Department testified that fewer than 15% of married couples faced any marriage penalty, while more than 85% of married couples enjoyed a tax reduction by filing joint returns. At that time, the marriage penalty affected only this relatively small number of upper-middle-income couples. It had virtually no impact at the bottom or top of the income scale. In the past twenty five years, both the scale and scope of income tax penalties on marriage have grown dramatically so that today, somewhere between one half and two thirds of all married couples pay greater income taxes solely because they are married.

2. There are two causes of this great expansion of income tax marriage penalties. The first is the transformation of the nation's workforce, in particular, the entry of married women into the labor market. Today, nearly three quarters of married women under age 55 are in the labor force. The median income of these families is 40% greater than families with only one wage earner.

Second, while the composition of America's labor force was changing so dramatically, Congress was adding to the tax code a variety of new marriage penalties. By so doing, incentives for divorce or for remaining unmarried were created for wide segments of the population that previously had been unaffected. The earned income tax credit provisions, which first came into the Internal Revenue Code in the mid–1970s and have been greatly expanded since, frequently impose a very large marriage penalty on low income workers. In some cases, the additional tax can be as much as one fourth of two low income workers' combined incomes. The 1993 changes in the tax rate schedule requested by President Clinton and accepted by Congress, added whopping marriage penalties for high-income taxpayers, in some cases as much as $15,000 of additional taxes a year. Income tax penalties on marriage now appear throughout the tax code, in the provisions taxing Social Security, for example, and in provisions such as last year's tax legislation's phase-outs of certian new benefits for families with children, and for education or retirement savings.

These recent new tax penalties on marriage have resulted from efforts by Congress to fit tax measures into a straightjacket imposed by budgetary revenue constraints coupled with a desire to make the distributional tables "look right." The fact that Congress now routinely enacts sizable penalties on marriage for the sole purpose of conforming to a specific combination of revenue and distributional targets demonstrates the dangers of subordinating important tax and public policy goals to such constraints.

3. Because marriage tax penalties have entered the code in recent years both through the tax rate schedule and through new penalties being added here and there within specific provisions, finding a clean and complete solution to this problem is not easy. There are two general approaches—both of which are represented in bills before this committee today—neither one of which is entirely satisfactory.

The first line of attack is to focus on specific marriage tax penalties and try to root them out whenever they seem important. This, of course, requires establishing priorities, which are inevitably controversial. For example, allowing a deduction for a portion of the wages of the lower-earning spouse, as was in the law prior to 1986 and has been re-proposed here today, reduces marriage penalties for taxpayers who can use the deduction, but does nothing to alleviate marriage penalties, for example, due to the workings of the earned income tax credit or the way Social Security benefits are taxed. It is not clear to me, why tax barriers to marriage are more important for higher-income citizens than for lower-income citizens or even for workers rather than retirees.

The second approach—exemplified by Congressman Weller's bill—is to allow a married couple to file tax returns as if they were unmarried. This is an expensive and potentially complex solution. It also reintroduces distinctions between married

couples who live in community property states and common law states—a distinction which has long plagued the income tax—and creates opportunities for tax savings by shifting the ownership of investment assets within a family.

I am inclined to think that if a general solution to this problem is to be attempted in the current income tax, it should be based on the aggregate income of the married couple, not on their individual incomes. For example, a married couple might be allowed to fill out their joint return, but to treat half of the income as earned by each spouse and file as single persons. This would avoid some of the potential problems of Congressman Weller's approach, but would also represent a comprehensive attack on the income tax penalties on marriage. I doubt if this alternative would be significantly less costly in terms of revenues than Congressman Weller's bill. The approach I have just described also would not solve the problem, which has been emphasized by some analysts, of taxing a married woman who enters the labor force at a marginal income tax rate that depends on her spouse's income. In other words, while this kind of approach could eliminate tax penalties solely due to marriage, it would not eliminate certain tax disincentives for married women to work. This does not trouble me, because I regard the marriage tax problem as a problem of an income tax system endorsing and incorporating the wrong values; I am far less concerned with its behavioral effects.

4. In my book, I suggest that the marriage tax penalty is one of the major reasons the American people have become so dissatisfied with the income tax, one of several reasons to take seriously the task of restructuring the nation's tax system. This penalty, to be sure, has induced some people to remain single who otherwise might have married, or to divorce, and no doubt has induced many more couples who do marry to postpone their weddings from December to January to save at least one year's marriage penalty. They and their families and friends all rightly hold Congress responsible for such an absurdity.

No one would design a tax system in a way that penalized marriage. No broad reform of the tax system recently introduced in the Congress—whether a restructuring of the income tax as Congressman Gephardt has proposed, or elimination of the income tax in favor of some form of consumption tax as others have proposed—should retain any tax penalty on marriage. The marriage penalty must be removed from our tax system. I am, however, somewhat skeptical about whether that can be done while retaining in place the current income tax with its many complexities and barnacles.

When a tax system departs dramatically from the fundamental values of the people it taxes, it cannot sustain public support. When people lose respect for a law, they will not obey it. Arbitrary and unfair tax distinctions—such as those based on marital status—instill disdain for the law and disrespect for those who write and enforce it. The voluntary compliance of private citizens which is essential to enforce any tax statute will diminish.

Consider this quote from an exchange reported in my book between Angela and David Boyter and Senator Robert Dole at an August, 1980 hearing of the Senate Finance Committee on this subject:

> Senator Dole: "You are divorced now?"
> Mr. Boyter: "We are divorced now and have been for several years."
> Senator Dole: "You live together, though?"
> Mr. Boyter: "That is right. The IRS told us that that was preferable to getting remarried every year and divorced."
> Mrs. Boyter: "My mother did not think so, but the IRS did."

I applaud the Chairman for calling these hearings to demonstrate that Congress has now become serious about responding to the changes in society, in the economy, and in the tax law, that have occurred since the marriage penalty was first introduced in 1969. The absence of a perfect, or even fully satisfactory resolution to this difficult problem should not become an excuse for not acting. The public is properly not indifferent about whether the nation's income tax law encourages marriage or divorce. I hope that this Committee will soon begin to bring the tax system into greater conformity with the values of America's mothers.

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# The Decline (and Fall?) of the Income Tax

MICHAEL J. GRAETZ

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*New York London*

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# It's a Sin to Get a Mexican Divorce

It's your wedding day. Even friends and relatives who had hoped you would make a better match send gifts, smile, wish you the best. Your government, however, has something unexpected for you: an income tax increase just because you got married. It isn't right. But it happens. Today, about two-thirds of all married couples pay more income taxes than they would if they divorced.[1] If Joe and Jane are single and each has $20,000 of income they are both taxed at a 15 percent rate, but when they marry, part of their income is taxed at 28 percent and their total standard deduction is lower. Sometimes married couples pay a lot more income taxes; for very-high-income couples, $10,000–$15,000 more each year. What happened to family values?

This marriage tax doesn't apply to everyone, only couples where both spouses have about the same incomes. If you marry

someone with a lot more or a lot less income than you, the couple may get a tax cut from filing a joint tax return. About one-third of married couples enjoy such a marriage gift.[2]

The tax law wasn't always like this. Until 1969, there was never a tax penalty for marriage. In fact, during the first thirty-five years of the income tax—from 1913 until 1948—the tax law tried to be marriage neutral. Married couples filed individual tax returns based upon their separate incomes. But some married couples soon found that they could reduce their total taxes by shifting investment income to the lower-earning spouse, an option the Supreme Court denied couples with only earned income. The ability of wealthy families to reduce their income taxes this way was an important landmark in instilling an unshakable belief in the citizenry that the arcane details of the income tax tend to work to the advantage of the well-off at the expense of the average wage earner.

The Supreme Court made the income tax more arbitrary and unfair by deciding that in those seven states where the property rights of a married couple were determined under a so-called community property regime—states located predominantly in the Southwest, from Louisiana to California—each spouse would be taxed individually on one-half of their community property income, regardless of which spouse actually earned the income. This meant that, for married couples in community property states, the husband and wife each paid the same tax as an unmarried person with one-half of the total income of the couple, but this tax-minimizing division simply was not possible in the other forty-one common-law states. Thus, prior to 1948, not only was a couple's federal income tax typically greater in common-law states than that of a married couple with the identical total income living in a community property state, but also the federal income taxes of married couples who had the same total incomes varied markedly in common-law states, depending upon how much income was earned by each spouse.

This bizarre state of affairs finally came to gall members of Congress. On the floor of the Senate, Senator John McClellan asked Senator William Knowland, Why is it that just because you live in California and I live in Arkansas, you pay "$646 less" every

year than I pay? "My family could use that money just the same as your family could."[3] Senator Tom Connally of Texas, a community property state, suggested that if Senator McClellan was unhappy with the Arkansas situation, he should move to Texas. Which, of course, is just what some people did, especially those who lived in the border town of Texarkana, where people could move across the state line and save income taxes without even leaving town.

Needless to say, this absurd situation did not engender great respect for the integrity of the income tax. In 1941, the House Committee on Ways and Means proposed to eliminate the geographical variations in federal income taxes by taxing all married couples on their consolidated income in a manner identical to single persons who had the same amount of income. This proposal would have increased taxes for virtually all married couples and also would have introduced into the income tax for the first time a marriage penalty. The Ways and Means Committee denied that this would "result in any increase in the divorce rate" or "adversely affect the morals of American families." Nevertheless, the tax lawyer Randolph Paul, in his classic treatment of the income tax, described the 1941 House provision as "un-American," noting that its opponents viewed it as "striking at the institution of marriage, promoting celibacy, and attacking the family, by penalizing fidelity and rewarding perfidy."[4] This idea did not become law.

A number of state legislatures then started to move to community property laws to lower their residents' federal income taxes, but in 1948, Congress halted this stampede by adopting new joint-return provisions, which allowed married couples to combine their income and deductions on a joint return and to pay twice the tax that a single person would pay on one-half of the couple's total taxable income. This change was hailed for equalizing the tax treatment of married couples throughout the land, for treating equally couples with only earned income as well as couples with investment assets, and for reducing taxes for all married couples who did not have exactly equal incomes.

But this solution was not universally applauded. It meant that two single people often would pay significantly more tax than a married couple with the same total income, in some cases as much as

40 percent more. These people did not regard the income tax as at all fair.

The most effective advocate for single people, a successful Connecticut businesswoman, Vivien Kellems, who was described in her youth in the *New York World Telegram* as "an animated Dresden figurine," founded an organization she called War Widows of America, a group of single women who had never been married, they claimed, because the men they might have married were killed in World War II. Once she retired from her business in the 1960s, she began a relentless campaign against the higher taxes paid by single people. Ms. Kellems filed blank tax returns except for her name and Social Security number. She refused to turn over any books or records to the IRS and asked the IRS to return to her the excess taxes she had paid since 1948 because she was single, plus 6 percent interest. She had kept twenty years of tax records and her claim came to $73,000. She told the IRS: "You send me a check, and I will resume payment." Until then she "suspended" payment of her income taxes.

Ms. Kellems held a television news conference on the front lawn of Wilbur Mills's home. Mills was the chairman of the House Ways and Means Committee and was then often described as the second most powerful man in America, the president presumably being first. At the age of seventy-seven, Ms. Kellems threatened to haunt the Ways and Means Committee for the next forty-nine years if it failed to give single people justice. She said she picked forty-nine years because it took the National Women's Party that long to get the equal rights amendment passed by Congress.

Ms. Kellems told the House Ways and Means Committee that there were six million more single women than single men and asked, "Is it a reasonable classification to penalize these women because there aren't husbands enough to go around? What do you do if you can't get a husband? Should you be taxed for that?"[5] Vivien Kellems inspired thousands of Americans to mail teabags to their representatives in Congress and their senators to remind them of the Boston Tea Party as a way of protesting what she regarded as the excessive taxation of single people. She told her audiences: "If you don't drink tea, put coffee grounds in the envelope.

Something that will spill out and make a mess." Congressmen who supported her begged: "Please stop the teabags. I'm for you. You don't need to send any more teabags." She claimed to have received 22,000 letters from supporters.

Vivien Kellems recruited important allies in her endeavor to reduce taxes on single persons, including Ed Koch, then a congressman from New York, who championed legislation to reduce income taxes on single persons. Perhaps her most effective ally was the actress Gloria Swanson, a woman who had been married six times, having failed to take the advice of the title of the Cecil B. DeMille movie that had made her a star: *Don't Change Your Husband.* But her marriages had not gone well. She told the House Ways and Means Committee that she had been "single most of her life." Ms. Swanson and Ms. Kellems were an effective team protesting the unfairness of income taxes on single persons, and in 1969 Congress handed them a victory that continues to haunt the income tax today.

In 1969, Congress introduced into the tax law for the first time a tax penalty on marriage. Congress has since discovered that under a progressive-rate income tax some important segment of the American public will regard their tax burden as unfair. The essential difficulty is this: it is impossible for a progressive-rate income tax to neither encourage nor discourage marriage, meaning that people who marry should pay neither more nor less than they paid on the same income before they married, and also to tax all married couples who have the same total income equally. (For readers with no math phobia, a simple mathematical proof of this proposition is contained in the notes.[6])

During the period 1913–1948, the tax law attempted to be marriage neutral, but, as I have told, tax planning and differences in states' property laws created arbitrary tax differentials among married couples with the same total income. From 1948 to 1969, all married couples with the same total income paid the same total tax, but this feature of the law created a tax bonus for marriage and stimulated complaints from single persons. The 1969 legislation was an explicit attempt to compromise among these goals. In doing so it created chaos, penalizing some married couples (when hus-

band's and wife's incomes are relatively equal) and advantaging others (when their incomes are quite unequal).

The initial economic impact of this new marriage penalty on the American public was small. In 1972 the Treasury estimated that fewer than 15 percent of married couples were disadvantaged by the marriage penalty while more than 85 percent enjoyed a tax reduction from filing joint returns.[7] The 1969 rate schedule imposed the greatest marriage penalty on upper-middle-income couples, reaching a maximum of about $4,500 a year when the husband and wife each had about $35,000 of income.[8] (A dollar then would be worth about $2 today.) Initially the marriage penalty had virtually no impact at the bottom or very top of the income scale, but both structural changes in the economy and subsequent actions of Congress soon conspired to extend the tax penalty on marriage.

Without doubt, the single greatest change in the nation's workforce in recent decades has been the dramatic entry of married women into the labor market. Today, nearly three-quarters of married women under age fifty-five are in the labor force.[9] The median income of these families is 40 percent higher than families with only one wage earner. For married women who entered the job market because it had become necessary for the economic well-being of their families, the income tax added a dose of bitter to their experience. The 1969 legislation and its progeny have given an ever-increasing number of married couples an arbitrary, capricious, and, they believe, unconstitutional income tax penalty to complain about.

All the while, Congress—completely out of touch with married people's growing anger—extended marriage penalties to segments of the population that previously had been unaffected. First, in the mid-1970s, Congress added and subsequently greatly expanded a refundable earned-income tax credit to reduce and in some cases eliminate the combined income and Social Security taxes of low-income workers. This provision sometimes imposes a very large marriage penalty on low-income workers. For example, in 1996 an individual who earned $10,000 and had two children was entitled to a tax credit of about $3,500; two such persons would receive a total of more than $7,000—so long as they didn't marry. However,

if these two people married, they would lose more than $5,000 of their tax credits, a marriage penalty equal to more than one-fourth of their combined incomes.[10]

President Bill Clinton and the Democrats in Congress got together and changed the tax rate schedule to add a whopping marriage penalty at the top end of the income scale in 1993, in some cases $15,000 in additional taxes a year. It could take $1 million of wealth to produce this much after-tax money annually.[11] For many wealthy married couples, the best tax-planning response to the 1993 tax rate increase is divorce. In the late 1960s, Congress created a marriage tax penalty that gave young people a reason for living together without marrying that their parents could understand; in the 1990s, President Clinton may have given this same generation a reason for divorcing that their children could forgive. In response to these tax penalties on marriage, some Americans engaged in America's favorite indoor sport: tax minimization.[12]

## David and Angela Boyter

David Boyter, a Defense Department physicist, and Angela Boyter, a federal procurement officer, married in Baltimore, Maryland, on April 2, 1966. They stayed married from 1966 through 1974, filing joint tax returns as a married couple. But in 1975, when a friend who had just gone through a traumatic divorce remarked at a dinner party, "at least my taxes will be lower," the Boyters' life changed.[13]

The income tax reduction from divorcing and paying taxes as single people would be more than enough to pay for both the Boyters' annual Caribbean vacation and a Haitian divorce.[14] At the Pratt Public Library in Baltimore, Angela Boyter found the names of seven Haitian attorneys, and took the lowest bid. On December 8, 1975, the Republic of Haiti granted the Boyters a divorce on the grounds of incompatibility of character. After a few more days of vacationing happily together in Haiti, they returned to Ellicott City, Maryland, and remarried there on January 9, 1976.

A year later, in November 1976, the Boyters traveled to Santo

Domingo in the Dominican Republic for another vacation and another divorce. Since Angela had been the complaining party in the Haitian proceedings, it was David's turn. The Dominican court granted the Boyters a second divorce decree, this time on the ground of "incompatibility of temperaments making life together unbearable."[15] On February 10, 1977, the incompatible and unflappable David and Angela once again remarried in Ellicott City, Maryland.

The media started using the Boyters' vacation-divorces to increase public awareness of the absurdity of the tax law. National papers including the *Wall Street Journal,* the *New York Times,* and, of course, the *National Enquirer* told their story. The Boyters appeared on more than seventy radio shows and on television talk shows in more than a half-dozen major cities. Their little pamphlet "Divorce for Fun and Profit" was in its fourth printing by 1980. Even the Internal Revenue Service heard about them and challenged their $3,000-a-year tax savings from filing taxes as single persons. The IRS claimed that, whatever their actual legal status, the Boyters were married under the Internal Revenue Code. This was peculiar since, in a rare moment of absolute clarity, the tax law provides that marital status depends only on whether a person is married on December 31 of the year.[16]

Nevertheless, the IRS challenged the tax validity of the Boyters' divorces in the United States Tax Court. The IRS attorney emphasized that, although their divorces were based on "incompatibility" of "character" and "temperaments," David and Angela stayed together in the same hotel rooms after their divorces. Angela and David both conceded under oath that their divorces had been purely tax-motivated, and, on cross-examination, Angela confessed that she and David had no intention of physically separating, separating their investments or other finances, or ever stopping living together.

In a strained effort to keep the Boyters' case within the bounds of prior precedents, the Tax Court judge concluded that David and Angela's divorces would not be recognized by the Maryland state courts, but he had no factual basis for such a finding. David Boyter remarked: "We were the only couple who were remarried in Tax

Court."[17] The Fourth Circuit Court of Appeals reversed this decision, noting that the Tax Court judge had no way to know Maryland's view without asking Maryland's courts actually to decide the legality of the divorces. But the court of appeals added that the divorce might be ignored under the tax law as a "sham."[18] After this decision, an increasingly confused David Boyter told the *Washington Post,* "Ask me if I am married or not and I will tell you I honestly don't know."[19] He added, "Corporations merge and diverge strictly for tax reasons and nobody questions it as a sham. Why should couples be treated differently?"[20]

But the Boyters did not sit idly by waiting to learn how much additional taxes, interest, and penalties the IRS might ultimately demand. They gave up their vacation-divorce-remarriage pattern to limit their debts to the IRS if they lost in litigation, and in November 1977 the Boyters divorced for the third time. This time they stayed divorced to preclude the IRS from challenging that divorce as a sham. In 1978, the IRS ruled that a couple who gets divorced for a variety of personal reasons, does not intend to remarry, and stays divorced, but lives together after the divorce, qualifies as two single people under the tax law.[21] The IRS apparently regards long-term living together as better public policy than divorces followed by remarriage. This led to the following exchange in August 1980 between Senator Robert Dole and the Boyters at a Senate Finance Committee hearing:

> SENATOR DOLE: "You are divorced now?"
> MR. BOYTER: "We are divorced now and have been for several years."
> SENATOR DOLE: "You live together, though?"
> MR. BOYTER: "That is right. The IRS told us that that was preferable to getting remarried every year and divorced."
> MRS. BOYTER: "My mother did not think so, but the IRS did."[22]

Despite their travails, David claimed that nothing the Congress or the courts could do would affect his and Angela's relationship with each other. Angela insisted, "We will stay single until the law is changed."

On the day in 1980 that would have been their fourteenth wedding anniversary, the Boyters, who made a total income of about $70,000 a year, told the Ways and Means Committee that they had saved more than $15,000 in taxes in the previous five years because of their divorces. They estimated that, even if they never got another salary raise, their divorces would save them more than $130,000 in taxes by the time they retired.[23] By this time, Angela had left her procurement officer job and had found her true calling as a certified public accountant.

The Boyters inspired Phyllis Pond, an Indiana legislator, to propose that married couples automatically be granted a twenty-four-hour legal separation on December 31 each year, which would expire one minute after midnight on January 1. She insisted that this was a serious legislative effort to solve the marriage penalty, not a ploy to spice up New Year's Eve.

Both Richard Cohen and Ellen Goodman, commentators for the *Washington Post,* recognized the Boyters in 1979 as "contemporary American heroes." Applauding their "quickie divorces to pay for their vacations," Cohen summed it up, "So here's to the Boyters, a little toast to them for standing up to the government, for fighting for fairness and the family. They were married once, but they're not any more. The government came between them."[24]

Vivien Kellems received similar recognition. The Raleigh, North Carolina, *News Observer* celebrated June 7, 1993, as Vivien Kellems Memorial Day: "A day to cheer Kellems, who protested what she considered unfair taxation."

Angela Boyter understood well both this kind of adoration and its implications. She told the Ways and Means Committee:

> In America today the fastest ways to become a national hero are to hit a home run in the World Series or to fight the IRS.
>
> In 1948 you convinced the single taxpayers that the system is unfair. In 1969 you added the two-earner families. If you continue adding complexities and favored groups to the tax code, you will eventually convince the

majority of the system's unfairness, and they will feel justified in making their own adjustments.

Needless to say, at that point we will no longer have largely voluntary tax compliance.[25]

## Conclusion

The married-single controversy, which has so plagued the income tax throughout its entire history, teaches several important lessons, lessons to which we shall return throughout this book. Most important, when a tax system departs dramatically from the fundamental values of the people it taxes, it cannot sustain public support.

Barber Conable, then the ranking Republican on the House Ways and Means Committee, admonished one married couple that "to base all of your decisions on tax consequences is not necessarily to maintain the proper balance and perspective on what you are doing."[26] But people like the Boyters are not wise enough to consider themselves lucky when the biggest problem with their marriage is additional taxes. And many couples who do marry postpone their weddings from December to January to save at least one year's marriage penalty. Never underestimate the imagination or the doggedness of the American people in their willingness to engage in tax-minimizing strategies. People routinely lose perspective when it comes to saving taxes. People of other nations may be readier to cheat outright, but America is a superpower in the game of creative tax avoidance.

When people lose respect for a law, they will not obey it. Arbitrary and unfair tax distinctions—whether based on geographical location, marital status, or the kind of income people make—instill disdain for the law and disrespect for those who write it and who enforce it. The voluntary compliance of private citizens, which is essential to enforce any tax statute, threatens to disappear.

Second, the tax law must respond to changes in society and the economy. Even if Congress in 1969 viewed the marriage penalty

as a barely acceptable trade-off to reduce excessive burdens on single people, changes in the nation's economy and the workforce soon rendered it unacceptable. The dramatic increase in the number of working wives in the workplace and the narrowing gap between men's and women's earnings have made completely obsolete Congress's Ozzie and Harriet vision of the family—where the man works and the woman stays home—the only vision that could have justified the 1969 change. Nothing is gained by Congress denying the reality of the lives of the people it is supposed to represent.

Finally, the absence of a perfect, or even fully satisfactory, resolution to a difficult problem does not excuse the failure of political leadership and judgment. The impossibility of satisfying the genuine claims for equity of married couples and single persons in a progressive-rate income tax system does not absolve politicians of responsibility for the compromises they fashion. The public properly is not indifferent about whether the nation's income tax law encourages marriage or divorce. Politicians must be held accountable for failing to respond when they legislate contrary to the fundamental values of the American people. Both political parties bear responsibility for legislation expanding and extending marriage penalties. Token changes are simply not enough.[27]

Although the Boyters, like Vivien Kellems before them, told the Congress that a flat-rate system would eliminate the penalties for being single or married,[28] the marriage penalty is not responsible for the recent flurry of flat-tax proposals in the Congress. But, if Congress refuses to embrace other remedies to eliminate it, perhaps the marriage penalty alone justifies a flat-rate, or at least flatter-rate, income tax.

Chairman ARCHER. Mr. Feenberg.

**STATEMENT OF DANIEL FEENBERG, RESEARCH ASSOCIATE, NATIONAL BUREAU OF ECONOMIC RESEARCH, CAMBRIDGE, MASSACHUSETTS**

Mr. FEENBERG. I work at the National Bureau of Economic Research in Cambridge, Massachusetts. I represent only myself.

Marriage penalties can be quite significant. For working couples with modest income, penalties of $1,000 or $2,000 are typical. For successful professionals, the increase can be $10,000 or $20,000. More significantly, for two working-poor parents near the EIC maximum, the penalty could be several thousand dollars.

While the available statistical evidence does not support a large effective marriage tax on marriage and divorce rates, the situation is morally troubling, to say the least. Economic analysis of the marriage penalty usually centers on other aspects. First the system may be thought to be unfair because it imposes the same tax burden on married couples with two earners as it does on a one-earner couple with the same income, even though the latter is better off by the value of the additional untaxed home-produced services. This is an important argument because it justifies different tax liabilities for families according to the within-family distribution of income. If this argument is accepted, it is again possible to reduce or eliminate the marriage tax without giving up graduated rates.

The second concern that economists generally have is that married women are typically thought to be quite responsive to changes in the aftertax wage rate. This makes it particularly inefficient to tax married women at their husband's marginal rate. In 1995, Martin Feldstein and I analyzed a number of tax reform proposals, including a revival of the second-earner's deduction which allowed the secondary earner to deduct 10 percent of her earnings up to $30,000 from total income. For married women with earnings below $30,000, this represents a 10-percent reduction in the marginal tax rate. With no change in labor supply, we found a cost of $7.2 billion at 1994 levels, but we estimated a net $5.7 billion increase in wage earnings. This would reduce the cost in the individual income tax side of the budget by $1.1 billion. In addition, the increased earnings also increase the payroll taxes by about $0.9 billion, bringing the net loss to $5.2 billion. In this case, the static revenue estimate overstates the actual loss by 38 percent. So the revenue argument against the deduction is substantially moderated by the consideration of behavioral effects.

We also simulated the law with a cap set at $50,000 rather than $30,000. This is a better match to the 1981 law after an allowance for inflation. The surprising feature of this analysis is that the more generous plan dominates the original. More specifically, the higher deduction limit raises the static revenue loss by about $700 million, but induces an additional $1.7 billion in earnings. While the personal income tax still falls by $200 million, this is offset by greater payroll tax revenues.

At the price, the secondary earner's deduction is an especially attractive plan because it reduces marriage penalties by about a third or more without much increasing marriage bonuses and with very little complication to the tax form. I note that the secondary earner's deduction has no phaseout range, and I applaud that. A phaseout of the benefit would just aggravate the marriage tax at some higher income level.

H.R. 2456 creates a new filing status called a combined return similar to optional separate filing but with deductions apportioned by formula and using the schedule for single taxpayers. My personal view is that combined return of the form contemplated is highly problematic from the tax administration complexity perspective. The plan adds at least 40 boxes to the form 1040 and doubles the number of supporting schedules that couples with separate property would have to attach. Even taxpayers not benefiting from the new provisions might spend substantial time confirming that disappointing fact, and few will understand the justice for their disappointment.

We did simulate a number of plans which allowed the secondary earner to file a separate return for wage income only and with all deductions and exemptions on the couple's primary return. While quite costly, these plans did well on a deadweight loss per dollar of revenue basis and would be worth considering. With only one form of income separately taxed, the additional lines on the form are few and the additional complexity is minimized.

There are a number of provisions in the law, including the earned income tax credit, the phaseout of personal exemptions, limitations on itemized deductions, and the thresholds for taxation of Social Security that aggravate the marriage tax. The apparent rationale for these phaseouts is that not only should the Tax Code be progressive overall, but that each provision of the Tax Code should be progressive on its own. This is not attractive logically. Progressivity should be a feature of the entire Tax Code, and not of the individual paragraphs of the Tax Code. Perhaps we could have fewer of these carbuncles on the Code if, like the British, we called them clawbacks instead of phaseouts.

Finally, separate filing provides a dramatic example of the role that graduated rates play in generating tax complexity. It is often alleged that taxes need not be flat to be simple since the effort of looking up the tax liability in the table is independent of the number of brackets that were used to create the table. But those 40 additional boxes on the 1040 that would be required by the combined return are due to the fact that with graduated rates the amount of tax depends upon exactly who has earned the income. It is the individual's specific marginal tax rate that means the tax cannot be simple unless it is also flat.

My last remark would be to point out that neither of the proposed bills do anything to ameliorate the marriage tax generated by the EIC phaseouts. This is very unfortunate because it is at these lowest income levels that the tax is the greatest in proportion to income and where the effects on marital status might be expected.

Thank you for your attention.

[The prepared statement follows:]

**Statement of Daniel Feenberg, Research Associate, National Bureau of Economic Research, Cambridge, Massachusetts**

With graduated rates, higher income taxpayers pay a greater percentage of their income in taxes. But there is no obviously correct way to compare individuals and couples. The individual with 50K of annual income pays a higher average tax rate than the individual with 25K of income. But what rate should the couple with 50K of income pay? Are they like the individual with the same income, and should they pay the higher rate? Or like two single taxpayers each with half that of income, and be subject to a lower average rate set for the less well off? Does it matter if both are working at a low wage, or just one at a high wage? And should couples with the same income pay the same tax, anyway? It isn't a question that can be answered scientifically by investigation into whether two can live as cheaply as one.

As you know, single and married people face different tax schedules under current law, with the tax liability of married individuals based on the couple's joint income. Consequently, tax burdens change with marital status, although whether up or down depends upon the closeness of the incomes of the spouses. The more equal the incomes, the greater the tendency for tax liabilities to increase upon marriage.

The marriage penalty is no mere technical problem, and marriage non-neutrality is inevitable in a tax system with income splitting and graduate rates. From 1982 to 1986 the law departed from pure income splitting by the introduction of the secondary earner's deduction. That substantially ameliorated the marriage penalty but was dropped when TRA87 provided an even greater relief from the marriage penalties through lower marginal rates. Recent increases in statutory marginal rates have aggravated the marriage penalty again, as has the introduction of taxable social security benefits. The 1997 Taxpayer Relief Act includes a child credit which adds a potential marriage tax of $500 per child to those couples where both husband and wife earn between $65,000 and $75,000. Their income together puts them above the phaseout range for a couple, but apart they would receive the full benefit.

Under current law the magnitude of the marriage penalty can be quite significant. For working couples with modest incomes, penalties of one or two thousand dollars are typical. For two very successful professionals, the increase could be ten or twenty thousand dollars. More significantly, for two working poor parents near the EIC maximum, the penalty could be several thousand dollars, perhaps 15% of income. Of course a similar number of couples receive a marriage bonus. It may hard to reduce the tax without increasing the bonus, or we may consider the bonus to be desirable.

While the available statistical evidence does not support a large effect of marriage taxes on marriage and divorce rates, the situation is morally troubling, to say the least.

Economic analysis of the marriage penalty usually centers on other aspects. First, the system may be thought to be unfair because it imposes the same tax burden on a married couple with two earners as it does on a one earner couple with the same income, even though the later is better off by the value of the additional untaxed home produced services.

This is an important argument, because it justifies different tax liabilities for families according to the within family distribution of earnings. If this argument is accepted, it is again possible to reduce or eliminate the marriage tax without giving up graduated rates.

The second concern is that while the labor supply response of married men to the after-tax wage is still controversial, most economists in both parties believe that women are quite responsive to changes in the after-tax wage rate. This makes it particularly inefficient to tax married women at their husband's marginal rate. In fact, currently the typical married woman's marginal rate is even higher than her husband's rate, once social security tax and benefit rules are accounted for. Reducing the marginal rate faced by the more elastic earner will improve efficiency.

In 1995 Martin Feldstein[1] and I analyzed a number of tax reform proposals including a revival of the secondary earner's deduction. This was a feature of the tax law from 1982 to 1986, and as with HR 2593, it allowed the secondary earner to deduct 10% of her earnings from total income. For married women with earning below $30,000 this represents a 10% reduction in the marginal tax rate.

In our analysis we forecast the revenue effect after accounting for the change in labor supply induced by the higher after tax wage rate and lower tax liability. We take the elasticity of hours with respect to the net of tax share to be .45.

[1] Feldstein, Martin, and Daniel Feenberg, "The Taxation of Two-Earner Families" in Martin Feldstein and James Poterba, editors, Empirical Foundations of Household Taxation, University of Chicago Press, 1996.

With no change in labor supply, we found a cost of 7.2 billion dollars at 1994 levels. But we estimated a net 5.7 billion dollar increase in wage earnings. This would reduce the cost on the individual income tax side of the budget by 1.1 billion to 6.1. In addition, the increased earnings also increase the payroll taxes that these women and their employers pay by about .9 billion, bringing the net loss to 5.2 billion. In this case the static revenue estimate overstates the loss by 38 percent. So the revenue argument against the deduction is substantially moderated by the consideration of behavioral effects.

We also simulated the law with a cap set at $50,000 rather than $30,000. That is a better match to the 1981 law after an inflation correction. The surprising feature of this analysis is that the more generous plan dominates the original. This occurs because the $30,000 cap provides no favorable effect on the incentives of secondary earners with initial earnings above $30,000, while nevertheless reducing the tax that they pay. More specifically, the higher deduction limit raises the static revenue loss by approximately $700 million, but induces an additional $1.7 billion in earnings. Although the personal income tax still falls by $200 million, this is offset by greater payroll tax revenues.

At the price, the secondary earner's deduction is an especially attractive plan because it reduces the marry about a third or more, without much increasing marriage bonuses, and with very little complication to the tax form. I note that the secondary earner's deduction has no phaseout range, and I applaud that. A phaseout of the benefit would just aggravate the marriage tax at some higher income level.

HR 2456 creates a new filing status called a "combined return", similar to optional separate filing but with deductions apportioned by formula and using the schedule for single taxpayers. We did not do an analysis for any form of optional separate filing, perhaps because the revenue cost seemed too great at the time, but I would expect that the importance of accounting for behavioral effects would be as or more important than for a secondary earner's deduction.

Anyone doing such an estimate for separate filing must face the problem that even if one knew the current distribution of property within the family, that distribution might be affected by tax-avoidance measures induced by the availability of the new filing status. With no simulations, I have no quantitative evaluation of HR 2456.

My personal view is that a combined return of the form contemplated by HR 2456 is highly problematic from the tax administration and complexity perspective. The plan adds at least 40 boxes to the Form 1040, and doubles the number of supporting schedules that couples with separate property would have to attach. Even taxpayers not benefiting from the new provisions might spend substantial time confirming that disappointing fact, and few will understand the justice of that disappointment.

We did simulate a number of plans which allowed for the secondary earner to file a separate return for wage income only, with all deductions and exemptions on the couples primary return. While quite costly, these plans did well on a"deadweight loss per dollar of foregone revenue" basis and would be worth considering. With only one form of income separately taxed, the additional lines are few, and the additional complexity minimized.

Finally, separate filing provides a dramatic example of the role that graduated rates play in generating tax complexity. It is often alleged that taxes need not be flat to be simple, since the effort of looking up the tax liability in the tax table is independent of the number of brackets. But those 40 additional boxes on the 1040 would be required under separate taxation with graduated rates because the amount of tax would depend upon exactly whose income is whose.

Neither HR 2456 nor HR 2593 do anything to ameliorate the marriage tax generated by the EIC phaseouts. This is unfortunate because it is at the lowest income levels that the tax is the greatest proportion of income and where effects on marital status might be expected.

Thank you for your attention.

*Daniel Feenberg is Research Associate of the National Bureau of Economic Research, Cambridge MA. The views expressed here are those of the author, and not of any institution.*

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Chairman ARCHER. Thank you, Mr. Feenberg.

Our next witness is David Lifson. Mr. Lifson, you may proceed.

**STATEMENT OF DAVID LIFSON, VICE CHAIR, TAX EXECUTIVE COMMITTEE, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS**

Mr. LIFSON. Mr. Chairman, and Members of this distinguished Committee: I am David Lifson, vice chair of the Tax Executive Committee at the American Institute of CPAs—the national professional organization of CPAs with more than 330,000 members. Many of our members are tax practitioners who, collectively, prepare income tax returns for millions of Americans. We appreciate this opportunity to testify today on the marriage penalty.

The AICPA urges that the tax system be modified to eliminate or reduce the marriage penalty. The tax system should be marriage neutral. Both simplification and equity must also be considered. This issue involves tax, social, and economic policy decisions that must be coordinated to maximize the benefit of any change. We want to help and we can be very helpful.

Your background studies confirm that under the current tax system, a marriage penalty, or a marriage bonus, exists. The bonus is intentional often, and is the result of prior tax policy. The penalty is often unintentional.

There are currently at least 63 provisions in the Internal Revenue Code where tax liability depends on whether a taxpayer is married or single. In 1996, when the GAO released their report on this topic, there were only 59 reasons. Then, there were 59 reasons to leave your spouse. Now, with the 1997 tax act, there are 63 reasons, representing nearly a 7-percent increase in only 1 year. [Laughter.]

The marriage penalty results from two root causes: stacking of joint income against progressive tax rates, and phaseouts of credits, deductions, and exemptions often designed to prevent abuses or to produce targeted benefits. We recommend that at a minimum Congress should consider adopting standard phaseouts for three income levels—low-income, middle-income, and high-income taxpayers—rather than the 20 current levels; and adopt one standard phaseout method for all. Note that the phaseout ranges would eliminate many of the 63 penalties since the joint amounts would be twice the single ranges, and the phaseout ranges applicable to married-filing-separate taxpayers would be the same as those for single taxpayers.

We have provided you a table to study our proposal further. In one careful step, you could go a long way to attack two of the most talked about issues today in taxes: complexity, and the marriage penalty.

In addition, there are related tax problems that arise because of marriage and joint liability. We urge this Committee to give these matters their due consideration. For example, the innocent spouse rules need modifications, as do the treatment of carryover tax attributes, and NOL computations in the 50 percent of our marriages that end in divorce. Further, we suggest that Congress provide for allocated liability instead of joint and several liability on joint tax returns. And perhaps most importantly, further consideration of separate returns or separate liability calculations must be considered as an option.

Again, we have provided you with background material in this area. It's with our materials.

The AICPA has been studying this area, including H.R. 2593 providing a limited two-earner deduction, and H.R. 2456 allowing limited combined returns. These and other bills included in the discussions today need to go further and need to be coordinated into a single rational improvement.

You should consider all possible approaches—provide for the separate calculations; provide for something like a two-earner deduction; provide a tax credit; adjust or broaden the current rate bracket schedules so that there is less marriage penalty; or, as I said earlier, you can adopt a standard phaseout for the three income levels, eliminating many of the 63 marriage penalties.

In conclusion, the AICPA urges that the tax system be modified to eliminate or reduce the marriage penalty or bonus. We have discussed a number of possible approaches to address this problem. However, each of these provisions needs to be thoroughly analyzed in order to provide the intended economic, tax, and social benefits. Standard phaseouts could go a long way. All alternatives should be considered.

American families, American workers, and all American taxpayers deserve everyone's careful analysis and consideration.

The AICPA thanks you for listening.

[The prepared statement and attachments follow. Appendices are being retained in the Committee files.]

**AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS**

**TESTIMONY OF**

**DAVID LIFSON, VICE CHAIR**
**TAX EXECUTIVE COMMITTEE**

**BEFORE**

**THE COMMITTEE ON WAYS AND MEANS**
**OF THE**
**UNITED STATES HOUSE OF REPRESENTATIVES**

**HEARING ON THE MARRIAGE PENALTY**

**JANUARY 28, 1998**

**AICPA TESTIMONY ON THE MARRIAGE PENALTY**
**HOUSE WAYS AND MEANS COMMITTEE**
**January 28, 1998**

## INTRODUCTION

Good morning, Mr. Chairman, and members of this distinguished Committee. We appreciate this opportunity to testify today on the marriage penalty. I am David Lifson, Vice Chair of the Tax Executive Committee of the American Institute of Certified Public Accountants (AICPA). The AICPA is the national professional organization of CPAs, with more than 320,000 members. Many of our members are tax practitioners who, collectively, prepare income tax returns for millions of Americans.

The AICPA urges that the tax system be modified to eliminate or reduce the marriage penalty. The tax system should be marriage neutral. Achieving neutrality would also involve elimination of the marriage bonus. In seeking a solution to the marriage penalty problem in the current tax system, both simplification and equity need to be considered. This issue involves tax, social, and economic policy decisions, all of which must be fully considered in order to maximize the benefits of any change. We would be happy to work with you on specific proposals as Congress moves forward in this area.

## BACKGROUND ON THE MARRIAGE PENALTY

Under the current tax system, a "marriage penalty" and "marriage bonus" exist. The "marriage penalty/bonus" results when two married individuals have a greater (penalty) or smaller (bonus) tax liability as compared to two similarly situated single individuals (i.e., individuals with the same total incomes). The marriage penalty is a likely, unintended result from prior legislative efforts to be equitable. As each Congress introduces changes to the Code, complexity and unintended tax effects often result.

There are also at least 63 provisions in the Internal Revenue Code where tax liability depends on whether a taxpayer is married or single. Most of these differences were created to be fair; to target benefits to specific taxpayers, or to prevent abuses. Some examples are the tax rates, standard deduction, and earned income tax credit, as well as social security benefits taxation, capital loss limits, IRAs, dependent care credit, child credit, and education tax incentives. The AICPA would like to contribute to the debate and help Congress find a balanced program to address the issue and simplify the Code at the same time. Simplification involves considering tax policy, individual taxpayers' calculations of tax, and the IRS's administration and collection efforts all at the same time. By working together, these goals can be attained.

The two major factors that have created the marriage penalty problems are:

1. The "stacking of income" problem, resulting from the different and progressive tax rate/bracket schedules applicable to different filing statuses, and

2. Different income thresholds and phase-outs of deductions and credits for single versus married taxpayers.

The progressive tax rate/bracket schedules impose a higher marginal tax on combined spousal earnings, as compared to two single persons. Additionally, the tax brackets for married filing joint are not twice as wide as those for single taxpayers, and the tax brackets for married filing separately do not equate to the tax brackets for single taxpayers. We refer to this phenomenon as the "stacking of income" problem and there are a variety of ways to address it.

The second factor contributing to the marriage penalty is the large number of provisions that phase-out based on income levels that may or may not differ based on marital/filing status. The *Taxpayer Relief Act of 1997* significantly increased the provisions with different phase-outs for different filing status (i.e., based on joint, single, or married filing separately). A chart and discussion of these different phase-outs are in Appendix A of the testimony.

We recommend, that to reduce marriage penalties and improve simplification, Congress should consider adopting standard phase-outs for three income levels -- low, middle, and high income taxpayers (rather than the 20 current levels), and adopt one standard phase-out method. Note that our proposed three phase-out ranges would eliminate marriage penalties, since the joint amounts would be twice the single ranges, and the phase-out ranges applicable to married filing separate taxpayers would be the same as those for single taxpayers.

There are also related joint liability issues. For example, when a married couple files a joint federal income tax return, each spouse becomes individually responsible for paying the entire amount of tax associated with that return. Because of this joint and several liability standard, one spouse can be held liable for tax deficiencies assessed after a joint return was filed that were solely attributable to actions of the other spouse. The current "innocent spouse" relief provisions are not effective, are too restrictive to help very many aggrieved taxpayers, and are in need of reform. In addition, due to the high divorce rate in this country, the current divorce taxation rules affect a large percentage of taxpayers inequitably, many of whom do not have or cannot afford sophisticated tax advice.

A number of bills have been introduced in Congress addressing the marriage penalty and joint liability problems, including:

- HR 2593 (Herger, R-CA), providing a two-earner deduction up to $3,000;
- HR 2456 (Weller, R-IL)/HR 2462 (Kasich, R-OH)/HR 3059(Jackson-Lee, D-TX)/S 1314 (Hutchinson, R-TX), allowing combined returns with single rates;
- S 1285 (Faircloth, R-NC), allowing combined returns with single rates and allocating half the taxable income to each spouse;
- HR 1584 (Johnson, R-TX), providing a $145 marriage penalty credit;
- HR 2718 (Knollenberg, R-MI), eliminating the marriage penalty in the standard deduction;
- HR 2467 (Stupak, D-MI), allowing divorce decree allocation; and
- HR 2292 (Portman, R-OH)/S 1096 (Kerrey, D-NE), requesting a study of separate returns.

**RECOMMENDATIONS**

The AICPA has been studying this area for many years and recommends that the marriage penalty be eliminated or reduced because it is inequitable. There are a number of possible approaches to address the marriage penalty problem.

1. Provide on one return, a separate calculation of each spouse's taxable income and use one tax rate schedule that would apply to all individuals. The income and deductions of each spouse could be allocated in a variety of ways, e.g., by property ownership, by AGI, by percentage of earned income, 50/50, or in the parties' discretion. In our opinion, conceptually, this one-return, separate calculation proposal could produce **the most equitable system**. However, any allocation of income and deductions adds complexity in return filing and tax administration. The total increase in complexity will depend on the allocation methods used. Many states that have an income tax, such as Virginia, use this approach. (This is similar to HR 2456 and related bills.)

2. Provide a deduction to reduce the marriage penalty, such as the two-earner deduction. This would be the **simplest** solution to implement, and would eliminate some, but not necessarily all, of the marriage penalty and could add to marriage bonuses. It would have to apply for regular tax and alternative minimum tax (AMT) and not be subject to an AGI phase-out to be fully effective. (This is similar to HR 2593.)

3. Provide a tax credit to address the marriage penalty. This would eliminate some, but not necessarily all, of the penalty. It would have to apply to both regular tax and AMT to be fully effective. Several considerations would have to be taken into account, such as the complexity in the calculation, the treatment of carryovers and carrybacks, and the priority ordering of the many tax credits that could apply. (This is similar to HR 1584.)

4. Adjust/broaden the current rate/bracket schedules applicable to married individuals. The joint schedule could be modified to eliminate the marriage penalty (by increasing the joint brackets to twice the single brackets) or to reduce the penalty. Another approach would be to conform the married filing separate and single rate/bracket schedules (such as in Arizona). This approach would be better than the current system and could be viewed as elective complexity for those couples that chose to file separately.

5. Adopt standard phase-outs for three income levels -- low, middle, and high income taxpayers (rather than the 20 current levels), and adopt one standard phase-out method. This would eliminate marriage penalties, since the joint amounts would be twice the single ranges, and the phase-out ranges applicable to married filing separate taxpayers would be the same as those for single taxpayers.

In addition, there are related tax problems that arise because of marriage and joint liability, and we urge the Committee to give these matters consideration. For example, the innocent spouse rules need modification, as do the treatment of carryover tax attributes and NOL computations in divorce situations. Further, we suggest Congress provide for allocated liability instead of joint and several liability on joint tax returns, and further consider separate returns as an option. We also note that various Internal Revenue Code regulations (i.e., under sections 108, 121, 154, 163, 1041, and 6013) regarding spouses and divorce situations need to be amended. (See Appendix B for further details.)

**CONCLUSION**

In conclusion, the AICPA urges that the tax system be modified to eliminate or reduce the marriage penalty or bonus. We have discussed a number of possible approaches to address the marriage penalty problem. However, each of these provisions needs to be thoroughly analyzed in order to provide the economic, tax, and social benefits that Congress determines is appropriate. Further, to eliminate marriage penalties and improve simplification, standard phase-outs (with joint ranges being twice the single and married filing separate ranges) for three income levels -- low, middle, and high income taxpayers (rather than the 20 current levels) -- and one standard phase-out method should be adopted. We would be happy to work with you on specific proposals as this Congress moves forward in this complex area that deserves careful analysis and consideration. The AICPA again thanks you for this opportunity to present our comments and recommendations on eliminating or reducing the marriage penalty.

Chairman ARCHER. Thank you for your testimony and your input.

Mr. Bartlett. We'd be happy to have your testimony.

**STATEMENT OF BRUCE R. BARTLETT, SENIOR FELLOW, NATIONAL CENTER FOR POLICY ANALYSIS**

Mr. BARTLETT. Thank you, Mr. Chairman. I'm a senior fellow with the National Center for Policy Analysis, which is a think tank based in Dallas, Texas.

First, I would like to say that I associate myself completely with all the statements previously made. I agree with everything that the other three witnesses have said, and in particular, I think that Mr. Graetz is right to point to the pernicious effect of the domination of income distribution tables in the tax policy process, because that's what has given us all these crazy phaseouts that are so well detailed in the previous testimony.

What I would like to concentrate on is the notion that anything short of fundamental tax reform is very unlikely to completely get rid of the marriage penalty. I support all of the legislation that has been offered, and I think that in the end it will probably be revenue constraints that determine how much or how little is ultimately able to be done in terms of the marriage penalty. I would just hope that whatever approach to alleviating the marriage penalty that Congress adopts be done with some vision of tax reform in mind. Personally, I think the flat tax is the best way that we should go, but going to a consumption tax, such as a national retail sales tax, would also get rid of the marriage penalty. I think that either of these approaches ought to be in the mind of the Congress as they adopt incremental changes to the Tax Code, whether it be in terms of the marriage penalty or in other legislation.

I would like to call attention to the discussion in the Joint Committee's pamphlet, which points out, quite correctly, that the Congress cannot simultaneously do three things. You cannot have progressive tax rates, you cannot have equal treatment of couples with equal incomes and be marriage neutral. Historically, the Congress has accepted the first premise—the first principle—and the second principle, and abandoned the third. And we are now here to try to redress this problem. But, anything we do to redress the marriage penalty in terms of the legislation that is under discussion is going to violate the second principle. You are going to have a situation in which married couples with the same gross income are going to be paying quite different taxes depending solely on how that income is earned; whether it's earned by a single earner or two earners, and what is the split of income between those two, because the marriage penalty is exacerbated, or it's worst, when a married couple each have approximately equal income.

So, I think that you need to be aware that you may be leaving one minefield for another, and that we'll be back here in a couple of years to try to fix another problem. And, as you know very well, Mr. Chairman, this whole problem came about because in 1969 the single earners were all complaining that they were overtaxed rel-

ative to married couples, and you changed the tax brackets to alleviate that problem and created another one.

So, I would emphasize the need to go to fundamental tax reform. And, as the Joint Committee's pamphlet correctly points out, a pure flat rate tax system does eliminate the marriage penalty; and also having a consumption tax would do the same thing. But that would require abandoning the first principle, which is the principle of progressivity in our tax system. I agree with Professor Feenberg that you don't necessarily have to have progressive rate structure to have a progressive tax system. You can do a lot of things with the personal exemption, with things like the earned-income tax credit to achieve pretty much any degree of progressivity you wish to have in the overall tax system without the necessity of having progressive tax rates. And, I believe that there is now a growing consensus, at least among economists, and among some tax theorists as well, that maybe progressivity of the rate structure is not necessarily something that we ought to accept without question.

Of course, the other approach you can take is to simply abandon the family as the fundamental tax unit and go to a pure individual filing system such as we had before 1948. There is a growing agreement, I think, among many tax theorists who are cited in my testimony to this regard as well. Certainly going to something like the choice system in the Weller-McIntosh bill moves us a long way in that direction, but it might be worth at least considering the possibility of going to a mandatory individual filing system.

I'll just stop there and take your questions. Thank you.

[The prepared statement follows:]

**Statement of Bruce R. Bartlett, Senior Fellow, National Center for Policy Analysis**

A marriage penalty results when a married couple pay more taxes by filing jointly than they would pay if each spouse could file as a single. Marriage penalties only result when both spouses have earned income. Single earner couples never pay a penalty and in fact always get a bonus from the Tax Code. A marriage bonus results when a couple pay less taxes than they would pay as singles.

The marriage penalty fundamentally results from progressivity of the Tax Code.[1] Marginal income tax rates rise from 15 percent to 39.6 percent. This causes a marriage penalty because the earnings of the secondary worker (the lower paid spouse) in effect come on top of the primary earner's. Thus, a secondary worker may find his or her income taxed at a marginal rate higher than they would pay if taxed as a single.

To see how this works, consider a husband with taxable income of $25,000 per year. Under both the single and joint tax schedules he would pay 15 percent tax on that income. If his wife also makes $25,000, however, only the first $17,350 of her income would be taxed at 15 percent. The remaining $7,650 of her income will be taxed at 28 percent, because it puts the couple's total income above the $42,350 ceiling for the 15 percent bracket. Thus she will pay 13 percent more tax on that income (the difference between 15 percent and 28 percent) than she would pay if she were taxed as a single. In this case, that would make the marriage penalty $994 per year.

On the same total income, a couple may either get a tax bonus or pay a tax penalty depending on what the income split is between husband and wife. The couple in the earlier example paid the maximum marriage penalty on their $50,000 joint income because each spouse earned half the income. However, if one spouse earned substantially less than the other, the marriage penalty would have become a marriage bonus. If the husband earned $40,000 per year while the wife earned $10,000, instead of paying a penalty of $994 per year, they would have received a bonus of $910. That is, they would pay $910 less in taxes as a couple filing jointly than they would pay if each were taxed as a single.

The marriage penalty is most likely to strike couples whose incomes are roughly equal. No couple with equal incomes or those within 10 percent of each other receive

a marriage bonus and most receive penalties. As noted earlier, no single earner couples pay a marriage penalty and virtually all, regardless of income, receive a bonus.

To get an idea of how marriage penalties and bonuses affect real people, the Congressional Budget Office (CBO) looked at Internal Revenue Service and Census data. The CBO found that the highest proportion of marriage penalties occurred when the higher earning spouse made between $20,000 and $75,000 per year. Couples with incomes above and below these levels were more likely to receive a tax bonus for being married.

Thus we see that marriage penalties are most likely to impact on couples with middle incomes whose incomes are roughly equal. In an interesting article, Professor Dorothy Brown of the University of Cincinnati College of Law has argued that these two factors mean that blacks are more likely to suffer a marriage penalty, while whites are more likely to receive a marriage bonus from the Tax Code.[2] The reason is because among married couples, black women are more likely to work than white women. Furthermore, working black women on average provide a higher percentage of the couple's total income than working white women. According to a 1990 study by the U.S. Commission on Civil Rights, 75 percent of black women work full-time, whereas only 62 percent of white women do. And working black women contribute 40 percent family earnings, while working white women contribute just 29 percent.[3]

Although the marriage penalty is inherent in the nature of progressive tax rates, its magnitude has gone up and down with changes in the tax law. When the income tax was established in 1913, there was no distinction between married and unmarried taxpayers. There was a single rate schedule that applied to both.

The tax problems related to working women were much less in those days because only a small number of married women worked outside the home. In the census of 1900, there were only 769,000 married women in the labor force, out of a total of 27,640,000 workers. Even single women were unlikely to hold a paying job at that time. The female labor force participation rate was just 20 percent in 1900, compared to 86 percent for men.[4]

In the 1920s, however, a number of couples in community property states began filing separate tax returns, with each spouse claiming half the couple's total income.[5] This was justified on the grounds that under community property each spouse is deemed to own half the couple's joint earnings, regardless of who earned them. By contrast, in common law states, the earnings of a spouse generally belonged to that spouse. Among the states with community property laws at that time were Texas, Arizona, Idaho, Louisiana, Nevada, New Mexico, Washington and California.

Initially, the Attorney General of the United States ruled that couples in community property states could split their income for tax purposes. This had the effect of reducing taxes for most couples. For example, if a husband had $20,000 of earnings and his wife had none, they would be taxed as if each earned $10,000. This generally put them in a lower tax bracket and lowered their joint tax liability. Had this state of affairs been allowed to continue, it would have led states to adopt community property laws just to give their citizens a cut in their federal income taxes.

Congress and the Treasury Department attempted to thwart the use of income splitting through legislation and regulations. Eventually, a case reached the Supreme Court on the question of income splitting. In Poe v. Seaborn (1930), the Court ruled that state community property laws did allow couples to split their incomes for federal income tax purposes. And as expected, it did indeed lead several states to change from common law to community property in order to give their citizens a tax cut at no expense to the state. This trend accelerated when tax rates shot up during World War II. By 1948, Oregon, Nebraska, Michigan and Oklahoma had changed their laws to become community property states.[6]

Obviously, this situation led to a great deal of unfairness, with citizens of some states paying significantly lower federal income taxes than citizens of other states with the same income. The magnitude of the marriage penalty for couples in common law states in 1947 was quite high. Some couples in common law states were paying 40 percent more in federal income taxes than they would have paid in a community property state. A couple with a joint income of $25,000, for example, would have paid $9,082 in federal income taxes in a common law state, but only $6,460 in a community property state.[7] As Professor Michael Graetz of Yale recently noted, "this absurd situation did not engender great respect for the integrity of the income tax."[8]

Congress finally resolved this problem in the Revenue Act of 1948, which extended the principle of income splitting to all married couples.[9] This constituted a significant tax cut for most married couples. The bulk of the benefits accrued to couples with middle incomes.[10]

More significantly, almost every married couple saw a sharp reduction in their marginal tax rate—the tax that applies to the last dollar earned. A couple earning $51,000, for example, saw their marginal rate drop from 75 percent to 59 percent between 1947 and 1948. Again, those in the middle brackets, not the rich, were the principal beneficiaries.

In practice, the impact of lower tax rates was mainly on women. Since a married woman's earnings came on top of her husband's, she was in effect taxed at her husband's marginal tax rate on the first dollar of her earnings. With marginal tax rates going as high as 90 percent after World War II, this very strongly discouraged married women from working.

Although the institution of income splitting was highly beneficial to most married couples, it created a problem for single taxpayers. As a result of income splitting, a married couple mow paid significantly less tax than a single earner with the same income. Congress tried to address this inequity in 1951 by creating a new tax rate schedule for single heads of households, which roughly split the difference between the married and single tax schedules.

Singles, however, continued to agitate for tax relief. By 1969, some single taxpayers were paying 42 percent more federal taxes than a married couple with the same income. That year Congress created a new tax schedule for singles that was designed to keep the tax burden on singles and married couples with the same income within 20 percent of each other. This legislation created a significant marriage penalty for the first time.[11] As a result, some married couples now paid more taxes by filing jointly than they would have paid if both filed as individuals.[12]

Further contributing to the rise of the marriage penalty was the steep rise in the number of women in the labor force. The number of women in the labor force increased by about 50 percent between the late 1940s and the early 1970s. The labor force participation rate for women has continued to rise since and in 1997 was almost double the rate of 1947. This is important because a marriage penalty only occurs when a husband and wife both have earned income. With women working in greater and greater numbers, this means that the likelihood of a couple suffering a marriage penalty rose concomitantly.

As knowledge of the marriage penalty grew, increasing numbers of couples began to take matters into their own hands by getting divorced for tax reasons. One couple, David and Angela Boyter, received national publicity for getting divorced each December, allowing each to file as single for the year, and then getting remarried in January.[13] Eventually the IRS cracked down on this charade, but not before moving Congress to action.[14] By 1981, there was strong political pressure to redress the marriage penalty problem. A variety of proposals were put forward to accomplish this goal.[15]

In the Economic Recovery Tax Act of 1981, Congress attempted to redress the marriage penalty by giving the lower paid spouse a 10 percent tax deduction on income up to $30,000, for a maximum deduction of $3,000. While this provision did not eliminate the marriage penalty, it did redress the problem substantially for most married taxpayers.[16]

The secondary earner deduction did not live long, however, and was eliminated by the Tax Reform Act of 1986. But because the Tax Reform Act sharply reduced tax rates for most taxpayers, the net effect was to reduce the number of couples suffering a marriage penalty and the magnitude of the penalty.[17] Nevertheless, some couples were worse off.[18]

The most recent tax legislation with a major impact on the marriage penalty is the 1993 tax bill.[19] Interestingly, the provision of the legislation that exacerbated the marriage penalty was not the increase in tax rates, but the expansion of the Earned Income Tax Credit (EITC). The EITC is a refundable income tax credit for workers with low earnings. It creates marriage penalties because it is phased-out as incomes rise and because it is maximized for workers with two children.[20] No additional credit is available for three or more children in a single qualifying family. Depending on their income, therefore, a two-earner couple might significantly increase their joint EITC benefit by divorcing. And if they have more than two children, the benefits of divorce can be enormous. In 1996, for example, a two-earner couple with four children and each earning $11,000 would have increased their EITC payment from $1,375 to $7,120 by getting divorced, with each spouse claiming two children.[21]

As noted earlier, the principal effect of the marriage penalty has been on wives, because they generally earn less than their husbands and thus are in effect taxed at their husbands' marginal tax rate. This means that wives generally receive less aftertax income on each dollar they earn than their husbands do. This alone is sufficient to significantly discourage work effort among married women. There is a con-

siderable amount of economic research clearly demonstrating that high marginal tax rates reduce labor supply, especially for married women.[22]

The disincentive effects of high marginal tax rates on married women are aggravated by their looser attachment to the labor force than men and their child-rearing responsibilities.[23] Although most married women who work do so because of financial necessity, many do not. Their income is not essential for maintaining a couple's standard of living. Such women may work for a variety of reasons, including the simple joy of doing so. But the consequence is that they are more easily driven from the labor force by tax disincentives than married men are. For this reason, economic theory suggests that married women should be taxed less than married men.[24]

Thus it should come as no surprise that tax policies affecting the marriage penalty have had a significant impact on female labor supply. The institution of income splitting in 1948 and the effective reduction in marginal tax rates had a significant effect on women's work decisions. Between 1947 and 1950 the labor force participation rate for married women shot up, raising their share of the female labor force from 46.2 percent to 52.1 percent. Those with a husband present, those most likely to be affected by income splitting, increased their labor force participation most, increasing their share of the female labor force from 40.9 percent to 48 percent. By contrast, single, widowed or divorced women, who gained nothing from income splitting, saw their labor force participation stay flat or decline. The labor force participation rate for men was also unchanged over this period.

A study of the 1981 tax act, which reduced the marriage penalty by instituting a secondary earner deduction, shows that married women's work expanded by almost enough to pay for the deduction's revenue loss.[25] Analysis of the Tax Reform Act of 1986, which lowered the top marginal tax rate from 50 percent to 28 percent, shows that married women responded more strongly to the increased work incentive than men did.[26] Another study estimated that if the marriage penalties remaining after the Tax Reform Act were eliminated, the average married woman would increase her hours worked by 46 hours per year. High-income and low-income women would respond even more strongly, increasing their work hours by 100 hours per year.[27]

The latest estimates by Martin Feldstein and Daniel Feenberg suggest that the labor supply response of married women to reduction of the marriage penalty could be quite large. Sharply cutting the tax rate on secondary workers could lead to an increase in earnings by such workers of as much as $66 billion per year.[28]

In addition to effects on labor supply, the marriage penalty also impacts the marriage/divorce decision. There is certainly no question that over time the number of couples living together without marriage has sharply increased. The Census Bureau reports that 523,000 adults of the opposite sex were living together in 1970. By 1996, this figure had risen to 3,958,000. In 1970, unmarried couples represented just 0.5 percent of the married couples in the United States. By 1996, this percentage had risen to 7.2 percent. At least some of this is undoubtedly due to tax considerations.

Several studies have looked at this question. They find that the marriage penalty has a small but significant impact on couples' decision to marry. When the marriage penalty rises aggregate marriage rates fall. There is a much greater impact on the timing of marriage, with couples often delaying marriage late in the year to minimize their marriage penalty.[29] Finally, there is some evidence that taxes encourage divorce, especially on the part of women who are affected most by the marriage penalty.[30]

As noted earlier, from 1913 to 1948 Congress adopted an approach to taxation that did not differentiate between married and unmarried persons. There was only one tax schedule and everyone paid the same rates. A single person and a married couple with the same income paid the same tax. Congress did not willingly adopt income splitting in 1948. It was forced to do so out of necessity resulting from the consequences of a Supreme Court case. Nevertheless, the effect was to replace the individual with the family as the fundamental unit for taxation.

It has long been known that a tax system cannot simultaneously do three things: (1) have progressive tax rates, (2) have equal tax treatment of couples with the same income, and (3) be marriage-neutral.[31] The last point means that marital status would have no effect on an individual's tax liability. If the first point is accepted, one must choose between the second and third. In 1948, Congress chose the first and second and abandoned the third.

In recent years, a number of tax theorists have questioned Congress's decision. Progressivity is no longer assumed to be a primary criterion of our tax system. Increasingly, tax theorists question whether it is fair to penalize those with higher incomes, while economists produce more and more data on the economic cost of progressivity. At the same time, others question the assumption of family-based tax-

ation. They argue that a system of individual filing would be fairer, simpler and more efficient.

The notion of progressivity has been under attack for many years. Tax experts have long known that exemptions, deductions and exclusions in the Tax Code can easily erode the nominal progressivity of the rate structure. They have also known that progressivity breeds complexity, evasion and imposes a large deadweight cost on the economy. But the idea that "fairness" demanded higher tax rates on those with upper incomes was too widespread to challenge.[32]

By the 1980s, however, opinion had shifted sufficiently that there was now serious support for the idea of a flat tax, one with a single tax rate for all taxpayers regardless of income. So popular was the idea that in 1986 Congress went a long way toward a flat tax by creating a two-rate tax system, with a top rate of just 28 percent. Eventually, even academic tax theorists began to come around to the idea. Now it is common to read criticism of progressivity in leading law journals, where earlier it would have been unthinkable.[33]

At the same time, economists have increasingly come to see the cost of progressivity as extremely high. One study put it this way:

> Even a mild degree of progressivity in the income tax system (as measured by the steepness of the marginal rate schedule) imposes a very large efficiency cost. For example, in comparison with an equal revenue proportional income tax, a progressive income tax with average tax rates varying over the life cycle between .23 and .32 and marginal rates ranging from .23 to .43 imposes an efficiency cost greater than 6 percent of full lifetime resources.[34]

Since that study appeared, many others have come to similar conclusions about the overall welfare cost of progressivity in the U.S. tax system.[35] As a result, a recent president of the American Economic Association has said, "Today, it is fair to say that many, if not most, economists favor the expenditure tax or flat rate income tax. This group has joined the opponents of progressive taxation in the attack on the income tax."[36]

Just as progressivity increasingly has become questioned as a norm of taxation, so too many tax theorists now question whether the family should be the fundamental unit of taxation. They suggest that the individual, rather than the family, is the most appropriate unit of taxation. Such a move would eliminate the marriage penalty completely, but would also eliminate marriage bonuses. Such bonuses, however, may be inappropriate because there is no particular reason why couples should receive special treatment from the Tax Code merely because they are married. To the extent that we wish to aid children, we could target tax deductions or credits directly to the children, rather than families in general.[37]

Individual taxation may also be better suited to changing societal mores. In 1948, relatively few women worked, few headed households, and most couples had a single earner. Now women work in almost the same percentages as men, female-headed households are common, and families represent a decreasing share of households. Indeed, growth of the marriage penalty is as much due to demographic changes as changes in the tax law.[38] According to the Census Bureau, nonfamily households have risen from 18.8 percent of all households in 1970 to 30.1 percent in 1996.[39] It is also worth noting that most major industrialized countries use the individual as the basic unit of taxation.[40]

It is not necessary to completely abandon the family as the basic unit of taxation in order to eliminate the marriage penalty. It would only be necessary to allow couples the choice of filing as singles or jointly. This would preserve marriage bonuses for single-earner couples, but eliminate the marriage penalty for two-earner couples. However, Congress would also have to pass rules about dividing joint income, such as interest and dividends, and allocating itemized deductions, such as for mortgage interest and dependents.[41]

The major objections to the choice approach are complexity, cost and abandonment of the principle that couples with the same income should pay similar taxes. It would be complex because many couples would, in effect, have to do their taxes twice: first jointly and then as singles to see which way they would come out ahead. Also, whatever rules are adopted for allocating joint income and deductions are bound to be complicated.

Allowing couples to choose their filing status would also be costly. According to the CBO, it would have reduced federal revenues by $29 billion in 1996.[42] It will also lead to situations in which certain couples will pay less total taxes than others with the same income. This could create pressure in future years for further tax measures to redress this perceived imbalance.

Congress certainly needs to be wary about adding additional complexity to an already overly complicated Tax Code. However, in recent years Congress has enacted a number of very complicated provisions to the tax law involving phase-outs for various tax benefits that also have the effect of worsening the marriage penalty for some couples. For example, the child credit is phased-out for couples with incomes over $110,000 and over $75,000 for singles. This means that a couple making $75,000 each would qualify for the full $500 per child credit if they divorce, but receive nothing if married.[43]

Almost any solution to the marriage penalty is likely to increase complexity and raise questions about cost and fairness.[44] Short of going all the way to an individual filing system, other options for redressing the marriage penalty include restoration of the second-earner deduction, such as that included in the 1981 tax bill, widening tax brackets and modifying provisions such as the EITC that create marriage penalties.[45] Given the cost of full elimination of the marriage penalty and budgetary realities, in the end Congress will probably be forced to choose among these more limited options if it decides to address the issue at all.

A better solution to further tinkering with the Tax Code would be to move toward a flat rate income or consumption tax. By eliminating progressivity, it gets at the root cause of the marriage penalty.[46] Although there are many other arguments for a flat tax, this one may prove most persuasive to two-earner couples.

## ENDNOTES

1. Other factors contributing to the marriage penalty are the standard deduction, personal exemptions, the Earned Income Tax Credit, phase-outs for personal exemptions, and the limitation on itemized deductions. See Congressional Budget Office (CBO), For Better or for Worse: Marriage and the Federal Income Tax (Washington: USGPO, 1997), pp. 15–25.
2. Dorothy A. Brown, "The Marriage Bonus/Penalty in Black and White," University of Cincinnati Law Review, vol. 65, no. 3 (Spring 1997), pp. 787–798.
3. U.S. Commission on Civil Rights, The Economic Status of Black Women: An Exploratory Investigation (Washington: USGPO, 1990), pp. 100, 105.
4. Bureau of the Census, Historical Statistics of the United States: Colonial Times to 1970, 2 parts (Washington: USGPO, 1975), pt 1, pp. 132–33.
5. The following discussion draws heavily on Joint Committee on Taxation (JCT), The Income Tax Treatment of Married Couples and Single Persons, Joint Committee Print JCS–17–80 (Washington: USGPO, 1980), pp. 19–25.
6. For a discussion of the spread of community property laws and other means by which people attempted to exploit the opportunity to split incomes, see Carolyn C. Jones, "Split Income and Separate Spheres: Tax Law and Gender Roles in the 1940s," Law and History Review, vol. 6, no. 2 (Fall 1988), pp. 259–310.
7. House Report 1274, 80th Congress, 2nd session (1948), p. 22.
8. Michael J. Graetz, The Decline (and Fall?) of the Income Tax (New York: W.W. Norton, 1997), p. 31.
9. For details, see Stanley Surrey, "Federal Taxation of the Family—The Revenue Act of 1948," Harvard Law Review, vol. 61, no. 7 (July 1948), pp. 1097–1164.
10. House Ways and Means Committee, Reduction of Individual Income Taxes, 80th Congress, 2nd session (Washington: USGPO, 1948), p. 28.
11. For evidence that small marriage penalties existed for some taxpayers before 1969, see John Brozovsky and A.J. Cataldo, II, "A Historical Analysis of the 'Marriage Tax Penalty,'" Accounting Historians Journal, vol. 21, no. 1 (June 1994), pp. 163–187.
12. Grace Blumberg, "Sexism in the Code: A Comparative Study of Income Taxation of Working Wives and Mothers," Buffalo Law Review, vol. 21, no. 1 (Fall 1971), pp. 49–98; Joyce Nussbaum, "The Tax Structure and Discrimination Against Working Wives," National Tax Journal, vol. 25, no. 2 (June 1972), pp. 183–191.
13. The reason this worked is because for tax purposes a couple are regarded as married for the full year if married on December 31, and they are considered separated for the full year if divorced on that day. For these and other complications regarding whether a couple is or is not married for tax purposes, see Toni Robinson and Mary Moers Wenig, "Marry in Haste, Repent at Tax Time: Marital Status as a Tax Determinant," Virginia Tax Review, vol. 8, no. 4 (Spring 1989), pp. 788–819.
14. Graetz, Decline of the Income Tax, pp. 35–38.
15. Lynda S. Moerschbaecher, "The Marriage Penalty and the Divorce Bonus: A Comparative Examination of the Current Legislative Proposals," Review of Taxation of Individuals, vol. 5, no. 2 (Spring 1981), pp. 133–146.
16. Joint Committee on Taxation, General Explanation of the Economic Recovery Tax Act of 1981 (Washington: USGPO, 1981), p. 35.
17. Harvey S. Rosen, "The Marriage Penalty Is Down But Not Out," National Tax Journal, vol. 40, no. 4 (December 1987), pp. 567–575; Douglas W. Mitchell, "The Marriage Tax Penalty and Subsidy Under Tax Reform," Eastern Economic Journal, vol. 12, no. 2 (April–June 1989), pp. 113–116.
18. Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1986 (Washington: USGPO, 1987), p. 19.
19. Daniel Feenberg and Harvey S. Rosen, "Recent Developments in the Marriage Tax," National Tax Journal, vol. 48, no. 1 (March 1995), pp. 91–101; Gregg A. Eisenwein, "Marriage Tax

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20. Anne L. Alstott, "The Earned Income Tax Credit and the Limitations of Tax-Based Welfare Reform," Harvard Law Review, vol. 108, no. 3 (January 1995), pp. 559–564; Edward McCaffery, "Taxation and the Family: A Fresh Look at Behavioral Biases in the Code," UCLA Law Review, vol. 40, no. 4 (April 1993), pp. 1014–1020.

21. Janet Novack, "The Worm in the Apple," Forbes (November 7, 1994), p. 98.

22. The most recent research is summarized in Congressional Budget Office, "Labor Supply and Taxes," CBO Memorandum (January 1996); and Robert K. Triest, "The Effect of Income Taxation on Labor Supply in the United States," Journal of Human Resources, vol. 25, no. 3 (Summer 1990), pp. 491–516.

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Chairman ARCHER. Thank you, Mr. Bartlett.

And my compliments to all of you because you have given us some excellent testimony, and I can assure you that the Committee is going to consider what you've said very seriously before we act.

Do all four of you basically agree on a particular approach which is appropriate to solve this problem? We have a problem; we know that. But the solution to the problem is what we have to focus on. Now, do you think all four of you could come together on the appropriate solution?

Mr. GRAETZ. Mr. Chairman, I think that there are two difficulties here in our coming together. One is the revenue that you are prepared to devote to this issue. If you give us unlimited revenue, I suppose we could reach a solution as quickly as the Committee could, but we all know that that's not the current reality. And so the question would be setting priorities about where you would first relieve the marriage penalty, and we might have different priorities.

I think that we probably would come fairly close to a solution once you told us how much revenue we had to spend on it. We could probably come to some agreement; although, I want to be clear that my differences with Mr. Feenberg are important. He is focused on the behavioral effects of this marriage penalty on people entering the labor market, and I'm focused on what taxing marriage does in terms of the signal it sends to the American people about how the Congress and the American people's values line up. I think this is a very serious issue. This was, as Congressman Thomas said earlier, it was a huge issue during the welfare debate, and it seems to me it's an extremely important issue now concerning values and how the tax system reflects values. So there is a difference between us. I wouldn't put as much weight on incentives as Mr. Feenberg.

I also want to compliment Mr. Lifson on the phaseout point. That is clearly something that I think we could all endorse in some fashion: to move to his phaseout solution. And this is the first time I've

heard that idea. As we said, Mr. Chairman, I've heard most of them over the past 25 years.

Chairman ARCHER. Mr. Feenberg, since your name was mentioned would you like to comment?

Mr. FEENBERG. There's no disagreement in values between me and Professor Graetz. I'm testifying to the things that I know most about. That doesn't mean that I disagree with what he testified about—other, no doubt, more important things.

Chairman ARCHER. Well, let me comment on that. Before, it seemed like we always talked about what is the economic impact of everything that we do here. Now I've begun to focus on what is the moral and social impact of how we tax. I believe we're going to have to talk more about that, and think more about that, because it has a dramatic effect on our society, both morally and socially. But, of course that's my own view which I expressed right in this room a week ago in the press conference that I held.

There was one reason for my asking you that question, beyond what we've discussed, and it is because I have reached the point of believing you will never fix the income tax; that the income tax is, in effect, an attractive nuisance, which is a very specific legal term meaning that it draws all kinds of bad things into it over time. I will say that I used to be for the flat tax, Mr. Bartlett, back in 1985, until I went through the 1985–1986 reform effort, and after that I became convinced you'll never fix the income tax. Though we shrank the amount of deductions, we did reduce the number of tax rates to two—statutorily at least. By 1990, we were already back to 3 rates, and by 1993 we were back to the 5 rates we have now. The empirical data prove that what we seem to learn from history is that we never seem to learn from history.

Now you tell me how we're going to keep an income tax, which inherently is an attractive nuisance, simple. I don't believe it's possible. I don't believe this body will pass a flat income tax without a deduction for charitable contributions and home mortgage interest. Nor do I believe that it will be able, politically, to pass a flat income tax without taxing dividends, rent, royalties, and what we call—I think inappropriately, but nevertheless—unearned income. It will not happen.

And so you are off to the races again. You planted the seed again, replanted the income tax—the roots are there and the tree is spouting even before you get out of this Committee. Inevitably you are back into all of the ramifications about how we solve this problem. That's why I asked you the question, because there is not unanimity among you as to how we solve it, and we will always have to redefine income. It is an uncertain term, and we will forever be creating inequities as we solve an inequity, and then we will have to patch that.

So, I personally believe that the right way to do this is to let people pay their taxes when they spend their money and then you have no problem with a marriage penalty. But, that's my own personal view which has been developed over the years.

Now, let me ask you all this—there are several things that are specific to this marriage penalty, and I want to ask you: under any proposal that you might be comfortable with, would there be a mar-

riage bonus? And if so, what would it be? And would that, over time, be perceived as being equitable?

Mr. BARTLETT. Well, speaking for myself, I think a case can be made for getting rid of the bonuses. I don't really see any reason as a matter of public policy why a man and a women without children who simply happen to be married should pay substantially less taxes than they would pay as singles. You'd get rid of that by going to an individual filing system.

I think when we talk about families, what we really mean are families with children, and I think you should target the tax relief to the children directly and not to the institution of marriage per se. Obviously, that's a somewhat controversial point, but I think that that's the way we ought to think about going. And I think that certainly the Weller-McIntosh bill moves a long way in that direction. But, I think it is worth noting that if you got rid of the bonuses, it's about the same in the aggregate as the penalties, so that if you went to a pure individual filing system it wouldn't really cost the treasury anything.

Chairman ARCHER. Before I move on to you, Mr. Graetz, I ask Mr. Bartlett: will the flat tax proposal that you endorse completely eliminate the marriage penalty insofar as doubling the exclusion for two people who are married compared to a single?

Mr. BARTLETT. It could easily be designed to do that.

Chairman ARCHER. No. But, let's take the Armey-Forbes approach, is it double the exclusion for a married couple compared to a single?

Mr. BARTLETT. No, I think it's more.

Chairman ARCHER. So it still has a marriage penalty. You cited that a flat tax gets rid of the marriage penalty, but their proposal does not get rid of it.

Mr. BARTLETT. Well, I would point out also that the sales tax proposal—the Schaefer-Tauzin bill, for example—also has a marriage penalty, because it has the rebate mechanism that is based on family size, based on the Census Bureau——

Chairman ARCHER. Well, of course, that is one proposal that is out there——

Mr. BARTLETT. I'm just saying that there are many marriage penalties, and you can design——

Chairman ARCHER. But certainly where all income is treated equally and you pay your taxes when you spend your money, you have no marriage penalty. All income is treated equally. You don't have to get into the definition of income.

Mr. BARTLETT. I'm just saying the rebate mechanism does, or can, create a marriage penalty, that's all.

Chairman ARCHER. But, the point I wanted to make is that there will not be an automatic elimination of the marriage penalty if you go to a flat income tax.

Mr. Graetz.

Mr. GRAETZ. Mr. Chairman, I just wanted to say a word about individual filing on a mandatory basis. That was the law before 1948. And, as you know well, what happened during the period of 1941 until 1948—which is the period when the income tax was extended to the masses because of the Second World War—is that a number of common-law States started moving to community prop-

erty. A number of States started to reverse their marital property laws which had been in place historically depending primarily on whether they had adopted the British property system or a continental system—as Texas did. You cannot have an individual filing that would not reintroduce the problem of community property and common-law States that caused such havoc in the forties. You also would introduce the prospect of tax planning by shifting the ownership of property to the low-income spouse. That is to say, if you just move some stock to the low-income spouse, then the dividends on that stock would be taxed at a lower rate than if the stock is owned by the high-income spouse.

The reason that we have a marriage bonus is that Congress decided in 1948 that the way to solve this problem under a progressive rate schedule was to give married couples the best possible split of income, which in a progressive system is to treat them as if the income came equally from each partner. I have to say, I think that marriage bonuses are much more benign than marriage penalties.

But I think that moving back toward an individual filing system is going to add complexity, in the filing of tax returns, and also in terms of family arrangements. You're going to hear from different couples than you heard from today, but I suspect you'll hear from some.

Chairman ARCHER. Well, don't you have to continue to define income and who earns the income? Now, I happen to believe that in a marriage, half of a married couple's income is earned by each spouse legally. Why should our tax laws not accept that? But then you have different laws within the States on property and you get all fouled up with the beginning point, which is who earns this income legally. That is a very difficult question to answer, and you never get away from it with an income tax.

Well, do either one of the other two of you want to comment on my initial question?

Mr. LIFSON. Well, I would say that we could agree to a method, and I would say that we could agree to a baseline. What we would have a hard time agreeing on is not elimination of the penalty, but who gets the bonus, if anybody.

But I would say as an accountant, I have listened to many enraged other accountants, quite enraged about who should get these bonuses. But I think that my fellow panelist said, it's a much more benign argument about who should receive a bonus than who should pay a penalty. The true issue is creating an equitable base line, and arguably looking at the concept about whether once you are married two of you are taxed jointly, because of your marriage, or whether you are allowed to remain an independent economic unit as so many marriages would like to remain. You can still respect and report your income jointly. And you can still tax it as if each person earns half. All of these are modest mechanical considerations that I think can be worked out. How to spend the bonus is beyond what I think we could work out.

Chairman ARCHER. Well, that's why I asked the question about the bonus. Because that is an inherent part of whatever we ultimately do.

Mr. BARTLETT. Could I just say one thing? I think that while it is very important that we have some idea of ultimately where we would like to go in terms of dealing with this problem, you can't overlook the budgetary constraints. And I just think that in the end you are going to be faced with a dilemma. You're going to have a certain pot of money, and you are going to have many competing interests, and at the end of the day you are going to have whatever: $5 billion, $10 billion, however many billion, to devote to this one problem, and you'll simply have to shoehorn some proposal that fits the numbers into it. But I would like to suggest that when the time comes that you look very carefully at the incentive effects because, as you know, the Joint Committee now has the authority to do some modified behavioral responses in terms of dynamic scoring, and it may very well make the difference between going with one approach or another that may have the same static cost but they may have quite different dynamic costs.

Chairman ARCHER. Well, I think you are absolutely correct in everything that you said. I want to highlight the end of it because when we took over as a Congressional majority 3 years ago, I pushed very hard for the Joint Committee on Taxation to begin to take into account behavioral response; they do that now, contrary to what an awful lot of people write out there. They do take into account behavioral response. What they do not, and cannot, take into account is microeconomic feedback because that is determined by CBO. The Joint Committee has really updated and modernized their estimating process, I think, to become more accurate.

Let me ask one last question. The Committee has indulged me and I apologize to the Members. The term targeting is now used more in the arena politically. You heard the President use it in his speech last night, that all tax relief should be targeted. Now, doesn't targeting, in effect, impact in a bad way on the marriage penalty?

Mr. GRAETZ. Mr. Chairman, this is a particularly complicated question because many of the new marriage penalties in the Code—and I mean the ones that are there because they have been added subsequent to the 1969 change in the rate schedule—are due to targeted provisions. For example, the reason that a married couple who are retired will pay more taxes in many instances than an unmarried couple who are retired is because of the way in which the income taxation of Social Security works. The reason that low-income workers—and I have to say, listening to the couple that was here today and the magnitude of the marriage penalties they were describing, I suspect—I don't know this because I haven't seen their returns, but I suspect—that part of the marriage tax they are talking about is because of the way the earned income tax credit works in its phaseouts. They said they made less than $10 an hour and it sounded to me like they might be in that targeted group. And here the problem, Mr. Chairman, is that many of these penalties—many of the largest of these penalties—now exist in specific provisions of the Code.

The AICPA again is to be complimented in looking for a general approach to some of these phaseouts. I have to say, I dread the thought of teaching the 1997 phaseout rules to my basic income tax

class, and I have the luxury of having Yale Law students to try and master them.

Chairman ARCHER. Well, in effect, I would synthesize what you said by saying that targeting can become a code word for greater marriage penalties and much higher complications in a Code that we say we want to simplify.

All of you are nodding your heads, and the record should show that.

I thank you very much for your testimony.

Any inquiry by other Members?

Mr. Weller.

Mr. WELLER. Again, thank you, Mr. Chairman, for your leadership by conducting this hearing. I think as we raise the profile of this issue every day we get closer to April 15, more of these 21 million married working couples are going to realize that they are paying this marriage penalty and they are going to be looking to the President and Congress to work together in a bipartisan way to solve it.

And I have a question that I would like to address to Mr. Lifson. And of course, I like your suggestion of working to make the Tax Code marriage neutral. And I appreciate your identifying 63 areas in the Tax Code where the marriage penalty exists beyond just the joint combined income situation.

As we worked on the Marriage Tax Elimination Act, and in consulting with many of your members who happen to reside in Illinois in my district and throughout the country—and of course many of them had their ideas and suggestions which produced the legislation that we have in the Marriage Tax Elimination Act—I remember one of them said—and that was just recently, in fact, I was just talking to one just this past week—he said, you know, I have a couple before me right now—we were on the telephone—and he says, this couple, I just informed them that had they stayed single, they each would have received a tax refund. But because they chose to get married, they are going to owe taxes. Clearly illustrating the problem in the marriage tax penalty.

Just from your perspective as representing a lot of the tax preparers across the country, which do you think is a higher priority: addressing the problem that comes from filing jointly with a combined income pushing you into a higher tax bracket, or eliminating those 63 targeted tax provisions, which creates 63 additional marriage tax penalties?

Mr. LIFSON. I think that in most of our discussions the easiest target, if you'll excuse the term, the easiest target for simplification is going to a single table, that is, one table for all. It has the greatest appearance of both simplification and equity to it. And neutrality, everybody pays according to one table.

I think to simply look at 1 of the 63 items is a naive approach and that you have to dig in deeper if you really want to solve the problem rather than the initial appearance of the problem. It won't take the American taxpayers long to come into my office and find out that just because it is advertised that there is now only 1 table that there aren't 60 more problems for them to think about. I think that you have to do both.

Mr. WELLER. Well, thank you.

Again, thank you, Mr. Chairman, for conducting this hearing because it does raise a very important issue that affects 21 million married, working couples across the country. And when you think about it, $1,400 on average for each of these couples is a drop in the bucket here in Washington, but for a couple back in Illinois, or any of our communities we represent, that's a year's tuition to a local community college, 3 month's worth of child care at a local daycare center, several month's worth of car payments. It means a lot. And the bottom line is we need to be working to eliminate this penalty.

Again, thank you, Mr. Chairman, for your leadership in conducting this hearing.

Mr. HERGER [presiding]. Thank you.

Mr. Feenberg, you mentioned in your testimony that you had done research on the labor market effects of restoring the two-earner deduction. I wonder if you could elaborate, that on how you feel that proposal would affect tax revenues.

Mr. FEENBERG. Our conclusion was just that the proposal would be cheaper than it looks because it lowers the marginal tax rate on a group that has relatively elastic response—elastic attachment to the labor force. There would be additional earnings from secondary earners and that would come back into the income tax and into the Social Security taxes which is just as important. And so that in the end the thing turns out to be cheaper than might look at first glance. And in particular, if you put a higher cap—$50,000 instead of $30,000—there are more people who are still at the margin, rather than receiving the capped amount, and so there is still more labor supply and that makes it even cheaper so that it dominates. That is it has a lower foregone revenue but it is better from a utility perspective from each taxpayer's point of view.

So, it's not really a statement about whether it's a good thing or a bad thing, it's just a statement that if you follow through all the effects on labor supply, it's likely to be cheaper than it looks at first glance.

Mr. HERGER. Thank you very much. I think that certainly is an important point to bring out. I appreciate your doing so in your testimony.

Mr. Hulshof will inquire.

Mr. HULSHOF. Thank you, Mr. Chairman. Just briefly, and I think each of you has mentioned in your own words that any time we talk about targeted tax relief, we are subject to budgetary constraints. Mr. Bartlett, I think you said it most forcefully at the end. And I think each of these particular provisions, whether it's Mr. Weller, Mr. McIntosh's bill; Mr. Riley, Mr. Salmon's bill, indeed even the freshmen class has a tax bill. And in our efforts to at least address the marriage tax penalty, we simply raised the deduction to twice that of what it would be for individuals. And one of the complaints of that, we understand, is for those that itemize, they would not then get that targeted tax break; even though 75 percent of the Americans in this country don't itemize.

But again, budgetary constraints being such that they are, we're looking at about $4 to $5 billion a year for that simple—and I emphasize simple—solution.

Mr. Lifson, I've had several CPAs in my district who have thanked me on behalf of their industry for what we have done with the Taxpayer Relief Act as far as job security and some of the complicating factors.

And Mr. Feenberg, this question goes to you because in your testimony you actually began to address, for example, how many additional lines it would be on certain forms because, quite frankly, even beyond the experts in the field, Mr. Lifson, from the CPAs, one of the concerns, slash complaints, I heard from constituents over the holiday was: thanks for the tax relief, but where was the simplification. So taking into account all of the measures here, Mr. Feenberg, are there certain proposals that you have considered that actually do promote simplification? I think in addition to more across the board relief for the American people, we need to look constantly at ways to simplify our present Tax Code. Which of these proposals, Mr. Feenberg, have you looked at that may be better than others as far as simplification.

Mr. FEENBERG. First of all let me say, the source for the information on how many boxes might be added to the form came from looking at State tax forms that do allow for this. And Iowa was the one I remember that had about 50 additional boxes for that; others were fewer. There is really no way around that kind of complexity, I think, if you allow for some sort of separate filing.

With respect to simplification as a way of reducing the marriage tax: Well the 63 phaseouts all go with 63 special provisions and the only way to get simplicity is to look at those provisions and see if you can do without them. We got very good results in terms of deadweight loss per dollar of foregone revenue from a relatively simple thing like the secondary earner's deduction. It doesn't devastate the law, but it's not going in the right direction, obviously, it's a small step in the wrong direction for simplification.

Mr. GRAETZ. Mr. Hulshof. If I could just add——

Mr. HULSHOF. Mr. Graetz, yes.

Mr. GRAETZ. Any time you increase the standard deduction, which as I understand it is the way you are approaching this problem, you will move people who otherwise would itemize, on to the standard deduction. And historically, this has been a very sound way of simplifying the tax law. That is, to the extent that more people don't have to keep records, and don't have to itemize their deductions, this does increase simplicity. So, I think on simplicity grounds your suggestion should get high marks.

Mr. HULSHOF. Any one else? Mr. Bartlett.

Mr. BARTLETT. I would just say that responding to Chairman Archer's point as he was leaving about targeting, is that I think targeting is a dirty word, contrary to what the President says. I think it has given us all these pernicious problems that we're dealing with here to a very large extent.

And I would emphasize what I said earlier that you should look at this whole problem with the obsession with distribution of taxation to the exclusion of every other provision. And that is basically what happened last year, as you know better than I do, is you can't give a tax cut to the rich, so we've got to put in a phaseout, and that creates additional problems and it just multiplies to the point where it becomes utterly absurd. And I would endorse Professor

Graetz's proposal that you not produce income distribution tables during the deliberation process. I realize that's probably politically impossible, but I would suggest it anyway.

Mr. HULSHOF. Well, Mr. Bartlett, let me say as my concluding thought that as a freshman Member in this body and certainly on this Committee, I probably personally have learned more in this past year than any year in my lifetime, other than the year after I got married. And it has been astounding to me in our debate on tax relief that somehow families, married couples who are successful, are demonized to some extent in the political argument and they should not be entitled to the same good policy decisions that those making less, or who aren't quite as successful. And that has been an interesting lesson to learn as a new Member.

Thank you, Mr. Chairman. I yield back whatever time I have remaining.

Mr. HERGER. Thank you very much, Mr. Hulshof.

And I want to thank our distinguished panel for their testimony.

And with that we'll move to our next panel on death taxes. And Congressman Jim McCrery, a Member of our own Committee, will be first to testify.

Mr. McCrery.

**STATEMENT OF HON. JIM MCCRERY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF LOUISIANA**

Mr. MCCRERY. Thank you, Mr. Chairman. If Chairman Archer were here, I would also thank him for the leadership that he exhibited last year in taking significant steps to lessen the burden of the estate tax, sometimes called the death tax.

And while we did some good work last year, I think there is more needed to reduce this unfair tax, especially burdensome, I think, on small businesses and family farms owned by hard working families. And eventually, Mr. Chairman, in my opinion, the estate tax should be abolished. We should not have an estate tax, and I think there are some sound reasons for that conclusion. Number one, as I said earlier, it's unfair. Number two, it discourages savings and investment. It destroys small businesses and family farms. It double taxes income. And, it doesn't provide much revenue to the Federal Government; less than 1 percent of our revenues are derived from this tax.

So, it ought to be done away with. But if we decide, for budget scoring reasons, as we did last year, that we cannot abolish the estate tax, then we ought to look at some more tinkering this year that would reduce the burden. And I think there are some ways that we can do that.

I want to suggest three ways, and I'll do these in order of priority. Number one, the family business exemption that we created last year should be increased. Simply by increasing that family business, family farm exemption, we do the most in the most efficient way to save family farms and businesses from extinction. Number two, we should consider making the unified credit a true exemption so that the lowest rate of 18 percent applies to the first dollar of value in a person's estate upon which they actually pay the tax. As you know, Mr. Chairman, now because of the unified credit the first tax rate that is applied in a taxable estate is 37 per-

cent, when we have an 18-percent rate on the books. So, that's the second thing that we ought to look at, making that a true exemption. Third, we should consider raising the unified credit. Mr. Chairman, those options are less attractive to me than abolition of the estate tax but, short of a proposal that allows us to abolish the estate tax, I think we ought to look at making adjustments in those three areas. Mr. Chairman, my full testimony is in writing, it has been presented to the Committee, and I would appreciate it submitted for the record.

[The prepared statement follows:]

**Statement of Hon. Jim McCrery, a Representative in Congress from the State of Louisiana**

Thank you Mr. Chairman for giving me the opportunity again to testify before the Committee on the estate and gift tax. Please also let me congratulate you on the leadership you showed last year in taking significant steps to reduce the burden of this unfair tax. As the author of the H.R. 1299, the Family Business Protection Act, which provided a $1.5 million exemption for family owned business, I am very pleased with the estate tax reduction in the Taxpayer Relief Act of 1997. Nevertheless, I know that you invited me here today because you understand more is needed to reduce this unfair tax, a tax especially burdensome on small businesses owned by hard working families, and that eventually, it should be eliminated.

Mr. Chairman, the death tax should be abolished because it discourages savings and investment, double taxes income, and collects minimal revenue. High estate tax rates serve to discourage savings. While we have several statutory rates for the taxation of estates, the first rate that is actually applied is 37%, then the rates go up to 55%. I doubt that many support rates of such magnitude even on the very wealthy, let alone a small businessperson who has never been guilty of conspicuous consumption, but through sound business practices has managed to build up an estate subject to the federal death tax.

The estate tax also has inordinately high compliance costs. Specifically, the National Federation of Independent Business estimated that the government and individuals collectively spend some 65 cents for each dollar of estate and gift tax collected-that's $5 to $6 billion annually-for enforcement and compliance activities. The end result of this process is for the businessperson to spend down their assets in an attempt to avoid the burden of this tax, thus depressing job creation and economic growth.

Mr. Chairman, the death tax is unfair because it taxes earnings that have already been subject to federal taxes. After all, business owners already pay income and capital gains taxes, yet when they die, they must pay taxes again.

And Mr. Chairman, despite the fact the estate tax only accounts for approximately one percent of federal revenues, eliminating the estate tax would have created salutary effects on the economy. For example, a 1996 study by the Heritage Foundation found that a repeal of the death tax would have positive effects on the American economy over a nine year period. It found that the nation's economy would average as much as $11 billion per year in extra output, an average of 145,000 additional jobs would be created, household income would rise by an average of $12 billion per year above current projections, and revenues would be recovered due to the growth generated by its abolishment. I would hope all of this evidence would lead us to conclude the death tax belongs only one place—six feet under.

Due to our scoring system, we decided abolition of the estate tax was too costly in 1997. Should we again make that determination, I believe we should make further modifications to the estate and gift tax. Many people believe only the wealthy pay estate taxes. While the affluent can afford the costs of attorneys and accountants to avoid or minimize the estate tax, the small businessperson cannot. In fact, the Internal Revenue Service reported that of the 69,772 death tax returns filed in 1995, almost 85% were for estates of $2.5 million or less. Since the unified credit has not been indexed beyond 2006, small businesses will continue to find their assets can easily exceed the threshold for taxation. Therefore, please consider the following proposals.

First, the family business exemption should be increased. As the value of the unified credit goes up, the value of the family business credit goes down so that the combined credit does not exceed $1.3 million. By 2006, the family exemption will only be $300,000. Considering the devaluation this credit will experience over the

course of ten years, many businesses may decide not to incur the costs of applying for the credit and instead continue to spend down their assets in an attempt to avoid the death tax. Increasing this exemption is the best way to save family farms and businesses from extinction.

Second, the outdated tax rate structure must be reformed. Mr. Chairman, while I am flexible in seeking these reforms, let me suggest the model set up in my legislation. According to H.R. 1299, the unified credit will be made a true exemption so that the lowest rate of 18% applies to the first dollar of value in a person's estate upon which they actually pay the tax. The rates would then be graduated, as under current law.

Lastly, we should consider raising the unified credit. If the unified credit had been indexed since 1986, it would be worth approximately $840,000 today. The unified credit will not reach that level, however, until 2003 and will continue to be undervalued when it reaches $1 million in 2006. In fact, I estimate the credit should be worth somewhere between $1.2–$1.5 million by that time. Thus, while our committee has made great strides to lower the burden of the estate and gift tax, we could do more to make the unified credit consistent with today's dollars.

While these options are not as good as abolition, and some could increase complexity, they are preferable to the status quo. Again, thank you for this opportunity to testify. I will be happy to take any questions at the appropriate time.

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Mr. HERGER. Without objection——

Mr. MCCRERY. Thank you, Mr. Chairman.

Mr. HERGER [continuing]. We'll do that. Thank you, Mr. McCrery. Mr. Cox, your testimony.

**STATEMENT OF HON. CHRISTOPHER COX, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA**

Mr. COX. I thank the Chairman and I thank the Members for focusing needed attention on this important issue. I want to commend you for your leadership in holding these hearings and I welcome the opportunity to talk about the urgent need to repeal the death tax.

We did important reform. We ameliorated, to a certain extent, the awful incidence of the death tax in the last Congress, but this tax, perhaps better than any part of the Internal Revenue Code, begs for elimination because tax simplification is all about making the system both fair, understandable on the one hand, and predictable on the other hand. The death tax is none of these things. In one fell swoop, we could get rid of over 80 pages of the Internal Revenue Code, nearly 300 pages of regulations, were we to eliminate it. But every time we change it, what happens in the real world is that small businesses have to call their lawyers, redo their estate plan, and take a look at the whole thing from key man life insurance to the way the business might be carried on in the event of partial liquidation.

It actually raises the costs of tax compliance and one of the very, very serious and pernicious aspects of this tax is not highlighted when economists tell us how much money it raises or what the cost of compliance is and that is what it costs people who are not dead or dying to prepare for that eventuality.

I just went to Sonny Bono's memorial service, as a lot of you did. He, tragically, met his death earlier than he'd expected, but we're all going to die. All of us, at some time. And so we all have to prepare for this. That's why we know that even the nominal compliance costs, the ones that economists can keep track off, by some es-

timates amount to 65 cents on every dollar that we collect. So, not only does this tax get us barely 1 percent to start with but then 65 cents out of every dollar is sucked out of the economy or sucked directly out of Federal revenues because that's what it costs to comply with the tax.

As you perhaps know, I've introduced legislation in each of the last three Congresses to kill the death tax and I'm proud to say that support has been growing ever since our colleague, Mr. Gephardt, drew attention to this tax by trying actually to increase it. Support has been growing for getting rid of it altogether. The White House Council on Small Business, which the White House itself gathers together, this is not a partisan thing, I hope, but the President of the United States and the White House, which he controls, are the ones that put the thing together. And they've made a list of over 50 important policy steps that they hope the Congress and the President will take together to protect and expand small business in America. Number four on that list is repealing this tax. Ending it, not mending it. Repealing this tax, number four on a list of over 50 that the White House Council on Small Business says is necessary for their survival.

Now, some people are going to tell you that the death tax isn't really a death tax, it's an estate tax. In fact, that's what the legal jargon is, the estate and gift tax. That, basically, this is a tax on the rich and its purpose is redistribution of wealth. It is utterly failed in that it does not redistribute wealth from rich to poor. To the contrary, it's one of the main causes of a conglomeration of wealth in America as multinational corporations, in many cases, acquire what used to be small businesses. It's one of the number one killers of small business in America.

And, furthermore, the people who pay the tax are not the rich because they can use an estate plan to either put that tax off forever or avoid it altogether. Rather, the people who pay the tax are not even the people who own small businesses or small ranches, although we hear about them a lot. They're the people who work in those operations. The incidence of this tax is greatest, heaviest, and most serious on low-wage workers in small businesses and on family farms and on ranches.

And no economic study that I've seen even attempts to quantify what it means to have a 100 percent tax when you lose your job, when you lose your livelihood. But that's what destroying a small business is all about, that's what a property tax masquerading as an income tax is all about, because that's what this is. Liquidity of the business, liquidity of the ranch, liquidity of the farm has nothing to do with whether the tax is owed. And so, given the steep rates and the fact that it's assessed on aftertax savings, aftertax values, almost always there's got to be litigation about the value of those assets which consumes more wealth and requires liquidation on the part of that business and then further liquidation in the end to satisfy the tax.

Because the American people understand how pernicious this tax is, because they understand it's not about redistribution of wealth, except to the extent that it's causing small business to go away and big business to get bigger, they've been voting to get rid of it routinely. In our State, Chairman Herger, you know that we repealed

this death tax, we repealed our inheritance taxes by an initiative vote of the people.

Now, the Los Angeles Times editorialized that this would be an extremely unpopular thing, that this would be protection for the rich, and so on, and you know what the vote was? You know what the vote of the people was? To eliminate the death tax in California? Sixty-five percent. And they didn't just eliminate the death tax. They said you can never bring this ugly thing back without another initiative of the people. Even the legislature can't do it.

I'd just like to close with a personal story about a constituent of mine who is an estate tax lawyer. One would think that perhaps the small lobby in favor of this tax would comprise chiefly people who make money from it, estate tax lawyers. Well, one person at least who is an estate tax lawyer doesn't feel that way. And he told me he could find another way to earn a living as a tax lawyer if we were to do the right thing and get rid of this tax. And he recounted to me an example, one of the reasons that he feels this way. Recently, he said, he was finishing the estate planning for one of his clients and, as he said, occasionally sadly happens in his business, that client became fatally ill. So serious was his problem that he had to go to his house and rush to his bedside. His family were all gathered there because it was clear he was slipping and on that man's last day on Earth, he spent two and a half hours with his estate lawyer who had him sign documents. And the lawyer told me that the effect of signing these documents was that the family could avoid that tax. There was no economic effect in real life, just a tax effect. And if he failed to sign the documents, then there would be a big liability and so he spent the time going over these documents with the man while his family sat outside and they missed those last hours with him because of us, because we imposed this horrible death tax. No one of our constituents, no American, should spend his or her last hours on Earth that way. This is an evil, pernicious, counterproductive assault on small business, thrift, savings, hard work and it deserves to die. I thank you.

[The prepared statement follows:]

**Statement of Hon. Christopher Cox, a Representative in Congress from the State of California**

Chairman Archer, I want to commend you for your leadership in holding these hearings today, and I welcome the opportunity to talk about the urgent need for repeal of the death tax.

Mr. Chairman, this tax raises less than 1% of federal receipts. It is not paid by the rich and those who can afford the fancy lawyers and accounts needed to legally avoid the tax. It is paid by the small businessman and the farmer and by those who work for these individuals who pay a 100% tax when they lose their jobs as businesses are liquidated.

Having introduced legislation in each of the last three Congresses to kill the death tax, I am proud to report that support has grown as the American people recognize the danger this most unfair tax poses to them and their families. They realize that the death tax is unfair, confiscatory, and contrary to the values of hard work and saving on which this country built its success. In 1993, when I first introduced the Family Heritage Preservation Act, my bill had only 29 co-sponsors in the House and had not been introduced in the Senate. Today, the same legislation is endorsed by 168 members of the House and 30 members of the Senate.

As far back as 1982, the voters of California sent this message to their state legislature when they overwhelming supported Proposition 6, which repealed the California state inheritance tax. Nearly 65% of the voters in the most populous state in the nation repealed their state inheritance tax by popular initiative. Proposition 6 not only repealed these onerous taxes, but it stipulated that the state legislature

could not reimpose this state death tax unless another popular initiative of the people instructed it to do so. Mr. Chairman, the people in my state could have tried changing the details of the law, they could have raised exemptions or lowered rates, but instead they wisely chose to do away with state death taxes completely.

Numerous states like Iowa have followed California's lead, and many other states like Pennsylvania are beginning to follow suit. Foreign nations like Israel, Australia, and Canada, which are not considered to be low-tax nations, have repealed their death taxes due to the social and economic harm they cause. I have received thousands of petitions that represent just a fraction of the millions of Americans who, like Californians in 1982, are fed up with the death tax.

Support for repealing the death tax transcends the usual boundaries that often seem to divide us. Democrat and Republican, rich and poor, white and black, people around the county want to kill the death tax. The death tax is not an issue of class warfare or left-leaning versus right-leaning economists—everyone agrees that the death tax seeks to repeal the most basic of human natures, the desire to provide for one's family and loved ones.

We are familiar with the concept of a sin tax, a government levy on goods like cigarettes and alcohol. "If we have to tax something," states the logic behind such taxes, "why not tax behavior that is damaging to society and individuals?" The death tax is the opposite of a sin tax—it is a virtue tax. Self-professed liberal scholar Edward McCaffrey labelled the death tax as a tax on virtue because it taxes exactly the kinds of behavior we consider to be virtuous and want to encourage: savings, investment, and most importantly, work.

After you have worked to put food on the table, clothes on your back and a roof over your head, the most powerful reason to continue to work is to provide for your family and those you care about. You want to work hard to make life easier for your children. Yet the death tax thwarts this basic human instinct. While you may have worked hard, taken risks, built a business, and paid your taxes, you discover that at the end of the line, Uncle Sam stands between you and your loved ones and demands up to 55% of everything you have left.

I will leave it to other witnesses here today to testify about the many economic benefits resulting from repeal of the death tax, but I want to take a moment to highlight a few of these, paying particular attention to the erroneous notion that repeal of the death tax will leave the federal government starved of revenue. When we consider the role death taxes play in tax revenues it is important to keep several points in mind:

• Death taxes collect approximately 1% of federal receipts, and one study suggests that 65 cents on every dollar is lost through enforcement, compliance and other costs. Instead of being confiscated or used to build elaborate legal devices to avoid the tax, this money would be used in an economically beneficial way by private citizens, expanding opportunity for all Americans, and therefore, the tax base for the federal government.

• The current discussion of the expected "budget surplus" indicates that we have achieved a balanced budget. Assuming this trend continues, it would more than offset any initial loss in revenue from death tax repeal.

• Repeal of the estate tax will lead to increased federal tax collections from income and payroll taxes. According to a Heritage Foundation study, repealing the death tax in 1997 would have resulted in increased annual economic growth by $11 billion, an additional 145,000 new jobs, and increased annual personal income by $8 billion each year. A retrospective study of the economy over the 20-year period from 1971 to 1991 showed that net annual federal revenues would have been *$21 billion higher* if the death tax had been repealed 20 years ago.

Some have suggested that we should again merely modify the death tax instead of repealing it outright. But this won't change the underlying incentives against hard work; it will simply add yet another layer of bureaucracy and regulation to what is already one of the most litigated and contentious areas in the entire tax code. Last year, in testimony before this Committee, one witness testified that this "mend it, don't end it" approach to the death tax would actually *add* $3 billion in new litigation and accounting costs to the current system as families and businesses try to structure their assets to meet the new standards.

We have the opportunity to simplify the tax code, to cut an entire section of the law that punishes savings and investment, punishes hard work, breaks up family businesses, and makes the next generation keep trying to climb the same rung of the economic ladder. The death tax is contrary to our principles, it is contrary to sound economic policy, and it should die.

I'd like to close with a story that illustrates that the death tax is not merely destructive but immoral. I was talking with a city council representative in one of the cities in my district. The city council is a part-time job, and this man is an estate

tax planner and a tax lawyer in his real life outside politics. He came up to me and he thanked me for my efforts to repeal the death tax and shared with me his experience as a tax lawyer. The day before, he said, he spent several hours with one of his clients on his client's deathbed. The man's family was waiting in the next room, but this dying man was forced to give up some of his last hours on earth to sign forms necessary to avoid the death tax. These papers created no new wealth, they were economically useless, except that they allowed this man's family to keep the wealth he had worked for them to have.

So this man signed the papers, but he was deprived of some of his last moments with his family. The government got no money. The tax lawyer got paid, and he came to his Congressman and complained that this is not what the government of the United States of America should do to its citizens during their final moments on Earth. I think that in this we must all agree.

The death tax deserves to die, and I thank the Committee for providing me this opportunity to testify.

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Mr. HERGER. Thank you very much, Mr. McCrery, and thank you for your work, Mr. Cox. I thank you both for your past legislation in this area of which I've been a cosponsor in the last several Congresses. Mr. Cox, your story reminds me of an example as well.

I'm from an agricultural community just north of Sacramento in Northern California and from an agricultural family. And I remember, in my office, not that many years ago, a family came in to talk to me and to discuss their individual situation in which this lady's father, who had farmed in our area and who I knew, grew up with, and knew all my life, explained to me the frugality of their family, which I already knew, and the fact that he had even saved money up and his ranch was debt-free. He had money, a seemingly substantial amount, in the bank to take care of the death tax. Yet, it was not nearly enough, and they were forced to sell this ranch that had been in the family since about the turn of the century. They were forced to sell it just to pay the death taxes. And, as I know you know and I certainly know, this is just one of many examples, not only on farms but on small businesses. No, you're absolutely right, this is a tax that, in my opinion should be done away with. I thank you very much.

Yes, Mr. Collins.

Mr. COLLINS. Thank you, Mr. Herger. Mr. Cox, you made a statement there that you know that a lot of family-owned businesses, small businesses are selling their businesses to conglomerates in order to avoid the death tax. Would you go into a little more depth of why?

Mr. COX. As I alluded to, the death tax which can exceed 50 percent, is imposed irrespective of whether there's any money in the business that is closely held or the farm that is closely held or the ranch that is closely held by the person who died. And so, you have to pay the tax somehow and that means you have to sell off whatever you've got. You might need to sell off the assets of the business but you might also need to sell off your house. I mean, the tax does not care whether it's a personal heirloom. Sell it. There is no quarter given by the death tax.

Mr. COLLINS. Yes, maybe I should just give you an opinion that I have as to why this may be occurring. Simply the tax rates themselves. If you wait and die, your estate is going to pay 55 percent, but if you sell, then you pay on the gain of that sale at a much

less or a much lower rate. And, too, oftentimes when a business is passed on due to the death of the principal owner, there is a tendency for that small business to fail because of the tax liability. It will exist because of the value of that estate, which often leads, as you say again, to a sale. But also, when the principal owner dies and money has to be borrowed to either pay the tax or to continue the operation of that business once the tax liability is met, it prevents the heirs from having the same financial status that the principal had; interfering with their ability to borrow funds to continue the operation of that business. So, I think that it is often the cause of the sale of a business. I do know that it is occurring and I do know that there are a lot of small businessmen who carry a tremendous amount of life insurance in hopes that they will be able to meet that liability and continue the operation of that business after it is passed to the next generation. I'm one of them. Thank you.

Chairman ARCHER [presiding]. The Chair would advise the remaining Members in the room that we have a vote on and that we have about 3 minutes left to vote so the Committee will stand in recess until after this vote. Hopefully 15 minutes from now or maybe less we will continue with our next panel. Thank you.

[Recess.]

Mr. HERGER [presiding]. We'll now reconvene our next panel on death taxes. First on the panel will be a brother and sister, Christopher Clements and Kimberly Clements, whom we will allow Mr. Hayworth to introduce in just a minute. Also, Richard Forrestel, Jr., Carl B. Loop, Jr., and Harold I. Apolinsky.

Mr. Hayworth, would you like to introduce your constituents?

Mr. HAYWORTH. Thank you, Mr. Chairman. Ladies and Gentlemen, I'm very pleased to introduce to my colleagues here on the Ways and Means Committee, Christopher and Kimberly Clements of Tucson, Arizona. Chris and Kim are the children of the last William M. "Bill" Clements, the owner of Golden Eagle Distributors, a beer wholesaler based in Tucson. Golden Eagle also has several facilities throughout Arizona's sixth district, including Casa Grande, Globe, Holbrook and Flagstaff. Bill Clements died unexpectedly, following a 2-month battle with cancer, and Chris and Kim will share with the Committee their experience with the death tax upon inheriting and keeping Golden Eagle Distributors. Thank you, Mr. Chairman.

Mr. HERGER. Thank you, Mr. Hayworth.

Kimberly, would you like to begin?

## STATEMENT OF CHRISTOPHER AND KIMBERLY CLEMENTS, GOLDEN EAGLE DISTRIBUTORS, INC., TUCSON, ARIZONA; ON BEHALF OF THE NATIONAL BEER WHOLESALERS ASSOCIATION

Ms. KIMBERLY CLEMENTS. Thank you, Congressman Hayworth and Mr. Chairman. Ladies and Gentlemen of the Committee, it is an honor for my brother, Christopher, and I to be testifying here today on the Federal estate tax. My name is Kimberly Clements and my brother and I are the third generation owners of Golden Eagle Distributors, Inc., headquartered in Tucson, Arizona.

Golden Eagle is an Anheuser-Busch beer wholesalership which just celebrated 50 years of doing business in the State. Unfortunately, this anniversary was not shared with the one who was responsible for the company's success. Three years ago, our father, William M. Clements, passed away after a brief but courageous bout with cancer. This left my mother, Virginia, my brother and I the task and responsibility of continuing our father's work in the community as well as in our industry.

If there was one thing that Chris and I learned from our father, it was commitment. In 1976, our tiny company with just a handful of employees was faced with a national brewery strike. Dad made a lot of sacrifices, but he never laid off one employee. Now, 22 years later, Chris and I are directly responsible for over 260 employees and their families. Our company has grown substantially because we have continuously reinvested dollars back into the business by building new warehouses, adding to our fleet, developing new departments, and, most of all, hiring more employees.

The most significant contributors in Tucson do not come from multinational corporations. They come from independent family businesses; the restaurants, the corner markets. And Golden Eagle is no exception. These businesses know the value of giving back to the community. These businesses know that value of family and its importance in today's society.

In a Congress that is deemed profamily, it has not fully recognized the unique nature of the family business. Golden Eagle Distributors is the core of the Clements family. It is what we have rallied around following the death of our father, knowing that the business is the family legacy.

When Dad died, there were so many questions that were asked not only to one another, but by our employees and by members of our community. What will happen to Golden Eagle Distributors? Thankfully, our estate plan was barely completed 6 months prior to his death. If we hadn't been prepared, the financial as well as emotional effects on the family and on our community would have been devastating.

Mr. CLEMENTS. Mr. Chairman, Ladies and Gentlemen of the Committee, this is the real impact of the Federal estate tax. It devastates families, businesses, and communities. The death tax barely comprises 1 percent of all Federal tax revenue yet its overall effect is much more far reaching.

My sister and I, quite frankly, are some of the lucky ones. We had a father who saw fit to plan accordingly to protect his family, his employees, and his community from the greed of the government. I say greed because much of our business has been taxed and over taxed already. The motions and moneys families must endure to protect themselves and their businesses from the government are well-documented. Lawyers, accountants, and open-handed insurance representatives are paid thousands of dollars to set up the trusts, the wills, the funds to pay the death tax. Our father was no exception, but at what cost? Certainly, these moneys could have been used more productively and invested back into our business and its employees.

Although this Congress saw fit to raise the death tax exemption levels in this year's budget agreement, it did little to calm the fears

and concerns of family businesses. In fact, the current legislation that attempts to give added relief to family businesses does not assist the majority of medium to large family businesses. These new laws are a pittance and fail to address the large amounts of capital the majority of family businesses have invested directly in their buildings, their inventories, their employees, capital that almost certainly would not meet the current or future exemption levels.

For example, in the coming year, Golden Eagle plans to invest in its Tucson operations well over $1 million in capital and human resource improvements. These expenditures are necessary in order to remain competitive in an already cutthroat business environment. The death tax exemption levels passed by this Congress would not even account for the inventory in our warehouse. However, the more insulting aspect of the death tax is the fact that the Federal Government offers families the privilege to pay the tax in installments over 14 years and charges them interest to do so, essentially taxing an already unfair tax.

Our own Arizona Senator, John Kyl, and his esteemed colleague, Congressman Chris Cox, who you heard from today, have the correct approach to the death tax. Do away with it. Indeed, according to a recent article in Insight magazine, if the death tax were eliminated, the U.S. economy would be producing $79.2 billion more in annual output and creating 228,000 more jobs a year.

Obviously, eliminating the death tax is not a completely realistic expectation for this Congress. Therefore, Mr. Chairman, we hope that you and your colleague will consider recognizing the unique nature of the family business, and exempt from the death tax those closely held by 50 percent or more of family members. It is time to lift this incredible burden from the families of America. It is time to recognize America's greatest resources: the entrepreneur, the philanthropist, the risk-taker. A family businessowner is all these things and more. We know. We learned from the best.

We thank the Chairman and the Committee for the opportunity to share our views on this vital, comprehensive issue and look forward to progressive steps to alleviate this unfair tax on American family businesses. Thank you very much.

[The prepared statement and attachments follow. Attachments are being retained in the Committee files.]

**Statement of Christopher and Kimberly Clements, Golden Eagle Distributors, Inc., Tucson, Arizona; on behalf of the National Beer Wholesalers Association**

Mr. Chairman, ladies and gentlemen of the Committee, we are very privileged and honored to address you today for not only ourselves, but also for beer wholesalers across the country who belong to the National Beer Wholesalers Association. We hope we will answer some pressing questions regarding the inequity of the death tax.

Why should a person build a business in America? Why should a person sacrifice everything to run the risk of having his or her livelihood taken away from his or her family?

It seems a silly question, but it is asked more frequently than many people think. This is the dilemma the American entrepreneur faces today—to invest capital in his or her company and community, and risk its future if anything were to befall him or her.

The vision of our Founding Fathers was simple enough—that all Americans should reap the fruits of their labor—that the right to life, liberty, and property is sacred and divined by God.

Hundreds of thousands of immigrants come to the United States every year fleeing from the tyranny of non-democratic regimes, from poverty, from terrorism. Whatever the reasons, people come with the thought that the United States will give them the inalienable freedoms of life, liberty, and property.

Many start families, begin businesses, work hard, and see their lives grow.

However, the thought that the government, over time, could take away all that they have built is unconscionable to many immigrants and, indeed, to many Americans who have been here for generations.

Today in America, without "proper planning"—which usually entails the investment of numerous resources in the guise of accountants, lawyers, and wayward insurance salespeople—a family can see their business and livelihood stripped away by the most destructive tax created—the estate tax (or now commonly known as the death tax.

The family entrepreneur, who puts his good name and reputation on the line to create jobs and wealth for his loved ones and his community, is one of America's greatest resources. Yet, if this vital resource fails to protect his family from the government to which he provided countless tax revenues and the creation of innumerable jobs, he may find that upon his passing that his family is forced to sell their life's work to pay the government again.

The greatest misperception about death taxes is that they only affect the very rich. However, death and taxes do not discriminate. Death taxes are hardest on the small farmer, the independent shopkeeper, the restauranteur, and the beer wholesaler—small business people with families and strong ties to the communities they serve.

In fact, a recent study reported that "nine out of 10 family businesses that failed within three years of the principal owner's death said that trouble paying estate taxes contributed to their companies' demise."

Mr. Chairman, our family is one of the lucky ones.

We had a father who planned properly and who allocated the appropriate resources to make sure his family, his employees, and his community would be well protected.

Yet who would have known?

Who would have known that during the Christmas of 1994, our father, William M. "Bill" Clements, an entrepreneur and philanthropist, would be driving down the street and suddenly be unable to see? Who would have known that subsequent tests and diagnoses would discover cancer throughout his body? Who would have known that two arduous months later he would leave a wife, two children, a business, and a community wondering...?

What is next?

To understand the answer to this question, we would like to share with the committee how far our family business has come and where it has yet to go.

In 1941, our grandfather, Dudley M. Clements, founded All American Distributing Co., which was a wholesale liquor operation in Phoenix, Arizona. Dudley, a banker by trade, was raised in Casa Grande, Arizona. His father, William Preston "W.P." Clements, was a banker and rancher. W.P. also served as mayor of Casa Grande back in the early 1900s.

They raised Dudley with a strict work ethic and he survived much of the depression by working in Idaho as head of the new state liquor board, which was formed following the repeal of prohibition. His son, Bill, was born April 29, 1936, in Boise, Idaho. After a brief move to New York City following Bill's birth, Dudley along with wife, Patricia, and son moved to Arizona.

Several partners joined to form All American Distributing. One of the more notable partners was the cinema singing cowboy, Gene Autrey. During that time, Arizona was a growing state and business was good. Over the years, All American grew from a small wholesaler with a limited portfolio of products into a large supplier of beers, wines, whiskeys, and scotches. Over time, the business even expanded to several different markets including Casa Grande, Globe, Flagstaff, Holbrook, and Tucson.

In 1956, August A. Busch, Jr., Chairman of Anheuser-Busch (A.B.) and affectionately known as "Gussy," called our grandfather to ask a seemingly simple question, but one with extensive implications.

Would Dudley handle Budweiser?

Our grandfather was skeptical. Back then, Budweiser was a regional brand known primarily in the Midwest and in the East. Schlitz, A–1, and Coors were the big brands in Arizona, with Budweiser merely an afterthought. Nevertheless, several of grandfather's key managers prodded him, and All American began to distribute Budweiser in Tucson, Casa Grande, Globe, and parts of Phoenix.

At that time, our father, Bill, was in college at the University of Washington, playing football and majoring in engineering. With all those activities, he had practically no interest in entering the family business.

After graduation, a degree in engineering brought many opportunities. In fact, Dad furthered his education and received a Ph.D. in Environmental Engineering from the University of California at Berkeley. He stayed in the San Francisco Bay area and eventually started his own firm. Much of his work involved the military and the National Aeronautical Space Administration (NASA). At one point, he was designing air flow specifications for spacecraft and consulting with the Defense Intelligence Agency (D.I.A.).

Government projects began to dry up in 1967, when President Lyndon B. Johnson successfully moved many contracts out of California and into his native state of Texas. Dad was left contemplating his future. As it turned out, back at All American, Anheuser-Busch began to inquire about the status of Dudley's son.

A.B. wanted a succession plan for the family.

Sensing the long-term stability and profitability in the wholesale business, Dad returned to Phoenix with his new wife, Virginia, and worked alongside his father. He worked hard to learn the wholesale business, which was no easy task since he had no formal experience or training. Moreover, his father was very strict with him, holding him to higher expectations than his other employees. Despite his doctorate, his father expected him to perform even the most menial tasks, like scrubbing floors. But Dad persevered and came to know the business from the ground up.

After several years, market pressures finally forced our grandfather to separate the liquor and the Budweiser side of business. Budweiser, along with Anheuser-Busch's other brands, had grown and deserved more attention. Consequently, Dad, Mom, and the two of us moved to Tucson to open the corporate headquarters for our new company.

So, in the spring of 1974, Golden Eagle Distributors, an exclusive distributor of Anheuser-Busch products was born.

The first few years in Tucson were difficult. Budweiser held a market share of less than 10 percent and, for a while, Golden Eagle destroyed more beer than it sold.

In 1976, a national brewery strike nearly crippled the company. Dad dug deep into his own pockets and borrowed to keep the company afloat. He lost nearly 18 months of profits but never laid off one employee. It was this type of commitment to his company that would endear his employees to him for years to come.

The strike soon ended and Golden Eagle finally had the freedom to grow. Between 1977 and 1984, Golden Eagle saw incredible change, including the proliferation of new brands like Natural Light and Michelob Light. In 1981, Tucson was the number one test market for a risky excursion in the light beer category, Budweiser Light.

With the new growth, our company created new departments and new job opportunities. Golden Eagle added an in-house Marketing Department (one of the first of its kind in the nation). Chain stores began to demand more attention, so Golden Eagle established a National Account Representative position to better serve local buyers. Growth in computer technology mandated the development of an in-house Data Processing Department that continues to change and evolve with the needs of the business. With more employees, human resource management became a priority and our company established a Vice President of Human Resources.

Through it all, Dad felt that it was imperative to give back to the community of Tucson and the cities of the surrounding branches for all he had received. He embraced *countless* community projects and donated his time and money to worthy causes. From Chairman of the United Way, to the Boy Scouts of America, to the Copper Bowl Foundation, to creating the Greater Tucson Economic Council—Bill Clements was a man who could never say "no" to anyone who asked for help. In addition, he was politically active and a close friend and confidant to many past and current members of this Congress. Not surprisingly, this legacy of duty to others continues to grow, both in ourselves and in our company.

On February 23, 1995, our father died unexpectedly after a brief yet valiant bout with cancer. He was 58.

At that time, we were both forced to forgo many training steps we would normally take and assume executive positions in the company. Currently, we are working to be recognized by Anheuser-Busch as Equity and Successor Managers of the company.

Luck, and extensive and expensive estate planning, has allowed Golden Eagle Distributors to survive. Indeed, with the unprecedented growth in the business over the past twenty years, we are extremely fortunate that Dad foresaw the need to protect what he had built.

Yet at what cost?

Thousands of dollars were spent to hire lawyers, accountants, and insurance people to draw up trusts, wills, and accounts to protect the fruits of Dad's labor. Congress making changes to the already complicated tax laws forced Dad to frequently reevaluate our company's plan. Ironically, he finished the final arrangements in our family's estate plan barely six months before his death.

Golden Eagle could have better used these "necessary" resources in the business for new salespeople, more trucks, better benefits, etc. In other words, we could have reinvested them in people.

It was hard work, sacrifice, perseverance, and faith in people that allowed our father to be successful. Dad, however, knew that success in America carried with it a terrible price. We are lucky that all these measures were in place and that our company did not have to be sold to satisfy the I.R.S. Hundreds of jobs would have been lost and countless lives devastated.

Thankfully, estate tax planning usually provides for no taxes due when the first spouse dies. However, at the death of the surviving spouse, it becomes very difficult and complicated to keep control of a family business for the next generation due to the heavy burden imposed by death taxes.

Today, nearly three years following the death of our father, Golden Eagle is still a growing company forged by a vision of teamwork, fairness, and duty.

Golden Eagle is a company of 242 employees across Arizona with annual wages and benefits of $10.3 million. It paid $3.1 million in state luxury taxes and purchased $5.3 million goods and services. Golden Eagle employees participate i funds from the corporation. Our health plan is one of the finest in the industry with employees able to choose almost any doctor they want.

All of this viable economic activity takes place in six separate counties statewide—communities that would be severely affected if the company ever had to be sold to satisfy the greed of the federal government.

There is a misconception in Washington, D.C., about how family businesses operate. Many government bureaucrats, who have never invested a lifetime in building a future for a family and a community, see family businesses as cash rich and easily able to pay the whopping 55 percent death tax levy.

However, the vast majority of families who own a business have capital tied up directly in the operation. Not only in the plant(s) and equipment, but in the lives of its employees. Golden Eagle, for example, has capital tied up in the education of salesman Orlando Iosue's children and in driver Rudy Duarte's new marriage. While tangible items may be easily sold, it is the human capital that is the most precious and the most fragile.

We are thankful that this Congress saw fit to pass new laws friendly to family businesses. Many in Congress, to their credit, attempted to alleviate the death tax burden by increasing the exemption levels from $600,000 to $1 million by the year 2006 in the last budget agreement.

Unfortunately, these new increases in the unified credit do little for the majority of family businesses. In fact, none of the provisions, including those specifically targeted to family-owned and operated businesses, provide significant help for medium to large family businesses. Moreover, they are very complex to implement for small family-owned businesses.

Further, although the current law provides for installments of 14 years to pay off a levied death tax, the government charges interest for this "privilege." Although Congress reduced the rate from four percent to two percent, expecting a family that has paid countless taxes over the life of a business to pay interest to the government when a loved one dies is ridiculous. This interest payment is not even deductible for estate or income tax purposes.

Again, an entrepreneur may have a net worth near or upwards of this amount, but most often his capital is tied up in nurturing his business. We think Senator Jon Kyl from Arizona and Congressman Christopher Cox from California have the correct approach to the death tax dilemma—do away with it! Mr. Chairman, we also know that if you had your way, this would be your solution as well.

According to a recent Insight magazine article on the nation's growing tax burden, if the death tax were eliminated, "the U.S. economy would be producing $79.2 billion more in annual output and creating 228,000 more new jobs a year." This is growing evidence that the tax revenue gained from the increase in Gross Domestic Product (GDP) and jobs would be enough to offset the elimination of the death tax.

Understandably, the thought of completely eliminating the death tax may not be completely realistic for this Congress. Therefore, it is important that Members of Congress continue to recognize the unique nature of the family-owned business and consider exempting from the death tax a family business that is closely held by 50 percent or more by family members. As you know, the current laws provide some help for these types of businesses, but fall well short of eliminating the tax.

Mr. Chairman, ladies and gentlemen of the Committee, the death tax is an injustice to American working families who have risked everything to make a business grow and create opportunities for their employees and communities. It is especially unfair to the smallest of businesses for they do not have the resources to set up the trusts, the accounts, and the wills to protect themselves from the death tax.

It is time to lift this burden from the hundreds of thousands of family businesses in this country. Let us begin to protect one of America's greatest resources—the entrepreneur, the risk taker, the provider, the community leader, the philanthropist. A family business owner is all these things, and more. We know—we learned from one of the best.

Why should a person build a business in America? To perpetuate it. To make it grow. To keep it through the generations. To provide opportunity for its employees and the community.

We are committed to sending the message for those who might not have a voice. We hope that other wholesalers and all closely held family businesses would see fit to rally behind this important cause and give it the support it deserves.

We thank the Chairman and the Committee members for the opportunity to address this vitally important issue and look forward to progressive steps to alleviate this unfair burden on American family businesses.

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Mr. HERGER Thank you, Mr. Clements. We'll now hear from Richard Forrestel, Jr., treasurer, Cold Spring Construction Co., Akron, New York, on behalf of the Associated General Contractors of America.

Mr. Forrestel.

**STATEMENT OF RICHARD FORRESTEL, JR., TREASURER, COLD SPRING CONSTRUCTION COMPANY, AKRON, NEW YORK, ON BEHALF OF ASSOCIATED GENERAL CONTRACTORS OF AMERICA**

Mr. FORRESTEL. Thank you and good afternoon. I am Richard Forrestel, Jr., a CPA and treasurer of Cold Spring Construction Company based in Akron, New York. I would like to thank Chairman Archer and the other Members of this distinguished Committee for the opportunity to discuss the devastating impact of the Federal estate tax, or death tax, on family-owned businesses. I am testifying on behalf of the Associated General Contractors of America, AGC, a national trade association representing more than 33,000 firms, including 7,500 of America's general contracting firms. AGC is the voice of the construction industry.

While AGC's membership is diverse, the majority of AGC firms are closely held businesses, like our own. AGC member firms are 94 percent closely held, 81 percent are owned by fewer than four persons, and over 80 percent are small businesses with an average construction project under $5 million.

Cold Spring was founded by Grandpa in 1911. We are a closely held, family-owned construction firm that specializes in highway and bridge construction. Our projects range in size from $1 million to $30 million. Dad and his brother, Uncle Tom, both entered the business after serving our country in World War II and worked together until Uncle Tom died in 1977. Dad, our chief executive officer, still remains very active today. In addition, my brother Steve, our president, and my brother Andrew, our vice president, are actively involved in managing the business. We have eight siblings who are not involved in Cold Spring, although each worked for

Cold Spring every summer to pay for college, as did 12 of my first cousins.

Congress needs to be reminded that Americans are smart people. When faced with an onerous tax like the death tax, family held businesses have been forced to jump through numerous, peculiar, and sometimes ridiculous tax hoops to ensure the livelihood and continuation of their family businesses.

I began working for Cold Spring in 1975 and would like to describe some of the estate planning techniques we have employed in our battle to save our family business. Uncle Tom died at the young age of 49 in 1977. At the time, both he and Dad owned half the business. Subsequent to Uncle Tom's death, Dad negotiated with Aunt Jo and bought Uncle Tom's stock in the company. This transaction was completed in 1979.

In 1980, Dad found himself with a potentially nasty estate tax problem brewing. Cold Spring did an estate freeze and created a preferred class of stock. In addition, a nonvoting common stock was created. Dad and Mom then began to gift the voting stock to the three of us involved in the business and the nonvoting stock to our eight siblings not involved in the business. Dad and Mom both used their unified credits to expedite the gifting. They brought their 11 children together in 1987 and told them of the gifting program. One of our sisters suggested that we have the option to call their nonvoting stock at some future date. This stock was called in the early nineties. As Dad approached 70, he felt it was necessary to create some immediate liquidity in his estate and the corporation redeemed his preferred stock.

In 1980, Cold Spring bought a large life insurance policy on Dad's life. The reason for this purchase was to create liquidity in Dad's estate in the event of his demise. Cold Spring still maintains the policy on Dad along with policies on Steve, Andy, and me. More than $2 million has been paid in life insurance premiums since 1980 on these policies. The primary purpose of these, of course, is to ensure liquidity in our various estates to pay for estate taxes. In addition, Cold Spring has spent more than $2 million since 1980 redeeming stock from various shareholders. Again, these transactions were driven by estate taxes.

Cold Spring missed a glorious planning opportunity in 1986 to become an S corporation when it found itself with three classes of stock. Those three classes of stock existed because of estate taxes.

Chairman Archer, I have hit the highlights as to the hoops Cold Spring has jumped through to provide for a fourth generation in our family business. We have diverted enormous amounts of capital and management time to this process. We ought to be buying bulldozers and backhoes built in Peoria, Illinois, rather than intangible life insurance policies. We should also be providing long-term security for our employees. I believe the country and our company would be better served had these capital and intellectual diversions not been necessary.

I appreciate the efforts made by this Committee in attempting to provide some estate tax relief to family-owned businesses as part of the 1997 Act. However, Congress needs to do much, much more to help the family-owned businesses threatened by the estate tax. AGC ultimately supports repeal. Short of full repeal, AGC supports

every effort to reduce the impact of estate taxes on family-owned businesses so that they may survive to the next generation. I urge you to include estate tax repeal or large-scale estate tax relief in any upcoming bill. Thank you.

[The prepared statement follows:]

**Statement of Richard Forrestel, Jr., Treasurer, Cold Spring Construction Company, Akron, New York, on behalf of Associated General Contractors of America**

I am Richard Forrestel, Jr., a CPA and Treasurer of Cold Spring Construction, based in Akron, New York.

I would like to thank Chairman Archer and other members of this distinguished Committee for the opportunity to discuss the devastating impact of the federal estate tax, or the death tax as we often refer to it, on family-owned businesses.

I am testifying on behalf of the Associated General Contractors of America, a national trade association representing more than 33,000 firms, including 7,500 of America's leading general contracting firms. They are engaged in the construction of the nation's commercial buildings, shopping centers, factories, warehouses, highways, bridges, tunnels, airports, waterworks facilities, waste treatment facilities, dams, water conservation projects, defense facilities, multi-family housing projects, and site preparation/utilities installation for housing developments.

While AGC's membership is diverse, the majority of AGC firms are closely-held businesses like my own. AGC member firms are 94% closely-held, 81% are owned by fewer than four persons, and over 80% are small businesses with an average construction project size under $5 million.

Please note that the survey data mentioned in my testimony is drawn from the 1997 AGC/Deloitte and Touche Insights in Construction Survey and the 1995 Center for the Study of Taxation Federal Estate Tax Impact Survey.

I. WHAT THE DEATH TAX HAS MEANT TO MY FAMILY

Cold Spring Construction Company was founded by Grandpa in 1911. We are a closely-held, family-owned construction firm that specializes in highway and bridge construction. Our projects range in size from $1 million to $30 million. Dad and his brother, Uncle Tom, both entered the business after serving our country in World War II and worked together until Uncle Tom died in 1977. Dad (C.E.O.) still remains very active in the business today. In addition, my brothers Steve (President) and Andy (Vice President) are actively involved in managing the business today. We have eight siblings who are not involved in Cold Spring, although each worked for Cold Spring every summer to pay for college, as did 12 of my first cousins.

Congress needs to be reminded that Americans are smart people. When faced with an onerous tax like the death tax, family-held businesses have been forced to jump through numerous, peculiar, and sometimes ridiculous, tax hoops to ensure the livelihood and continuation of their family businesses.

I began working for Cold Spring in 1975 and would like to describe some of the estate tax planning techniques we have employed in our battle to save our family business. Uncle Tom died at the young age of 49, in 1977. At the time, both he and Dad owned 50% of the business. Subsequent to Uncle Tom's death, Dad negotiated with Aunt Jo and bought Uncle Tom's stock in the company. This transaction was completed in 1979.

In 1980 Dad found himself with a potentially nasty estate tax problem brewing. Cold Spring did an estate freeze and created a preferred class of stock. In addition, a non-voting common stock was created. Dad and Mom then began to gift the voting stock to the three of us involved in the business and the non-voting stock to our eight siblings not involved in the business. Dad and Mom both used their unified credits to expedite the gifting. They brought their eleven children together in 1987 and told them of the gifting program. One of our sisters suggested that we have the option to "call" their non-voting stock at some future date. This stock was called in the early 1990's. As Dad approached 70, he felt it was necessary to create some immediate liquidity in his estate and the corporation redeemed his preferred stock.

In 1980 Cold Spring bought a large insurance policy on Dad's life. The reason for this purchase was to create liquidity in Dad's estate in the event of his demise. Cold Spring still maintains that policy on Dad today along with life insurance policies on Steve, Andy, and me. More than $2 million has been paid in insurance premiums since 1980 on these policies—the primary purpose of these is, of course, to ensure liquidity in our various estates to pay for estate taxes. In addition, Cold Spring has

also spent more than $2 million since 1980 in redeeming stock from various shareholders. Again, these transactions were driven by estate taxes.

Cold Spring missed a glorious planning opportunity in 1986 to become an S Corporation when it found itself with three classes of stock. Those three classes of stock existed because of estate taxes.

Chairman Archer, I have hit the highlights as to the hoops Cold Spring has jumped through to provide for a fourth generation in our family business. We have diverted enormous amounts of capital and management time to this process. We ought to be buying bulldozers and backhoes built in Peoria, Illinois rather than wasting capital on intangible life insurance policies. We should also be providing long-term job security for our employees. I believe the country and our company would be better served had these capital and intellectual diversions not been necessary.

## II. What the Death Tax Means to All Family-Owned Construction Firms

The federal estate tax is one of the most onerous obstacles to business continuity and growth. When the owner of a family business dies, his or her estate is subject to federal and state estate taxes. The total value of the estate includes the value of the family business along with other assets such as homes, cash, stocks and bonds. Currently, an estate over $625,000 is subject to the federal estate tax, and an estate over $3 million will be taxed at an astronomical 55% rate. This unfair tax is on top of the income, business, property, sales and capital gains taxes that have been paid on these same assets over a lifetime. This is double taxation of the worst kind.

Even the smallest contractor has lifetime capital assets, property, real estate and insurance over $625,000. Most family-owned construction firms invest a significant portion of their after-tax profits in equipment, facilities, and working capital. This is necessary for these firms to increase their net worth, create jobs, and continue to be bonded for larger projects.

Accordingly, the burden of the federal estate tax falls squarely on family-owned businesses, such as my own. The result is that many of these family-owned business must be sold, downsized, or liquidated just to pay the estate tax.

Please allow me to tell you about several ways that the estate tax impacts small family-owned construction firms—focusing on business continuity, cost of estate planning, job destruction, and the human toll.

### *Business Continuity*

It is part of the American Dream to create a prosperous business and to pass that success on to future generations. Business continuity—the passing of years of hard work to the next generation—is a great concern to most family-owned businesses. Unfortunately, more than 70% of family businesses do not succeed to the second generation and 87% do not survive to the third generation. Furthermore, it is estimated that 90% of family businesses that fail shortly after the death of the founder fail because of the estate tax burden placed on family members.

This is especially true in the case of capital-intensive industries such as construction. In a recent survey, 62% of AGC's membership said that the federal estate tax would make it significantly more difficult for the business to survive the death of the principle owner. For a business like Cold Spring, the federal estate tax and other tax considerations of passing a business to the next generation are an overwhelming obstacle.

### *Cost of Estate Planning*

Let me state for the record, I am fortunate as a CPA to have a grasp of the impact of the death tax on our business. However, most of my colleagues in family-owned construction firms do not have an accounting background. More importantly, many construction firms do not have a CFO or in-house accountant. Remember, our goal is to construct buildings, bridges and highways. You can only imagine the frustration I share with my colleagues in the construction industry when we are confronted with the intricacies of the Internal Revenue Code. The current tax code, and particularly the estate tax, is so difficult to understand that most construction firms, notably smaller firms, are forced to hire costly outside accounting and legal advisors for estate planning.

Those family-owned businesses that do survive to the next generation have spent thousands, sometimes millions of dollars, on estate planning so they are capable of paying the estate tax. Please note that I said to pay the tax, not to avoid the tax. Of AGC firms involved in estate planning, 63% purchase life insurance, 44% have buy/sell agreements and 29% provide lifetime gifts of stock. Again, allow me to use

Cold Spring as a family-owned business example. We spend in excess of $100,000 a year in insurance costs and accounting fees to ensure that we have the capital to pay the estate tax and transfer our business from one generation to the next.

These finances are being diverted from useful means that could support firms like mine in becoming more efficient and creating jobs. In fact, it is not unusual for contractors to forgo new equipment, manpower, and technology to plan for estate taxes. This monetary cost is in addition to the valuable time spent by family-owned business owners on estate planning, which would be better spent managing their companies so they are able to better compete in the marketplace.

*Job Destruction*

The estate tax not only affects the business owner, but also his or her employees. The Center for the Study of Taxation found that family-owned businesses created 78% of all new jobs in the United States from 1977 to 1990. In fact, AGC's family-owned firms employ on average 40 persons and have created on average 12 new jobs each in the last five years. At Cold Spring we help support 150 families through employment. The estate tax, however, can destroy these jobs because firms are often forced to sell, downsize or liquidate to pay this onerous tax. On average, 46 workers lose their jobs every time a family-owned business closes. Finally, let us not forget the impact that these family-owned businesses have on their immediate community. These family-owned businesses not only offer jobs, but they are also a vital part of every community providing specialized services, supporting local charities, and returning earnings back to the local economy.

*The Human Toll*

It has been said that, "At birth you get a certificate...at marriage you get a license...at death you get a bill." That is the human side of the estate tax. Little needs to be said of the immense grief of the passing of a loved one. However, I do not believe that the fear of losing one's business should be any part of mourning the passing of a parent or sibling. Making a decision on the future of a family-owned business includes generations of hopes and dreams of your family, as well as your employees. The estate tax has a toll—it hits when families are most in turmoil, especially owners of small family-owned businesses.

III. PROVIDE DEATH TAX RELIEF NOW

I appreciate the efforts made by this committee in lowering the estate tax as part of the Taxpayer Relief Act of 1997. I also understand that numerous pieces of legislation have been introduced in the 105th Congress that would repeal or reform estate taxes. However, Congress needs to do much more to help the growing number of family-owned businesses facing the estate tax. AGC ultimately supports repeal of the federal estate tax. Short of full repeal, AGC supports every effort to reduce the impact of estate taxes on family-owned businesses so they may survive to the next generation. I urge you to include estate tax repeal or large-scale estate tax rate relief in any upcoming tax bill. This issue continues to loom over employers and their employees on a daily basis.

Thank you for the opportunity to speak to you about this important issue. I will be happy to answer any questions.

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Chairman ARCHER [presiding]. Thank you, Mr. Forrestel. Let me just quickly interject, before I recognize Mr. Loop, that no, we have not done enough, but we should never forget the dramatic change for improvement rather than disimprovement that occurred after the election in 1994, because prior to that time the issue was, is the exclusion going to be reduced. You may remember that.

Mr. FORRESTEL. Yes, sir.

Chairman ARCHER. Mr. Loop.

**STATEMENT OF CARL B. LOOP, JR., PRESIDENT, LOOP'S NURSERY AND GREENHOUSES, INC., JACKSONVILLE, FLORIDA; VICE PRESIDENT, AMERICAN FARM BUREAU FEDERATION; AND PRESIDENT, FLORIDA FARM BUREAU FEDERATION**

Mr. LOOP. Thank you, Mr. Chairman, Members of the Committee. My name is Carl Loop. I'm president of Loop's Nursery and Greenhouses, Incorporated in Jacksonville, Florida. I serve as president of the Florida Farm Bureau. I'm also vice president of the American Farm Bureau. I'm pleased to be here today to talk about the unfairness of estate taxes and the threat they pose to family farmers and ranchers.

Farm bureau's position on estate taxes is straightforward; we recommend their elimination. This issue is so emotionally charged that last year farm bureau members sent more than 70,000 letters to Washington calling for an end to the death taxes. I wrote several of those letters myself because death tax threatens the continuation of my family's livelihood.

In 1949, I started a nursery business with a $1,500 loan and a borrowed truck. In the early years, we got by living on my wife's salary from teaching school and everything I earned went back into the business. For 49 years, I worked with my wife and children. We worked hard to build our business into one of the largest wholesale growers of flowering pot plants and tropical foliage in the southeastern United States.

My family feels that our operation not only grows a needed product, but makes a positive contribution to our community. We employ over 85 people year round, support community activities, and provide a stable tax base. It's hard for us to understand why the government wants to penalize us for being successful, especially when we've already paid taxes on everything that we've earned. Inflation has increased the value of both our land and equipment to the point that my family would have to sell part of the nursery to pay death taxes. This could prove fatal to our business. Because greenhouses are a single-purpose structure, they don't have a whole lot of market value and the only thing a forced partial sale would accomplish would be to destroy our business viability.

My son and daughter would like to continue the family business and I would like to pass it on to them. For the past 5 years, I've been working with attorneys to plan for my death. I purchased life insurance. I recapitalized the business, issued two classes of stock, set up revocable and irrevocable trust agreements, gifted assets, given stock options, and shifted some control of the business. After hours of worry and large attorney fees, I still don't know if my estate plan will serve to save our family business. I guess that won't be known until after my death.

It seems to me and my family that Loop's Nursery and Greenhouses is worth much more to our community and the government as an ongoing business compared to the amount of a one-time estate tax payment. If my family is forced out of business by the death tax, the business will close, my family will lose their livelihood, people will lose their jobs, and a community-minded business that pays taxes will be gone.

My situation is not unique. As a farm bureau official, I talk with farmers and ranchers across this country and I can tell you that

people everywhere are concerned that death taxes will destroy their family businesses. Many don't know how severely they will be impacted because they don't realize how much the value of their property has increased because of inflation. Others understand the consequences but fail to adequately prepare because, first, the law is complicated, second, estate planning is expensive, and third, death is a subject that is difficult for a lot of people to talk about.

The Tax Relief Act of 1997 made improvements in the estate tax system by increasing the exemption to $1 million by the year 2006 and creating the $1.3 million family business exemption. We commend Congress for enacting these changes. While they are helpful, most of the benefits are far in the future and the family business exemption has made the estate tax law even more complicated.

Farm bureau renews its call for the elimination of estate taxes. Action by Congress is needed to preserve our Nation's family farms and ranches, the jobs they provide, and the contribution they make to their communities. I want to thank the Committee for this opportunity to be here today to explain why farmers and ranchers feel so strongly that death taxes should be eliminated. Thank you.

[The prepared statement follows:]

**Statement of Carl B. Loop, Jr., President, Loop's Nursery and Greenhouses, Inc., Jacksonville, Florida; Vice President, American Farm Bureau Federation; and President, Florida Farm Bureau Federation**

My name is Carl B. Loop, Jr., I am president of Loop's Nursery and Greenhouses, Inc., a wholesale plant nursery operation in Jacksonville, Florida. I serve as President of the Florida Farm Bureau Federation and as Vice President of the American Farm Bureau Federation. Farm Bureau is a general farm organization of 4.7 million member families who produce all commercially marketed commodities produced in this country.

Last year's Taxpayer Relief Act made cuts in estate taxes that are helpful to agricultural producers but stopped short of ending death taxes that can destroy a family business. I am pleased to be here today to talk about the unfairness of estate taxes and the threat they pose to family farmers and ranchers.

Farm Bureau's position on estate taxes is straightforward. We recommend their elimination. The issue is so emotionally charged that last year Farm Bureau members sent more than 70,000 letters to their representatives and senators calling for an end to death taxes. I wrote several of those letters because death taxes threaten the continuation of my family's livelihood.

In 1949, after graduating from the University of Florida, I started my nursery business with a $1500 loan and a borrowed truck. In the early years we got by living on the teacher's salary of my wife, Ruth. Everything that I earned was reinvested in the business. For 49 years I, along with my wife and children, have worked hard to build our business into one of the largest wholesale nursery operations in the southeastern United States.

I am proud that my nursery has allowed me to support my family and send my three children, Carol, 42, David, 39, and Jane, 32, to college. David, earned his degree in ornamental horticultural and agriculture economics and now runs the business on a daily basis. Without his involvement I wouldn't have been able to come here today. My youngest daughter, Jane, would also like to come into the business.

Loop Nursery and Greenhouses, Inc., grows flowering pot plants and tropical foliage in 350,000 square feet (nine acres) of greenhouses. Also part of the business are warehouses, cold storage and the equipment needed to grow, harvest and market our products. Between 85 and 100 people are employed year-round.

My family feels that our operation not only grows a needed product, but makes a positive contribution to our community. In addition to employing 85-plus people, we are a community minded business which provides a stable tax base for city, county, state and federal government. We do not understand why the government wants to penalize us for being successful, especially since we already paid taxes on what we have earned.

Inflation has increased the value of both our land and equipment to the point that my family would have to sell part of the nursery to pay death taxes. This could prove fatal to our business because our assets can't be easily liquidated. Because

greenhouses are single purpose structures, they don't have much market value and the only thing a forced partial sale would accomplish would be to destroy the viability of our business.

My son and daughter want to continue our family business and I would like to pass it on to them. For the last five years, I have been working with attorneys to plan for my death. I have purchased life insurance, recapitalized the business, issued two classes of stock, set up revocable and irrevocable trust agreements, gifted assets, given stock options, and shifted control of the business. After hours of worry and large attorney fees I still don't know if my estate tax plan will save our family business.

It seems to me and my family that Loop's Nursery and Greenhouses, Inc., is worth much more to our community and the government as an ongoing business when compared to the amount of a one-time estate tax payment. If my family is forced out of business by death taxes everything that I have worked for will be lost, my family will lose its livelihood, 85-plus families will lose their incomes and the community will lose a valuable part of its business base.

My situation is not unique. As vice president of the American Farm Bureau, I talk with farmers and ranchers from across the country and I can tell you that people everywhere are concerned that death taxes will destroy their family businesses. Many don't know how severely they will be impacted because they don't realize how much their property has increased in value due to inflation. Others understand the consequences but fail to adequately prepare because the law is complicated, because lawyers, accountants and life insurance are expensive and because death is a difficult subject.

It bothers me and my family that while death taxes can cost farm and ranch families their businesses and cost them hundreds of hours and thousands of dollars for estate planning, relatively little revenue is generated for the federal government. The estate tax raised a total of about $17.2 billion in fiscal year 1996, as reported by the Office of Management and Budget.

The potential impact of estate taxes on the future of American agriculture is enormous. Ninety-nine percent of U.S. farms are owned by individuals, family partnerships or family corporations. About half of farm and ranch operators are 55 years or older and are approaching the time when they will transfer their farms and ranches to their children.

The situation in my state of Florida is acute. The value of farmland there has been inflated far beyond its worth for agriculture because developers are willing to pay high prices to convert farmland to other uses. It is not uncommon for land to be valued at as much as $10,000 an acre. On paper this makes a Florida farmer look like a wealthy person, but my farm neighbors aren't rich. They simply don't have the money to pay a huge estate tax bill without selling part or all of their business. While estate tax planning can protect some of the farms, it is costly and takes resources that could be better used to upgrade and expand their businesses.

The Tax Relief Act of 1997 made improvements in the estate tax system by increasing the per person exemption to $1 million by 2006 and creating the $1.3 million family business exemption. We commend Congress for enacting these changes. While they are helpful, most of the benefits are far in the future and the family business exemption has made the estate tax law even more complex.

Farm Bureau renews its call for the elimination of estate taxes. Action by Congress is needed to preserve our nation's family farms and ranches, the jobs they provide and the contribution they make to their communities. Until repeal of estate taxes can be accomplished, Farm Bureau urges increasing the estate tax exemption to $5 million per person, indexing the exemption for inflation and cutting the tax rate for assets above the threshold by half. Special-use valuation should be expanded, an estate tax exemption for protected farmland should be put in place and the annual gift tax exemption should be increased to $50,000.

Thank you for the opportunity to be here today to explain why farmers and ranchers feel so strongly that death taxes should be eliminated.

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Chairman ARCHER. Thank you, Mr. Loop, and finally, a gentleman who is no stranger to our Committee and a gentleman who I greatly respect, who is one of the Nation's outstanding experts on the death tax and all of its details and complexities, Mr. Harold Apolinsky.

**STATEMENT OF HAROLD I. APOLINSKY, GENERAL COUNSEL, AMERICAN FAMILY BUSINESS INSTITUTE, AND VICE PRESIDENT, LEGISLATION, AND PAST CHAIR, SMALL BUSINESS COUNCIL OF AMERICA**

Mr. APOLINSKY. Thank you, Mr. Chairman. It is a privilege to be with these members on these panels. These stories to me of family businesses are just absolutely chilling. Mr. Loop is correct when he says that the majority of people, I think maybe 80 percent of the people in this country who will be impacted by this 55 percent death tax, do not really know it. Unless you hire me or somebody else as an estate tax lawyer or sell life insurance, it just does not occur to you. We all get a dose of income tax every April but we do not get a dose of death tax until someone dies.

As you say, I am an estate tax lawyer. I have been doing this for 36 years. I have been teaching estate planning at both the University of Alabama School and Law and Cumberland School of Law for 26 years. I flew up this morning and go back this evening. I feel privileged, on behalf of the American Family Business Institute and the Small Business Council of America, to share ideas with this Committee for your important work.

In my firm, we have 110 lawyers in Alabama. We believe that is enough lawyers to solve any problem or cause any problem, depending on what the client really would like to hire us to do. We have nine full-time trust and estate lawyers and yet we all agree that this death tax needs to be repealed. Even though it would impact our practices, we will find something productive to do. We have seen how harmful it is to family businesses, family farms, family capital to want to get rid of it.

It is relatively easy to calculate the death tax. Most people, as Mr. Loop says, have not. You simply add up the fair market value, of everything a person owns; qualified retirement plans, life insurance, even tax exempt bonds are not exempt from the 55 percent death tax. You subtract liabilities, you subtract $1 million, and then multiply by 50 percent. That's a little conservative because the top rate, as you know, is 55 percent. If you have a large qualified retirement plan, you basically pay 75 percent in tax, both income and estate, and so the children get 25 cents on the dollar.

Thank you for repealing the 15 percent extra excise tax on retirement accounts because when that hit, only 10 percent went to the children. But I still think a 75 percent tax on qualified retirement plans is unreasonable.

And then, if parents decide they want to leave assets to grandchildren, there may be an extra 55 percent generation-skipping tax. I am blessed with two grandchildren. One is seven and one is four. I understand why they are called grandchildren because they really are grand. But if you want to leave the grandchildren a significant amount, I'm widowed, let's say more than $1 million, there's an extra 55 percent generation-skipping tax on top of the 55 percent estate tax on what goes to grandchildren. So, it is really confiscatory.

I am grateful that your Committee encouraged Congress to increase the tax-free amount from $600,000 to, this year, $625,000. It moves up in rather odd increments, I must admit. It is good that you do not build stairs in houses or people would fall down because

it is so unusual and uneven. It would be easier if it went up equally but I understand the budget problems.

I tell my clients that, the tax-free amount will be $1 million in 2006 so please live as long as you can, which seems to please them. Unfortunately, if you have a qualified family-owned business interest, you really need to die early. You have described the Code, and I agree, Mr. Chairman, as a lawyer in your past life, as an attractive nuisance. In my judgment, 2033 A, the Qualified Family Owned Business Exclusion, is an unattractive nuisance. Both the American College of Trust and Estate Counsel, ACTEC, senior estate planning lawyers, I am a member, and the Real Property and Probate section of the American Bar Association have asked that this provision be repealed. In the most recent issue of *Trusts and Estates*, the writer described 2033 A as one of the most ambiguous and complicated tax provisions to be passed in decades. So help me, this is true. There is even a web page now on the Internet on 2033 A. I have given the Committee my exhibit C to my testimony as a tool to try and understand 2033A. As Professor Graetz said, I, too, am apprehensive as I kick off my estate planning class this spring as to whether the law seniors can understand this Code section. I warned them that they may go through the entire semester and then I will be so happy if I get the estate tax repealed. I promised all 56 of them an A but they will get no tuition rebate.

I determined if a business fits under 2033A, you have to master a fraction with 14 variables. It is simply so complex. With dynamic scoring the cost of repeal will drop dramatically. Please put this as number one because this is the one thing, as the Clements family mentioned, that you cannot program. You just do not know when death is going to strike. You can program a lot of other things, but this one, I would say, we ought to try to put first. If we repeal the death tax, obviously the inherited step-up in bases would logically go away. Income tax will be collected when assets are sold. It should not bother anybody because if you are going to sell something, you know the price, so we can stop litigating values. You also expect to pay a tax when you sell something. We do not have to worry about the profit on a home anymore.

If you still find you do not have enough money, repeal 2033A. It will not harm the lawyers because we really have not picked up all the legal fees yet that are out there that we will when we explain and investigate 2033A. Remove the death tax from qualified retirement plans. And, number three, reduce the top rate. I do not think of this as a prowealth situation. As the panel described it, I think it is profamily and projobs. I believe the American people will endorse that. Sixty Plus, a great organization started us down this road of repeal. We are grateful to Roger Zion and his team and Jim Martin. They did a poll recently of the American people and 77 percent of them said that they would rather vote for a Member of Congress who repealed the death tax, as for someone who would not. That 77 percent wanted that death tax repealed. I have attached as exhibit D, a list of 15 states that have repealed their State death taxes since 1980, 15 of them. They took an exit poll in California and people said it was not fair to tax during life and at death. It was a fairness issue in California and elsewhere. Indiana is going to repeal, I believe, this year, and Kansas will repeal as well.

H.R. 902 in the House, Representative Cox's bill, now has 166 cosponsors to repeal. Senator Kyl now has 30. Please strike a blow for fairness and simplicities and families. Put me and my colleagues out of work. Repeal the death tax. It would be one of the most wonderful things we could do. We should, in my personal view, repeal the Internal Revenue Code but I think that may come a little bit later. I would like to get rid of the death tax first. Thank you, Mr. Chairman.

[The prepared statement and attachments follow:]

**Statement of Harold I. Apolinsky, General Counsel, American Family Business Institute; and Vice President, Legislation, and Past Chair, Small Business Council of America**

Mr. Chairman and Members of the Committee, I am Harold I. Apolinsky, General Counsel of the American Family Business Institute and Past Chair of the Small Business Council of America (SBCA) and currently Vice President—Legislation. I am also a practicing tax attorney (over 30 years) who specializes in estate planning and probate. For over 25 years, I have taught estate planning and estate, gift and generation-skipping taxation as my avocation to law school seniors at both the University of Alabama School of Law in Tuscaloosa, Alabama and the Cumberland School of Law in Birmingham, Alabama. I am here to present our views on the unfairness of the estate, gift and generation-skipping taxes.

The American Family Business Institute is a year old non-profit organization. Our members are family businesses employing over 5,000 employees throughout the United States facing forced sale or liquidation because of this 55% death tax. Our mission is to educate and alert family business owners regarding the death tax and to seek its repeal by Congress. We hope you will put us out of business this year.

SBCA is a national nonprofit organization which represents the interests of privately-held and family-owned businesses on federal tax, health care and employee benefit matters. The SBCA, through its members, represents well over 20,000 enterprises in retail, manufacturing and service industries, which enterprises represent or sponsor over two hundred thousand qualified retirement and welfare plans, and employ over 1,500,000 employees.

We are delighted and heartened by the overwhelming response that this issue has evoked from Members of Congress and their staffs. It is indeed refreshing to observe the level of understanding and commitment that individual Members have demonstrated. The existence and harm of the 55% death tax is not generally known other than to estate tax lawyers and families who have suffered the loss of a loved one owning more than the applicable exclusion amount, now $625,000.

Thank you for the increase in this tax-free amount. I advise my clients to try and live to 2006, but die early if they own a qualified family business. Unfortunately, neither this nor the unworkable 2033A Family-Owned Business Exclusion will save 90% of family businesses.

We submit that the time has come for Congress to repeal the estate, gift and generation-skipping taxes. It is unfair to tax people all their working lives and then again at death.

An estate tax due nine months after death is imposed on the transfer to children or other heirs of the taxable estate of every decedent who is a citizen or resident of the United States ($625,000 of assets are now exempt). The graduated estate tax rates begin effectively at 37% and increase to a maximum rate of 55% (see *Exhibit "A"* for how the tax is calculated). Taxes on bequests to spouses may be deferred until the last-to-die of husband and wife.

A gift tax is levied on taxable gifts (excluding $10,000 per donee per year) as a back-stop to the estate taxes. The graduated rates are the same. (The current $625,000 exempt amount may be used during life for gifts or at death.)

An extra, flat 55% generation-skipping tax is imposed on gifts or bequests to grandchildren ($1,000,000 is now exempt).

Combined income and estate taxes frequently consume 75% or better of retirement plan accounts at death (see chart attached as Exhibit "B"). Thank you also for repealing the 15% excise tax. With that, only10% would go to children.

The 1995 White House Conference on Small Business recommended repeal of estate and gift taxes. In fact, ranked by votes, this was the number four (out of sixty) recommendation to come out of the Conference.

It is well known that only 30% of family business and farms make it through the second generation. Seventy percent (70%) do not. Only 13% make it through the

third generation. Eighty-seven (87%) do not. The primary cause of the demise of family businesses and farms, after the death of the founder and the founder's spouse, is the 55% estate tax. It is hard for the successful business to afford enough life insurance. (Premiums are not deductible and deplete working capital.)

The new Qualified Family-Owned Business Interest Exclusion (QFOBI) is now the most complex provision in the Tax Code. At best, it will help less than 5% of family businesses facing sale or liquidation from the death tax. Just look at *Exhibit "C"* which I use to try and teach 2033A. It may make you laugh. Both the American College of Trust and Estate Counsel (to which I belong) and the Real Property and Probate Division of the American Bar Association have urged repeal. In an article in the January 1998 issue of *Trusts & Estates* the author referred to 2033A as "one of the most ambiguous and complicated tax provisions to be passed in decades."

The estate tax took its present form primarily in the early 30's. The express purpose was to "break-up wealth." Is this consistent with a free enterprise economic system and a very competitive world economy? The 55% estate and gift tax cannot be justified as playing an important role in financing the federal government; it now brings in less than 1.2 percent of total federal revenues. The expense of administering this system probably offset 75% or more of the revenue. Since the step-up in basis will also be repealed, resulting in tax when assets are sold by heirs, the net loss of revenue will be modest.

Since 1980, 15 states have repealed their state death tax (see *Exhibit "D"*). California voters approved Proposition 6 in 1982 to repeal the California death tax. Exit polls determined that voters, even in this state with such a wide disparity between rich and poor, did not feel it fair to pay taxes during life and at death. The fair approach is to repeal the death tax in 1998.

As I have testified before, if the estate tax were repealed, we believe based upon studies conducted by Professor Richard Wagner of George Mason University, by the Heritage Foundation and by Kennesaw State College that the beneficial effect on the economy would be significant. According to the study conducted by Professor Richard Wagner of George Mason University, the effect of the estate tax on the cost of capital is so great that within eight years, a U.S. economy without an estate tax would be producing $80 billion more in annual output and would have created 250,000 additional jobs and a $640 billion larger capital stock.

The Heritage Foundation study utilizing two leading econometric models also found that repealing the estate tax would have a beneficial effect on the economy. The Heritage analysis found that if the tax were repealed in 1996, over the next nine years:

- The nation's economy would average as much as $11 billion per year in extra output;
- An average of 145,000 additional new jobs could be created;
- Personal income could rise by an average of $8 billion per year above current projections; and
- The deficit actually would decline, since revenues generated by extra growth would more than compensate for the meager revenues currently raised by the inefficient estate tax.

We submit if repealing estate taxes accomplished only half of these things, the country would be significantly better off than staying under the current draconian estate tax system. The estate tax system raises very little revenue at a heavy cost to the economy. It generates complex tax avoidance schemes, it promotes spending instead of saving and it promotes people "giving up" on the family business or farm. It helps my estate tax lawyers (now 9 in my 110 lawyer firm), but is not fair to families or good for my country.

The Kennesaw State College Study on the Impact of the Federal Estate Tax, prepared by Astrachan and Aronoff, studied in detail the impact of the estate tax on members of the Associated Equipment Distributors (AED), an association composed of capital-intensive family-owned distribution businesses and on newly-emerging, minority-owned family enterprises selected from lists published by Black Enterprise Magazine. The study showed that for the AED group:

- Nearly $5 million is spent annually in life insurance premiums in order to have proceeds available to meet their estate tax liability. The survey shows an average of $27,000 per year expended by distributors on such insurance.
- $6.6 million has been spent on lawyers, accountants and other advisors for estate tax planning purposes. On average companies spent nearly:
- $20,000 in legal fees
- $11,900 in accounting fees
- $11,200 for other advisors

• In addition to the protection provided by life insurance premiums, roughly 12% of the AED respondents reserved over $51 million in liquid assets for the purpose of having cash available for the payment of the estate tax.

The study showed that 57% of the businesses felt that the imposition of the estate tax would make long term survival of the business after the death of the current owner significantly more difficult. They are not wrong—the statistics show it is extraordinarily difficult to have the family business survive the death of the first generation. Working capital to a business is like fuel to an airplane. When you run out of fuel, the plane comes down whether at an airport or not. Removing 55% of the value of a family business often removes more than 55% of the working capital.

Australia repealed their estate and gift tax laws in the mid–1970's. It was felt that these transfer taxes were an inhibitor on the growth of family businesses. The legislative body of Australia sought more jobs which they believed would come if family businesses grew larger and were not caused to sell, downsize, or liquidate at the death of the founder to pay estate taxes. More recently, Canada has also repealed estate taxes for the same reasons.

The SBCA has a legal and advisory board comprised of the top legal, accounting, insurance, pension and actuarial advisors to small business in the country. It is contrary to the financial interests of these board members in their tax practice and advisory businesses to urge repeal of these transfer taxes. We stand firmly behind repeal or significant reform, however, because it is the right thing to do to help grow family businesses, provide jobs and encourage the entrepreneurial spirit needed for small businesses to become large businesses.

We applaud the bills introduced by Congressman Cox (HR 902 now with 166 co-sponsors) AND Senators Kyl (S–75 now with 30 co-sponsors) and Lugar (S–30) to repeal these taxes. The country will be far better off if any of them become law. As a country, we cannot stand by and see one more farm or one more small business get torn apart because of an obsolete tax supposedly in place to redistribute massive wealth. Part of the problem with estate taxes is that many of the families who are ultimately destroyed by the estate tax are not even aware that it exists. Many times no one in the family has ever been subjected to it.

The 55% death tax (the highest in the world) does the most harm to capital of any tax we have. Once it leaves the family at death and goes to Washington, it never seems to come back to provide jobs back home. It is simply not fair!

**EXHIBIT "A"**

**CALCULATION OF ESTATE TAXES**

A. Gross Estate (fair market value at death of all assets, including real estate, stock, cash, life insurance, retirement accounts, etc.).

B. Deductions:

1. Debts and expenses.
2. Marital (assets left to spouse if citizen).
3. Charitable.

C. Taxable Estate.

D. Add Prior Taxable Gifts.

E. Total transfer to heirs (life and death).

F. Apply Rates: 18% to 55%.

G. Less credit ($202,050*)

H. Net tax (effective 37% to 55% [plus 5% for larger estates] due 9 months after death.

I. Extra 55% tax for bequests to grandchildren in excess of $1 million.

* This is tax on $625,000 taxable estate. The credit will reach $345,800 (tax on $1,000,000) in 2006 for those lucky to live that long.

The complexity for filing the estate tax return is demonstrated by the 35 hours and 83 minutes estimated pursuant to the Paperwork Reduction Act Notice.

**EXHIBIT B**

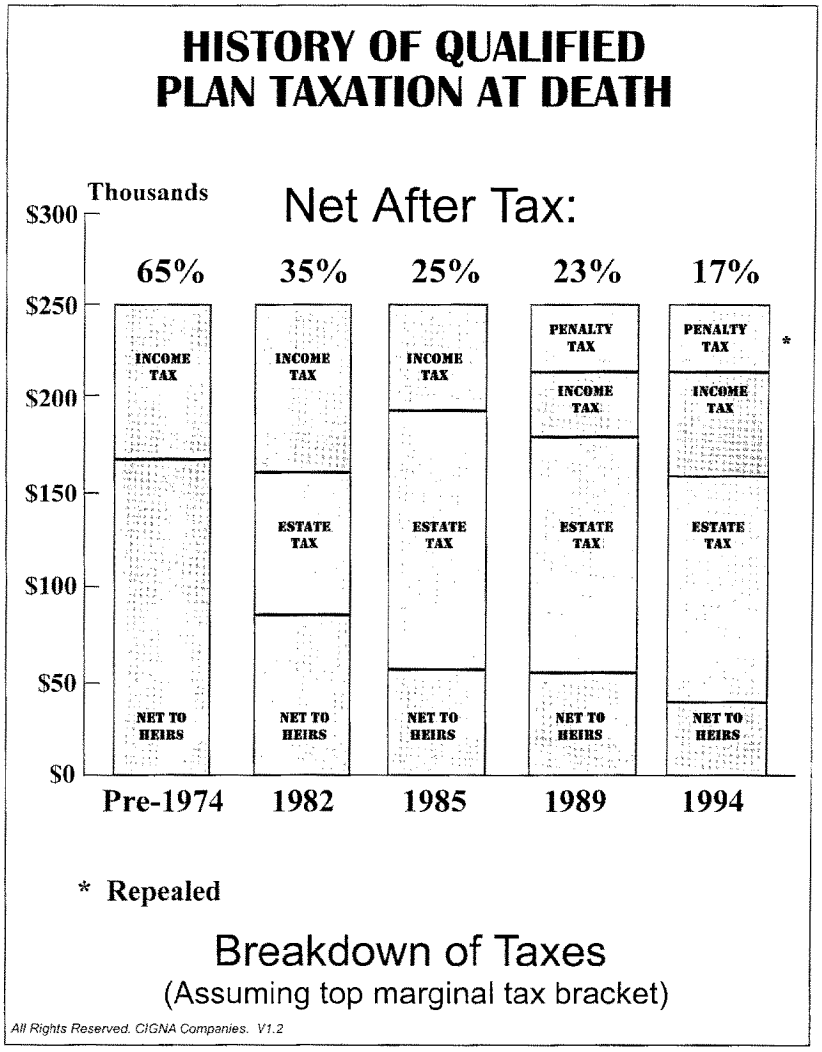
HISTORY OF QUALIFIED PLAN TAXATION AT DEATH
Thousands
Net After Tax:
$300
$250
$200
$150
$100
$50
$0
65%
35%
25%
23%
17%
INCOME TAX
ESTATE TAX
NET TO HEIRS
PENALTY TAX
*
Pre-1974
1982
1985
1989
1994
* Repealed
Breakdown of Taxes
(Assuming top marginal tax bracket)
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EXHIBIT "C"

## AN EXAMPLE OF HOW TO QUALIFY UNDER SECTION 2033A

Aggregate Value of all qualified family owned business interests that are included in the gross estate and are acquired by or passed to a qualified heir from decedent (AV) = $11,000,000

Adjusted Taxable Gifts and Annual Exclusion gifts of qualified family owned business interests to family members if still held by family member (ATG + AE) = $2,000,000

Gifts of QFOBIs Included in the Gross Estate (GQIGE) = $3,000,000

Cash or marketable securities that exceed reasonably expected day-to-day working capital needs, i.e., Excess Liquidity (EL) = $500,000

Personal Holding Company-type assets (PHC) = $500,000

Total Indebtedness of decedent (TI) = $5,000,000

Qualified acquisition indebtedness for personal residence, i.e. Personal residence Mortgage (Mort) = $2,000,000

Debt to pay Education or Medical expenses (EdMed) = $200,000

Other Debt up to $10,000 (OD) = $10,000

Decedent's Gross Estate without regard to Section 2033A (GE) = $15,000,000

Gifts to Spouse within 10 years of death (other than GQIGE above) (GSP) = $1,000,000

Nontaxable Gifts within 3 years of death (NTG) = $3,500,000

Gifts otherwise Included in Gross Estate (GIGE) = $2,000,000

$$\frac{AV + ATG + AE - GQIGE - EL - PHC - (TI - Mort - EdMed - OD)}{GE - TI + ATG + AE - GQIGE + GSP + NTG - GIGE} > \frac{1}{2}$$

$$= \frac{\$11{,}000{,}000 + 2{,}000{,}000 - 3{,}000{,}000 - 500{,}000 - 500{,}000 - (5{,}000{,}000 - 2{,}000{,}000 - 200{,}000 - 10{,}000)}{\$15{,}000{,}000 - 5{,}000{,}000 + 2{,}000{,}000 - 3{,}000{,}000 + 1{,}000{,}000 + 3{,}500{,}000 - 2{,}000{,}000}$$

$$= \frac{\$6{,}210{,}000}{\$11{,}500{,}000}$$

$= .54 > \frac{1}{2}$, therefore Section 2033A applies.

**EXHIBIT "D"**

# States In Which Inheritance Tax Has Been Repealed

| | State | Inheritance Tax Repealed |
|---|---|---|
| 1. | California | 1982 |
| 2. | Colorado | 1980 |
| 3. | Connecticut | 1997 |
| 4. | Illinois | 1983 |
| 5. | Iowa | 1997 |
| 6. | Louisiana | 1997 |
| 7. | Maine | 1986 |
| 8. | Massachusetts | 1995 |
| 9. | Michigan | 1993 |
| 10. | New York | 1997 |
| 11. | Rhode Island | 1985 |
| 12. | Oregon | 1986 |
| 13. | Vermont | 1995 |
| 14. | Washington (state) | 1982 |
| 15. | Wisconsin | 1992 |

Chairman ARCHER. Thank you, Mr. Apolinsky. Let me piggy-back momentarily on what Mr. Loop said. I believe it's accurate to say that we did not increase the complexities in the Code relative to the small business exemption but we did not simplify them. We left in place the complexities that were already in the Code. Is that a fair statement, Mr. Apolinsky?

Mr. APOLINSKY. Mr. Chairman, I am afraid we did add to the complexity. I am afraid that 2033 A is an additional complexity because it incorporates 14 provisions from 2032 A. I realize it is elective, which is useful. But, from an estate planner's perspective, we feel the necessity to contact all of our family business clients, explain the law to them, have them engage us to check it out, make any required changes and, document material participation. So, this is an additional burden, and expense to family businesses. I worry that only about 2 to 5 percent of family businesses will really qualify. But I think every family business needs to take a look at it to see if they can, ultimately, qualify because it may save $400,000 or $500,000 in tax.

Chairman ARCHER. My understanding, though, and you certainly have been one of my educators on this over the last several years, is that the existing definition of small business or farm in the Code before the 1997 act was already so very complex that it, in itself, limited the practical application to a very small percentage of people who thought they probably qualified. Is that a fair statement?

Mr. APOLINSKY. Mr. Chairman, that is a fair statement. As you remember better than I, in 1976, Congress wanted to save the family farm, a great idea. Congress passed 2032A. It is 11 pages of statute. It has now been challenged constantly in court. There have been 138 court decisions to date. About two-thirds were won by the Internal Revenue Service. This is probably at least an equal number in the pipeline. You are exactly right. And then, you know, I realize, it was not the House, in my judgment authorized 2033A. It came out of the Senate. I tried to start teaching this in 1995 when it was the Dole-Roth.

Chairman ARCHER. That is a correct thing to say in this room, Mr. Apolinsky. Thank you very much. [Laughter.]

Mr. APOLINSKY. I hope no Senators are here. [Laughter.]

Chairman ARCHER. Let me comment just briefly on a couple of things. I read an article recently where a financial counselor was telling his clients, you should not have an IRA, you should not have a tax-deductible retirement plan because in the end the taxes are so brutal at the time of your death that it is far better to do something else. Now, what a terrible thing to have to say to the American public. It is terrible to tell people if they get married, they're going to pay more taxes. It is also terrible to tell them if they put aside for their own retirement, it's a mistake because of the Tax Code.

I don't think the Members of Congress understand that the savings that the law permits, and our salaries, which go into a thrift savings account for our retirement, will be taxed at unbelievably high rates at the time of death. As you've pointed out, that applies to all tax-deductible savings accounts, so much so that you end up,

if you leave funds in that account and you die prematurely, before you actuarially have been able to pull out the amount there in your lifetime, what you leave to your children gives them roughly 25 percent. That is highway robbery and I appreciate your suggestion that if we don't do anything else, we should change that, well, you've said many other things, but as a part of it, that we should change that provision in the Code.

Now, let me ask you if you have any data for us as to the net revenues that the death tax provides to the Federal Government, because I've read articles that say that the cost of collecting it and the loss of other revenues, through other tax programs, actually is virtually an offset to where it produces no net income to the Federal Government. Do you have any data on that at all?

Mr. APOLINSKY. One of the members of the next panel, Bill Beach, has worked with a group that I have assisted from a technical standpoint to try and do a study of what would be the revenue from a combination where you repeal the death tax, factor in the expenses, and, although I have not seen their final study, factor in some income from sales by heirs selling—using a carryover basis.

Chairman ARCHER. Good.

Mr. APOLINSKY. But, my impression, everything I have seen, supports the concept that roughly 65 percent of the dollar goes into the cost of collecting. Then, if you factor in the revenue that will come from the sale by heirs from that, I think it would be a question whether it is 2 or 3 or 4 years before it becomes positive revenue. More revenue will flow if family businessowners spend time with their marketing people, their manufacturing people, and less time with their tax lawyers. As much fun as I enjoy being with them and I love being paid by them.

I have one client in Birmingham, Alabama, a little town, that is paying $2 million a year in life insurance premium to try to keep a family bottling company in the family through the third generation. His expansion has just stopped. I told him, I said, Jimmy, let me tell you what I'm working on, to repeal. Would it mean anything to your company if I got the tax repealed? His eyes got wide. He said, Harold, I'll promise you I will build a bronze statue to you at Legion Field, which is our football stadium. People will walk by and say, who's that old man in the houndstooth hat, because we have Bear Bryant's statue there. They'll say, I don't know him but I know that's Harold Apolinsky. He got the estate tax repealed. [Laughter.]

Chairman ARCHER. That's a great story. Now, in a socialist or communist country, I could understand it, but it defies me that in a free-enterprise country that has built the finest life, economically, for any people in the history of the world, not without its faults, but nevertheless in a relative sense, the finest life for the people who are its citizens of any country in the history of the world, that we would say to people in the later years of their life, if you continue to work and to produce and to expand the wealth of this country, you will be losing because all that you can ever leave to kids out of that will be 25 percent. That the government will get 75 percent because at 44 percent income tax that comes off the top and then another 55 percent of the 56 percent that is left leaves

you with 25 percent. What incentive is there for people to continue to produce and to build more for everybody in this country, jobs, and so forth? And, clearly, it is wrong and we should do something about it.

Let me stop there and recognize my colleagues for any inquiry they might like to make. First, Mr. Hulshof.

Mr. HULSHOF. Thanks, Mr. Chairman. Ms. Clements, Mr. Clements, I hope that America hears your story and I'm confident that your father is probably looking down and smiling because he knows that the lessons he taught you you have learned well. As the only son of a Missouri farm family, I know firsthand your plight.

First of all, we welcome you here to Washington, DC. We have to continue to tell this story back home and I hope you go back to Arizona and continue to talk about your story because of the incredible battle we have ahead of us. Just a few short months ago, a high-ranking official in this White House made the public pronouncement that those of us who seek to change the death tax laws are committing the ultimate act of selfishness. A high-ranking Congressman from my State of Missouri, who once sat on this Committee when his party was in the majority, has tried in the past to lower the exemption so that more family businesses and more family farms, Mr. Loop, are subject to paying the tax in an effort to satisfy the government's insatiable appetite for more taxes. And so, when we have those on the other side that are fighting the efforts to repeal and do away with the death tax, we have formidable foes but I think if your story and stories that each of you have told, if we can talk back home in our congressional districts and tell those stories, then I believe the best policy will come out. And, quite frankly, Ms. Clements, I thought your testimony hit the nail squarely on the head in that the vision of our Founding Fathers was very simple. And that is, all Americans should be able to reap from the fruits of their labors. And that's the right of life and the liberty and property and that is a sacred right and we should be able to pass on the fruits of our labors to those who follow us and that, in essence, is the American dream. So, please continue to tell your story because my personal opinion is a simple one and that is that the death of a family member should not be a taxable event, period. So, we welcome you here but please help us continue to fight this fight. And I appreciate the time, Mr. Chairman, and yield back.

Ms. CLEMENTS. Thank you.

Mr. CLEMENTS. Thank you, very much.

Chairman ARCHER. Mr. Hayworth.

Mr. HAYWORTH. Thank you, Mr. Chairman. I'd like to thank all members of the panel and, of course, I'm especially pleased to have Chris and Kim Clements here from Tucson. I would echo the comments of my colleague from Missouri and point out the irony. We saw it again last night in the State of the Union Address, to have one side of the chamber rise in enthusiastic applause for the largest tax increase in American history, which I thought was extremely telling, and, from the Chief Executive, this rather unique modern revisionism less than 5 years after the fact.

Be that as it may, Chris and Kim, in a town not very far from one of your facilities, you have one in Holbrook, over in Winslow,

Arizona we had a townhall meeting a couple of months ago. I think it ties into what Mr. Apolinsky said. Many concerned citizens came by there. We had the townhall there in the council chambers. Two young men, in particular, who hope to go to military academies had received permission to leave their class and come to the townhall. And we were talking with small business owners, with seniors, about the scourge of the death tax and one of the young men, so earnest as a high school junior or senior, stood up, Congressman, sir, do you mean to tell me the government taxes you upon your death? And the knowing laughter, almost a variation of Art Linkletter's "Kids Say the Darndest Things," was incredible, but all too often that laughter is to keep from crying because we are talking about our tax policy in the realm of the absurd.

Chris, I have no compulsion to try to dredge up emotional times for you and Kim, but so often people are accused of putting on the green eyeshade and looking at the bottom line, all of that. Can you take us back to that trying time immediately following your father's death? Both emotionally and financially. Is there any way to encapsulate the challenges you faced immediately, even following the plan that your father had instituted? If you had to sum it up, what was the greatest challenge in the wake of all that and dealing with this notion of the death tax, Chris?

Mr. CLEMENTS. The greatest challenge. Well, I think the greatest challenge in this regard is really comforting our employees, comforting our mother who had no experience in the business other than being the wife of our father, and assuring everyone that, indeed, the business would go on, that we would attempt to perpetuate it the best we could.

Kimberly touched on the vast outpouring of affection in terms of questions and what we received not only from our employees but also our community. We have a company that is very active in our community and in many of the communities around the State. And the questions came from them much more, in terms of will the business be sold, do you have to pay a large levy. And people were rather educated about it and, because we give so much back, they were wondering exactly what would happen to us.

Congressman Cox hit right on the head with his tale today about the gentleman who was on his deathbed and preparing his estate. Kimberly motioned to me and said, well, that sounds really familiar because our mother was doing the same sort of things because our father was virtually incapacitated. She was making sure everything was OK, that the business would not have to be sold, and it's interesting because now we're engaged in evaluating the life of our mother. How long will she live? When she dies, what would the business be worth then? At that time, how much insurance will we need to provide for ourselves in order to pay the government? That's a very interesting task because we're not tax lawyers and we certainly don't understand all of it. All we understand is that our father is gone, and that we have a responsibility to our employees and our community to continue what he had started. That's the only thing we've ever understood.

Mr. HAYWORTH. Chris, thank you very much. Mr. Forrestel, as the treasurer of your family business, you left us with a very intriguing statement. We won't ask you to inventory it right now but

you talked about the amazing possibilities that existed for your business if that money weren't taken out to deal with this type of planning.

Mr. Loop, I thought one particular observation you had was especially germane: why should you be punished for succeeding and living the American dream.

And, just in conclusion, Mr. Apolinsky, "J.D." in my name does not stand for juris doctor. I'm not an attorney, I've never played one on television. But, I do find it encouraging that you and your brethren in the legal profession are perfectly willing to take on other work and, in conclusion, Mr. Chairman, I'd just simply like to echo the words of our dear colleague from Colorado, Bob Schaffer, who makes the point that he believes there should be no taxation without respiration. I thank you and yield back.

Chairman ARCHER. Gentlemen and ladies, thank you very much for all of your testimony. We appreciate your coming and giving us the benefit of it. You're excused and we will go to the next panel, the next and final panel.

Douglas Stinson, Jeannine Mizell, Roger Hannay, and William Beach, if you'll please come to the witness table.

Welcome to each of you to the Committee. Thank you for coming today. Mr. Stinson, would you lead off, and give us the benefit of your testimony, and I think since you've been in the audience you know the general procedures here that we'd like for you to limit oral testimony to 5 minutes or less, and your entire written statement, without objection, will be printed in the record. You may proceed. Mr. Stinson? Yes, sir, and if you'll identify yourself for the record.

**STATEMENT OF DOUGLAS P. STINSON, OWNER, COWLITZ RIDGE TREE FARM, TOLEDO, WASHINGTON, ON BEHALF OF FOREST INDUSTRIES COUNCIL ON TAXATION, AMERICAN FOREST & PAPER ASSOCIATION, AMERICAN TREE FARM SYSTEM, AND WASHINGTON FARM FORESTRY ASSOCIATION**

Mr. STINSON. Thank you, Mr. Chairman. My name is Doug Stinson, and I'm a tree farmer from the State of Washington. My wife and our three children own the Cowlitz Ridge Tree Farm which consists of four parcels of forest land totaling 1,000 acres near Toledo, Washington. I'm here today to represent the American Tree Farm System, a national network of 70,000 private forest landowners committed to protecting water, wildlife, soil and recreation and at the same time to grow trees for forest products. We are committed to sustainable forestry.

Tree farmers are private citizens from all walks of life who take great pride in practicing forest stewardship on their land, and I'm proud to be speaking on their behalf. In addition, I'm proud to be speaking for the Forest Industries Council on Taxation, the American Forest and Paper Association, and the Washington Farm and Forest Association.

Two years ago, I sat before this Committee and told you about the disincentives built into the Federal Tax Code that discourage people from being good forest stewards, specifically, the capital gains tax and the estate tax provisions. The Taxpayer Relief Act of 1997 went a long way toward remedying these problems, and I

commend you for your actions and your support for American forests, but to ensure the long term health of American private forests which make up 58 percent of our total forest land, we must go further.

Cowlitz Ridge Tree Farm has four goals: first, to earn a living; second, to live in balance with nature; third, to leave the land in better condition than when we acquired it, and fourth, to educate the public and other landowners on the value of good forest stewardship.

Cowlitz Ridge is managed as an economically viable forest. We are operating on a sustained yield basis and have harvested approximately 65 percent of our forest growth in the past 26 years. In other words, we're growing more wood than we're harvesting. To make sure that our forests remain sustainable we invest $325 per acre to establish and nurture a new stand of trees. We will not see any cash flow for 25 years and will have to wait 60 to 80 years for the full return of that investment.

You can see investing in timberland is not for the faint-hearted. Many risks, including wildfire, wind storms, and insect blights and regulatory uncertainty are involved as we work to build a legacy for our children and grandchildren, and this legacy is not just for our family. We give educational tours to several hundred people each year. Our forest lands are open to the public for hunting, berry picking, hiking, and horseback riding.

Today, family-owned tree farms are still being destroyed by the Federal estate tax, because many of them are highly illiquid. For tree farmers, much of their cash is in standing trees. If you've heard the saying, "land rich and cash poor," well, that's an apt description of many forest landowners. The annual household income of the average tree farmer is less than $50,000, yet, on paper, the typical tree farmer can be valued at well above $2 million. Even with the increase in the exemption under the unified credit and newly created business exclusion, which provides a total exclusion of $1.3 million, the death tax hit on these forest lands can be several hundred thousand dollars. This forces many families to liquidate the timber or, even worse, to fragment the woodland by selling off pieces of their forest land. We need incentives for landowners to stop conversions.

In Washington State, the Department of Natural Resources current figures show there's 100 acres a day of prime forest land being converted. The death tax is the leading cause of forest fragmentation today, and in my opinion, the greatest threat to the long-term health of American forests. Thousands of American families like mine cycle earnings back into their businesses. At Cowlitz Ridge, we spend approximately $25,000 each year on forest regeneration and timber stand improvement. We protect and enhance habitat and watersheds. We have excluded 200 acres of forested wetlands and streamside buffers from harvest. We minimize soil disturbance when we harvest and keep our regenerative cuts to between 5 and 20 acres. Because we replant immediately after we harvest and use large, high quality seedlings, we minimize herbicide use and avoid aerial spraying.

The death tax provisions you included in the Taxpayer Relief Act of 1997 will ease the estate tax burden of many small landowners,

but it leaves many issues unresolved. For instance, the $10,000 gift exclusion and the $750,000 special use valuation were areas indexed for inflation. The increase in unified credit was not indexed. When you consider that many harvests don't occur for 40 to 60 years or more, you can see that inflation alone can put many families over the total exclusion limit.

My family has worked hard on our tree farm to earn a living and create a forest where wildlife, water, air quality, and aesthetic beauty are sustained. We have formed a limited family partnership to help pass this legacy on to our children. We are in the process of forming a habitat conservation plan, but I'm still concerned with all that we have done, our children will still be forced to break up Cowlitz Ridge Tree Farm. It's disturbing to know that the death tax generates only 1 percent of all Federal revenues, and for that jobs are lost, communities damaged, and forests destroyed. It seems to me that's a high price to exact on our national heritage for such little return. Thank you.

[The prepared statement follows:]

**Statement of Douglas P. Stinson, Owner, Cowlitz Ridge Tree Farm, Toledo, Washington, on behalf of Forest Industries Council on Taxation, American Forest & Paper Association, American Tree Farm System, and Washington Farm Forestry Association**

My name is Doug Stinson, and I am a Tree Farmer from Washington State. My wife, our three children, and I own the Cowlitz Ridge Tree Farm—four parcels of forestland totaling 1000 acres near Toledo, WA.

I am here today representing the American Tree Farm System, a national network of nearly 70,000 private forest landowners committed to protecting water, wildlife, soil and recreation opportunities and at the same time grow trees for forest products. We are committed to sustainable forestry. Tree Farmers are private citizens from all walks of life who take great pride in practicing forest stewardship on our land, and I'm proud to be speaking on their behalf. In addition, I am proud to be speaking for the Forest Industries Council on Taxation, American Forest & Paper Association and the Washington Farm Forestry Association.

Two years ago, Tree Farmer Chester Thigpen of Mississippi, and I sat before this committee and told you about the disincentives built into the federal tax code that discourage people from being good forest stewards—specifically the capital gains and the estate tax provisions. The Taxpayer Relief Act of 1997 went a long way toward remedying those problems. Along with millions of other Americans, I commend you for your actions and support for America's forests. But to insure the long-term health of Americas private forests, which make up 58 percent of our total forestland—we must go even further.

As I told this committee in 1995, we have four goals at Cowlitz Ridge Tree Farm:

1. To earn a living.
2. To live in balance with nature.
3. To leave the land in better condition than when we purchased it.
4. To educate the public and other landowners on the value of good forest stewardship.

Cowlitz Ridge is managed as an economically viable forest. We are operating on a sustained yield basis, and have harvested approximately 65% of our forest growth in the past 20 years. In other words, we are growing more wood than we are harvesting.

To make sure that our forests remain sustainable, we invest $325 per acre to establish and nurture a new stand of trees at Cowlitz Ridge. We won't see any cash flow for 25 years and will have to wait between 60 and 80 years for the full return on that investment.

So as you can see, investing in timberland is not for the fainthearted. Many risks, including wildfire, wind damage, and insect blights are involved as we work to build a legacy for our children and our grandchildren. Just two weeks ago, in fact, New Hampshire Tree Farmer Tom Thomson lost 90 percent of his 1,060-acre woodland to an ice storm. For the past 20 years, Tom had been building a legacy for his son. Today, most of that legacy lies in splinters on the ground.

But many Tree Farmers face another risk, one that is much more certain to strike than an ice storm: The Death Tax.

Today, family-owned Tree Farms and small businesses are still being destroyed by the federal estate tax because many of them are highly illiquid. For Tree Farmers, much of our cash is literally in our standing trees. You've heard the saying "land rich and cash poor." Well, that's an apt description of many forest landowners. The annual household income of the average Tree Farmer is less than $50,000. Yet on paper, the typical Tree Farm can be valued at well above $2 million. Even with the increase in the exemption under the unified credit and newly created business exclusion which provides a total exclusion of $1.3 million, the Death Tax "hit" on these forestlands can be several hundred thousand dollars. This forces many families to liquidate the timber, or even worse, to fragment the woodland by selling off pieces of their property.

In Washington State, 25,000 acres of prime forest land a year is converted to other uses. The Death Tax is the leading cause of forest fragmentation today, and in my opinion is the greatest threat to the long-term health of America's forests.

Thousands of American families like mine cycle earnings back into their businesses. At Cowlitz Ridge Tree Farm, we spend approximately $25,000 each year on forest regeneration and timber stand improvement. We protect and enhance habitat and watersheds. We have excluded our 150 acres of wetlands from harvest. We minimize soil disturbance when we harvest and keep our harvest areas small. Because we replant immediately after we harvest, and use large high quality seedlings, we minimize herbicide use and avoid aerial spraying. This is a large investment of time and money. But it's worth it to me as long as I know I can pass our legacy along to our children and their children's children.

The Death Tax provisions you included in The Taxpayer Relief Act of 1997 will ease the estate tax burden of many small landowners, but it leaves many issues unresolved. For instance, the $10,000 gift exclusion and the $750,000 special use valuation were the only areas indexed for inflation. When you consider that many harvests don't occur for 60 years or more, you can see that inflation alone can put many families over the total exclusion limit.

My family has worked hard on our Tree Farm to earn a living and create a place where wildlife, water and air quality and aesthetic beauty are sustained. We have formed a limited family partnership to help pass on this legacy to our children. We are in the process of forming a habitat conservation plan. But I am concerned that even after all I've done they will be forced to break up Cowlitz Ridge Tree Farm. It's disturbing to know that the Death tax generates only one percent of all federal revenues. And for that, jobs are lost, communities damaged and forests destroyed. I'm not an economist, but it seems to me that's a high price to exact on our national heritage for such little return.

I applaud you for convening these hearings. Further reforms in the estate tax for Tree Farmers and small business owners will save jobs, strengthen communities and help guarantee the long-term health and productivity of our nation's private forestlands.

Thank you.

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Chairman ARCHER. Thank you, Mr. Stinson. Our next witness is Jeannine Mizell. If you'll identify yourself, we'll be pleased to hear your testimony, and you may proceed.

**STATEMENT OF JEANNINE MIZELL, OWNER AND MANAGER, MIZELL LUMBER AND HARDWARE COMPANY, INC., KENSINGTON, MARYLAND, AND MEMBER, U.S. CHAMBER OF COMMERCE**

Ms. MIZELL. Good afternoon, Mr. Chairman and Members of the Committee. I am Jeannine Mizell, a third-generation owner and manager of Mizell Lumber and Hardware Company which is located in Kensington, Maryland. I am also a member of the U.S. Chamber of Commerce, the world's largest business federation, representing more than 3 million businesses and organizations of every size, sector, and region. I appreciate this opportunity to tell

my story and to express the views of the U.S. Chamber on the Federal estate and gift tax and the need for its repeal or significant reform.

My grandfather founded Mizell Lumber in 1922. In 1931, he purchased the property on which Mizell Lumber is still operated. He paid approximately $55,000 for the property. My father, Fred Mizell, joined his dad in the family business in 1947. My father worked 6 days a week for 37 years. He rarely took a vacation or even a day off. Then, one Friday night in 1984, he drove home from work, suffered a heart attack, and died at the age of 63. At that time, his assets, the most valuable of which was Mizell Lumber, passed to my mother. My mother died on September 7, 1990. In administering my mother's estate, my two brothers and I were told by our attorney that we would need to hire appraisers to determine the fair market value of the business including the land on which Mizell Lumber is operated. I can recall feeling shocked when I learned that we would have to pay Federal estate taxes on the value of the lumber company as of the date of my mother's death. The land, which my grandfather originally had purchased for $55,000 and which had been in the family for almost 60 years, was now appraised at $1, 247,000. To our surprise and chagrin we owed a whopping $297,000 in Federal estate taxes. In addition, we had to pay more than $5,000 for the appraisals and $40,000 for attorneys' fees because the estate had many issues so complex that it took two and a half years for it to be settled, and all of this was occurring as we were grieving the loss of our mother.

These days I hear so much talk that Americans are not saving enough for retirement and are buying too many things on credit. Well, my father could have taught a class on fiscal responsibility. He never used a credit card in his life. He didn't purchase a new car until he had the money saved up to pay cash for it. My dad worked hard, 6 days a week, 52 weeks a year. He always lived within his means and saved for the future. His number one priority was his children's education. He sent all 3 of us through 12 years of catholic school and then to the college of our choice and most importantly he wanted to leave a legacy to his children and grandchildren.

How was my father rewarded for his lifetime of hard work and frugality? We had to liquidate his certificates of deposit, bank accounts, stocks and bonds, and send nearly all of the cash we could come up with to the Internal Revenue Service, yet, that still wasn't enough to pay the Federal estate taxes. We were allowed to defer paying approximately $150,000 of the total tax liability over 15 years. We have sent an estate tax payment of about $19,000 to the Internal Revenue Service every June and will continue to do so until the year 2006.

I feel very fortunate that we didn't have to liquidate or sell the business in order to pay off these estate taxes. Nonetheless, I ask, where is the incentive to work hard, invest, be responsible, and pay as you go if a businessowner's estate is taxed the fair market value on property that has been in the family for decades.

I have three small children. My oldest son is 9 years old, and he sits behind me today. He is a fourth-grader at Holy Cross Elementary School in Garrett Park, Maryland. He is a straight-A student

and recently won the National Geographic Geography Bee for his entire school, beating out all of the older students in grades five through eight. He deserves to attend one of the finest universities in the United States. If I could invest my share of the estate taxes that we are paying, his college education and that of my two younger children would be assured.

In conclusion, it is clear to me that the estate and gift tax depletes the estates of taxpayers who have saved their entire lives forcing many successful family businesses to either lay off workers, borrow funds, reduce capital investments, or, in a worst case scenario, liquidate or sell to an outsider. Taxpayers should be motivated to make financial decisions for business and investment reasons and not be punished for individual initiative, hard work, and capital accumulation. The U.S. Chamber believes that the estate and gift tax should be completely repealed, however, if outright repeal is not feasible at this time, it should be significantly reformed in order to reduce or eliminate its negative effect on individuals and the owners of family businesses.

Thank you for allowing me the opportunity to testify here today, and I ask that my entire written statement be placed in the record.

[The prepared statement follows:]

**Statement of Jeannine Mizell, Owner and Manager, Mizell Lumber and Hardware Company, Inc., Kensington, Maryland, and Member, U.S. Chamber of Commerce**

Mr. Chairman and members of the Committee, my name is Jeannine Mizell and I am a third generation owner and manager of Mizell Lumber and Hardware Company, Inc., which is located in Kensington, Maryland. I am also a member of the U.S. Chamber of Commerce—the world's largest business federation, representing more than three million businesses and organizations of every size, sector, and region. I appreciate this opportunity to relate my story, and to express the views of the U.S. Chamber on the federal estate and gift tax and the need for its repeal or significant reform.

I hereby ask that my entire statement be incorporated into the record. While this afternoon's topic of discussion is the federal estate and gift tax and its negative affect on businesses, such as mine, the U.S. Chamber would also like to point out that additional tax relief measures need to be enacted to further increase economic growth, productivity and international competitiveness.

These tax measures include: repealing, or in the alternative, further reducing the alternative minimum tax and capital gains tax; permanently extending the research and experimentation tax credit; simplifying the foreign tax rules; reforming and restructuring the Internal Revenue Service, simplifying the worker classification rules, further expanding individual retirement accounts; lowering the maximum tax rate on the reinvested earnings of all flow-through entities, and further reforming the S corporation rules.

BACKGROUND OF THE ESTATE AND GIFT TAX

Originally, federal estate taxes were imposed primarily to finance wars or threats of war. The first federal estate tax was a stamp tax imposed in 1797. The first progressive estate tax was adopted in 1916, with the maximum tax rate varying from 10 percent in 1916 to 77 percent in 1941. The gift tax was first imposed in 1924, repealed two years later, and then reinstated in 1932.

Before 1976, estate taxes were imposed on transfers occurring at death, while gift taxes were imposed on transfers made during a taxpayer's life. In 1976, the estate and gift tax structures were combined and a single unified graduated estate and gift tax system was created. This unified tax system has since applied to the cumulative taxable transfers made by a taxpayer during his or her lifetime and at death.

In 1948, Congress provided the first marital deduction, allowing 50 percent of the value of any property transferred to a spouse to be excluded from a decedent's taxable estate. This deduction was later increased to 100 percent. In addition, an individual can give to an unlimited number of recipients up to $10,000 in gifts annually without triggering the gift tax.

Under the current estate and gift tax rate structure, rates begin at 18 percent on the first $10,000 of cumulative transfers and reach 55 percent on transfers that exceed $3 million. In addition, a 5-percent surtax is imposed upon cumulative taxable transfers between $10 million and $21,040,000.

A unified tax credit is available to offset a specific amount of a decedent's federal estate and gift tax liability. From 1987 through 1997, the unified credit effectively exempted the first $600,000 of cumulative taxable transfers of a decedent from the estate and gift tax. Under the Taxpayer Relief Act of 1997, the effective exemption amount was increased to $625,000 for 1998, $650,000 for 1999, $675,000 for 2000 and 2001, $700,000 for 2002 and 2003, $850,000 for 2004, $950,000 for 2005, and $1 million for 2006 and years thereafter. The exemption amount, however, will not be indexed for inflation after 2006.

In addition, the Taxpayer Relief Act of 1997 created a new exemption for "qualified family-owned business interests" beginning in 1998. However, this exemption, plus the amount effectively exempted by the applicable unified credit, can not exceed $1,300,000. Whether a decedent's estate can qualify for the maximum $1,300,000 exemption amount will depend on the blend of personal and qualified business assets in the estate at death.

## THE ESTATE AND GIFT TAX IS COMPLEX, UNFAIR AND INEFFICIENT

When the government in a free society uses its power to tax, it has an obligation to do so in the least intrusive manner. Taxes imposed should meet the basic criteria of simplicity, efficiency, neutrality and fairness. The federal estate and gift tax fails to meet any of these requisites.

The estate tax is anything but simple to understand or comply with. It is a multi-layered taxing mechanism so complex and convoluted that it has given rise to a cottage industry of estate tax planners, accountants and lawyers. While this may be acceptable to those professionals who make their living from the federal estate and gift tax system, it is not acceptable to the thousands of individuals who are forced to pay billions of dollars each year in estate taxes, planning fees, and compliance costs.

Even the simplest of estates require a certain amount of estate tax planning in order to avoid the pitfalls of this complicated tax system. Estate tax planning often includes the creation of one or more trusts, such as a living trust or "Q–TIP" (qualified terminable interest property) trust, adding even more expense for taxpayers. The estate tax system also contains generation-skipping provisions designed to tax transfers from grandparents to their grandchildren. While the newly-created "qualified family-owned business interest" exclusion will reduce estate taxes for some businesses, the provisions have added complexity to an already overly complicated tax system.

The estate and gift tax is also inefficient. Taxes are efficient when they waste few resources in the collection process, impose no unnecessary compliance costs on taxpayers and make a high percentage of the proceeds available for public goods. The estate tax has very high collection and compliance costs, even though its revenues only account for slightly more than one percent of total federal tax collections. Individuals and businesses that do not owe estate tax still spend millions of dollars on estate planning and tax return preparation. For example, in 1995, approximately 31,000 estates were subject to estate tax, however, about 70,000 estates had to go through the expense of filing estate tax returns.

The other characteristics of an acceptable tax are its neutrality and fairness. While measuring these aspects require a certain amount of subjectivity, the estate tax can not be considered either neutral or fair to individuals or businesses. The highly-progressive nature of this tax severely penalizes those who have saved more, risked more, and worked harder than others.

Furthermore, those with large estates often hire expensive estate tax planners and attorneys to establish elaborate estate plans in order to eliminate, substantially reduce, or defer their estate tax liabilities. Unfortunately, many small and family-owned business owners are either unaware of the need for estate tax planning or unable to afford it, which later results in enormous estate tax liabilities for such businesses. In order to pay such liabilities, these businesses are forced to either lay off workers, borrow funds, reduce capital investments, liquidate, or sell to an outside buyer. These actions hurt everyone connected with these businesses, including its owners, employees, customers, vendors, and families.

## THE ESTATE AND GIFT TAX THWARTS ECONOMIC GROWTH AND PRODUCTIVITY

Public policies should not only improve our nation's current economic environment, but also ensure our future prosperity. The key to a stronger economic future is simple to define (i.e., a high rate of economic growth), but difficult to achieve. It is strong economic growth that will allow us to maintain our position of world leadership, increase our standard of living, and meet the daunting demographic challenges that will begin to present themselves early in the next century.

But economic growth does not occur by accident. Just as our farmers do not rely on good luck for bountiful harvests, neither can we rely on chance or the momentum of the past to propel us in the future. The seeds of tomorrow's economic success must be planted today, and so, when evaluating economic policies, we must ask how they would cultivate long-term economic growth.

By definition, economic growth is simply the product of growth in the labor force (i.e., the number of hours worked) and growth in productivity (i.e., output per hour). With growth in hours worked largely determined by demographics, sensible economic policy must emphasize strong productivity growth.

This is a crucial issue because productivity growth has been languishing for the past quarter-century or so. After expanding at a healthy 2.7 percent rate during the 1960's, for example, productivity growth has slowed to an anemic one percent rate so far in the 1990's. With growth in hours worked hovering a little below 1.5 percent, long-term economic growth is thus limited to 2.5 percent—well below the average of the post-World War II era.

While measurement problems related to productivity have expanded with the growing share of the economy devoted to service-producers rather than goods-producers, the decline in economic growth over the same period confirms that we are suffering a decline in the underlying growth rate in productivity. The question then becomes: What can we do to raise productivity growth?

Like the farmer who sows the seed corn and cultivates the soil, households and businesses must also prepare for the future. Virtually all economists agree that this is done by saving and investing in capital—both human capital (education) and physical capital (plant and equipment). Thus the issue of long-term productivity growth and, in turn, economic growth becomes one of fostering additions to, and improvements in, capital. Consequently, today's economic policies must be targeted toward improving economic growth by fostering saving, investment, and capital formation. Only through such pro-growth policies can we lay the foundation of prosperity and security for our children into and beyond the 21st century.

To boost productivity, the federal government must end its misdirection of resources and curb its appetite for borrowing so that national savings and investment can be increased. This will yield stronger productivity growth, which in turn will propel the economy on a higher growth track. Besides balancing the budget, other policy elements that would aid long-term economic growth include overhauling our regulatory and tort systems, enhancing education and job training programs, reducing the tax burden, and reforming the tax code.

## THE ESTATE AND GIFT TAX NEEDS TO BE REPEALED OR REFORMED

While the Taxpayer Relief Act of 1997 will provide some businesses with relief from the estate and gift tax, and is certainly a step in the right direction, the best solution would be to repeal the tax outright. The U.S. Chamber supports legislation introduced by Senator Jon L. Kyl (R–AZ) and Representative Christopher Cox (R–CA)—the Family Heritage Preservation Act (S. 75, H.R. 902)—which would immediately repeal the federal estate and gift tax. However, if repeal is not politically feasible in the near term, additional reforms should be implemented to make the tax less harmful to small business owners and their workers.

First, the unified credit (and its corresponding exemption amount) should be increased even further. In today's marketplace, the value of many "small" businesses easily exceed the prescribed exemption amounts, making them potentially subject to estate tax. In addition, the recently-enacted $1-million exemption amount should be phased-in over a much quicker time period. For example, while the effective exemption amount is scheduled to increase to $1 million by 2006, such amount will not exceed $700,000 until 2004. The credit also needs to be indexed for inflation so its value is not eroded over time. Under current law, once the effective exemption amount reaches $1 million, it is scheduled to remain at that level indefinitely.

Second, overall estate and gift tax rates—which can reach as high as 60 percent—need to be significantly reduced. The value of a decedent's taxable estate only has to exceed $2 million before it becomes subject to a 49-percent rate, and $3 million before it becomes subject to a 55-percent rate. These rates are excessive and need

to be significantly lowered in order to promote business and job growth. The U.S. Chamber supports legislation introduced by Senator Don Nickles (R–OK)—the Estate Tax Reduction Act of 1997 (S. 650)—which would drop the maximum marginal estate tax rate to 30 percent.

Third, in order to promote the continuation of family-owned businesses, the amount of the newly-enacted "qualified family-owned business interest" exclusion needs to be further increased, as well as expanded to encapsulate more businesses. When a substantial portion of a decedent's wealth is invested in his or her business, payment of the estate and gift tax can be extremely difficult without having to liquidate or sell the business, sell key assets, lay off hard-working employees, or borrow against its assets. The U.S. Chamber supports legislation introduced by Representatives Jim McCrery (R–LA), Jennifer Dunn (R–WA), and others—the Family Business Protection Act (H.R. 1299)—which would, among other things, exempt from estate tax the first $1.5 million in value, and 50 percent of any excess value, of a "qualified family-owned business interest."

Fourth, existing installment payment rules need to be further broadened. Under current law, the estate tax attributable to a "closely-held" business can be paid in annual installments over a 14-year period. In addition, tax on the first $1 million in value of a such a business is eligible for a special two percent interest rate. In addition to increasing the 14-year installment period, more businesses should be able to qualify for installment plans, and a greater amount of estate tax should be eligible for a low, or zero percent, interest rate. The U.S. Chamber supports legislation introduced by Senators Charles E. Grassley (R–IA), Trent Lott (R–MS), and others—the Estate Tax Relief for the American Family Act of 1997 (S. 479)—which would, among other things, increase the installment payment period to 20 years.

## MY ESTATE TAX HORROR STORY

My grandfather founded Mizell Lumber in 1922. In 1931, he purchased the property on which Mizell Lumber is still operated for approximately $55,000. My father, Fred Mizell, joined his Dad in the family business in 1947. My father worked six days a week for 37 years, rarely taking a vacation or even a day off. Then one Friday night in 1984, he drove home from work, suffered a heart attack, and died at the age of 63. At that time, his assets, the most valuable of which was Mizell Lumber, passed to my mother. However, my mother died on September 7, 1990.

My two brothers and I were told by our estate tax attorney that we would need to hire appraisers to determine the fair market value of the business, including the land on which Mizell Lumber is operated. I can recall feeling shocked when I learned that we would have to pay federal estate taxes on the fair market value of the lumber company as of the date of my mother's death. The land, which my grandfather originally had purchased for $55,000, and which had been in the family for almost 60 years, was now appraised at $1,247,000. To our surprise and chagrin, we owed a whopping $297,000 in federal estate taxes! In addition, we had to pay more than $5,000 for the appraisal itself, as well as $40,000 for attorney fees because the estate had many issues so complex that it took two and one-half years to settle the estate. All this was occurring as we were grieving the loss of our mother!

I hear so much talk in the news regarding the fact that Americans are not saving enough for retirement and are buying too many things on credit. Well, my father could have taught a class on fiscal responsibility. He never used a credit card in his life. He didn't purchase a new car until he had the money saved up to pay cash for it. My Dad worked hard six days a week, 52 weeks a year. He always lived within his means and saved his money for the future. His number one priority was his children's education. He sent all three of us through twelve years of Catholic schools and then to the college of our choice. Most importantly, he wanted to leave a legacy to his children and grandchildren.

How was my father rewarded for his lifetime of hard work and frugality? We had to liquidate his certificates of deposit, bank accounts, stocks and bonds, and send nearly all of the cash we could come up with to the Internal Revenue Service. And yet that still wasn't enough to pay the federal estate taxes! We deferred paying approximately $150,000 of the total taxes due over fifteen years. Mizell Lumber has sent an estate tax payment of about $19,000 every June, and will do so until the hear 2006. I feel very fortunate that we didn't have to liquidate or sell the business in order to pay off these estate taxes. Where is the incentive to work hard, invest, be responsible and pay-as-you-go if a business owner's estate is taxed at fair market value on property that has been in the family for decades?

I have three small children. My oldest son is nine years old. He is a 4th grader at Holy Cross Elementary School in Garrett Park, Maryland. He is a straight-A stu-

dent and recently won the National Geographic Geography Bee for his entire school, beating out all the older students in grades 5 through 8. He deserves to attend one of the finest universities in the United States. If I could invest my share of the estate taxes that the business is paying, his college education, and that of my two younger children, would be assured.

CONCLUSION

The estate and gift tax depletes the estates of taxpayers who have saved their entire lives, often forcing successful family businesses to liquidate or take on burdensome debt to pay the tax. Taxpayers should be motivated to make financial decisions for business and investment reasons, and not be punished for individual initiative, hard work, and capital accumulation. The U.S. Chamber believes that the estate and gift tax should be completely repealed. However, if outright repeal is not politically feasible, it should be significantly reformed in order to reduce or eliminate its negative effect on individuals and the owners of family businesses.

Thank you for the allowing me the opportunity to testify here today.

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Chairman ARCHER. Thank you, Ms. Mizell, and, without objection, your written statement will be put in the record in full as will be true of all witnesses. The next witness is Mr. Hannay. Welcome.

**STATEMENT OF ROGER HANNAY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, HANNAY REELS, INC., WESTERLO, NEW YORK, ON BEHALF OF NATIONAL ASSOCIATION OF MANUFACTURERS**

Mr. HANNAY. Thank you, sir. Good afternoon, Mr. Chairman and other Members of the Committee. My name is Roger Hannay, and I am president and chief executive officer of Hannay Reels, Inc., a small manufacturer in the foothills of the Catskill Mountains in upstate New York, 25 miles from Albany. What we make is heavy duty reels that wind up hoses such as on a fire truck or on a fuel delivery aircraft refueler, and so forth.

I'd like to address you today about the death tax. It's been aptly named that several times today. For years, it's been euphemistically known as the estate tax, which reminds me more of a nice place in Virginia that you raise horses than a tax, so I will continue to refer to it as the death tax—it is, after all, indeed, a tax on dying.

On November 10, 1997, my dad, George, was lost to us, to myself and my siblings, and he was a second-generation owner and former chief executive officer and current chairman when he passed away. He missed just about as few days of work as my counterpart's dad did over the years he was there; he was still at work 1 week before his death at age 77. I'd like to thank, in absentia, but in spirit, Mike McNulty—my own Congressman who's on this panel—for his kindness to us at that time. He and his dad were both there for the memorial service.

Our fourth generation which consists of my son, Eric, and my daughter, Elaine—who's with us a little bit further back in the room today—they represent the hopes and plans of our company for continuation of the business. They are both committed to succeeding in both senses of that word. To do so, we'll have to successfully navigate the mine field of the normal family planning issues: getting along with each other; making the business work; deciding who has gifts for what areas of the business, and, also, surviving

the repeated blows from the death tax. It's a challenge that revisits us with every generation. The tax challenge is definitely in our case the more difficult of those two challenges in our family which is reasonably nondysfunctional—to use a double negative.

Death taxes are an issue, not just because of the recent loss of our dad but also because of the need to prepare for my passing. I just realized, looking in the mirror, I'm now the older generation. So, for the sake of our 150 employees and what they represent to our little community which has about 300 residents, we'd like very much to see that happen without the necessity for selling the business simply to pay the taxes.

My dad's estate will, not may, be subject to a full IRS audit; it's a sure thing; it's a slam dunk because of its dollar value. Almost any successful small manufacturing business or small farm or tree stand will be for an automatic audit. As chief executive officer and also other roles such as oldest son, older brother, executor, and father to my kids, I will literally be dealing with the grief over our dad's loss for probably the next 4 years. I heard one optimistic number earlier today of two and a half years, but it makes it very difficult to have closure over the loss of our dad. I also lost my mom April 20 of last year, so it was kind of a double whammy kind of year for us.

I will not attempt, today, to deal with the more technical issues of the tax. There are many people in this town and beyond that are much better trained and qualified to do that than I, and you heard some of them today, however, even with my limited tax knowledge I am aware of a couple of basic points. First of all, I understand that the net revenue produced by this tax after factoring out the costs of collecting it and auditing it are roughly 1 percent of Federal revenues. If we're wrong, we're all wrong together today, because we've all been using roughly that number. The modest source of revenue that that brings imposes unbelievably complex and costly burdens on my business. It causes a dark cloud over our business and thousands of others like it. Did we, indeed, dot all the i's and cross all the t's? Can you ever really know in advance with certainty that the estate plan is correct and complete? I don't think so. What's the value of 20/20 hindsight when we, as executors, talk about could have done, should have done, might have done, if the business has to end up being sold. At least with most other taxes, you can debate and adjust while you're still alive; not so with the death tax.

It's also very obvious to me and others here today that it represents at least double taxation without representation which Patrick Henry would have had difficulty with. Everything in one's estate has already been taxed once before, in some cases twice.

From time to time I lament with my accountants also that I'd like to spend some more of my time and money with them talking about creative and positive things, not defensive things like planning for the death event. There really are other things that accountants and lawyers can do besides this activity as we've already heard.

I'd like to make it real clear that I'm not advocating further tinkering, tweaking with the present tax, although we do appreciate the modest Band-Aid that's been applied for the next few months.

We basically want to kill the death tax as New York State, for one, has already done for the year 2000.

Why is dying a taxable event? It's almost like this is the punishment for having the audacity to die. I sense quite a bit of support for repeal out in the hinterlands. It has been said at least partially in jest, "If it moves, tax it." I'd like to suggest—maybe we could propose a new saying, "If it quits moving, don't tax it anymore."

Since some friends have become aware that I would be active on this subject, I began receiving some unsolicited war stories one of which very much resembles my colleague to the left here in terms of a forest land where the loss of a multigenerational family farm, or family business, has indeed occurred; there was no alternative.

In closing, I've heard that something close to 95 percent of family-owned businesses don't make it successfully to the fourth generation as ours is attempting to do, and a very high number not to the second or third. If so, I think we have to candidly ask ourselves, "How many of these failures are because the families just didn't get along or competitive pressures—which are certainly formidable challenges—and how many are successful in those arenas only to lose it to the tax man?" I thank you very much for your kind invitation to be here today.

[The prepared statement follows:]

**Statement of Roger Hannay, President and Chief Executive Officer, Hannay Reels, Inc., Westerlo, New York, on behalf of National Association of Manufacturers**

Good afternoon gentlewomen and gentlemen, my name is Roger Hannay and I am President and CEO of Hannay Reels, Inc., a small manufacturer with 150 employees in the foothills of the Catskill Mountains, 25 miles from Albany, New York.

I'd like to address you today about the "death" tax, which for years has been euphemistically known as the "estate" tax. Frankly, the word "estate" reminds me more of a nice place in the countryside of Virginia where you raise horses, rather than a tax, so I will continue to refer to it as the "death tax." After all, it is indeed a tax on dying. On November 10, 1997, my siblings and I lost our Dad, George, a second generation owner and former CEO and then Chairman of our company. On April 20 of the same year, we had lost our Mom. Our fourth generation, my son, Eric, and my daughter, Elaine, who is with me here today, represent the hopes and plans we have for continuation of the business. They are both committed to "succeeding" in the business (in both senses of that word). To do so, we will have to successfully navigate the minefield of "passing the torch" of leadership in the company and surviving repeated blows from the death tax. The tax challenge is definitely the more difficult one of the two in our reasonably non-dysfunctional family (to use a double negative). Death taxes are an issue not just because of the recent loss of my father, but also because of the need to prepare for my passing. For the sake of our 150 employees and what they represent to the community, we would like very much to see that happen without being forced to sell the business simply to pay taxes.

My father's estate will be subjected to a full audit by the IRS, because of its dollar value. Almost any successful small manufacturing business will exceed the threshold for an automatic audit. As CEO, and also oldest son, older brother, executor, and father, I will literally be dealing with the grief over the loss of my parents last year for about the next four years until the final death tax audit is complete. This makes it very difficult to have closure regarding the loss of my parents.

I will not attempt today to deal with the more technical issues of the tax. There are many people, in this town and beyond, who are much better trained and qualified to do that than I. However, even with my limited tax knowledge, I am aware of a couple of basic points. First of all, I understand that the net revenue produced by this tax, after factoring out the costs of collecting and auditing it, are roughly one percent of federal revenues. This modest source of revenue imposes unbelievably complex and costly burdens on my business. It casts a dark cloud over our business and thousands of other family owned businesses: Did we indeed dot all the i's and cross all the t's? Can you ever know (in advance) with certainty that the estate plan

is correct and complete? What is the value of 20/20 hindsight when we talk as executors about "could have done" or "should have done" if the business has been sold? At least with most other taxes, you can debate and adjust, while you are alive. Not so with the death tax.

It is also very obvious to me that it is a tax that represents at least double taxation without representation, a principle that would have been unthinkable to Patrick Henry. After all, virtually everything in one's estate has already been taxed at least once before.

From time to time, I lament with my accountants that I would like to spend some of my time and money with them talking about creative and positive things, rather than defensive things like planning for the death event. There really are other things accountants can do in addition to tax planning.

I'd like to make it very clear that I am not advocating further "tinkering" or "tweaking" with the present tax, although we do appreciate the modest tinkering with the lifetime exclusion that has been proffered as a short-term Band-Aid. We basically want to "Kill the death tax." Why is dying a taxable event? It's almost as if this tax is the punishment for having the audacity to die.

I sense quite a bit of support for repeal out in the hinterlands. It has been said, at least partially in jest, "if it moves, tax it." Perhaps we could begin to agree on a philosophy of "if it quits moving, don't tax it anymore."

Since some friends have become aware that I would be active on this subject, I've begun to receive unsolicited "war stories" from these folks about the situations of their own parents, and what it meant in terms of the loss of a multi-generational family farm or family business. As I become aware of more of these in detail, I will be happy to share them with all who are interested.

In closing, I've heard that something close to 95 percent or more of family-owned businesses do not make it successfully to the fourth generation, as ours is striving to do. If so, I think we have to candidly ask ourselves how many of those failures are because of competitive pressures or families just not getting along (which are certainly formidable enough challenges), and how many are successful in those arenas only to lose these endeavors to the death tax?

I thank you very much for your kind invitation to be with you today.

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Chairman ARCHER. Thank you, Mr. Hannay. Our last witness on this panel is Mr. William Beach. Mr. Beach, welcome.

**STATEMENT OF WILLIAM W. BEACH, JOHN M. OLIN SENIOR FELLOW IN ECONOMICS; AND DIRECTOR, CENTER FOR DATA ANALYSIS, HERITAGE FOUNDATION**

Mr. BEACH. Thank you very much, Mr. Chairman. Members of the Committee on Ways and Means of the House of Representatives, it's a great pleasure for me to be here today. My name is William W. Beach. I am the John Olin Senior Fellow in Economics at the Heritage Foundation and being the last witness on the last panel, I am literally at the end of the day.

I'm going to abandon my formal remarks; what you've heard from everybody on the panels preceding what I'm about to say. It's much more important than what I'm about to say, because they are speaking to the heart of the matter, and the heart of the matter is that we have in the estate tax an utter contradiction, not only the rest of the Tax Code and everything it stands for but of the basis of this country; that if we work hard; if we live by the law; if we try to succeed; educate ourselves; save, we will succeed, and as Carol Moseley-Braun, a Senator from Illinois, said in a hearing before the Finance Committee not too long ago, "in fact, it's the nightmare of the American dream." It's the thing that you wake up when you're 55 years of age, and you say, "Oh my gosh, my accountant has just told me that there's something out there called the estate tax." So let me being—since I'm the last witness, sort of

be the sum-up person—and also, Mr. Chairman, I'm the one that wears the green eyeshade, and I have some answers to revenue questions that you asked in the previous panel.

There are a number of arguments for why we should repeal the estate tax; you've heard them all, and it's very important to listen to what is being said about how it hurts businesses. The other side of that and not represented at these panels is it hurts people who have jobs in these businesses. So, an indirect effect of the estate tax is that it reduces the number of jobs. It also reduces the number of potential jobs, thus, hurting people who are young; who are struggling; who are entering the labor force. We could say an indirect effect of the estate tax is to hurt the working man and the working women in the place in which they live most and that is in their checkbook.

Represented at these panels today and at other panels at other Committee hearings on this subject have been women in business. It's very important to note that with the fastest growing segment of the self-employed people being women entrepreneurs, that the estate tax has become a quintessential women's issue. So among the victims of the estate tax, not only do we count people who are laboring, workers, we can now count women.

Did you know, Mr. Chairman, that the most feared tax among black businessmen today is not the income tax; not the corporation income tax; not the foreign services tax, it's the estate tax. A recent survey by Kennesaw State University professors of accounting and economics—a very nice survey, which I'm happy to send you if you don't have a copy of it—of black businesspeople in this country, African-Americans, who have struggled to provide for their children the kind of life that they didn't have when they started out says the estate tax is the surprise, the thing that would be the most unexpected development. And why this is such a feared tax is all of their life savings have gone into their businesses. These are people who are successful in their businesses but not in their pocketbook.

Asian-Americans, we could go on and on and on again. In fact, I think, Mr. Chairman, the strongest argument today for the estate tax comes from the liberal wing of the American tax community. You know because you have had testimony from Professor Edward McCaffery. His amazing admission being a person who in every other respect will approach taxes from a liberal standpoint, but he must now conclude that he is not in favor, cannot be in favor, must be opposed to the estate tax, and I'll read one short paragraph from his testimony before the Senate Committee on Finance June 7, 1995, "I am an unrequited liberal in both the classical and contemporary political senses of that word whose views on social and distributive justice might best be described as progressive," and indeed he will haunt this Committee because of a recent book that he just published called Taxing Women—you'll see it come up many, many times during this tax season.

I used to believe in the gifts and estate tax as a vehicle for obtaining justice. I am now prepared to confess that I was blind, but now I can see.

It seems to me that there are three ways to repeal the estate tax, Mr. Chairman, and that's in my written remarks. First, outright repeal, it has an amazing support in both the House and Senate,

and, indeed, the economic and revenue effects of outright repeal, similar to that in House Resolution 902 or in Senate bill number 75, are very, very good. In a study we prepared in 1996, in August, on this subject we found that if we were to repeal the estate and gift tax, we would have $11 billion more annually in gross domestic product, 145,000 more additional jobs; personal income would rise by $8 billion a year, and the deficit would in fact be unaffected after the fifth year. I would strongly support outright repeal as the way in which we should proceed, particularly as a result of last night's speech by the President. Oddly enough, he put us on a 1 year short order for Social Security reform. If we, indeed, go the direction of personalization or even partial personalization as a majority of the advisory council on Social Security have recommended, then we're going to have projections of many middle-income Americans with substantial estates upon their retirement in the year 2025 to 2040. The estate tax, if it's not addresses, will be a problem that everybody will face.

The second way is phaseouts. Phaseouts are very attractive. We don't get the economic benefits of repeal immediately, but if you're interested in revenue and protecting the revenue then there are ways to phase out the estate tax over a 10-year period. I would recommend rate reduction coupled with a steady increase in the unified credit, and we are working on simulations that show what that does.

The most interesting and exciting approach—and I'll conclude with this—is what we are calling the unified capital gains. This is a relatively new idea that came out of a hearing in front of the Senate Finance Committee last year. The unified capital gains repeals the estate tax and takes all of the estate tax base and places it under the capital gains tax. It follows directly what Mr. Apolinsky was talking about where we in fact no longer have step-up in basis. Putting in place a $1 million exemption for taxable dispositions out of estates and taxing the rest of those dispositions if they are taxable under capital gains law essentially results in about a 50-percent reduction statically in what you would otherwise get from the estate tax. The dynamic effects are substantial. We're measuring now the economic effects of eliminating compliance, putting all of that together, Mr. Chairman—to answer the question you asked Mr. Apolinsky—out of a total static loss from outright repeal of $180 billion in estate tax revenues over 7 years, the Treasury of the United States would be at a loss of no more than $24 billion if you take in the static and dynamic effects from unified capital gains.

On any of these proposals, we'd be very happy to supply the Committee with additional details. We've measured each of these; measured them using, I think, the best macroeconomic models available, The Warten Econometric Forecasting Associates, DRI, McGraw-Hill. Most economists, now, are on the side of phasing out at least the estate tax or of the unified capital gains tax move.

Thank you very much for allowing me to have these remarks, and I urge the Committee to move forward on estate tax reform.

[The prepared statement follows:]

**Statement of William W. Beach, John M. Olin Senior Fellow in Economics; and Director, Center for Data Analysis, Heritage Foundation**

My name is William W. Beach, and I am delighted to present the following arguments in support of estate tax repeal to the Committee on Ways and Means of the United States House of Representatives. I am the John M. Olin Senior Fellow in Economics at the Heritage Foundation, a Washington based public policy research organization. The following remarks constitute my own opinions, and nothing in this testimony should be construed as representing the views of The Heritage Foundation or support by the Foundation for any legislation pending before the Congress.

TESTIMONY

The 105th Congress took important steps in the Taxpayers Relief Act of 1997 toward lightening the burden of death taxes on certain well-defined taxpaying segments. By expanding the exemption of taxable wealth for estates containing small businesses or farms, the Congress officially recognized the harmful effects that death taxes now have on entrepreneurship and family-owned enterprises. By increasing the unified credit from six-hundred thousand to one million dollars over 10 years, the tax writing committees signaled their understanding that estates of this size will be increasingly common in the near future and that small estates should not be taxed.

The tax act of 1997, however, did little more than address the immediate shortcomings of this peculiar tax. The increase in the unified credit keeps taxpayers roughly even with inflation, even though a little less than half of the higher credit comes in the last two years of the ten-year phase-in period. The additional exemptions for small businesses will offer some taxpayers relief, but the complex steps that taxpayers must take to discover whether they are eligible for the higher exemptions will require significant legal advice and the counsel of high-priced accountants. It is doubtful that more than a few hundred estates containing small business assets will ever qualify for these "tax savings" Congress enacted last year.

The actions taken by Congress in last year's legislation had one additional effect: they left largely in place all of the arguments for repealing federal death taxes. It remains a tax that unintentionally falls most heavily on small businesses, farmers, ethnic minorities, women entrepreneurs and, indirectly but importantly, on poor people. While virtually every Congress since the middle 1930s has spent considerable effort designing tax policy that would help these types of taxpayers, intergenerational wealth transfer taxation has produced an effect almost completely opposite that of nearly every other part of the Code. It appears that the estate tax actually bears down most heavily on the intended beneficiaries of wealth taxation, not the tax policy's apparent targets:

- owners of small and medium-sized businesses, who often are ethnic or female, discover too late for remedy that their legacy of hard work and frugality will not pass to their children but instead will fall victim to confiscatory taxation and liquidation;
- farmers, many of whom are descendants of the Populists who rallied at the end of the nineteenth century in support of wealth taxation, lose their farms not because of wealthy agribusinesses or capitalist "robber barons" but because the federal government demands a tax payment upon death from people who have invested their earnings back into their family legacy and have maintained meager liquid savings;
- workers suffer, too, when small and medium-sized businesses are liquidated to pay estate taxes and when high capital costs depress the number of new business creations that could offer new jobs;
- and poor people are harmed by the estate tax, not only because the general economy is weakened by the estate tax's rapacious appetite for family-owned businesses but also because the estate tax discourages savings and encourages consumption (particularly among wealthy individuals), thus undermining the federal income tax from which the funds are raised to support programs for disadvantaged Americans.

What should Congress do to address these problems stemming from federal death taxes? In my view, nothing short of repeal will eliminate the significant indirect effects of the tax, such as job losses that result from forced liquidations of businesses contained in taxable estates. Indeed, repeal may be the only appropriate step if Congress wishes to address the moral quandaries raised by multiple taxation.

There appears to be three repeal options open to Congress: immediate repeal of those Code sections that permit estate, gift, and generation-skipping taxation; a phase-out plan that reduces the top tax rate and raises the unified credit over a specified number of years; and the unified capital gains tax (which repeals federal

death taxes and unifies the old estate tax base with the capital gains tax base). Let me describe each option separately.

### IMMEDIATE REPEAL

Ending death as a taxable event is the objective of H.R. 902, sponsored by Congressman Chris Cox, and S. 75 offered by Senator Jon Kyl. These two identical bills repeal estate, gift and generation-skipping taxes and currently enjoy substantial support in their respective chambers: there are 31 sponsors of the Senate bill and 161 sponsors of this legislation in the House.

Many of the co-sponsors of these two bills doubtless support repeal because of the compelling moral argument behind this reform, which I describe below. However, others are more comfortable with repeal following several demonstrations that federal revenues are enhanced by elimination of federal death taxes rather than harmed.

An analysis by The Heritage Foundation using two leading econometric models found that repealing the estate tax would have a large and beneficial effect on the economy.[1] Specifically, the Heritage analysis found that if the tax were repealed this year, over the next nine years:

- the nation's economy would average as much as $11 billion per year in extra output;
- an average of 145,000 additional new jobs could be created;
- personal income could rise by an average of $8 billion per year above current projections; and
- the deficit actually would decline, since revenues generated by extra growth would more than compensate for the meager revenues currently raised by the inefficient estate tax.

The Heritage analysis of repeal's positive effects has been recently supported by work on the unified capital gains tax by Richard Fullenbaum and Mariana McNeill.[2] Their work includes estimates of how much economic output would change from eliminating the costs of complying with death tax law. These costs were not included in the Heritage study of 1996. Had they been, the positive effects described above would be enhanced.

### PHASING DOWN TAX RATES AND INCREASING THE UNIFIED CREDIT

A number of Members have expressed interest in slowly but steadily reducing the top statutory tax rate on estates. Congressman Pappas in particular has championed this approach to repeal. Others have indicated an interest in coupling reductions in rates with increases in the unified credit, which accelerates the phase-out period by shrinking the number and size of taxable estates. Over time, federal death taxes simply disappear.

There are a number of unpublished revenue and economic estimates of various phase-out plans, all of which indicate that significant improvements to economic efficiency follow reductions in death tax burden. However, the positive economic and revenue effects that come from immediate repeal overwhelm those that stem from a slow phase-out program. Not only do compliance costs continue to burden taxpayers, but tax avoidance behavior persists, which results in capital and labor costs remaining higher than they otherwise would be following outright repeal.

Despite the likelihood that phasing out the estate tax would result in fewer economic bonuses than would immediate repeal, the advocates of the phaseout option argue that the Treasury would "lose" fewer tax dollars than under the immediate repeal option. While my research indicates that immediate repeal produces more total income tax revenue after the four years than the phase-out option, the advocates of this more cautious approach are doubtless correct on the direction of revenue change in the very short run.

### THE UNIFIED CAPITAL GAINS TAX

The unification of the estate tax base and the capital gains tax base through the unified capital gains tax appeals to those repeal advocates concerned with the moral dimensions of federal death taxes as well as those focused on repeal's revenue effects. The proposal repeals all federal death taxes (thus ending death as a taxable

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[1] William W. Beach, "The Case for Repealing the Estate Tax," The Heritage Foundation Backgrounder, no. 1091, August, 1996.

[2] Richard F. Fullenbaum and Mariana A. McNeill, "The Effects of the Federal Estate and Gift Tax on the Aggregate Economy," forthcoming from The Research Institute for Small & Emerging Business (1998).

event) and imposes the long-term capital gains tax rate on only those asset transfers from estates that 1) would be taxable under existing capital gains law and 2) exceed a special one-million dollar exemption on otherwise taxable dispositions from estates to persons as defined and recognized in present tax law. Some advocates of this approach would end step-up in tax basis.

By making the "tax moment" the disposition of an asset rather than the death of a taxpayer, the unified capital gain tax addresses many of the moral concerns advanced by supporters of outright repeal. Death is not the taxable event, and unprepared taxpayers will no longer be forced to liquidate ongoing businesses or family assets just to pay a tax. Of course, the unified capital gains tax only eliminates one layer of multiple taxation: many assets created from after-tax income will be taxed again under capital gain tax law. However, the repeal of the estate tax clearly moves tax policy in the direction a flatter tax system, and the proposal should interest those tax policy reformers interested in fundamental tax changes.

Economic analysis of the unified capital gains tax by Fullenbaum and McNeill indicates that this tax policy change would likely result in improved economic performance and surprisingly little revenue "loss" in the short run. Fullenbaum and McNeill predict significant employment and income gains from repeal, largely stemming from the drop in capital and compliance costs that follow unification. The small drop in revenues reverses sign after four years, and income taxes from individuals and corporations grow above CBO baseline projections.

## THE MORAL ARGUMENT FOR REPEAL

All three of these proposals for repealing federal death taxes draw on a growing body of empirical evidence and philosophical argument that is ineluctably undermining the historical justification for intergenerational wealth transfer taxation.

Between 1913 and 1916 the Congress deployed a system of income taxation that had two objectives: to raise revenue for the federal government and to contain the economic power of wealthy individuals through taxation. This latter objective dominated Congress's discussion of income taxation and inspired support among political activists during the ratification process for the Sixteenth Amendment to the United States Constitution. In its common translation, the "containment" objective of early tax policy meant simply this: the increasing concentration of wealth in the hands of a few individuals prevents many Americans from enjoying the economic opportunities that this country was founded to provide and that our fundamental law protects.

While revenue requirements were always high on Congress's agenda, especially during the ensuing world war, it is fair to say that wealth containment was the fundamental public policy goal that Congress intended wealth taxation to achieve. It also is fair to say that, after eighty years of estate taxation, this objective has not been met.

If it was Congress's intention to craft a public policy that threatens and destroys small and medium-sized businesses, devastates rural communities, weakens the economy and depresses job growth for new and displaced workers, and makes it more, not less, difficult for poor people to rise up the income ladder and participate more fully in the economic opportunities of American civilization; they could have done little better than the estate tax. But this outcome, of course, was precisely the opposite of Congress's purpose.

U.S. wealth taxation policy surely is a classic instance of unintended consequences. Reversing these perverse results should be the current Congress's principal tax policy program. It is politically unconscionable as well as morally dubious to assert, on the one hand, that a principal objective of U.S. tax policy is to expand economic opportunity for disadvantaged Americans—blacks, Hispanics, women, workers, and poor people—while, on the other hand, vigorously enforcing a part of U.S. tax policy that contracts their economic opportunity.

This dilemma is resolved only by repealing the estate, gift and generation-skipping tax. Reforms that "protect" certain taxpayers from the estate tax (an intriguing admission in itself of the contradictions inherent in the law) through increases in the unified credit do nothing for those Americans above the new taxable threshold but who are no different from their brothers and sisters just below the threshold except that they are modestly more successful. Reforms do nothing for workers in firms that are not "protected," for farmers whose land values have risen above the new threshold because they abut a new suburb or cross a cellular transmission grid, or for poor people living in an economy still insufficiently robust to lift them out of poverty. Reforms do nothing to reverse the incentive to consume rather than save or to purchase expensive life insurance, legal and accounting advice that moves resources to sectors of the economy that do little to raise worker productivity and

worker wages. And reforms do nothing to resolve the public's increasing demand that Congress enact substantive tax reforms that result in a simpler, flatter, and fairer tax system.

It is ironic but perhaps fitting that most of the energy for estate tax repeal has come from political conservatives. One would think that the rich tradition among American liberals of supporting middle class incomes, jobs for new workers, economic opportunities for disadvantaged groups, and protection of the family farm would have made estate tax repeal a top objective. Surely the liberal objection that repeal would only benefit rich people could be addressed by modest changes to capital gain tax law where, indeed, many wealthy people currently choose to be taxed. And surely the objection that too much revenue would be lost with repeal could be addressed by simple demonstrations that the estate tax currently undermines the income tax directly through legal avoidance schemes that shelter income from estate taxes and indirectly through consumption rather than savings.

Take, for example, the growing evidence of the estate tax's harm to the general economy and to jobs in particular. Economists across a wide political spectrum have produced a rich body of empirical and inferential evidence that the estate tax reduces economic activity and fails to achieve its stated purpose. For example, Alan Blinder, who served in President Clinton's first Council of Economic Advisers and later as Vice-Chairman of the Board of Governors of the Federal Reserve System, argued that "[t]he reformer eyeing the estate tax as a means to reduce [income] inequality had best look elsewhere."[3]

The complex estate and gift tax edifice rests on the foundation that taxing intergenerational wealth transfers results in less concentrated wealth holdings and that this leads in turn to greater economic opportunity and a more democratic society. If the tax's supporters cannot sustain the argument that the estate tax improves equality of economic opportunity, then there exists little else (except perhaps inertia) to recommend continuation of this part of U.S. tax policy. Other, simpler taxes could meet revenue objectives far more efficiently and fairly.

Academic support for intergenerational wealth taxation remains warm, in large part because of the role it plays in the most important theoretical treatise on liberal egalitarianism, John Rawls's A Theory of Justice.[4] Since its publication in 1971, this careful, magisterial presentation of the case for liberal democracy infused with just institutions has permeated thinking on most issues in social and political theory. It is fair to say that no stronger theoretical case for intergenerational wealth taxation exists.

At the center of Rawls's case for wealth taxation is the principle that "[a]ll social primary goods—liberty and opportunity, income and wealth, and the bases of self-respect—are to be distributed equally unless an unequal distribution of any or all of these goods is to the advantage of the least favored."[5] While at first blush this principle would appear to suggest radical egalitarianism in economic and political life, Rawls recognizes the superiority of "free" over socialized markets to produce benefits for the least advantaged citizens, which leads him and many like-minded political theorists to support significant differences in the economic conditions of individuals within a generation. After a century of economic experimentation, there can belittle doubt that everyone achieves greater economic benefit when individuals are allowed to discover their own comparative advantage and focus their labor in the area where they can make the greatest economic difference.

This tolerance for intragenerational differences leads Rawls to oppose all income taxes, since economic income stems from natural differences in talent and from differing propensities of individuals to apply themselves to hard work.[6] However, two

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[3] As quoted in Edward J. McCaffery, "The Uneasy Case for Wealth Transfer Taxation," The Yale Law Journal, Vol. 104 (November 1994), p. 322, note 143. Also see Joseph E. Stiglitz, "Notes on Estate Taxes, Redistribution, and the Concept of Balanced Growth Path Incidence," Journal of Political Economy, Vol. 86 (1978), Supplement, pp. 137–150; Alan S. Blinder, "A Model of Inherited Wealth," Quarterly Journal of Economics, Vol. 87 (1973), pp. 608–626; Blinder, "Inequality and Mobility in the Distribution of Wealth," Kyklos, Vol. 29 (1976), pp 607, 619; Michael Boskin, "An Economist's Perspective on Estate Taxation," in Death, Taxes and Family Property: Essays and American Assembly Report, ed. Edward Halback, Jr. (St. Paul, Minn.: West Publishing Co., 1977); Lawrence H. Summers, "Capital Taxation and Accumulation in a Life Cycle Growth Model," American Economic Review, Vol. 71 (1981); Martin Feldstein, "The Welfare Cost of Capital Income Taxation," Journal of Political Economy, Vol. 86 (1978); and Laurence J. Kotlikoff, "Intergenerational Transfers and Savings," Journal of Economic Perspectives, Vol. 2 (1988).

[4] John Rawls, A Theory of Justice (Cambridge, Mass.: Harvard University Press, 1971).

[5] Ibid., p. 303.

[6] Rawls advances a consumption tax to replace income taxes. "For one thing, it is preferable to an income tax (of any kind) at the level of common sense precepts of justice, since it imposes

principles considerations compel Rawls to take substantial exception to intergenerational differences in economic condition.

First, Rawls opposes the transfer of accumulated property to succeeding generations because it undermines the first principle of a just society: that everyone has "an equal right to the most extensive total system of equal basic liberties compatible with a similar system of liberty for all."[7] Those who begin with a significant unearned endowment of property resources place others not so advantaged in a less equal condition, and this undermines the principle that everyone should have access to the same system of equal basic liberties.

Second, this difference might be tolerated if it produced greater benefits for the least advantaged than for the advantaged. However, intergenerational wealth transfers create benefits that flow in the opposite direction: Over time, they enhance the advantages of inheriting generations and generally degrade the liberties of the unbenefitted. The "[t]he taxation of inheritance and income at progressive rates (when necessary), and the legal definition of property rights, are to secure the institutions of equal liberty in a property-owning democracy and the fair value of the rights they establish."[8]

While Rawls does not advance confiscatory taxation of intergenerational wealth transfers, his argument does imply substantial taxing discretion by the state. In his universe, the state guides the institutions of distribution; should government determine that wealth transfers constitute significant barriers to the equal enjoyment of liberties (as defined by Rawls), it clearly has the power to tax away as much of the wealth that moves between generations as it deems necessary to restore justice.

A number of objections could be raised against the Rawlsian case for wealth transfer taxation, not the least of them being the questionable assertion of government authority over the intergenerational disposition of private property. If wealth is acquired legally and transferred peacefully (that is, in some non-tortious fashion that breaches no contract pertaining to property), government has no ethical standing to interfere with its disposition.

Of course, liberal egalitarians claim a more expansive role for government, a principal element of which is the progressive enhancement of equality of condition among citizens. Thus, it is important first to consider the estate tax within the context of the argument that justifies the tax's existence. If it can be shown that the estate tax does not advance the ethical program of the liberal egalitarians, then other objections to this tax that can be raised without assuming this ethical and moral framework become more compelling.

This approach to analyzing the estate tax was taken in a seminal monograph by Edward J. McCaffery published in The Yale Law Journal in 1994.[9] Professor McCaffery comes to the debate over the estate tax with impeccable political credentials. Unlike many critics of intergenerational taxation who frame their objections within a larger, politically conservative analysis of contemporary government, McCaffery formulated his critique of the estate tax within a liberal framework. As he stated last year before this committee:

> I am an unrequited liberal, in both the classical and contemporary political senses of that word, whose views on social and distributive justice might best be described as progressive. I used to believe in the gift and estate tax as a vehicle for obtaining justice. As to the latter belief, only, I am now prepared to confess that I "was blind, but now can see."[10]

McCaffery raises five general objections to the liberal egalitarian argument supporting intergenerational wealth taxation. Each of them assumes the ethical and moral objectives of the liberal program.

1) The currently combined income and estate tax system encourages large inter vivos gift transfers, which have the effect of creating a greater inequality of starting points or a less level economic playing field. This predictable effect of the estate tax law is aggravated further by the fact that high estate tax rates encourage the consumption rather than the transfer of wealth. Purchasing goods and services instead of saving the funds that support that consumption produces larger differences between rich and poor people. Thus, the estate tax is illiberal because it undermines

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a levy according to how much a person takes out of the common store of goods and not according to how much he contributes (assuming here that income is fairly earned)." Ibid., p. 278.

[7] Ibid., p. 302.

[8] Ibid., p. 279.

[9] Edward J. McCaffery, "The Uneasy Case for Wealth Transfer Taxation," The Yale Law Journal, Vol. 104 (November 1994), pp 283–365.

[10] Edward J. McCaffery, "Testimony before the Senate Committee on Finance, June 7, 1995."

rather than advances the liberal egalitarian objective of equality of economic opportunity.

2) While higher wealth transfer taxes might reduce the level of inter vivos gifts, and other tax law changes could be made to penalize the spending behavior of rich families, it currently is both practically and politically impossible to do so. On the one hand, analysts are becoming increasingly aware of the intergenerational focus of much current saving behavior at all income levels. Liberals should promote the creation of transferable wealth among the less advantaged. On the other hand, politicians are becoming increasingly aware of how much voters want taxes to fall, not rise. The estate or inheritance tax has been repealed in Australia, Canada, Israel, and California; and the movement for tax reform is a spreading, worldwide movement.

3) There will always be differences between the starting conditions of people in a non-ideal world.

If liberal egalitarians attempted to eliminate all the differences that stem from intergenerational wealth transfers, they would risk leaving the least advantaged even worse off than they were before. Not only would confiscatory taxation reduce the consumption behavior of wealthy people, thereby also reducing employment and incomes among poorer citizens, but it would depress the amount of economic capital as well, thereby reducing economic expansion and income growth, both of which are central to improving the conditions of the least advantaged.

4) "[It] is the use and not the mere concentration of wealth that threatens reasonable liberal values." [11] Generally speaking, the accumulation of savings and the promotion of earnings that underlie the growth of savings are "goods" that liberals like. Earnings and savings create a "common pool" of resources that can be used to promote improvements in the general welfare through public and private means. Liberals generally regard the consumption behavior of the wealthy as objectionable; thus, wealth transfer taxation, which attacks savings and promotes wanton consumption, is wholly ill-suited to the attainment of an ideal liberal society.

5) The best tax policy that liberal egalitarians could pursue, if attaining liberal social and political objectives truly motivates the liberal program, is one that taxes consumption, not savings. McCaffery writes that "[b]y getting our reasonable political judgments wrong—by taxing work and savings while condoning, even encouraging large-scale use [consumption]—the status quo impedes the liberal project.... The real threats to liberty and equality from private possession alone turn out, on closer scrutiny, to relate to possession qua potential or actual use, each of which can be addressed—indeed, can best be addressed—in a tax system without an estate tax." [12]

Not only, then, is the estate tax inconsistent with a liberal program of promoting quality of economic condition, but it encourages behavior that works against liberal objectives. It supports consumption and depletion by penalizing savings and earnings. it encourages the kind of strange world where it costs less for a millionaire like Steve Forbes to spend $30 million of his own money on a presidential campaign than to save $30 million for his children's future—an investment upon which he will pay 55 percent transfer tax as opposed to a campaign expenditure upon which no additional taxes are ever levied. How many new jobs and new businesses did Mr. Forbes's campaign create as opposed to the same amount saved in a bank that lends the funds to entrepreneurs and business managers? Liberals and conservatives are beginning to answer this question in precisely the same way.

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Chairman ARCHER. Thank you, Mr. Beach, and you certainly are the appropriate person to wind up this hearing today with your expertise in this field. I believe, personally, that if it were not for revenue implications—and that's what you addressed to a great degree in your testimony—we would be pursuing repeal of the death tax.

Mr. BEACH. I agree.

Chairman ARCHER. And that the majority in this Congress, a majority that has had a new approach to things beginning in January 1995, would be supportive of that.

Mr. BEACH. Yes.

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[11] McCaffery, "The Uneasy Case for Wealth Transfer Taxation," p. 296.
[12] Ibid.; emphasis in original.

Chairman ARCHER. But we do have to deal with the revenue constraints, and we do have to deal with the official estimates and not the estimates that come from Heritage even though in the end the estimates coming from Heritage, may prove to be more accurate. We have that limitation.

Mr. BEACH. That's right.

Chairman ARCHER. And we are limited by the constraints of the Budget Act, such that—as I've been saying over the last few days—we cannot risk tipping the balance into a deficit again in this country. We're on the threshold of a balanced budget, which to me is a millennium in itself. It's a dream that I had when I came to Congress in 1971, but only a dream, and it is going to become a reality. We must adhere to that for the benefit of our children, and the death tax is relative to what's going to happen to our children too, which is awfully important. I hope that your data will be factored by CBO and the Joint Committee when they undertake their estimates on whatever proposal comes before the Congress, but we are forced to live with those official estimates of the Joint Committee and CBO. And as a result, even though it is a relatively small percentage of the revenue that comes into the Federal Government, it still is a significant amount of money unless we can get those estimates changed, so I personally will welcome your input, and I hope that it will be considered very carefully by the estimating agencies of the government.

I thank all of you for your testimony, because I've said over and over again now for 2 or 3 years that the income tax is bad for this country because it puts all Americans in a tax trap: the harder you work, the longer you work, the more you pay, and that's wrong. But when you add the death tax on top of it, it becomes the harder you work, the longer you work, the more you save, the more you pay, and that is doubly wrong. That creates an environment that works against the best interests of all Americans, not just the producer but those who benefit from that production by having gainful jobs and the ability to support their own families. To me, that's the essence of what our country stands for: to encourage a work ethic, to encourage savings, and, thereby, to create more wealth that can be shared by all the people in this country.

So, I am completely with you philosophically on what we need to do, but we have to work through this estimating process and these revenue estimates if you——

Mr. BEACH. If I could just have one comment on that, Mr. Chairman. First of all, we've been blessed to work very closely with the Joint Committee and to learn how they work with their staff, and this Committee is well served by the Joint Committee staff. The revenue estimates I could disagree with, but the level of disagreement would be under $1 billion per year. But it is true—and I think your economists will privately tell you this as well—that here we're dealing with a tax issue that more even than the income tax has an economic story that needs to be understood. So, let me recommend this—knowing your rules, and knowing that you need to work with the static—what I call the static estimates—to ask the Joint Committee to do what it did last year and that is to bring several groups together each posed with the problem, measure the effects of the elimination of the estate tax, and have that report

produced by whoever will now be the Chief of Staff and given to this Committee to inform them of the range of estimates—ours is one of those—that come from repeal. I think that information would be very informative to the Committee. It would do two things: It would move the estate tax forward, and it would also move this Committee forward, I hope, more closely to consensus, dynamic revenue estimating.

Chairman ARCHER. Well, we began, 3 years ago, to get more behavioral response into the estimating process, as I mentioned during the discussion on the marriage penalty, and I'm pleased about that because I've been Chairman of the Joint Committee on Taxation as well as Chairman of the Ways and Means Committee, and I believe we should always strive for accuracy. I don't want something to come out because it weighs in favor of what I believe in that isn't accurate. That means that we do have to take into account behavioral response, and in the end we have to bridge the disconnect between the CBO and Joint Committee, and that disconnect is as follows: that the CBO, today, has a responsibility for the macroeconomic impact; that is, how many more jobs are going to be created, and how much extra income tax will flow into the Treasury as a result of whatever we do? The Joint Committee does not have the ability to do that, nor do they have, under the law, the responsibility to do that. They must accept whatever the baseline is that the Congressional Budget Office puts out, and then they must overlay their estimate as to the specific tax change, and the baseline that the CBO puts out is not changed to accommodate what impact the tax change will have on the economy. Now, that's our responsibility; to find a way to overcome that, and we're in the process right now of trying to work through that, but our goal should always be accuracy, and I just want to assure that I'm going to do everything I can to see that happen.

Mr. Hulshof.

Mr. HULSHOF. Thank you, Mr. Chairman. Thank each of you for being here, and Ms. Mizell, it's great to have your supporters here. It sounds like that straight-A 9-year-old fourth grader might have a future in politics someday.

Mr. Beach, I want to be a devil's advocate for the brief moments I have, and I want to be, just for purposes of this question, as a hard as it is for me, an unrequited tax liberal.

Mr. BEACH. All right.

Mr. HULSHOF. And here is their argument: If the principle objective of our U.S. tax policy is to expand economic opportunities for disadvantaged Americans, and the way we do that is to redistribute income from one segment to another, then doesn't your proposal to repeal—and, again, this is a hypothetical—the fact that you're trying to repeal the death tax—shouldn't the Bill Gates of the world be required to pay to help provide economic opportunity for those on the lower rungs of society? What is the response to that liberal tax argument?

Mr. BEACH. Well, thank you for that question, and I know, Mr. Hulshof, that that was difficult question for you to ask. [Laughter.]

It's an interesting response. The tax rate of the estate tax is so high that it does several things if you're wealthy. First of all, it tells you, "Don't save your money, spend it today." So instead of

saving money that creates jobs for ordinary Americans; that expands the economic pie—and by the way, that expands the income taxes that come into the Federal Government—what we have is a signal sent by the estate tax, "Buy that cigarette boat; go to that vacation home in Vale, and buy expensive art in London." In other words, it supports consumption expenditures rather than savings. So, it doesn't have the effect that you would expect it to have on wealthy people. Now, wealthy people also have this advantage: They can hire Harold Apolinsky; they can hire the high-priced accountants and lawyers which allow them to find out early in life that they're going to have this problem and then to set in place a lifetime plan which is oftentimes very expensive of avoiding the 55, the 50, even the 35 percent tax rate. So, they have that ability, and the people that you've heard today generally do not; they're surprised by that tax. And then they can distribute their money through gifts and trusts and other kinds of things, again, expensive to their children and to other people. What happens when that happens? It maldistributes wealth. It perpetuates wealth just like the consumption of wealth maldistributes consumption.

So, I think—and there are many other responses I could make here, but if you go down all of these responses and you talk to someone who's on the liberal side in a quiet moment in a bar perhaps, they have to conclude, "This is the tax I have to oppose," because it is keeping people from entering the work force. It is telling people to consume and to—you know, conspicuous consumption, and we lots of pictures from Aspen and Vale are troublesome sometimes. It is undermining the income tax; it is hurting blacks and women, minority entrepreneurs, all of them.

Mr. HULSHOF. How so? How does repeal of the death tax—how would help the disadvantaged or minorities?

Mr. BEACH. Well, if I'm—let's suppose that I'm a Hispanic person and I have worked and saved and now I've opened a business and 20 years later this business is a big business for me; I've hired 5 or 6 people. Why have I done that? To provide a better life for my children. That's really the overriding thing. The intergenerational consideration of parents overrides money any day; trumps it.

Let me give you the story of Wen Trac. She escaped from Indochina when she was 13 years old; illegally entered the United States—this is a documented case—and began to work the streets in Seattle—it was the only thing she knew how to do. She saved some money and she opened a bucket and washerboard business, and by the time she was 30 she had enough money to open a storefront drycleaning business; married, two daughters. Now, she's 72 years of age. She has two drycleaning businesses. She has learned that she's going to have to liquidate the entirety of her holdings in order to pay the estate tax. All of her savings was in that business, not in the form of cash, but in the form of a job for her two daughters, and those two daughters are now going to have to go back—maybe on the street, but certainly not where Wen Trac wanted them to go.

And we all know the famous story of Mr. Thigpen. He was in the tree business, and he and his wife of 40 years working up a business—treegrowers of the year twice in a row. This is a wonderful business. Liquidating that business, and it's a very strong prospect.

Mr. Thigpen, by the way, is a grandson of slaves that his son is going to have to go to work for one of the local Mississippi farmers. Now, they may be a white farmer.

Is that the outcome that people on the liberal side want? Is that what they want for Wen Trac or the Hispanics or for the African-Americans? It's that contradiction which led Mr. McCaffery to depart and say, "This is not consistent with the liberal vision of what taxes should do." We have spend 70 years now building a Tax Code that would help disadvantaged people and redistribute wealth. This is wrong; it is contradictory; it is inconsistent; it has to be excised from the body of Tax Code in order for the rest to be consistent.

Mr. HULSHOF. Well, I appreciate that, and your description of this conspicuous consumption suddenly brings the realization—my parents, I think, just put a new bumper sticker on their car that says, "I'm spending my children's inheritance."

I want to thank Mr. Chairman for the time and thank each of you for being here.

Chairman ARCHER. Well, thank you, Mr. Hulsolf, and I'm grateful to all four you for the input that you've given the Committee today.

I want to make one last comment, and that is relative to—was it McCaffery that you said, Mr. Beach?

Mr. BEACH. Yes, Mr. Chairman.

Chairman ARCHER. Who identified himself as a contemporary liberal and a historic liberal, or what was the other?

Mr. BEACH. Classical as well as contemporary.

Chairman ARCHER. Classical as well as contemporary. And I would say that that is an oxymoron——

Mr. BEACH. Well, that may be.

Chairman ARCHER [continuing].—because I would refer everyone in this country to read the recent book on Thomas Jefferson called *American Sphinx.* He was the classical liberal, and I am identified as an 18th century liberal, and in today's contemporary times I'm identified as a conservative. There is no connection between the classical liberal and the contemporary liberal because Thomas Jefferson said, when the Constitution was being framed, No. 1, the Federal Government should never have any taxing authority. He was the classical liberal. The Federal Government should have no taxing authority. And then he, furthermore, said, during the creation of the Constitution, to his friend James Madison, "Godsend that our Nation never have a government it can feel."

Now I say to all of you, do you feel the estate tax, the death tax? Do you feel the income tax? Do you feel the government regulations? Do you feel the government programs from Washington? And I think the answer is very clear.

Thank you very much. I wish you well.

The Committee will be adjourned.

[Whereupon, at 3:50 p.m., the hearing was adjourned subject to the call of the Chair.]

# REDUCING THE TAX BURDEN

**WEDNESDAY, FEBRUARY 4, 1998**

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
*Washington, DC.*

The Committee met, pursuant to call, at 10 a.m., in room 1100, Longworth House Office Building, Hon. Bill Archer (Chairman of the Committee) presiding.

Chairman ARCHER. The Committee will come to order. We're still awaiting our first witness, but in the interim, I would like to make a few comments and then recognize Mr. Coyne for what comments he might like to make.

Today we hold the second in a series of hearings on proposals to reduce the tax burden on the American people. Taxes as a percentage of gross domestic product this year are at the highest level in our Nation's history in peacetime.

Disappointingly, the President's budget increases taxes to an even higher level in 1999. High taxes represent a moral and a social challenge to families that are struggling to make ends meet. The more the government takes, the less the families have to invest in themselves, their children, their retirement, their health care, their education, and their communities.

This year I intend to do two things: reduce the national debt and provide tax relief. If we fail to do both, millions of middle-income taxpayers, especially those who are planning for their retirements, will suffer.

When the government takes away the resources people were counting on to help themselves, the people will turn to big government to solve their problems. High taxation creates an endless cycle of public dependency and too big government.

Isn't it better to pay down the debt and reduce taxes so people have more money to spend on their own child care needs, health care needs, and everyday needs? They should be free to invest this money themselves.

Today our hearing will look at tax rates—what they are, and what they should be. The Tax Code has five statutory tax rates, but according to a report released today by the Joint Committee on Taxation, 21 hidden tax provisions force more than 33 million Americans to pay higher taxes than they thought. These sneak attack tax hikes are akin to false advertising by the government.

One in four taxpayers aren't in the brackets that they thought they were. For example, a senior citizen earning $30,000 a year who thinks that he or she is in a 28 percent tax bracket really pays a marginal rate of 42 percent, thanks to a phaseout of the exclu-

sion for Social Security benefits. Five million seniors suffer that fate.

A single parent making $40,000 a year with 2 children in college who thought that he or she was in the 15 percent bracket will pay a marginal rate of 53.5 percent, 53 and a half percent, due to the phaseout of the Hope scholarship that they are involved in. 1.2 million Hope scholarships taxpayers are hit by this sneak attack tax hike.

The list goes on and on, but that's just under the regular rate. There's also the two-rate alternative minimum tax, which can kick in at unpredictable times.

What throws you into the AMT? Three major things: paying State and local taxes, having children, and getting sick. Do those sound like tax shelters? I don't think so.

According to Joint Committee estimates, the individual AMT, which applied to only 414,000 taxpayers in 1995, will hit 8.8 million in the year 2008. And that's just the taxpayers who will pay the AMT.

There are also millions more who will lose some or all of their child credit, Hope credit, lifetime learning credit, dependent care credit, and other tax credits each year because credits cannot reduce regular tax liabilities below the AMT liability. The AMT is a tax hike time bomb. And it's disappointing that the President's budget leaves it ticking.

Finally this morning we'll hear about a proposal to protect taxpayers who make as little as $26,000 a year by lowering the 28 percent tax bracket to 15 percent for millions of Americans. For every $5,000 the 15 percent tax bracket is expanded, each taxpayer affected would save $650.

This across-the-board, middle-class tax cut would let 25 million Americans have more money to invest in themselves, their children, and their communities. It's another reason why reducing taxes solves more social problems than increased spending.

Let me just close with a reminder as the Committee weighs the merits of various tax proposals. I intend to be conservative. I am not going to over-promise the American people and create unrealistic expectations. I will never, I repeat, never, tip the budget out of balance. And I will favor proposals that simplify the Tax Code.

I will say to my colleagues that all of us are in for a rude awakening when we learn that the budget law, the PAY–GO provisions, which is the law of the land today, prohibit us from using any surplus moneys for tax reduction. And that in itself, unless it is changed, will severely limit the ability of this Committee to create a tax relief bill. I will add also that that same budget PAY–GO provision prohibits us from using any savings in discretionary spending for tax relief.

I am going to do all that I can to see that this law is changed. But in the interim, it is going to be very, very difficult to be able to pass a tax reduction bill unless we simply increase taxes on somebody else, which results in no net tax relief. And that is not a desirable position for this Committee to take.

So, having said that, I now recognize Mr. Coyne for any statement that he might like to make on behalf of the Minority.

Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman, for the opportunity to make this statement on behalf of the Ranking Member, Mr. Rangel.

As we begin this hearing on Federal tax burden and as we begin putting together the tax component of the fiscal 1999 budget, I want to urge the Committee to take a serious look at the recommendations contained in President Clinton's budget regarding taxes.

I believe that there is fairly broad bipartisan support for many of his provisions; for example, the low-income housing tax credit. Our colleagues Mr. Ensign and Mr. Rangel have introduced legislation to increase the State volume limitation on the low-income housing tax credit. I am a cosponsor of the bill, and there is a great deal of bipartisan support for the low-income housing tax credit.

I would ask the Chairman to hold a hearing on this issue and to include this provision in the Chairman's mark that he will eventually present to the Committee.

The President's budget request also recommended an expansion of the education zone program that was included in last year's Taxpayer Relief Act. This expansion would provide needed assistance to State and local governments in meeting the need to repair and construct public schools. Addressing this issue through the expansion of last year's act would help our community schools while minimizing bureaucracy and administrative costs.

Many of us hope that there will be bipartisan interest in addressing the issue of tax credits for school construction bonds. I would also ask the Chairman to consider including this provision in his mark as well.

The President's budget request included tax provisions to assist working families in meeting child care expenses. This, too, is an issue of bipartisan concern and interest. I hope that we can develop a bipartisan child care initiative similar to the one suggested by the President.

The President's budget also proposes an extension of expiring Tax Code provisions like the research credit, the work opportunity credit, the welfare-to-work credit, and the brownfields tax incentives. I would hope that we could work together in a bipartisan fashion to address these issues as well.

The hearings that we are currently engaged in seem to be designed to highlight some of the problems that exist in the current tax system. Such hearings can be very helpful to the Committee in suggesting important focal points for our tax reform efforts.

Some of the issues that are being raised, however, like the marriage penalty, have been discussed in this Committee as long as I have served on it. We all agree on the nature of the problem and the need to fix it. The sticking point has always been how to fix such problems in a fiscally responsible way.

I look forward to the Chairman's proposal for solving this difficult question, and I hope that we can work together to address it.

Thank you, Mr. Chairman.

Chairman ARCHER. The Chair thanks the gentleman for his statement. And now, without objection, any other Member will be permitted to insert a written statement into the record.

[The opening statement of Mr. Ramstad follows:]

**Statement of Hon. Jim Ramstad, a Representative in Congress from the State of Minnesota**

Mr. Chairman, thank you for your leadership in examining the tax burdens confronting American families.

I especially appreciate this focus on tax rates, which is fundamental to discussions of tax fairness.

We know that more and more families are going to be pushed into alternative minimum tax situations, which is probably the only thing on earth worse than paying the ordinary income tax.

And I am pleased we will be looking into the "hidden rates" in our tax code that effectively raise the tax burden beyond statutory rates.

As you point out, Mr. Chairman, Americans are now paying more in taxes as a percentage of GDP than at any peacetime in history. I look forward to our discussion today and in the coming weeks, as we explore critical tax issues facing American families.

Thank you, Mr. Chairman.

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We now turn to our first witness, one of our own colleagues, Congressman John Thune. John, we're happy to have you before the Committee today, and we're pleased to receive your testimony.

I will say to you and for the benefit of any subsequent witnesses that the rules of the Committee are not too different from other Committees. We're going to ask you to keep your oral testimony to 5 minutes. And the yellow light will come on in front of you when there's 1 minute to go, and the red light will come on when 5 minutes have expired. Your entire printed statement will, without objection, be inserted in the record. And that will apply to all witnesses.

So we're happy to have you, John. You may proceed.

Mr. THUNE. Thank you, Mr. Chairman and Members of the Committee.

## STATEMENT OF HON. JOHN R. THUNE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF SOUTH DAKOTA

Mr. THUNE. I do appreciate as most of you I think should have a copy of my written statement. And I will try as best I can to explain briefly these proposals and summarize my comments.

Let me just start by saying that the reason I think we're having this discussion today is that we are for the first time in about 30 years in a position where we're talking about operating in the black, potentially having a surplus. And any time you do that, it's a situation where I think for some politicians, that's a dream, but for the taxpayers, it's a nightmare.

My concern has been all along with respect to this issue that we look at putting aside money to retire the debt, to repay the trust funds. And, in fact, I am cosponsoring legislation which would do that here in the House.

But I sort of got interested in this whole subject where these bills are concerned as I was listening some weeks and months ago to many of the President's proposals for new spending. The thing that struck me about that was that I think it's a very dangerous precedent to start embarking on a course of new spending because we are doing well today and building in a lot of new government pro-

grams into the base assuming that at some point in the future, we'll have the revenue to support those programs. And I'm not sure at this point in time we're prepared to make that assumption.

So, as an alternative to that, people would ask me, "Well, if you don't like what the President's proposal is with respect to child care, what do you have as an alternative?" And so we started to think about that.

Really, what we came up with were a couple of proposals that I think address the need but do it in a very different way. And that is to allow individuals and families to make the decisions about how they want to address those needs in their lives, rather than having a government solution to it. And so we drafted a couple of bills.

Of course, let me just say also that I agree with you, Mr. Chairman, that anything that we do ought to be in the context of a balanced budget. We should not in any way finance any tax relief with our children's future. And so to the extent that we are able to do anything, I think it's going to mean it's because we have the room to accommodate and absorb within the budget any tax relief that we might put out there.

Having said that, the two bills that I would bring before you today really are an attempt I think to do something which is sort of novel around here. One of the things that troubles me the most about many of the President's proposals is this obsession with targeting, you know, that we're going to try to pick winners and losers and we're going to please this group if you act this way.

These bills really are designed to distribute tax relief in a broad, even way. And, frankly, as I look at the first bill, which raises the caps, the income caps, at which the 28-percent rate would apply, it does, in fact, take a number of people, about 10 million filers we're told in this country, out of the 28 percent bracket back to the 15 percent bracket and allows I think people who are trying to improve their lives, trying to do better to be rewarded and rather than as a disincentive push into a higher, much higher tax rate. And so it's a way which I think is very simple and clean, and that's the other aspect I like about that bill.

With the whole issue of where we go in terms of tax policy in this country, I think it's the right approach. And when you made the comment in your opening statement about you're going to favor attempts to simplify the Tax Code, that, too, is a priority of mine and one reason why I think this particular proposal makes so much sense. It starts moving us to where we are getting more people paying at the 15-percent rate. And I think that's something that's a very positive development.

The other bill just let me say briefly as well is a fairly straightforward, simple thing. And that is to raise the personal exemption for each individual taxpayer.

When you sit down and figure out again who benefits from raising the exemption or from the raise in the thresholds, it does deliver tax relief to those in the middle- and low-income categories.

Now, if you assume, of course, that the payroll tax comes off somewhere in the $60,000 range, you've got people who are caught in the middle there who are paying the payroll tax, the 28-percent rate. And I think what this does is you are really penalizing people

in the middle-income categories. This attempts to correct that, and it also, with the personal exemption bill, helps those who are currently in the 15 percent tax bracket.

So in trying to summarize all of that, what we were looking at doing with these is an approach which is simple, which is fair, which is a broad-based approach, rather than a targeted picking winners and losers, which treats people the same, whether they are married or whether they are single.

I've had people ask me "What does a single person get out of all of this tax relief?" Most of the bills that we pass we say we're doing this for married people or married with children.

And, again, this is not discriminatory in the approach. It's very straightforward. It's across the board. And I think it's the right approach for the future as we move toward what I hope will be a debate about tax reform, about how we can further simplify the Code and make it more friendly to the taxpayer.

Let me just close by saying that I don't know what we might have in terms of budgetary constraints, what we might be able to accommodate in terms of a tax relief proposal this year, but to the extent that we can, my own view is having looked at a lot of the tax relief proposals that are out there, that this makes the most sense in my view and moving toward the long-term goal again of simplifying the Tax Code and of doing tax relief in a way that benefits everybody in this country and not a select few.

So, with that, I will close. Thank you for the opportunity to present testimony this morning.

[The prepared statement follows:]

**Statement of Hon. John R. Thune, a Representative in Congress from the State of South Dakota**

Chairman Archer, members of the Committee, thank you for the opportunity today to talk about tax reform proposals. This is indeed an important and timely topic. The American taxpayers are on the verge of realizing the most significant tax cut in over 17 years.

The Taxpayer Relief Act of 1997 provided important relief for taxpayers at every stage of life from the cradle to the grave. At the same time, we did nothing to make the already complicated tax code any simpler. The passage of the Middle Class Tax Relief Act of 1998 and the Taxpayer Choice Act of 1998 would help us make strides toward tax relief that is both broad and simple. I also hope these bills can be considered as an alternative to future targeted tax cuts and as an alternative to new government spending.

In his State of the Union address, the President outlined his policy goals. Now that his budget is out, we know his ideas translate into some $150 billion in new Washington spending. Most of us can agree with his goals. From important priorities like caring for and educating our children, to providing health care for an aging population. These are important issues. On that we all agree.

However, the differences are clear in trying to determine how best to achieve those goals—particularly with the prospect of a revenue surplus. The President's programs mark an incredibly expansive reach by the federal government into the lives of Americans. At the same time, he is highlighting the need to reserve any surplus for Social Security. While I agree Congress must begin to restore the Social Security Trust Fund, the juxtaposition of saving and spending sends mixed signals to me and to the American public.

There is a responsible approach to dealing with any potential surplus. Accordingly, I support an approach that would apportion any potential surplus to paying off debt and restoring the integrity of the various federal trust funds, while reducing taxes on hard working Americans. Such an approach would allow us to give something back to the taxpayers of this country. After all, it is their money.

If the President is able to build $150 billion in new Washington spending into his budget, it would necessarily follow that the President and Congress could give back the same amount to the taxpayers. The best solution to helping working families

deal with tough issues like child care is to give them some money back and allow them to make the best decision about how to address this important need.

In order to provide for some tax relief that is both fair and effective, my friend and colleague from the State of Washington, Congresswoman Jennifer Dunn, and I introduced two pieces of tax relief legislation that I believe will serve as alternatives to the new Washington spending in the President's budget. At the same time, these bills are consistent with the dual goals of distributing tax relief broadly and evenly and of simplifying an inordinately complicated tax code.

The first bill, the Middle Class Tax Relief Act, addresses the concept of "bracket creep" by allowing working Americans to enjoy success rather than suffer the penalty imposed by a significantly higher tax bracket. The Middle Class Tax Relief Act would lower taxes by raising the income threshold at which the 28 percent tax bracket would apply. Simply put, more income of working Americans would be subject to the 15 percent tax bracket rather than the much higher 28 percent bracket.

This legislation would help middle income-earners who are doing better and making more, but as a consequence, have graduated from the 15 percent tax bracket. Due to bracket creep, 28 cents of each additional dollar they earn now goes to the federal government. Under our legislation, many of these hardworking people would have an incentive to continue to be hard working people, by removing the threat of a higher tax rate on each additional dollar they earn.

And this relief pays no attention to family status or other behavioral factors. Presently, the higher 28 percent tax rate applies to a single person making more than $25,350. Our legislation would raise that threshold to $35,000. For heads of household, the 28 percent rate starts at $33,950. We would raise that to $52,600. For married couples, the 28 percent rate starts at $42,350. We would raise it to $70,000.

According to the Tax Foundation, over 29,000,000 filers would see their taxes lowered under this proposal, with the average savings of nearly $1,200 per filer. Over 10 million filers would move out of the 28 percent bracket to the 15 percent bracket.

A $1,200 tax cut could pay for sixteen weeks of child care, four car payments, and up to three months of housing bills, or fourteen weeks of grocery bills. That's real help for working families.

The other bill I propose is the Taxpayer Choice Act. The Taxpayer Choice Act would raise the personal exemption from $2,700 to $3,400. The bill would reduce the taxable income of hard working Americans and allow them the freedom to choose how best to use the benefit of their tax reduction. By reducing taxable income by $700, this legislation would deliver broad based tax relief to taxpayers in the lower and middle income ranges.

This change is straightforward and easy to calculate. For someone in the 15 percent tax bracket, I have estimated a savings of $100, or for a family of four, $400, or the approximate equivalent of five weeks of child care, a car payment, housing payment or five weeks of grocery bills. That's real relief and those are real life choices. For earnings in the 28 percent tax bracket, I estimated the legislation would provide $200 per individual, or $800 per family of four. That is approximately equal to ten weeks of child care, almost ten weeks of grocery bills, three car payments, or a couple of housing payments. As is true today, the deduction would phase out for wage earners whose incomes exceed $124,500.

These bills both say to the people of this country: You have the freedom of choice. We trust your judgement. We believe you are capable of caring for your children and making good decisions about their future. We believe that as a matter of principle, America is infinitely better off when families and individuals are making decisions rather than Washington bureaucrats.

As we reform the tax code, we should resist from targeting tax cuts. Too often, Washington has chosen to pick winners and losers as it moves to cut taxes. For too long Washington has tried to dissect our society as it attempts to do something as simple as lowering taxes. I supported last year's Taxpayer Relief Act, which had plenty of targeting in it. That law has made important changes in the tax code to lower the burden of many individuals and businesses.

However, I believe we should strive toward a more perfect union and look for ways that allow all Americans—irrespective of marriage status, age, or heritage—to participate in the benefits of the greater freedom that comes with lower taxes. We should strive to make all taxpayers equal under the law.

Furthermore, we should take a consistent approach to making the tax code simpler. Most of the tax relief proposals I have seen to date further complicate the tax code. Such efforts do not take us down the road toward a less intrusive and more user friendly government.

I would like to come back to a point I made earlier. We agree with the President that working families in America need relief. However, the President has mistakenly interpreted that need as a request for more Washington spending and targeted

tax cuts. What working families are really asking for is not more federal government, but relief from more federal government.

At the same time, the two bills, the Middle Class Tax Relief Act and the Taxpayer Choice Act, both work toward a tax code that is more simple and more fair. Americans waste way too much time and money filling out tax returns. It's a dream for lobbyists, lawyers and tax preparers. It's a nightmare for the American taxpayer.

The two bills I introduced yesterday are consistent with a simpler, fairer approach to the tax code. Now is the time to reform the code with a focus on inviting all Americans to participate in the benefits of a growing economy. These are our goals and I look forward to working with the Chairman and the rest of this committee to make these initiatives become a reality.

Again, I thank the chair and would be happy to answer any questions you may have.

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Chairman ARCHER. Thank you, Congressman Thune.

Does any Member of the Committee wish to inquire?

[No response.]

Chairman ARCHER. If not, I compliment you on your testimony. We're glad to have your entire statement. And we wish you well.

Mr. THUNE. Thank you. We need your help. Thanks.

Chairman ARCHER. The next panel is: Dr. J.D. Foster; Mr. Michael Mares; Dr. Martin Regalia; and Mr. Kenneth Kies. I think all of you were in the room when I cited the rules the Committee likes to operate under in these hearings. So I won't repeat them but just to welcome all of you en banc, as it was, to the Committee.

And according to the schedule before me, Dr. Foster will lead off. So if you are prepared, Dr. Foster, we will be pleased to receive your testimony.

I would like to add one other thing in that I'd like for each of you to identify yourselves and if you're representing anybody, to identify who that is before you commence your testimony.

Dr. Foster.

Mr. FOSTER. Thank you very much, Mr. Chairman.

## STATEMENT OF J.D. FOSTER, PH.D., EXECUTIVE DIRECTOR AND CHIEF ECONOMIST, TAX FOUNDATION

Mr. FOSTER. I'm J.D. Foster, the executive director and chief economist of the Tax Foundation. I appreciate the opportunity to appear before the Committee today.

I personally think we have a very good reason to be talking about tax reductions today. The economy is producing tax revenues far in excess of what was projected just a few months ago. As the President's budget makes clear, the surpluses that we're looking forward to in the near future are largely the product of these revenues. So I find a certain simple logic for using some of these tax revenues for tax relief.

In considering tax cuts, I think we should take a couple of lessons from tax reform. One of these lessons is the imperative of focusing on economic growth. Yes, it's true the economy is doing well right now, but that's no reason why we shouldn't allow it to do better. I believe tax cuts should always be gauged by their ability to encourage economic growth.

A second lesson from tax reform is tax simplification. Complexity in the Tax Code is wasteful, and it is wrong. The one sure consen-

sus on tax reform is that the Tax Code is too complex. Tax reform is not the issue today, but the lessons are the same.

No tax cut should complicate the Tax Code. Every tax cut should be oriented toward encouraging economic growth. Reducing marginal tax rates hits on both counts. Reducing marginal tax rates has many other benefits, however.

If your concern is the tax burden on families generally, then tax rate reduction is your answer. If your concern is the marriage tax penalty, tax rate reduction will help without the complexity inherent in many of the solutions we have been talking about. If your goal is to encourage private savings, then again tax rate reduction is your answer.

This Committee has heard for years that Americans save too little. Assuming this is true, high marginal tax rates must bear much of the blame. People respond strongly to incentives and disincentives. Why do you suppose brokerage houses advertise track records of yielding value to investors if investors are not swayed by yields?

Why do supermarkets advertise their prices in the local paper? Because even reductions in the price of a can of soup or a bunch of bananas is going to alter consumer behavior.

Even the Tax Code relies heavily on disincentives to function. It has a highly developed system of tax penalties to discourage tax cheating. If monetary penalties discourage tax cheating, why would we think that high marginal tax rates wouldn't discourage saving? Reducing marginal tax rates and thereby reducing the tax burden on saving will increase national saving.

If your goal in tax reductions is to increase investment in plant and equipment, then again tax rate reduction is your answer. Reducing marginal tax rates reduces the cost of capital, particularly if those rate reductions are extended to the corporate tax system.

The 1997 tax bill was criticized because many provisions affecting individual taxpayers introduced new complexities in the Tax Code. I've attached to my testimony the new rules on capital gains and losses. These new instructions are mind-numbing. And it is wrong to inflict them on taxpayers.

Despite these complexities, I believe last year's tax bill was a great victory for taxpayers. It slowed but did not halt the rising tide of taxes. And it may have ushered in a new era of tax cutting. However, it also opened up the Congress to real criticism for reasons beyond complexity.

The bill created millions of winners, but it created a legion of the ignored. In appearance, this was rent seeking at its worst. This is not a game I believe the Committee or the Congress should be playing.

The surest way to avoid this unseemly game while providing significant tax relief is to reduce tax rates. Tax rate reduction can be devised so that all taxpayers benefit and not just a select few.

Tax rate reduction is simple. Many tax cut proposals are complex. Its simplicity encourages a sense of public fairness. Tax rate reduction is easy to explain and, therefore, easily garners public support. And tax rate reduction is very flexible. By lowering rates and raising bracket points, you can fine-tune the amount of tax relief that you want to give the American people.

The opponents of marginal tax rate reduction are primarily special interests who want to get a bigger slice of the pie for their own constituencies, appropriate for a democracy but not the best way to reduce taxes in my opinion.

Some might argue that we've reduced our statutory tax rates significantly over the last 17 years and we probably shouldn't go any further. This argument might be valid if we are only talking about whether to cut taxes. But once we're talking about cutting taxes, the argument has no merit.

High marginal tax rates of the past were counterproductive and have been roundly repudiated. Today's rates have no basis in theory. They're a product of revenue requirements and politics. If the politics and the revenue requirements have changed and would permit tax reductions, then marginal tax rate reductions should be this Committee's primary goal.

I believe it's time to create a virtuous cycle. Cut taxes to spur economic growth. Use the additional revenues from faster economic growth to cut taxes further and keep the process rolling. Cutting marginal tax rates I believe is your first best choice for tax reduction. They're your first best choice for creating this virtuous fiscal cycle.

Thank you, Mr. Chairman.

[The prepared statement follows:]

**Statement of J.D. Foster, Ph.D., Executive Director and Chief Economist, Tax Foundation**

Mr. Chairman, Mr. Rangel, Members of the Committee, it is with great pleasure that I appear before this Committee to testify to the importance of focusing on tax rates as the centerpiece of any tax reduction program in 1998.

I am the Executive Director and Chief Economist of the Tax Foundation. The Tax Foundation is a 60-year old non-profit, non-partisan research institution. Our mission is a simple one: To provide accurate and timely information on matters of federal, state, and local fiscal policy so that policymakers may make better policy.

Mr. Chairman, we have good reason today to discuss tax reduction. We have an economy that is yielding tax revenues far in excess of official expectations of only a few months ago. This enormous revenue stream has created the possibility of budget surpluses in the near or very near future. While the caution previously urged by White House officials and others against a change in policy predicated on surpluses is well-taken, it is perfectly appropriate for this Committee to consider what actions it might want to take should a surplus arrive earlier than expected. Further, as this happy prospect of surpluses is the product of extraordinary growth in tax receipts, there is a certain simple logic to using the surpluses for tax relief.

Another reason to consider tax relief is simply that taxes are now at their highest levels in our nation's history. Last year, Tax Freedom Day arrived on May 9, the latest day ever. Tax Freedom Day is a simple representation of the total federal, state, and local tax burden. If all of the average taxpayer's income goes to pay his taxes beginning on January 1st, then Tax Freedom Day is the day his annual fiscal debt to society is marked "Paid In Full." Tax Freedom Day 1998 is almost certain to fall even later in the calendar.

It's also important to rite last year's historic tax cut. Why is that? Because last year's tax cuts were slight indeed compared to the revenues produced by a strong economy.

WHICH TAXES TO CUT

There are, therefore, very good reasons to consider tax reductions at this time. In establishing a tax cut program, I believe the Committee should take a couple pages from the tax reform debates. The number one tax policy lesson from these debates is the great imperative to get the tax base right. Economic distortions due to taxation are minimized when the definition of the tax base is correct. On the other hand, whatever the tax rate, economic distortions grow with each error in the tax base.

A second lesson from the tax reform debates is the importance of tax simplification both economically and politically. Complexity in the tax code is wasteful and it is wrong. If there is anything about tax reform about which there is a general consensus, it is this—the current tax system is too complex. Perhaps if the Members of the Committee were required to do their own taxes as a condition for sitting on this Committee, then the proliferation of complex tax changes would cease halt.

Of course, tax reform is not the issue here, today. But the lessons remain the same. In an ideal world the Committee's focus ought to be to effect tax policy changes that simplify the system and that move the federal income tax in the direction of a proper definition of taxable income. That would mean, for example, increasing as far as possible the ability of taxpayers to exclude capital income from taxation, eliminating that abomination of federal tax policy known as the Alternative Minimum Tax, and integrating the personal and corporate income taxes.

To the extent reality impinges on this ideal world, as it must in a democracy, I would urge the Committee to eschew narrow, targeted tax changes in favor of reducing marginal tax rates. Whatever distortions exist in the federal income tax, and they are legion, they are given greater r are the marginal tax rates to which taxpayers are subjected. Conversely, reducing tax rates reduces virtually all the distortions created by the tax code that rob the economy of vitality and rob the American people of greater opportunity and prosperity.

This Committee is fully versed in the distortions to the economy created by the federal income tax and in the multitude of opportunities for greater prosperity lost as a result. Therefore, I will not discuss them in great detail. Instead, I will briefly enumerate the most important of these.

Income taxes imposed on wages and salaries reduce the incentive to work and, conversely, increase the incentive to take one's leisure. At very low tax rates, one's incentive to work is about equal to one's economic contribution to society. At low tax rates the price of leisure is high. At high marginal tax rates, one's return to work a few more hour's drops rapidly and the price of leisure drops along with it. Reducing marginal tax rates directly reduces the disincentive to work.

This Committee has heard for years that the people of the United States save too little. Assuming this is true, the federal income tax must bear much of the blame. Despite the many slivers of tax relief available to some saving, current law continues to heap layer upon layer of tax on additional saving. In most cases, income is taxed as earned irrespective of what one does with it. If it is saved, it is likely to face multiple layers of additional tax in the form of taxes on interest, dividends, corporate income, capital gains, and estate taxes.

People respond to incentives and disincentives. Why do brokerage houses advertise their strong track records yielding value to investors if investors are not influenced by yields? Why would car companies advertise price reductions, year-end discounts, and low financing rates if they fail to elicit more sales? Why do supermarkets advertise their sales in the local papers? Because even reductions in relatively low-priced items can alter consumer choices.

The tax code has a highly developed system of tax penalties to discourage taxpayers from cheating on their taxes. Why would we believe that monetary penalties would be effective in discouraging tax cheating, and yet not believe that monetary penalties would be effective in discouraging saving? Reducing marginal tax rates and thereby reducing the tax on saving directly reduces the disincentive to save.

To demonstrate how widespread would be the benefits of marginal tax rate reductions, consider:

- If a major concern is the tax burden on families generally, then rate reduction will help.
- If your concern is the marriage penalty, or even the single tax filer penalty, then rate reduction will help—without the complexity inherent in most solutions to this problem.
- If your goal is to encourage additional investment in plant and equipment, then rate reduction is your answer because it would reduce the cost of capital, particularly if the rate reduction is extended to the corporate income tax rates. Rate reduction reduces the tax on dividend and interest income and, if extended to capital gains, it can further reduce the tax burden on capital gains.

The 1997 tax bill was criticized, not entirely unfairly in my opinion, for being a hodgepodge of tax provisions, some large and some small. Many of the provisions, particularly as they relate to individual taxpayers, introduced enormous new complexities into the tax code. I have attached to my testimony the new rules appearing in this year's tax instructions for. These instructions are mind numbing. Indeed, perhaps the Committee could use these instructions as a simple test of the qualifications of any person seeking employment at the Joint Tax Committee: They must be

able to explain this procedure, in English, after reading it through no more than ten times. I suggest few would pass the test.

I believe last year's tax bill was a tremendous victory for taxpayers. The tax cuts slowed, but did not halt the tide of rising taxes and may have ushered in a new era of tax cutting. However, last year's tax bill also opened the Congress to real criticism for reasons beyond complexity. The bill created millions of winners, but it also created legions of the ignored. In appearance, at least, this was rent seeking at its worst. This is not a game I believe the Committee or the Congress should be playing.

The surest way to avoid a similar trap and yet to provide significant tax relief is by reducing tax rates. Tax rate reduction can be devised so that all taxpayers benefit, and not just a select and well-represented few. There are other important reasons to favor tax rate reduction:

• It is simple. A great many tax cut proposals would increase the tax complexity hurdle for those lucky taxpayers who would qualify.

• It's simplicity further enhances a public sense of its fairness. The Congress would not be perceived as bestowing relief on a select few.

• It is very flexible. Through the lowering of rates and raising of bracket points, the Committee has a great ability to fine-tune the amount of relief, again without complex special rules and effective dates.

• And it is easy to explain and therefore easily garners credibility and public support.

The case for making tax rate reduction a major component of any tax relief bill is so compelling it is worth considering why it might not be favored in some quarters.

One valid reason for emphasizing alternate tax cut proposals would be if the Committee was to choose to correct the tax base instead. As noted above, taxable income is badly defined under current law. Working towards an economically sound definition of taxable income should always be a policy goal of the first order.

A second source of opposition to across-the-board marginal tax rate cuts might arise from special interests who will fight to get a bigger piece of any tax cut pie for their own constituencies. Even when their objectives are sound, as is often the case, they put this Committee in the terrible position of playing Santa Claus to a select few. A good example of such a special interest is the "pro-family" groups whose efforts resulted last year in the child tax credit—an item of zero consequence for economic growth and one that specifically targeted certain beneficiaries to the exclusion of all others. This year these same groups are back fighting to eliminate the marriage tax penalty. The marriage tax penalty relates to the tax burden of some married couples relative to the tax they would owe if they were "single" filers. It is problematic. Yet for every four couples suffering from the penalty, there are five couples who pay less tax because of their joint filing status than they would had they filed single.

If the pro-family groups were fightiress the marriage bonus families and the marriage tax penalized. To my knowledge, they are silent on the bonus, and so they stand self-indicted as purely special interests. Across-the-board rate cuts, in comparison, would benefit proportionately those subject to the marriage penalty, those subject to the marriage bonus, and all single tax filers.

Finally, some might argue that statutory tax rates have declined significantly over the past 17 years, and that further reductions are therefore not needed. If one opposes tax reductions generally, then this argument is at least defensible. However, if the question is not whether to cut taxes, but how, then this argument is without foundation. The high marginal tax rates of the past were found to be counter-productive and have been roundly repudiated. Today's rates have no basis in theory. They are the product of revenue requirements and politics. If the politics and revenue requirements permit tax reductions, then marginal tax rate cuts should be the Committee's primary goal.

## Attachment Relating to Taxation of Capital Gains

## to the Testimony of

## J.D. Foster, Tax Foundation

**Part IV** **Tax Computation Using Maximum Capital Gains Rates**

| | | | | | |
|---|---|---|---|---|---|
| 19 | Enter your taxable income from Form 1040, line 38 | | | 19 | |
| 20 | Enter the **smaller** of line 16 or line 17 | 20 | | | |
| 21 | If you are filing Form 4952, enter the amount from Form 4952, line 4e | 21 | | | |
| 22 | Subtract line 21 from line 20. If zero or less, enter -0- | 22 | | | |
| 23 | Combine lines 7 and 15. If zero or less, enter -0- | 23 | | | |
| 24 | Enter the **smaller** of line 15 or line 23, but not less than zero | 24 | | | |
| 25 | Enter your unrecaptured section 1250 gain, if any (see page D-4) | 25 | | | |
| 26 | Add lines 24 and 25 | 26 | | | |
| 27 | Subtract line 26 from line 22. If zero or less, enter -0- | | | 27 | |
| 28 | Subtract line 27 from line 19. If zero or less, enter -0- | | | 28 | |
| 29 | Enter the **smaller** of line 19 or $41,200 ($24,650 if single; $20,600 if married filing separately; $33,050 if head of household) | | | 29 | |
| 30 | Enter the **smaller** of line 28 or line 29 | | | 30 | |
| 31 | Subtract line 22 from line 19. If zero or less, enter -0- | | | 31 | |
| 32 | Enter the **larger** of line 30 or line 31 | | | 32 | |
| 33 | Figure the tax on the amount on line 32. Use the Tax Table or Tax Rate Schedules, whichever applies ▶ | | | 33 | |
| 34 | Enter the amount from line 29 | | | 34 | |
| 35 | Enter the amount from line 28 | | | 35 | |
| 36 | Subtract line 35 from line 34. If zero or less, enter -0- | | | 36 | |
| 37 | Multiply line 36 by 10% (.10) ▶ | | | 37 | |
| 38 | Enter the **smaller** of line 19 or line 27 | | | 38 | |
| 39 | Enter the amount from line 36 | | | 39 | |
| 40 | Subtract line 39 from line 38. If zero or less, enter -0- | | | 40 | |
| 41 | Multiply line 40 by 20% (.20) ▶ | | | 41 | |
| 42 | Enter the **smaller** of line 22 or line 25 | | | 42 | |
| 43 | Add lines 22 and 32 | 43 | | | |
| 44 | Enter the amount from line 19 | 44 | | | |
| 45 | Subtract line 44 from line 43. If zero or less, enter -0- | | | 45 | |
| 46 | Subtract line 45 from line 42. If zero or less, enter -0- | | | 46 | |
| 47 | Multiply line 46 by 25% (.25) ▶ | | | 47 | |
| 48 | Enter the amount from line 19 | | | 48 | |
| 49 | Add lines 32, 36, 40, and 46 | | | 49 | |
| 50 | Subtract line 49 from line 48 | | | 50 | |
| 51 | Multiply line 50 by 28% (.28) ▶ | | | 51 | |
| 52 | Add lines 33, 37, 41, 47, and 51 | | | 52 | |
| 53 | Figure the tax on the amount on line 19. Use the Tax Table or Tax Rate Schedules, whichever applies | | | 53 | |
| 54 | **Tax.** Enter the **smaller** of line 52 or line 53 here and on Form 1040, line 39 ▶ | | | 54 | |

Chairman ARCHER. Thank you, Dr. Foster.

Our next witness is Dr. Regalia. And if you'll identify yourself, we'll be pleased to receive your testimony.

Mr. REGALIA. Thank you, Mr. Chairman.

**STATEMENT OF MARTIN A. REGALIA, PH.D., VICE PRESIDENT AND CHIEF ECONOMIST, U.S. CHAMBER OF COMMERCE**

Mr. REGALIA. My name is Martin Regalia. I'm vice president and chief economist for the U.S. Chamber of Commerce. And we thank you for inviting us here today to testify.

Well, few people actually like paying taxes. Most of us understand the need to pay tax to provide basic services, provide roads, infrastructure, national defense. However, we believe the government also has the responsibility to tax in a simple, efficient, and fair manner and to keep the overall burden on individuals and businesses as low as possible.

Our Federal tax burden is too high. Total Federal receipts as a percentage of GDP were 19.8 percent in 1997, up from 17.8 percent just 4 years ago. We agree with you, Mr. Chairman, that Federal taxes as a percentage of GDP need to be reduced. And we appreciate your leadership in this area.

The maximum marginal tax rate for individuals is now a stifling 39.6 percent and applies to income derived from sole proprietorships, partnerships, limited liability companies, and S corporations.

In addition, the corporate income tax rates vary from 15 percent to a troubling 39 percent. Tax rates should be lower and less steeply graduated for all individuals and businesses.

Furthermore, the Tax Code contains various hidden taxes created by phaseouts of tax benefits and tax floors for certain expenses.

Some benefits phase out at a low level of income, yet are justifiable because they are intended specifically to benefit low-income taxpayers.

Other benefits, however, such as itemized deductions and personal exemptions, phase out at middle and upper incomes and are really done so only to raise more revenue. While doing so, they create disincentives for work, savings, and investment. And the Tax Code should be adjusted to remove these disincentives.

Social Security and Medicare taxes have climbed dramatically since their inception. The combined employer-employee tax rate for self-employed individuals, which self-employed individuals bear entirely themselves, is an astounding 15.3 percent, up from 9.6 percent in 1970 and 3 percent in 1950. These taxes should be reduced, or at a minimum, made deductible for income tax purposes.

The Federal estate and gift tax is onerous tax which should be repealed or significantly reformed by further increasing the unified credit, reducing overall tax rates, and expanding the family-owned business exclusion.

Another counterproductive tax is the alternative minimum tax. Originally envisioned as a method to ensure that all taxpayers pay a minimum amount of tax, the AMT penalizes individuals and businesses that save and invest, both requirements for economic growth.

While the 1997 tax act made certain reforms to the corporate AMT, it did not fully repeal the depreciation adjustment or reform the individual AMT. The AMT should be eliminated. If that's not possible, additional reforms should be enacted, such as creating an exemption for unincorporated businesses, eliminating the depreciation adjustment, increasing the individual exemption amounts, and

allowing taxpayers to offset their current year AMT with accumulated tax credits.

The 1997 act provided approximately $151 billion of gross tax relief over the next 5 years. However, business and business-related tax and investment incentives accounted for a very small portion of those.

We urge Congress to continue to reduce the Federal tax burden. And we think that there are a number of ways that they could do this. We think that permanently extending the research and experimentation and the work opportunity tax credits, further reforming Subchapter S rules, reforming the foreign tax rules, simplifying the worker classification rules, providing corporate capital gains relief, and increasing the equipment expense allowance are all areas for concern.

Finally, we think that restructuring the IRS to make it a more efficient, accountable, and taxpayer-friendly organization is something that needs to be done now.

Thank you very much.

[The prepared statement follows:]

**Statement of Martin A. Regalia, Ph.D., Vice President and Chief Economist, U.S. Chamber of Commerce**

Mr. Chairman and members of the Committee, my name is Martin Regalia. I am Vice President and Chief Economist of the U.S. Chamber of Commerce—the world's largest business federation, representing more than three million businesses and organizations of every size, sector and region.

The U.S. Chamber appreciates this opportunity to express our views on how to reduce the federal tax burden of individuals and businesses. I will be addressing various aspects of this increasingly growing problem, including high statutory tax rates, "hidden" taxes buried throughout the federal tax code, the alternative minimum tax for individuals and corporations, and additional tax relief measures which would reduce the overall federal tax burden.

OUR OVERALL TAX BURDEN IS TOO HIGH

Justice Holmes once commented that taxation is the price we pay for civilization. Let's face it, nobody likes paying taxes. However, most of us understand that our federal, state and local governments need to tax its citizens in order to provide basic services which we all want and expect (e.g., roads, national defense, schools). I suspect most individuals and businesses would not complain so much about taxes if they were fair, simple, properly administered, and promoted economic growth, saving, and investment. Unfortunately, our existing federal tax system fails to meet these basic criteria.

Simply stated, taxes should be levied for the purpose of obtaining those revenues necessary to fund limited government expenditures in a way that minimizes their negative impact on taxpayers, overall economic growth and the international competitiveness of American business. History demonstrates that taxation carried to unreasonably high levels defeats its basic purpose by doing irreparable harm to the civilization and freedom that government is designed to protect. Aggravating the problem of overtaxation in America is the notion that the federal government wastes a good portion of its revenues on unproductive projects, services, and bureaucracies.

The overall tax burden on American families and businesses is too high. According to the Tax Foundation, total taxes imposed on individuals as a percent of total income was almost 35 percent in 1996. Federal taxes accounted for 23 percent, while state and local taxes accounted for 12 percent. Based on this study, Americans work almost three months every year to support the federal government.

According to the Office of Management and Budget (OMB), total federal receipts, as a percentage of Gross Domestic Product (GDP), was 19.8 percent in 1997, up from 17.8 percent just four years earlier. Federal individual income tax receipts, as a percentage of GDP, has risen from 7.7 percent in 1992 to 9.3 percent in 1997, while the percentage for corporate income tax receipts has risen from 1.6 percent in 1992 to 2.3 percent in 1997. In addition, social insurance and retirement receipts,

as a percentage of GDP, has increased from 1.6 percent in 1950, to 4.4 percent in 1970, to 6.8 percent today.

FEDERAL TAX RATES NEED TO BE LOWERED

Federal individual income taxes are too high and need to be lowered. Generally, an individual's federal income tax liability is determined by multiplying his or her taxable income, or tax base, by the applicable tax rates, and then subtracting various tax credits.

Overall income tax rates for individuals dropped significantly in the 1980's. The Economic Recovery Tax Act of 1981 reduced the maximum statutory tax rate from 70 percent to 50 percent, and the Tax Reform Act of 1986 further reduced it to 28 percent. However, the Tax Reform Act of 1986 also eliminated or limited certain deductions or exemptions, such as those relating to personal interest and passive losses, which expanded the tax base for many individuals.

Since 1986, however, the maximum statutory tax rate has been increased, first to 31 percent in 1990, and then to 39.6 percent (36 percent plus a 3.6 percent surcharge) in 1993. Deductions and exclusions for individuals, on the other hand, have not been increased in equal measure. This is a primary reason why the federal income tax burden on individuals has increased over the last few years.

For 1997, a 15 percent tax rate applies to the first $24,650 of taxable income for single filers ($41,200 for married couples filing joint returns). The marginal tax rate then almost doubles to 28 percent for single filers with taxable incomes between $24,650 and $59,750 (between $41,200 and $99,600 for married couples). The rate increases to 31 percent for single filers with taxable incomes between $59,750 and $124,650 (between $99,600 and $151,750 for married couples), and to 36 percent for single filers with taxable incomes between $124,650 and $271,050 (between $151,750 and $271,050 for married couples). For taxable incomes above $271,050, a maximum statutory 39.6 percent rate applies for both single filers and married couples. A taxpayer's effective maximum tax rate can be even higher when various phase-outs (e.g., certain itemized deductions, personal exemptions) are taken into effect.

These tax rates are not only too high, but apply to most types of income, including those derived from a sole proprietorship, partnership, limited liability company or S corporation. This creates a disincentive for business owners to work longer hours and generate additional income since they realize that an ever increasing share of their income will be going to the federal government. At a minimum, legislation should be enacted to lower the maximum income tax rate on the reinvested or retained earnings of these business owners.

Furthermore, the progressive nature of the federal income tax system causes many married dual-earner couples to be subjected to a "marriage penalty"—that is, they pay more in combined income taxes than they would if they were not married and were filing single returns. This is simply unacceptable and needs to be remedied.

The high rates of income tax imposed on corporations are just as troubling. The maximum federal corporate income tax rate is 39 percent, and applies to taxable income between $100,000 and $335,000. Taxable income in excess of $335,000 is subject to varying rates of 34 percent, 35 percent and 38 percent. The taxable income of certain personal service corporations, including those that perform health, law, consulting, and engineering services, is taxed at a flat rate of 35 percent.

To make matters worse, certain amounts of corporate income are subject to double taxation—first at the corporate level, and then at the individual level when non-deductible dividends are distributed to shareholders. Small or family-owned businesses may be able to characterize most or all payments to their owners as deductible wages, rather than non-deductible dividends. However, such payments would have to be deemed "reasonable" compensation, and could be subject to a maximum individual income tax rate of 39.6 percent, as well as Social Security and Medicare taxes.

Social Security and Medicare taxes, perhaps two of the most criticized taxes, have climbed dramatically since their inception. The combined employer-employee tax rate—which self-employed individuals must bear entirely on their own—is currently 15.3 percent, up from 9.6 percent in 1970 and 3 percent in 1950. The maximum taxable wage (and self-employment) base has also increased steadily, from $7,800 in 1971 for both Social Security and Medicare, to $68,400 today for Social Security, and an unlimited amount for Medicare.

These two taxes have become a growing thorn in the side of American workers and businesses. Individuals must work harder and longer hours to fund these programs, which may or may not be fiscally sound when they retire. Regardless of

whether Social Security becomes fully or partially privatized, we need to reduce the growing tax burden of this, as well as the Medicare, systems. At a minimum, such taxes should be deductible for income tax purposes in order to eliminate double taxation on the wage bases.

The federal estate and gift tax is another tax which needs dramatic reform. This tax is extremely onerous, not only because it is triggered by death and is based on the value of a decedent's accumulated assets, but because its tax rates are so high and take affect at such a low threshold. For example, in 1997, a tax rate of 37 percent applies once a taxable estate exceeds $600,000. The rate quickly climbs to 55 percent once the taxable estate exceeds $3 million. In fact, a 60 percent rate applies to taxable estates between $10 million and $21 million.

The estate tax should be repealed. If repeal is not feasible, significant reforms should be implemented. Such reforms include further increasing the unified credit, reducing overall tax rates, increasing and expanding the newly created "family-owned business interest" exclusion to encapsulate more businesses, and broadening the installment payment rules.

There are other federal taxes which have high rates of tax. These include the federal unemployment tax (FUTA), alternative minimum tax on individuals and corporations, capital gains tax, accumulated earnings tax, personal holding company tax and various excise taxes (e.g., airline ticket tax, fuels tax).

All of these federal taxes create an enormous financial drain on American individuals and businesses and dampen capital formation, job growth and work initiative. While it would be difficult for us to state with exact specificity the ideal tax rate for each type of federal tax, we do support lower and less steeply graduated tax rates for all individuals and businesses.

### "Hidden" Taxes Should be Eliminated

In addition to the high maximum income tax rates, there are numerous provisions in the federal tax code which have the effect of increasing the effective marginal rates of tax on individuals and businesses. One of the more common forms of a "hidden" tax is the phase-out of various tax benefits (e.g., credits, deductions, and exemption amounts).

Tax credits that phase-out include the earned income tax credit, dependent care credit, adoption credit, and the newly-enacted child and education tax credits. Tax deductions with phase-out ranges include those relating to individual retirement accounts (both deductible and non-deductible Roth IRAs), total itemized deductions, the $25,000 allowance for certain "passive" losses, and student loan interest expenses. Tax exemptions that phase-out include the personal exemption for both regular and alternative minimum tax purposes.

The phase-out ranges for the above-mentioned tax benefits vary widely across the income spectrum. Some benefits, such as the earned income tax credit, phase-out at relatively low levels of adjusted gross income (AGI) (e.g., $30,095 for families with two children). Such phase-out levels are justifiable because the credits were intended specifically to benefit low-income taxpayers.

Other tax benefits phase-out at middle- and upper-income levels. For example, in 1998, married couples who participate in employer-provided retirement plans are not eligible to deduct IRA contributions once their AGI reaches $60,000. Personal exemptions for single individuals begin to phase-out once their AGI reaches $121,200 in 1997 ($181,800 for joint filers). Certain itemized deductions begin to phase-out (up to 80 percent) once a single individual's or married couple's AGI reaches $121,200 in 1997. There appears to be no direct correlation between these benefits and the levels of income at which they phase-out. The phase-out ranges make no economic sense, and appear designed solely to reduce the benefits' costs to the federal government or to act as revenue-raisers for other provisions in the tax code.

In addition, the tax code contains several percentage "floors" which must be exceeded before certain deductions can be claimed. For instance, qualified medical expenses are only deductible to the extent they exceed 7.5 percent of a taxpayer's AGI. Certain miscellaneous deductions, such as unreimbursed employee expenses and investment fees, must exceed 2 percent of a taxpayer's AGI before they can be deducted. These floors affect all taxpayers and should be reduced or eliminated to allow taxpayers to claim legitimate deductions.

### The Alternative Minimum Tax Must be Further Reformed

One of the most counter-productive taxes ever created is the alternative minimum tax (AMT). Originally envisioned as a method to ensure that all taxpayers pay a minimum amount of taxes, the individual and corporate AMT penalizes businesses

that invest heavily in plant, machinery, equipment and other assets. The AMT significantly increases the cost of capital and discourages investment in productivity-enhancing assets by negating many of the capital formation incentives provided under the tax system, most notably accelerated depreciation. The AMT cost-recovery system is among the worst of industrialized nations, placing our businesses at a competitive disadvantage internationally.

To make matters worse, many capital-intensive businesses are perpetually trapped in AMT as they are unable to utilize their suspended AMT credits. The AMT is essentially a prepayment of tax which is substantially unrecoverable for most businesses. In addition, those not subject to AMT must still expend valuable time and resources in order to maintain several depreciation schedules and calculate the AMT.

Significant reforms of the corporate AMT were enacted in the Taxpayer Relief Act of 1997. "Small" corporations (those with average gross receipts of less than $5 million in 1994, 1995 and 1996, $7.5 million in years thereafter) are no longer subject to the AMT. In addition, for all other corporations, depreciation recovery periods (e.g., 5-year property, 10-year property) used for AMT purposes are conformed to those used for regular tax purposes for property placed in service after 1998.

The legislation, however, did not eliminate the AMT depreciation adjustment for recovery methods (e.g., accelerated versus straight-line depreciation). Therefore, depreciation will continue to be slower for AMT purposes than for regular tax purposes. Furthermore, the repeal of the depreciation adjustment for recovery periods only applies to assets placed in service after 1998. Therefore, all existing assets of corporate businesses will continue to be subject to this depreciation adjustment.

Moreover, the recently-enacted tax law did not reform the AMT for individuals. A "small business" exemption was not created, the depreciation adjustment was not repealed or modified, and the AMT tax rates of 26 percent and 28 percent were not reduced. Furthermore, the AMT exemption amounts ($33,750 for single filers, $45,000 for married couples filing joint returns) were not increased to keep up with inflation or to take into account the new child and education tax credits.

As a result, many individuals will soon find themselves subject to a tax they never even knew existed. Sole proprietors, partners and S corporation owners will continue to be exposed since their business income flows through to their individual income tax returns. According to the Joint Committee on Taxation, the number of individual taxpayers subject to AMT is expected to increase from approximately 600,000 in 1997 to 8.4 million in 2007, while the AMT tax burden is expected to grow from about $3.6 billion in 1997 to $18.4 billion in 2007.

The best way to provide individuals and corporations with relief from the AMT would be to repeal it outright. If repeal is not possible, the AMT should be substantially reformed in order to reduce its harmful effects on businesses and individuals. Such reforms include: providing a "small business" exemption for individuals; eliminating the depreciation adjustment for both individuals and corporations; increasing the individual AMT exemption amounts; allowing taxpayers to offset their current year AMT liabilities with their accumulated minimum tax credits; and making the AMT system less complicated and easier to comply with. We urge you to enact these reforms as soon as possible.

## ADDITIONAL BUSINESS TAX RELIEF IS NEEDED

The Taxpayer Relief Act of 1997 provided approximately $95 billion of net tax relief ($151 billion of gross tax relief) to families and businesses over the next five years. Gross business-related tax cuts, however, only accounted for about $19 billion of the total. While we commend Congress for enacting the legislation, we urge it to continue reducing the overall federal tax burden on the business community. We agree with you, Mr. Chairman, that federal taxes, as a percentage of GDP, need to be reduced, and appreciate your leadership in this area.

There are many other tax issues of great importance to our members, and we look forward to working with you to further them in Congress. These issues include:

### *Capital Gains Tax*

While the new tax law reduces the maximum capital gains tax rate for individuals from 28 percent to 20 percent (10 percent for those in the 15 percent income tax bracket), it also lengthened the holding period for long-term capital gains from 12 months to 18 months. This holding period should revert back to 12 months, and rates should be further reduced, if possible. In addition, capital gains tax relief is still needed for corporations, whose capital gains continue to be taxed at regular income tax rates.

*Equipment Expensing*

In 1998, businesses can generally expense up to $18,500 of equipment purchased. This amount will gradually increase to $25,000 by 2003. This expensing limit needs to be further increased, and at a faster pace, in order to promote capital investment, economic prosperity, and job growth.

*Foreign Tax Rules*

While the new tax law contains some foreign tax relief and simplification measures, our foreign tax rules need to be further simplified and reformed so American businesses can better compete in today's global marketplace.

*Individual Retirement Accounts (IRAs)*

While the new tax law expands deductible IRAs and creates nondeductible Roth IRAs, both types of IRAs need to be further expanded (e.g., increase contribution limits, eliminate phase-out ranges) in order to promote saving and personal responsibility.

*Independent Contractor / Employee Classification*

The current worker classification rules are too subjective and restrictive, and need to be simplified and clarified. We support the creation of a more objective safe harbor for independent contractors, while leaving the current 20-factor test and Section 530 safe harbors in tact.

*Internal Revenue Service Reforming and Restructuring*

The overall management, oversight and culture at IRS needs to be changed in order to make it a more efficient, accountable and taxpayer-friendly organization. We support legislation which the House overwhelmingly passed in November and look forward to working with you towards its enactment.

*Research and Experimentation (R&E) Tax Credit*

While the new tax law extends this credit through June 30, 1998, it needs to be extended permanently, and further expanded, so businesses can better rely on and utilize the credit.

*S Corporation Reform*

While the Small Business Jobs Protection Act of 1996 contained many needed reforms for S corporations, such as increasing the maximum number of shareholders from 35 to 75, there are many other important reforms which still need to be enacted, such as allowing preferred stock to be issued and creating family attribution rules.

*Self-Employed Health Insurance Deduction*

This deduction is scheduled to increase from 40 percent in 1997 to 100 percent in 2007. We believe this timetable should be accelerated to give self-employed individuals a full deduction as soon as possible.

*Work Opportunity Tax Credit*

This credit, which encourages employers to hire individuals from several targeted groups, needs to be permanently extended beyond its June 30, 1998 sunset date.

CONCLUSION

Our long-term economic health depends upon sound economic and tax policies. Our federal tax burden is too high and needs to be significantly reduced. In addition, our tax system encourages waste, retards savings, and punishes capital formation—all to the detriment of long-term economic growth. As we prepare for the economic challenges of the next century, we must orient our current tax policies in a way that encourages more savings, investment, productivity growth, and, ultimately, economic growth.

Thank you for allowing me the opportunity to testify here today.

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Chairman ARCHER. Thank you, Dr. Regalia.

Our next witness is Mr. Michael Mares. We're happy to have you here, and you may proceed.

Mr. MARES. Thank you, Mr. Chairman.

**STATEMENT OF MICHAEL MARES, CHAIR, TAX EXECUTIVE COMMITTEE, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS**

Mr. MARES. Good morning. Good morning, Members of the Committee. I am Michael Mares, chair of the AICPA's Tax Executive Committee. We appreciate the opportunity to testify today on hidden tax rates and the individual alternative minimum tax, or AMT.

Let me begin with the AMT, one of the most complex parts of our tax law. The AMT is designed to ensure that taxpayers pay a minimum amount of tax on their economic income.

In many cases absent the AMT, taxpayers taking advantage of special deductions and exclusions would pay little or no tax. However, since the AMT exemptions and brackets aren't indexed for inflation, more and more taxpayers have been snared in the AMT's web over the past few years.

In many cases, it is difficult or impossible to calculate the AMT without a great deal of added effort and time. Furthermore, the inclusion of adjustments and preferences from passthrough entities compounds the problem.

Aggravating the situation is the AMT impact that the Taxpayer Relief Act of 1997 will have on middle-income taxpayers. For example, the child credit, the Hope credit, and the lifetime learning credit will not be able to reduce AMT.

The result is that, as our examples in Appendix C show, a married couple with less than $70,000 of income can pay an alternative minimum tax or, worse, a single parent with only $45,000 in income pays an $800 AMT. Can these problems be reduced or eliminated?

We believe so and would offer the following separate recommendations: first, index the AMT brackets and exemptions; second, eliminate itemized deductions and personal exemptions as adjustments for AMT; third, reduce the regular tax benefits of AMT preferences for all taxpayers—for example, by lengthening the depreciable lives for regular tax purposes, the AMT adjustment could be eliminated—fourth, allow certain tax credits against AMT, such as the child credit and the tuition tax credits; fifth, provide an exemption for low- and middle-income taxpayers from AMT if their adjusted gross income is less than $100,000; and, finally, consider the impact of AMT in all future tax legislation.

Of course, repealing AMT would solve the entire problem for all individuals. We are also deeply concerned, as the Treasury pointed out, that AMT will apply to more and more taxpayers over the next few years, most of whom I could argue were never intended to be covered or affected by AMT.

Since these taxpayers have little or no familiarity with the rules, it is likely that the IRS will need to allocate more resources to educate them and to answer their questions.

The AMT also poses a compliance challenge to the IRS since many of the underlying adjustments or preferences appear nowhere else on a taxpayer's return. This makes verification of the calculation difficult.

Another area of complexity is the hidden tax rate, also known as phaseouts of various benefits or credits over a wide range of incomes based on a variety of definitions of income. There is currently no consistency among phaseouts in either the measure of the income, the range of income over which the phaseouts occur, or the method of applying the phaseouts.

Even filing status doesn't consistently affect tax phaseouts. For example, the individual retirement account deduction phaseouts vary for single individuals versus married couples filing a joint return. However, the phaseout range for the $25,000 passive loss allowance for certain rental activities is the same for both types of taxpayers.

Further compounding the complexity is the fact that many of the phaseout ranges from married, filing separate taxpayers versus joint filers are not consistent.

Simplicity can be achieved by eliminating the phaseouts altogether and, if necessary, making the politically difficult decision to raise tax rates to generate the needed revenue. However, significant simplification can be achieved by providing consistency in the measures of income, the range of income over which the phaseouts apply, or the method of applying the phaseouts.

We suggest that there be three phaseout ranges: low-, middle-, and high-income taxpayers. Our written testimony in Appendices A and B contains our proposed ranges.

We also suggest that the phaseout ranges for married, filing separate taxpayers, single taxpayers, and head of households be 50 percent of the phaseout range for joint filers. This would eliminate the marriage penalty as well.

Finally, we recommend the deduction or benefit phaseouts evenly over the phaseout range. Phaseouts which are merely disguised tax rate increases create computational problems and frustrations at all levels of income. If they are to be retained, they should be standardized and applied consistently.

This Committee has the opportunity as a result of these hearings to help the American taxpayer by eliminating or substantially reducing two areas of extreme frustration and complexity. The AICPA is willing to assist you in any way that we can to help resolve these issues.

I will be happy to answer any of your questions. Thank you.

[The prepared statement and attachments follow:]

**AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS**

**TESTIMONY OF**

**MICHAEL MARES**
**CHAIR, TAX EXECUTIVE COMMITTEE**

**BEFORE**

**THE COMMITTEE ON WAYS AND MEANS**
**OF THE**
**UNITED STATES HOUSE OF REPRESENTATIVES**

**HEARING ON TAX RATES AND AMT**

**FEBRUARY 4, 1998**

**AICPA TESTIMONY ON TAX RATES AND AMT**
**HOUSE WAYS AND MEANS COMMITTEE**
**February 4, 1998**

## INTRODUCTION

Good morning, Mr. Chairman, and members of this distinguished Committee. We appreciate this opportunity to testify today on tax rates and on the individual alternative minimum tax (AMT). I am Michael Mares, Chair of the Tax Executive Committee of the American Institute of Certified Public Accountants (AICPA). The AICPA is the national professional organization of CPAs, with more than 331,000 members. Many of our members are tax practitioners who, collectively, prepare income tax returns for millions of Americans.

The first part of my testimony will focus on the AMT and the second part on tax rates and phase-outs.

### Background on AMT

Our tax laws give special treatment to certain types of income and allow special deductions for certain types of expenses. These laws enable some taxpayers with substantial economic income to significantly reduce their regular tax. The purpose of the AMT is to ensure that these taxpayers pay a minimum amount of tax on their economic income.

### Complexity of AMT

The AMT is one of the most complex parts of the tax system. Each of the adjustments of Internal Revenue Code (IRC) section 56, and preferences of IRC section 57, requires computation of the income or expense item under the separate AMT system. The supplementary schedules used to compute many of the necessary adjustments and preferences must be maintained for many years to allow the computation of future AMT as items "turn around."

Generally, the fact that AMT cannot always be calculated directly from information on the tax return makes the computation extremely difficult for taxpayers preparing their own returns. This complexity also calls into question the ability of the Internal Revenue Service (IRS) to audit compliance with the AMT. The inclusion of adjustments and preferences from "pass through" entities also contributes to the complexity of the AMT system.

### Effects of the *Taxpayer Relief Act of 1997* and AMT on Individual Taxpayers

Several items enacted in the *Taxpayer Relief Act of 1997* will have a dramatic increase on the number of individuals who will find themselves shifting to the alternative minimum tax (AMT) system in addition to being subject to tax under the regular tax system. For many, this will come as a real surprise, and in all likelihood, will cause substantial concern to the IRS, which will have to focus significant efforts to this area in the future to enforce compliance, educate taxpayers, and handle taxpayer questions.

In fact, John Scholz, Deputy Assistant Secretary in the Treasury Tax Policy Analysis Office, has stated that the number of taxpayers subject to the AMT (which is currently less than one percent) is expected to escalate at a rate of 30 percent a year for at least ten years. He noted that the trend will mean eight percent, or 11 million individuals, will be subject to AMT by 2007. One point to keep in mind is that if 11 million individuals will actually have to pay the AMT, how many million more will have to fill out the complex Form 6251 to show they do <u>not</u> owe it?

Most sophisticated taxpayers understand that there is an alternative tax system, and that they sometimes wind up in its clutches; unsophisticated taxpayers by contrast may never have heard of the AMT, certainly do not understand it, and do not expect to ever have to worry about it. Unfortunately, that is changing - and fairly rapidly - since a number of the more popular items, such as the education and child credits that were recently enacted, offset only regular tax and not AMT. Due to these changes, we believe it is most important that Congress obtain information (from

Treasury, the Joint Committee on Taxation staff, or OMB) not only as to the revenue impact of the interaction of all these recent tax changes with the AMT, but also of the likely number of families or individuals that will be paying AMT as a result of 1997's tax legislation.

Specifically, taxpayers' situations will be exacerbated by the following.

1. The child tax credit is not available against the AMT. Thus, middle-income taxpayers will see their regular tax go down by $500 or more (depending upon the number of dependent children), but their AMT potential liability will not be reduced at all.

2. Under the Hope tuition tax credit, middle-income families receive up to a $1,500 credit, per eligible student, for regular tax purposes, though none of the credit is available against AMT. The same is true with respect to the Lifetime Learning Credit, with a maximum $1,000 credit through 2002, and $2,000 credit thereafter. These credits alone will generate a substantial number of new AMT filers. With one or more children in college and others at home below 17 years of age, the result is a potentially significant new group of taxpayers who would under no circumstances be considered rich, but who will now be paying the alternative minimum tax.

   For example, a couple with a teenage child ($400 child care credit), a child in the first year of college ($1,500 Hope Scholarship Credit), and a child in the last year of college ($1,000 Lifetime Learning Credit), with the spouses earning $30,000 and $35,000, and with $3,000 interest and dividends, and $500 IRA deductions each, and a standard deduction of $7,100 and $13,500 of personal exemptions would have a net regular tax liability of $4,587 ($7,487 tax, less $2,900 credits), but because of AMT would lose in credits in the amount of, and pay extra tax of, $1,133. (See the attached Appendix C for further details.)

   Another example (also in Appendix C) is a head of household taxpayer, earning $45,000 and with $500 interest and dividends, and a $750 IRA deduction, and $6,250 of standard deduction, and $8,100 of personal exemptions for herself, and one child with a $1,500 Hope Scholarship Credit and one child with a $1,000 Lifetime Learning Credit. This taxpayer pays an additional $800 in lost credits due to the AMT.

**Indexing the AMT Brackets and Exemption**

While the AICPA has not undertaken detailed studies, anecdotal examples (such as those in our attached Appendix C) exist that indicate the likelihood that taxpayers with adjusted gross incomes in the $60,000-$70,000 range (or below) will be subject to AMT. Aside from the fairness issues involved - this is not the group that the AMT has ever been targeted to hit - we see some potentially serious problems of compliance and administration as well. Many of these taxpayers have no idea that they may be subject to the AMT (if, indeed, they are even aware that there is an AMT). Thus, we anticipate large numbers of taxpayers not filling out a Form 6251 or paying the AMT who may be required to do so, thus requiring extra enforcement efforts on the part of the IRS to make these individuals (most of whom will be filing in absolute good faith) aware of their added tax obligations.

**Individual AMT Recommendations**

We wish we had "the" answer to the problem, but recognize there is no simple solution given the likely revenue loss to the government. As a start, however, Congress should consider:

1. Indexing the AMT brackets and exemption amounts.

2. Eliminating itemized deductions and personal exemptions as adjustments to regular taxable income in arriving at alternative minimum taxable income (AMTI) (e.g., all -- or possibly a percentage of -- itemized deductions would be deductible for AMTI purposes).

3. Eliminating many of the AMT preferences by reducing for all taxpayers the regular tax benefits of AMT preferences (e.g., require longer lives for regular tax depreciation).

4. Allowing certain regular tax credits against AMT (e.g., low-income tax credit, tuition tax credits).

5. Providing an exemption from AMT for low and middle-income taxpayers with regular tax AGI of less than $100,000.

6. Considering AMT impact in all future tax legislation.

Due to the increasing complexity and compliance problems, and a perceived lack of fairness towards the intended target, an additional alternative Congress might also want to consider eliminating the individual AMT altogether.

**Contribution to Simplification of AMT**

The goal of fairness that is the basis for AMT has created hardship and complexity for many taxpayers who have not used preferences to lower their taxes but have been caught up in AMT's attempt to bring fairness. Many of these individuals are not aware of these rules and complete their return themselves, causing confusion and errors. The 1997 law and the impact of inflation on indexed tax brackets and the AMT exemption are causing more lower income taxpayers to be inadvertently subject to AMT. Recommendation 1 of indexing the AMT brackets and exemption would solve this problem.

Under recommendation 2, those individuals who are affected only by itemized deductions and personal exemption adjustments would no longer have to compute the AMT amount. Itemized deductions are already reduced by the 3 percent AGI adjustment, 2 percent AGI miscellaneous itemized deduction disallowance, 7.5 percent AGI medical expense disallowance, $100 and 10 percent AGI casualty loss disallowance, and the 50 percent disallowance for meals and entertainment. Similarly, the phase out of exemptions already affects high income taxpayers. It is also worth noting that because state income taxes vary, taxpayers in high income tax states may incur AMT solely based on the state in which they live, while other taxpayers with the same adjusted gross income (AGI), but who live in states with lower or no state income taxes, would not pay AMT.

In addition, under recommendation 3, many of the AMT preferences could be eliminated by reducing for all taxpayers the regular tax benefits of present law AMT preferences (e.g., require longer lives for regular tax depreciation). This would add substantial simplification to the Code, recordkeeping and tax returns.

Under recommendation 4, those who are allowed for regular tax purposes certain credits, such as the low income or tuition tax credits, would be allowed to decrease their AMT liability by the credits. This would increase simplicity and create fairness. Compliance would be improved.

Under recommendation 5, fewer taxpayers will be subject to AMT and the associated problems. By increasing the AMT exemption to exclude low and middle income taxpayers, the AMT will again be aimed at its original target -- the high-income taxpayer.

By eliminating AMT altogether, all the individual AMT problems would be solved.

**Conclusion on AMT**

In conclusion, we see AMT issues as becoming more prevalent and causing considerable disillusion to many taxpayers who do not see themselves as wealthy and who will believe they are being "punished" unfairly. Many taxpayers to whom it would appear AMT was not originally intended to affect, are or will be paying AMT. We have recommended several ways to help fix the AMT problems, from indexing the AMT brackets and exemption amounts to eliminating certain adjustments and preferences.

**Hidden tax rates**

Hidden tax rates are a result of the complexity added to our tax laws over the last decade. Specifically, the phase-outs of itemized deductions, personal exemptions, and IRA deductions are examples of hidden rates which add to the effective tax rate individuals pay. In addition, the limitation on deductions, such as 7.5 percent of AGI for medical expenses, 2 percent of AGI for miscellaneous itemized deductions, and 10 percent of AGI for casualty losses is an increase in the effective tax rate to which individuals are subject. Since married filing separate taxpayers are denied many deductions, their effective tax rate is even higher. There has been a reluctance by Congress to raise tax rates to achieve progressivity. Instead of a straight forward rate increase, Congress has used backdoor approaches, such as, phase-outs and limitations to raise the effective tax rate on high-income individuals. A chart detailing many of the phase-outs in current law is attached.

The impact of new or complex tax laws and complicated phase-outs must be considered when tax legislation is enacted. Congress should actively strive for simplification and stability. Tax law complexity originates with the statutes. Higher than expected effective tax rates result from disguising revenue needs and progressivity by limiting provisions throughout the Code to certain taxpayers, instead of simply increasing tax rates. Complexity in the tax law is the result. The phase-outs are the clearest example of hidden tax rates, so we have concentrated the remainder of our testimony on them.

**Background on Phase-outs Based on Income Level**

Numerous sections in the tax law provide for the phase-out of benefits from certain deductions or credits over various ranges of income based on various measures of the taxpayer's income. There is currently no consistency among these phase-outs in either the *measure* of income, the *range* of income over which the phase-outs apply, or the *method* of applying the phase-outs. Furthermore, the ranges for a particular phase-out often differ depending on filing status, but even these differences are not consistent. For example, the traditional IRA deduction phases out over a different range of income for single filers than it does for married-joint filers; whereas the $25,000 allowance for passive losses from rental activities for active participants phases out over the same range of income for both single and married-joint filers. Consequently, these phase-outs cause inordinate complexity, particularly for taxpayers attempting to prepare their tax returns manually; and the instructions for applying the phase-outs are of relatively little help. See the attached Appendices A and B for a listing of most current phase-outs, including their respective income measurements, phase-out ranges (for 1998) and phase-out methods.

Currently, many of the phase-out ranges for married-filing-separate (MFS) taxpayers are 50 percent of the range for married-filing-joint (MFJ), while many of the phase-out ranges for single and head of household (HOH) taxpayers are 75 percent of married-joint. That increases the marriage penalty as the spouses' incomes become equal.

**Recommended Change to the Phase-outs**

Simplicity can be achieved by eliminating phase-outs altogether. However, if that is considered either inequitable (simplicity is often at odds with equity) or bad tax policy, significant simplification can be achieved by providing consistency in the measure of income, the range of phase-out (including as between filing statuses) and the method of phase-out.

Instead of the 20 or so different phase-out ranges (shown in attached Appendix A), there should only be three phase-out ranges for low, middle, and high income taxpayers.

If there are revenue concerns, the ranges and percentages could be adjusted, so long as the phase-outs for each income level group (i.e., low, middle, high income) remained consistent for all relevant provisions. In addition, the "marriage penalty" impact should be considered in adjusting phase-out ranges for revenue needs.

We have proposed that, to eliminate the marriage penalty and simplify the Code, all phase-out ranges for married-filing-separate (MFS) taxpayers would be the same as those for single and head of household (HOH) taxpayers, which would be 50 percent of the range for married-filing-joint (MFJ) range.

The benefits that are specifically targeted to low-income taxpayers, such as the earned income credit, elderly credit, and dependent care credit, would phase-out under the low-income taxpayer phase-out range. The benefits that are targeted not to exceed middle income levels, such as the traditional IRA deduction and education loan interest expense deduction, would phase-out under the middle-income taxpayer phase-out range. Likewise, those benefits that are targeted not to exceed high income levels, such as the new child credit, new education credits and IRA, and the new Roth IRA, as well as the existing law AMT exemption, itemized deductions, personal exemptions, adoption credit and exclusion, series EE bond exclusion, and section 469 $25,000 rental exclusion and credit, would phase-out under the high-income taxpayer phase-out range. See the chart below.

Additionally, instead of the differing methods of phase-outs (shown in attached Appendix B), the phase-out methodology for all phase-outs would be the same, such that the benefit phases out evenly over the phase-out range. Every phase-out should be based on adjusted gross income (AGI).

**Proposed Income Level Range for Beginning to End of Phase-Out for Each Filing Status**

| Category of Taxpayer | Married Filing Joint | Single & HOH & MFS |
|---|---|---|
| *LOW-INCOME* | $ 15,000-$ 37,500 | $ 7,500-$ 18,750 |
| *MIDDLE- INCOME* | $ 60,000-$ 75,000 | $ 30,000-$ 37,500 |
| *HIGH-INCOME* | $225,000-$450,000 | $ 112,500-$225,000 |

**Contribution to Simplification of Phase-outs**

The current law phase-outs complicate tax returns immensely and impose marriage penalties. The instructions are difficult to understand and the computations often are difficult to do manually. The differences among the various phase-out income levels are significant. The phase-outs should be eliminated by adjusting rates, or by applying the phase-outs to consistent ranges, and using a consistent methodology. This would ease the compliance burden on many individuals. If there were only three ranges to remember and only one methodology, it would be a lot simpler and easier to recognize when and how a phase-out applies. Many portions of numerous Internal Revenue Code sections could be eliminated. By making the MFJ phaseout ranges double the ranges applicable to single individuals and making the MFS ranges the same as single individuals, the marriage penalty relevant to phase-out ranges would be eliminated.

**Conclusion**

In conclusion, true simplicity could easily be accomplished by eliminating phase-outs altogether. However, if that is not feasible, for whatever reason, significant simplification can be achieved by creating consistency in the measure of income, the phase-out range (including as between filing statuses) and the phase-out methodology. We would be happy to discuss any or all of these approaches further and work on any solutions to this problem. The AICPA again thanks you for this opportunity to present our comments and recommendations on reforming the AMT and tax rates.

APPENDIX A - Selected AGI Phase-out Amounts

| IRC Section | Provision | Ft nt. | Current - Joint | Current - Single & HOH | Current - Married/Sep. | *Proposed - Joint* | *Proposed - Single & HOH & MFS* |
|---|---|---|---|---|---|---|---|
| PHASE-OUT LEVELS FOR *LOW-INCOME TAXPAYERS* | | | | | | | |
| 21 | 30 Percent Dependent Care Credit | (3) | $10,000-$20,000 | $10,000-$20,000 | No credit | *$15,000-$37,500* | *$7,500-$18,750* |
| 22 | Elderly Credit | (4) | $10,000-$25,000 | $7,500-$17,500 | $5,000-$12,500 | *$15,000-$37,500* | *$7,500-$18,750* |
| 32 | EITC (No Child) | (2,3, 4) | $5,570-10,030 | $10,030 | No credit | *$15,000-$37,500* | *$7,500-$18,750* |

*-- table continued on next page --*

| IRC Section | Provision | Ft nt. | Current - Joint | Current - Single & HOH | Current - Married/Sep. | *Proposed - Joint* | *Proposed - Single & HOH & MFS* |
|---|---|---|---|---|---|---|---|
| 32 | EITC (1 Child) | (2,3, 4) | $12,260-$26,473 | $12,260-$26,473 | No credit | *$15,000-$37,500* | *$7,500-$18,750* |
| 32 | EITC (2 or More Children) | (2,3, 4) | $12,260-$30,095 | $12,260-$30,095 | No credit | *$15,000-$37,500* | *$7,500-$18,750* |
| PHASE-OUT LEVELS FOR *MIDDLE-INCOME TAXPAYERS* | | | | | | | |
| 219 | IRA Deduction w/ retiremt. plan | (1,7,9) | $50,000-$60,000 | $30,000-$40,000 | No deduction | *$60,000-$75,000* | *$30,000-$37,500* |
| 221 | Education Loan Interest Exp. | (1,2,6) | $60,000-$75,000 | $40,000-$55,000 | No deduction | *$60,000-$75,000* | *$30,000-$37,500* |
| PHASE-OUT LEVELS FOR *HIGH-INCOME TAXPAYERS* | | | | | | | |
| 24 | Child Credit | (1,5,6) | $110,000- | $75,000- | $55,000- | *$225,000-$450,000* | *$112,500-$225,000* |
| 25A | Hope Credit & Lifetime Learning Cr. | (1,2,6) | $80,000-$100,000 | $40,000-$50,000 | No credit | *$225,000-$450,000* | *$112,500-$225,000* |
| 23 & 137 | Adoption Credit/ Exclusion | (1,7) | $75,000-$115,000 | $75,000-$115,000 | No benefit | *$225,000-$450,000* | *$112,500-$225,000* |
| 55(d) | AMT Exemption | (1,8) | $150,000-$330,000 | $112,500-$247,500 | $75,000-$165,000 | *$225,000-$450,000* | *$112,500-$225,000* |
| 68 | Itemized Deduction level | (2) | $124,500- | $124,500- | $62,250- | *$225,000-$450,000* | *$112,500-$225,000* |
| 135 | EE Bond int. Exclusion | (1,2,7) | $78,350-$108,350- | $52,250-$67,250 | No exclusion | *$225,000-$450,000* | *$112,500-$225,000* |
| 151 | Personal Exemption | (2) | $186,800-$309,300 | $124,500-$247,000 HOH$155,650-$278,150 | $93,400-$154,650 | *$225,000-$450,000* | *$112,500-$225,000* |
| 219(g)(7) | IRAw/spouse w/retrmt.plan | (1,6,7) | $150,000-$160,000 | $10,000-$20,000 | No deduction | *$225,000-$450,000* | *$112,500-$225,000* |
| 408A | Roth IRA Deduction | (1,6) | $150,000-$160,000 | $95,000-$110,000 | No deduction | *$225,000-$450,000* | *$112,500-$225,000* |
| 408A | IRA to Roth IRA Rollover | (1,6,7) | $100,000 | $100,000 | No rollover | *$225,000-$450,000* | *$112,500-$225,000* |
| 469(i) | $25,000 Rent Passive Loss | (1,7) | $100,000-$150,000 | $100,000-$150,000 | $50,000-$75,000 | *$225,000-$450,000* | *$112,500-$225,000* |
| 469(i) | Passive Rehab. Credit | (1,7) | $200,000-$250,000 | $200,000-$250,000 | $100,000-$125,000 | *$225,000-$450,000* | *$112,500-$225,000* |
| 530 | Education IRA Deductn | (1,6) | $150,000-$160,000 | $95,000-$110,000 | No deduction | *$225,000-$450,000* | *$112,500-$225,000* |

Footnotes: (1) Modifications to AGI apply; (2) Inflation indexed; (3) Earned income limitations; (4) Low income only; (5) Phase-out range depends on number of children; (6) Newly enacted in 1997; (7) Also see section 221(b)(2); (8) Phase-out applies to alternative minimum taxable income rather than AGI; (9) Increases for future years are specifically provided in the statute.

APPENDIX B - Current Method of Phase-Out

| Code Section(s) | Tax Provision | Current Methodology for Phase-outs' Application |
|---|---|---|