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John K. Meagher

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OUTLOOK FOR TAX LEGISLATION IN THE 97TH CONGRESS

JOHN K. MEAGHER, ESQ.

Thank you, Emeric.

Having graduated sixteen years ago from the Marshall-Wythe School of Law prior to beginning my legal career in the legislative branch of the Federal government, it is a distinct pleasure for me to return to William and Mary. It is, indeed, more personal to me as I am presently leaving the legislative arena and this provides me with the opportunity for a personal retrospective of the Carter Administration's tax policy over the last few years and for offering some perspective as to the likely tax policy of the new Reagan Administration. The contrast will be interesting.

There is no intent to mislead you on my topic, *i.e.*, the "Outlook for Tax Legislation in the 97th Congress." The answer, in my opinion, can be found, as in the past, by focusing on the character of the last Congress under the executive's tax proposals and ascertaining results, patterns, and emerging policy changes. I believe it useful, therefore, to study the Carter tax proposals and results under the 96th Congress and to compare the questions that will be faced by the 97th Congress when confronted with the Reagan tax proposals. The analysis, then, concentrates on the proposals of the past president and the probable proposals of the new president as the principal medium for predicting the likely legislative actions of the 97th Congress.

Before beginning on my tax prophecy, I should like it to be known I am honored to participate in this distinguished Tax Conference. It's always been a sincere hope that I would be invited.

It's more than shocking and exciting to see the change effected by the November elections. Even as a Republican, I never anticipated both a change in the executive and control over the Senate; the significant increase of strength in the House was equally surprising. The combination of these and other economic factors will have a major impact on policies of the government in general and tax policy in particular.

There has been some question (Wall Street Journal) raised regarding whether Congress remains a viable institution. The budget process among other problems appears to symbolize the inadequacies of Congress which when confronted with special interest advocates suggests the possibility of a complete breakdown. One major issue that the media has not focused upon, and which has a major impact on the legislative process, is the tremendous changeover in Congress. Before the last election, 55 percent of the House members had been there for less than five years. The Senate reflects a similar situation. This phenomenon is further complicated in view of the fact that many of those recently elected ran, more or less, on a non-partisan basis, that is they were elected primarily on their own. This has created a breakdown in party control and in the ability of various chairmen to control their com-

mittees. In my opinion, this Congress, by and large, is a group of rookies who are used to doing things on their own. Until they obtain some status and realize their growth in power depends upon political accommodation, the situation will not likely change except to the extent they individually agree on policies.

A combination of important factors may reverse the course of congressional paralysis. Those factors include eventual political socialization of the new members as to the perks of cooperation, the increased number of members with similar political values, and the opportunities for leadership by the new Reagan Administration. These factors will also impact on the type of tax policy adopted and the speed with which it is enacted. Be assured the new Congress will, in my opinion, deal effectively and successfully with our national problems. The new energy from the last election and the latest crop of "newborn" members may provide an impetus for Congress to act vigorously in the early days of the Reagan Administration.

As I have indicated, the future tax policy of the 97th Congress can be seen from the perspective of comparing the Carter tax policy and its results to that of the new administration and its likely results. The Democratic Party is made up historically of a number of constituencies. Those constituencies include minority groups, labor unions, universities and consumer groups—these are the core of the Democratic Party. Without exception, these groups demand a large central government which will in turn bestow benefits on the constituencies. These benefits are costly and require significant revenue, and these demands have become increasingly expensive due to the high rate of inflation over the last number of years. In simplified terms, this means the Carter Administration was caught in the political dilemma of raising revenue while avoiding public recognition of this tax policy. This was a serious political dilemma which may have played a negative role in the election. The revenue raising tax policy of President Carter was wrapped in popular ideologies. They included closing tax "loopholes", increasing social security taxes (227 billion dollars) and adopting a Windfalls Profits Tax (another 227 billion dollars). Few citizens recognized that they would personally be paying these added tax costs. Other aspects of the revenue raising policy were carefully offered in other relatively popular political packages such as closing the three-martini lunch deduction. See Cong. Record of Aug. 2, 1980 where it is claimed that President Carter's total tax initiatives if enacted would have generated over 319 billion by 1983. By 1978, these proposals by and large were out of political synchronization with even the Democratic controlled Congress. Some Democratic members of the Ways and Means Committee such as former Congressman Vanik were asking for tax tranquility and relief from tinkering tax reforms. Undaunted, the President approached Congress with the same old but needed package and what happened—Congress took over and wrote its own tax legislation in 1978 which resulted in an historic reduction on the tax rate applied to capital gains. Much to President Carter's dismay, he was forced to sign into a law the Revenue Act

of 1978 which significantly reduced taxes for the upper income groups. His threat to veto the bill was converted into the customary Rose Garden chatter on its execution; that is, it doesn't go far enough but it will provide some needed tax reforms. The Revenue Act of 1978 was, in my opinion, a very underpublicized defeat of the administration's policies and corresponding to the emergence of an independent Congress in terms of tax policy.

Before discussing what I believe will be the Reagan tax policies, it's important to briefly identify a number of tax items on the congressional agenda which have general nonpartisan support of both parties. Included are the marriage penalty tax, earned income credit, savings incentives, indexing, increased investment tax credits, and depreciation reform (10-5-3). All present the usual consideration of cost and benefits but positive action on some or most of these items can be anticipated and should be considered both independent and part of Reagan's policies. I have serious doubts about indexing because Congress enjoys the political benefits of lowering taxes which would no longer be their exclusive option if income tax rates were pegged to the rate of inflation.

President Reagan's policies like the past administration will be based on his constituency. He will be tested on the degree to which Congress adopts his approach. The major difference starts with a review of what his constituents want—decrease in taxes and increased incentives to invest. Both of the factors simply favor major tax reductions whether in the form of Kemp-Roth or some modified version; we will see this before the end of next summer. The major difficulty I envision for the new administration is in dealing with the demand for targeted tax relief for certain depressed segments of our economy such as the auto and steel industry. What this suggests is some groups on the business side are requesting a form of subsidy—this is going to be a real hot potato. If the Reagan administration favors decreasing the tax burdens which limit growth so as to allow general market conditions to operate without governmental interference, does that also mean or suggest tax subsidies on a selected industrial basis is conceptually consistent with primary Republican principles. It's a delicate question which, if I were one of Reagan's advisers, I would defer to his judgment. It is a subtle and likely losing issue for the new president no matter what he decides. It opens all types of attacks on stated general tax policy. For example, my former boss, Rep. Conable, ranking Republican on the Ways and Means Committee, has always rejected, on principle, treating various groups as special interests—everyone should uniformly face the same tax treatment. The advent of Chrysler and steel companies looking to the government for financial transfusions can effect an interesting change of policy.

I believe you can also expect as part of tax reduction under the Reagan Administration further decreases in capital gains tax, increased estate and gift tax credits, and real support for the depreciation reforms of 10-5-3. Another area which generally is in the category of Reagan's more creative proposals deals with the establishment of enterprise zones. I call this approach the tax model cities program; it's intended

to stimulate business activity in the hard core poverty areas through specifically targeted tax incentives. You can observe the beginnings of this approach in the historic designation exception of existing law whereby renovation costs may be written off in five years as long as general standards are met. This is an interesting idea and one I expect President Reagan will push in Congress.

There are parts of the Reagan constituency which present problems. Balancing the budget, increasing defense expenditures, decreasing taxes are not presently logically deliverable. There are in addition other groups of his constituency—Moral Majority, anti-ERA, anti-abortion who will be seeking their part of the action. While not all of their claims will involve issues of tax policy, some do, such as tuition tax credits. Tuition tax credits will create a major stress on the tight economic balancing that President Reagan will try to effect. Can he defer action on tuition tax credits or similar programs while delivering on the major aspects of his program without losing, chip by chip, his political support. There have been many presidents who have come to power with an even stronger congressional control and who were expected to deliver on the major themes of their campaigns but because of other pressing emergencies and ensuing subtle political defection, time robbed them of success. Other facets of their claims (the other segments of the Reagan constituency) may impact by paralyzing Congress in deliberating on difficult non-tax problems. For example, a massive congressional debate on abortion could cause serious delay and fracture the political base that President Reagan starts with on January 20, 1981.

While ebullience and great expectation should be part of every new start, President Reagan faces major economic hassles; it's not inconceivable there could be a prompt dissipation of support if the existing expectations are unrealistic and a test of patience breaks into a series of special interest conflicts. President Reagan cannot say yes to all, but for a brief period, if he is to maintain broad political support to enact and execute his policies, it must look like he is doing so. We have not been a patient country; further economic pressure will be focused back on the president for resolution. What we need is magic. What the 97th Congress has is only a brief period of time to experiment with a different supply-business tax policy.

Finally, we must also recognize that President Reagan's major conflict will likely be the debate on the budget. It is likely the 97th Congress will strongly support the tax reductions and deductions discussed herein. But will the country have sufficient revenue to pay for defense and other costs of the government? President Reagan looks to feedback revenue to bridge these dilemmas. If it's there, and not at the cost of increased inflation, President Reagan and his economic advisers will have provided the needed national elixir! If it (feedback revenue) is not there, then President Reagan will face a test of political will—can tax reductions be continued with increased deficits and inflation without total absorption of the benefits?

CONCLUSION

It is my judgment that President Reagan will find initially very strong support from the 97th Congress with regard to his tax policies. They will be enacted, albeit in a modified version, by the end of next summer. In addition, a number of less controversial tax matters (marriage penalty, depreciation reform, etc.) are also generally set for enactment by this Congress either as part of the major tax bill or as separate tax legislation. However, after the enactment of the major tax legislation, both President Reagan and the 97th Congress will be forced to deal with the economic and political situation existing in 1982; if their combined action on tax legislation results in a favorable environment, we will see more of the same medicine in 1982 through 1984. If the reverse condition exists, with significant increases in unemployment, we will be facing serious political and economic chaos which precludes any suggestion of mine as to what the 97th Congress will do in that event. I simply hope, as you, this does not occur! We should not forget, however, that the early Congressional crisis will be observable in the debate on the budget and not on tax legislation.

You can be sure I will be watching these developments closely and will miss the excitement in not being involved in the legislative process on the Hill. Thank you for inviting me—and listening to my prophecies. Despite my reservations, I must emphasize that my outlook is basically optimistic. As you can see—Jeanne Dixon I'm not, but there are enough signposts that suggest the described interactions; phophecy of actual results I leave to those more visionary. President Reagan and the 97th Congress will need everyone's support and the good luck of other variables over which they have little control.