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THE IMPACT OF REPEAL OF THE DEDUCTIONS FOR STATE AND LOCAL TAXES

HEARINGS

BEFORE THE

SUBCOMMITTEE ON MONETARY AND FISCAL POLICY

OF THE

JOINT ECONOMIC COMMITTEE

CONGRESS OF THE UNITED STATES

NINETY-NINTH CONGRESS

FIRST SESSION

JUNE 10, JUNE 24, AND JULY 15, 1985

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CONTENTS

WITNESSES AND STATEMENTS

MONDAY, JUNE 10, 1985

MONDAY, JUNE 24, 1985

MONDAY, JULY 15, 1985

SUBMISSIONS FOR THE RECORD

MONDAY, JUNE 10, 1985

MONDAY, JULY 15, 1985

THE IMPACT OF REPEAL OF THE DEDUCTIONS FOR STATE AND LOCAL TAXES

MONDAY, JUNE 10, 1985

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON MONETARY AND FISCAL POLICY
OF THE JOINT ECONOMIC COMMITTEE,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:30 a.m., at 24 Federal Plaza, New York, NY, Hon. Alfonse M. D'Amato (member of the subcommittee) presiding.

Present: Senators D'Amato and Moynihan.

Also present: Robert Salomon, legislative assistant to Senator D'Amato.

OPENING STATEMENT OF SENATOR D'AMATO, PRESIDING

Senator D'AMATO. I am going to ask those people who are still going about their business and setting up their equipment to see if they can't hold the noise level down.

This is the Subcommittee on Monetary and Fiscal Policy of the Joint Economic Committee which is convening here in New York. Senator Moynihan, a member of the Finance Committee, as well as senior Senator of the State of New York, has graciously agreed to participate in this hearing and bring his expertise to bear.

So that we may hear our first witness now, I ask that my opening statement be placed in the record in its entirety so that we can save time.

Let me briefly point out, though, several features.

What will the impact of doing away with the deduction of State and local taxes be? According to the Internal Revenue Service, and some other data, over 33 million people in the United States of America will lose some $35 billion as a result of the loss of the deductions from State and local taxes; 28 million of these people make between $22,000 and $50,000. So we are not talking about wealthy Americans. We are talking about working middle-class families; 28 million families making between $22,000 and $50,000 will comprise the basic loss of that $35 billion.

Second, in 1982, New York City residents deducted $986 million in State and local taxes, and saved an average of $1,100 from their Federal taxes.

The fact is that this is going to be a blow to the average resident of the city of New York; $1,100 is a lot of money for middle-income people.

One other aspect. What does double taxation cost individuals paying taxes in New York? In other words, I believe we have to have some reciprocity. I will ask the Governor this question. It would seem to me that if we deduct State and local taxes from our Federal income taxes, then people who pay city taxes should also have the ability to deduct those taxes from their State taxes—that would save those people who work in the city of New York some $80 million. In order to fully address the issue of fair play, we will have to ask the State legislature to address the issue of double taxation as well.

With that, I am going to ask that the balance of my opening statement be placed in the record in its entirety.

[The written opening statement of Senator D'Amato follows:]

WRITTEN OPENING STATEMENT OF HON. ALFONSE M. D'AMATO

THIS HEARING WILL ANALYZE THE IMPACT OF TREASURY'S PLAN TO REPEAL THE FEDERAL TAX DEDUCTION FOR STATE AND LOCAL PROPERTY, SALES, AND INCOME TAXES. I WOULD LIKE TO THANK OUR DISTINGUISHED WITNESSES FOR TAKING THE TIME TO TESTIFY TODAY, ESPECIALLY GOVERNOR CUOMO AND MAYOR KOCH.

REPEAL OF THIS VITAL DEDUCTION WILL HAVE A DEVASTATING IMPACT ON THE EDUCATION OF OUR CHILDREN AND ON OUR ECONOMY, BUT IT IS THE ADVERSE IMPACT ON THE PEOPLE THROUGHOUT THE NATION THAT IS OF THE MOST CONCERN TO ME.

WHAT WILL THE IMPACT BE? ACCORDING TO IRS DATA, OVER 33 MILLION PEOPLE WILL LOSE $35 BILLION FROM LOSS OF THE DEDUCTION FOR STATE AND LOCAL TAXES. 28 MILLION OF THESE PEOPLE MAKE BETWEEN $22,000 AND $50,000. THESE ARE MIDDLE-INCOME FAMILIES THAT CANNOT AFFORD TO PAY MORE TAXES.

ACCORDING TO THE IRS, IN 1982, NEW YORK CITY RESIDENTS DEDUCTED $986 MILLION IN STATE AND LOCAL TAXES AND SAVED ON AVERAGE $1,105 FROM THEIR FEDERAL TAXES. IN YONKERS, OVER $48 MILLION OF STATE AND LOCAL TAXES WERE DEDUCTED FROM FEDERAL RETURNS YIELDING TAX SAVINGS OF $1,240 PER RETURN ON AVERAGE. FOR THESE PEOPLE, TAX REFORM WILL BE A EUPHEMISM FOR TAX INCREASE.

THE EVIL OF DOUBLE TAXATION WILL ROB THESE PEOPLE OF THE EQUITY IN THEIR HOMES. WITHOUT THE DEDUCTION FOR PROPERTY TAXES, THE VALUE OF HOMES WILL DROP. THIS IS CRITICAL IN A NATIONAL ECONOMY SUCH AS OURS THAT RELIES SO HEAVILY ON THE HOUSING MARKET.

DOUBLE TAXATION IS WRONG. IT IS WRONG WHEREVER AND WHENEVER IT OCCURS. IT IS IMPARITIVE THAT THE FEDERAL DEDUCTION FOR STATE AND LOCAL TAXES BE PRESERVED. BUT, IT IS EQUALLY IMPORTANT THAT INDIVIDUALS THAT PAY INCOME TAXES TO NEW YORK CITY AND YONKERS BE ALLOWED A DEDUCTION ON THEIR STATE RETURNS. PEOPLE WHO HAVE BEEN PAYING TAXES TO NEW YORK CITY AND TO YONKERS INCUR DOUBLE TAXATION. THIS IS WRONG.

WHAT HAS DOUBLE TAXATION COST INDIVIDUALS PAYING TAXES TO YONKERS AND NEW YORK CITY? THE ANSWER IS $80 MILLION. PEOPLE PAYING INCOME TAXES TO NEW YORK CITY AND

YONKERS ARE GETTING A RAW DEAL. THE FEDERAL DEDUCTION FOR ALL STATE AND LOCAL TAXES MUST BE PRESERVED. BUT DOUBLE TAXATION MUST BE ENDED IN OUR OWN STATE. EQUITY DICTATES THAT THIS IMPORTANT STEP TOWARDS TAX FAIRNESS BE UNDERTAKEN.

SINCE THE CURRENT INTERNAL REVENUE CODE WAS PASSED IN 1954, CORPORATIONS HAVE BEEN PROTECTED FROM THE EVILS OF DOUBLE TAXATION ON THEIR FOREIGN INCOME. IF A CORPORATION PAYS TAXES OVERSEAS, THAT AMOUNT IS ALLOWED AS A CREDIT AGAINST U.S. TAX LIABLITY. FOR INSTANCE, IF GENERAL ELECTRIC PAYS $100 MILLION IN TAXES TO FRANCE, THEN $100 MILLION MAY BE TAKEN OFF GENERAL ELECTRIC'S U.S. TAX OBLIGATION.

NOW TREASURY WANTS TO RADICALLY CHANGE THE RULES FOR BOTH INDIVIDUALS AND CORPORATIONS. TREASURY BUREAUCRATS BELIEVE THAT INDIVIDUALS SHOULD BE FORCED TO PAY TAXES ON TAXES. THIS WOULD BE ACCOMPLISHED BY REPEALING THE DEDUCTION FOR STATE AND LOCAL TAXES.

INTERESTINGLY, HOWEVER, THESE SAME TREASURY BUREAUCRATS DO NOT BELIEVE THAT CORPORATIONS SHOULD BEAR THE BURDEN OF DOUBLE TAXATION. TREASURY HAS PROPOSED THAT COMPANIES NOW BE RELIEVED FROM VIRTUALLY ANY FORM OF DOUBLE TAXATION.

FIRST, TREASURY WOULD PRESERVE THE ENTIRE FOREIGN TAX CREDIT WITH ONLY SMALL MODIFICATIONS. IN SHORT, TREASURY SAYS THAT A COMPANY SHOULD GET A BREAK ON ITS U.S. TAXES IF IT PAYS ANY TAXES IN JAPAN, FOR EXAMPLE. BUT IF A MIDDLE-CLASS PERSON PAYS TAXES TO SUPPORT THE LOCAL SCHOOL SYSTEM IN LOS ANGELES, OR BRIDGEPORT, OR BUFFALO, THEN NO FEDERAL DEDUCTION SHOULD BE ALLOWED.

THINK ABOUT IT, A COMPANY THAT PAYS TAXES OVERSEAS WOULD RECEIVE A FULL U.S. TAX CREDIT, BUT, UNDER TREASURY'S PLAN, AN INDIVIDUAL WOULD NOT EVEN RECEIVE A TAX DEDUCTION.

THIS IS DISGRACEFUL. TREASURY CLAIMS THAT THEIR PURPOSE IS NEUTRALITY IN THE TAX CODE. BUT THEN THEY PROPOSE THAT PEOPLE AND CORPORATIONS BE TREATED DIFFERENTLY.

ON TOP OF THIS, TREASURY ALSO PROPOSES THAT COMPANIES NO LONGER INCUR DOUBLE TAXATION ON THE DIVIDENDS THEY PAY. THIS WOULD BE ACCOMPLISHED BY ALLOWING COMPANIES TO DEDUCT ~~HALF~~ 10% OF THEIR DIVIDENDS PAID TO STOCKHOLDERS FROM THEIR CORPORATE INCOME.

BY PROPOSING THIS CHANGE, TREASURY CLEARLY HAS INDICATED ITS BELIEF THAT DOUBLE TAXATION OF CORPORATE

DIVIDENDS IS EVIL. BUT IF DOUBLE TAXATION IS EVIL FOR COMPANIES, WHY IS IT NOT ALSO EVIL FOR INDIVIDUALS?

WHEN TREASURY ADMITS THAT DOUBLE TAXATION IS WRONG, THEY ARE RIGHT. BUT IT IS TREASURY'S THIRST FOR ADDITIONAL REVENUE THAT HAS RESULTED IN THEM IGNORING THIS OBVIOUS CONTRADICTION AND PROPOSING REPEAL OF THE DEDUCTION FOR STATE AND LOCAL TAXES.

THERE IS AN IMPORTANT PRINCIPLE AT STAKE IN THIS DEBATE: IS DOUBLE TAXATION RIGHT OR WRONG? THIS IS AN ISSUE FOR ALL THE NATION, NOT JUST ONE OR TWO STATES. THIS IS WHY I WILL VIGOROUSLY FIGHT ANY ATTEMPT TO REPEAL THE DEDUCTION FOR STATE AND LOCAL TAXES.

Senator D'AMATO. Senator Moynihan.

OPENING STATEMENT OF SENATOR MOYNIHAN

Senator MOYNIHAN. Thank you, Senator. First, I would like to express my appreciation for your graciousness in letting me share this occasion with you, and thank in advance all our witnesses who have prepared for today.

We are trying to make a record on what is going to be a hectic encounter on many levels, on many issues in Washington. The Finance Committee opens its hearings tomorrow morning. We will have Secretary Baker testify and I will be able to ask him questions that are raised here.

Just for the record, I have an opening statement which I ask be included, and draw attention to a level of government which is not much in evidence here or most anywhere. It is a universal, modest public regarding branch of our government called the school district. There are 15,000 in the country. They have taxing powers. They have the responsibility for public education in this country. They are extraordinarily important. As I say, nonpartisan. And the plain fact is that by analysis, you can show that the real cost, the price of school taxes in the United States, would rise by 40 percent in the aftermath of the withdrawal of the deduction. A 40-percent increase in the real price of school taxes, the real cost, the dollar cost to the present people.

A 40-percent increase in cost is inevitably going to bring a reduction, in our case, and there are estimates on that having to do with—the formula is complicated. It doesn't matter. It is generally agreed that a 40-percent increase will end up with a 20-percent drop. You can seriously estimate that over the next 10 years school education expenditures will end up 20 percent below what they otherwise would have done.

If this is a decision to cut back on education at the local level resources, at the same time we are cutting back at the national level, it seems at least we ought to get it up front and say that's what we are doing, and that's what we want to do. If we don't want to do it, let's not do it. Thank you, Senator D'Amato.

[The written opening statement of Senator Moynihan follows:]

WRITTEN OPENING STATEMENT OF HON. DANIEL PATRICK MOYNIHAN

Mr. Chairman:

Tax simplification is the central issue before the 99th Congress. A key feature of the President's tax simplification plan is the repeal of the deduction for State and local taxes. There could be few more direct and certain ways to cripple State and local governments than this proposal.

Just when the pressures on State and local governments are again increasing, following the latest round of Federal budget cuts, the Administration would severly limit the ability of States and localities to raise the revenues to meet their growing obligations. The repeal of this deduction would achieve just that, raising the real burden of all State and local taxes.

Every State and local Government will feel the effects, but none more keenly than those responsible for educating our children. This proposal will hurt every schoolchild in this country.

The reason is simple. School districts rely overwhelmingly on the property tax to finance their operations. This tax is now deductible. If this plan were enacted, the average American property taxpayer would experience a 40% increase in the burden -- the true economic cost of his property taxes. Yes, these same taxpayers might benefit from filing lower tax rates. But they will see their property tax bills in a new light -- a non-deductible light -- and experience suggests that taxpayers will vote to cut in these taxes -- and the services they support -- at the first opportunity.

The public finance literature provides some guidelines on how voters are likely to respond. Even using conservative estimates, it is likely that over the next few years, voters will accept only half of this sudden increase in their property tax bills by about half. That is our experience. And the implications for school finances are ominous. In the 1983-1984 school year, we spent about $3,400 per child on public education. As the repeal of deductibility would increase the real burden of school taxes by 40 percent, this suggests that over the next few years average spending per student would decline by half that, 20 percent, or some $605 per child.

This will happen everywhere, not just in the so-called high tax states. New York will find itself cutting education expenditures by some $870 per student. The cut in Kansas would come to $678 per student. In Delaware, $776 per student; Pennsylvania, $726 per student.

The essence of the Federal idea is that there are spheres of government which must not be invaded by other governments. Now this is not a rigid compartmentalization. All membranes in the Federal system are permeable. But they are not to be ripped. Nowhere is this more important than in the sphere of taxation, wherein the initiative and independence of different levels of government commences.

Yet this is what the Treasury proposal would do.

And no level of Government will feel the effect more than the most local, our municipalities and local school districts.

ESTIMATED REVENUE LOSS PER PUPIL FROM ELIMINATION OF

THE STATE AND LOCAL DEDUCTION, 1984-85

State	Elementary and Secondary Education Revenues from State and local Sources ($$ in Millions) 1/	Total Estimated Loss in Revenue for Education Per State ($$ in Millions) 2/	Estimated 1984-85 Expenditure Per Pupil 3/	Estimated Revenue Loss Per Pupil 4/
U.S. Average	$2,349.4	$467.5	$3,429	$605.55
Alabama	$1,326.9	$242.8	$2,241	$333.71
Alaska	608.1	5/	6,867	5/
Arizona	1,347.4	249.3	2,801	439.68
Arkansas	877.2	152.6	2,344	352.70
California	12,250.0	2,462.3	3,291	593.26
Colorado	1,814.1	355.6	3,398	651.97
Connecticut	1,882.5	421.7	4,477	882.20
Delaware	329.7	71.2	4,155	775.88
Washington, D.C.	326.4	72.5	4,753	829.55
Florida	4,684.4	918.1	3,409	602.46
Georgia	2,317.6	438.0	2,692	417.26
Hawaii	503.6	104.2	3,596	637.84
Idaho	461.0	76.5	2,290	363.08
Illinois	5,932.8	1,204.4	3,517	655.61
Indiana	2,735.0	538.8	2,638	553.26
Iowa	1,520.0	275.1	3,409	560.97
Kansas	1,355.6	275.2	3,668	678.13
Kentucky	1,456.6	263.6	2,792	409.05
Louisiana	2,000.8	412.2	2,821	517.97
Maine	544.1	105.6	3,038	508.09
Maryland	2,347.8	479.0	4,101	710.93
Massachusetts	3,072.5	617.6	3,889	703.42
Michigan	5,497.8	1,098.6	3,434	624.56
Minnesota	2,469.5	466.7	3,408	671.13
Mississippi	799.1	106.3	2,205	231.52
Missouri	2,078.7	413.7	2,993	521.17
Montana	515.6	99.0	3,968	641.86
Nebraska	735.0	136.0	3,128	512.01
Nevada	429.5	83.3	2,998	549.47
New Hampshire	432.5	87.4	2,964	551.02
New Jersey	5,179.2	1,129.1	5,220	1,010.13
New Mexico	753.3	146.1	3,278	560.04
New York	11,323.1	2,287.3	5,226	871.05
North Carolina	2,370.5	419.6	2,588	383.36
North Dakota	326.0	69.4	3,249	586.98
Ohio	5,421.4	1,089.7	3,315	603.34
Oklahoma	1,801.4	369.3	3,264	625.93
Oregon	1,557.3	280.3	3,963	627.51
Pennsylvania	6,243.5	1,236.2	4,002	726.30
Rhode Island	452.1	88.2	4,097	658.04
South Carolina	1,304.9	240.1	2,650	398.36
South Dakota	309.6	55.4	2,813	451.07
Tennessee	1,535.9	314.9	2,349	383.67
Texas	8,474.6	1,864.4	3,287	609.31
Utah	863.8	147.7	2,182	378.58
Vermont	291.7	49.6	3,783	545.65
Virginia	2,655.9	549.8	3,043	569.61
Washington	2,287.7	457.5	3,437	617.50
West Virginia	924.0	195.0	2,866	537.28
Wisconsin	2,534.7	474.0	3,880	617.56
Wyoming	555.0	110.4	4,809	1,069.90

Footnotes

1) Source: National Educational Association, "Estimates of School Statistics, 1984-85" Table 8 columns 3 and 4.

According to NEA, the estimates in column 1 of this table are almost entirely composed of deductible State and local taxes paid by individuals. However, since some States finance education in part through general funds that may in turn be financed in part by corporate excise and property taxes, a small portion of the estimates in column 1 may not be deductible. However, according to NEA, data on non-deductible portions of revenue from State and local sources used for education is not available.

2) According to analyses by the Congressional Research Service, the tax price effect can be analyzed from the perspective of itemizing taxpayers because itemizers dominate local political processes; Dennis Zimmerman, "Treatment of State-Local Taxes and Tax Exempt Bonds Under Tax Reform Proposals: Effect on the State-Local Sector", January 18, 1985.

Estimates also based on data from the Office of Tax Analysis, Office of the Secretary of the Treasury, "Tabulations from the 1982 Statistics of Income File for the Fiscal Relations Study", December 14, 1984, Table 2.

3) Source: National Education Association, "Estimates of School Statistics, 1984-85" Table 11, column 3.

4) Data derived from column 2 and National Education Association, "Estimates of School Statistics, 1984-85" Table 4.

5) Alaskans finance elementary and secondary education expenditures from sources other than deductible State and local taxes. Nearly half of Alaska's expenditures for elementary and secondary education are financed by a severance tax on oil.

Senator D'AMATO. Mayor Koch.

STATEMENT OF HON. EDWARD I. KOCH, MAYOR, CITY OF NEW YORK, ACCOMPANIED BY CLAIR TOWNSEND, DEPUTY MAYOR OF FINANCE

Mayor KOCH. Let me introduce Clair Townsend, deputy mayor of finance. And let me say to the two Senators that we appreciate the fight you are making.

Rather than read my prepared statement I would prefer to file it and make some comments, and that will give greater opportunity if there are questions.

The argument as it relates to our opposition to what President Reagan and the Secretary of the Treasury wish to do are very simple. They, I am sure, bear restating so that we can talk about them. But they are not complicated. We have had, since 1913, the progressive income tax and ever since that time, under federalism, based on the fact that there is a relationship between the States and the Federal Government—but they are separate governments—the principle of no tax on a tax has been accepted as paramount. And, in fact, many people believe were the President to be successful in his onslought, that litigation would ultimately result which would deny this power of the Federal Government to make this change.

I am not willing to leave the fate of the country in the hands of the courts and protracted litigation. I believe the battle should be fought in the Congress, as you are fighting that battle.

Now, we are not alone because, as you have pointed out, Senator Moynihan, the impact on education would be devastating.

You know, New York City is unique. We don't raise our educational funds by a separate educational tax. It's part of our unified budget and comes out of the general treasury, but that is unique in this country. There are a couple of other cities that do it that way, but most cities have a special tax on real property in addition to the real property tax that also is the basis for revenues for many cities.

In our research we found, for example, that Boston derives 98 percent of the tax revenues from the real property levy. Memphis, 79 percent. And in almost every other case the educational funds come from additional tax on the real estate.

So we have natural allies. I don't think that the people of this country yet realize the devastating impact on their real property, on the value of their homes in middle America. And those are the allies that I believe ultimately will join you with their Members of Congress in stopping this aspect.

Now, in terms of the fairness. You know, when the President and the Secretary say: Well, why don't they lower their taxes? Well, why doesn't the Federal Government accept its responsibilities? We are taking over, simply as a matter of compassion in one case, and as a matter of mandate in another case, the responsibilities of the Federal Government. Let me point it out in a very brief way.

There is something really outrageous that we should be bearing locally a $1.5 billion in costs for Medicaid and welfare and, a national problem. If we didn't have that $1.5 billion coming out of our general revenues each year to be paying that cost, we could do a lot more in reducing taxes. How are we going to pay it if we don't have our taxes?

What was interesting to me is that in this extraordinary country we all recognize that, nevertheless, there is a huge poverty and you have homeless people who are actually homeless without a place to sleep. So we provide on an average night in the neighborhood of 7,000 beds for people who have no homes. Single individuals and they come and we give them three meals and a blanket and sheets and medical care. It's a dormitory. It is not something you would not want to live in if you had an apartment, but it is a hell of a lot better than being out on the streets.

We took a little survey in three of those 19 dormitories that we provide. And what did we find? That 8 percent of the people who were in those three dormitories had not slept in the State of New York the night before. They came from other States.

Or how about the enormous influx—and we are delighted that under the immigration laws we open up our shores and people come and it is helpful, it's been the way this country has been built. But where do they come? This is the port of New York and the place through which many, if not most of the new immigrants, foreign immigrants enter the United States and they stay here in great part.

Twenty-four percent of all of the people who live in the city of New York—and I consider that a great plus, the diversity we get out of it—24 percent of the New Yorkers were born in foreign countries, but they have to get a start. So when they need a start, who is going to help them? Local government. How do you help? Well, you help in providing the services and providing the special care. It costs money.

Now, New Yorkers don't like paying taxes. Who likes paying taxes? I don't. Nobody does. And so when the President says: We want to have tax equity and tax reform. God bless him, if that's what he were doing. But there is no tax equity and tax reform in the sense that we are talking about. Although much of the bill has things in it that we are supportive of.

What we are addressing now are the inequitable, the unfair aspects of the bill. And so in order to have what they refer to as a revenue neutral tax reform program, they want—it's not revenue neutral. They are taking our revenues. They call it revenue neutral. They are taking our revenues. And what do I mean by that?

They are taking our revenues because of what the impact will be. If today, and Clair can give you the five cities that we analyzed, if you want them. If today you ask a New Yorker: Well, you know, you are paying more here than you would in Newark across the river, you are paying more here than you would in Denver, and we have taken five cities around the country, in different parts of the country. They would say: We don't like paying more but we are willing to pay that differential as New Yorkers. But then when you say to them: You know, under the President's program you are not only going to pay that differential, you are going to pay twice as much; then they are going to say: Why should I do it? And they will move elsewhere.

Now, is that helpful? I heard Donald Regan, when he was the Treasurer, U.S. Commissioner of the Treasurer, Secretary of the Treasury, saying that he had moved to New Jersey quite some time ago. He made his money in New York. But he took it to New Jersey. Is that fair? I mean, do you boast about that?

In my judgment, what people should be saying is: Well, if there are States out there, and we are not alone, that are burdened and saddled with these responsibilities dealing with poverty, let's not make it even more difficult for them.

And that is why we are urging the Congress, and we know that you are already there so we are not urging you; you are the leaders in the fight—urging the Congress to look at it from a fairness point of view.

[The prepared statement of Mayor Koch follows:]

PREPARED STATEMENT OF HON. EDWARD I. KOCH

I am pleased to have this opportunity to discuss the President's new tax proposals. First, the President is to be commended for his proposal which in the main is a courageous initiative to confront one of the most complex issues of our times. While Members of Congress of both parties have advanced similar proposals containing many of the best aspects of the President's program, making any real progress on this issue requires a President's personal commitment and leadership. His entry into the effort to reform taxes is welcome.

Having said this I turn my attention to the details of the President's proposal. I strongly support reduced tax rates and an increase in the personal exemption. Eliminating many of the tax preferences that disproportionately benefit the wealthy and distort investment incentives is also long overdue. Corporate and individual minimum taxes also need to be made tougher to assure that all citizens, corporate and individual alike, pay a fair share of the costs of the government they all need.

It will come as no surprise, Mr. Chairman, that I oppose the elimination of the deduction of state and local taxes. My opposition to this element of the proposal is shared by the National League of Cities, the U.S. Conference of Mayors, the National Association of Counties and the National Conference of State Legislators, as well as by individual state and local officials across the country.

Before I detail the reasons why this deduction should be preserved, I think it is necessary to be candid about what the President's proposal is, and what it is not. It is one of many possible versions of how to accomplish some needed changes in our federal tax structure and, as I have noted, it is terribly misguided on at least one major element. However, this proposal is not the only possible formulation. It is not so sacrosanct that no one should dare to tamper with it. It can be changed while still preserving its positive elements. It is just a proposal which, like all proposals, makes certain political concessions and compromises certain interests. And, we must bear in mind that this proposal, in all of its elements, depends entirely on federal revenue estimates which are likely to be only as good as such estimates have been in the past.

Although the Administration's tax proposals already reflect many concessions to specific industry interests, the state and local deduction has been singled out for elimination. These priorities are misguided. States and localities are not "special interests" but cornerstones of the federal system which provide citizens with the essential services upon which they must rely everyday. As the federal government retreats from fiscal responsibilities it once bore, there will be an even greater need to rely upon states and localities, and on local funding sources, for the provision of public services.

The elimination of state and local taxes is neither essential for genuine tax reform, nor necessary to close loopholes that enable some to avoid paying their fair share of government costs. Tax reform and simplification can and should be accomplished without eliminating deductibility, and can be accomplished without upsetting the revenue neutrality of the Administration's plan. For example, the $40 billion savings from repeal of deductibility projected for 1990 under this plan could be made up by adopting a portion of the business-related tax recommendations made in the original

Treasury plan. The accelerated depreciation and oil industry deduction proposals which were dropped from the President's plan would yield over $65 billion in 1990. Other items which were mysteriously deleted from the Treasury plan and should be considered for reinstatement include a more appropriate level of tax on capital gains and income from limited partnerships, and tighter limitations on deductions for expenses for meals and entertainment. Increasing the federal excise tax on gasoline is another alternative, which would also promote energy conservation and make us less dependent on imported oil. Each one cent in additional tax per gallon raises $1 billion annually. In short, we can afford to have genuine tax reform and to preserve the deduction of state and local taxes, and I am convinced that others will come to this conclusion as the debate ensues. Now let me review why I believe that this nation cannot afford to be without this deduction.

The state and local tax deduction has been an important and established principle of federalism since the institution of the federal income tax in 1913, and of virtually every revenue-raising decision made by states and localities since that time. State and local taxes in New York pay for essential human services and pressing human needs. They help pay for the cost burdens -- many of which are properly national responsibilities -- that have been shifted from the federal budget to state and local budgets.

The loss of this deduction would have serious consequences for many states and localities, but would have especially harsh effects on those which, like New York, are bearing a disproportionate share of the costs of feeding, sheltering and training the nation's poor and otherwise needy population, and have high taxes as a result. Repeal of deductibility would diminish our ability to compete economically, place an undue burden on our middle-income taxpayers and ultimately force cities into the untenable position of having to choose to either reduce services and rapidly cut taxes, or watch the erosion of our economic and social structures as higher income individuals relocate to less heavily taxed regions of the country.

New York in many ways typifies the dilemma current federal budget and tax policies pose for American cities. This City is the traditional gateway of opportunity for people migrating from elsewhere in the United States and from other countries. Just a few familiar examples tell the story.

If New York City were a state, we would rank as the second poorest in the nation. According to the 1980 Census, 12.5% of the national population was poor; in 1980, 19.4% of New York City's population fell below the poverty line.

In 1980, one out of six families with children nationwide were headed by females. In New York City, it was one out of three. While registered aliens represented 2.3% of the nation's population in 1980, they constituted 4.6% of New York State's population and 8.5% of New York City's. In fact, nearly one-quarter of the City's population was born in another country.

In large part because of the massive shift of federal costs to states and localities, New York City must shoulder the costs of caring for a disproportionate concentration of needy individuals and families whose needs must increasingly be met with local public funds. Because caring for such people is a national responsibility, states and localities are prohibited from setting residency requirements for public programs.

The resulting disparities in service levels and taxes among states and localities are glaring. Some regions have fewer poor than we, some have simply declined to pay for acceptable education, health, and social welfare services. There are also stark differences from region to region in the amount of wealth available for taxation. These differences are self-fulfilling -- some jurisdictions will tend to have more poor, more costs, higher taxes and thus less wealth to tax. For others, the opposite trends will prevail and grow.

However, instead of attempting to ameliorate these disparities, the President's proposals give people and businesses additional incentives to "vote with their feet," i.e., high-income and mobile individuals and businesses are encouraged to migrate from high-cost, high tax areas like New York to lower cost jurisdictions. This "beggar thy neighbor" approach pits state against state, region against region and city against suburb in an unequal competition for jobs and economic opportunities. Regions carrying unequal public sector burdens would have to struggle to provide basic services with a declining economic base.

The share of state and local taxes paid by the wealthy would decline -- either as the result of their relocating to places where their taxes would be lower or because of state and local tax reductions which would be required in order to convince them to stay.

To demonstrate this effect:

Currently, New York City families with incomes of $50,000 pay close to $1,900 a year more in combined federal, state and local taxes than similarly situated families in Bridgeport, Connecticut and $1,950 more than similar Houston families. This disparity would be increased under the President's plan. Without deductibility, a New York City family earning $50,000 would pay $2,800 more than a Bridgeport family and $2,900 more than a Houston family. Similarly, for families with $100,000 in income, the current differences of $4,300 and $4,700 when compared to these two cities, would grow to $7,400 and $8,100, respectively after deductibility's repeal.

To just preserve the present tax differentials, New York City's taxes would have to be cut by a minimum of $800 million annually. If this $800 million were to be financed by cuts in state and local services directly affecting New York City residents, there would be terrible consequences. To provide some perspective on these consequences, $100 million in City funds could provide all of the following services:

> 500 police + 500 teachers + 500 new street maintenance workers + 100 new skilled parks workers + 1000 additional youth service corps slots + job training for 1000 disadvantaged youths + 230,000 meals delivered to homebound elderly + a 50% increase in school maintenance funding.

State and local public services in New York City would have to be reduced by <u>eight times these amounts</u> in order to permit the tax cuts that would be required just to maintain the <u>current</u> level of disparity in state and local tax burden.

Elimination of deductibility also violates principles of federalism. The state and local tax deduction, part of the federal income tax structure from its inception, is based upon the inequity of a "tax upon a tax" and upon the determination that income net of state and local taxes is a better measure of ability to pay federal income taxes. In fact, given that most of the City's personal income tax is paid through withholding, elimination of the federal deduction for these taxes would mean that individuals would become liable for federal taxes on income they never receive.

This is precisely the reason the President gives for allowing a continuation of the credit for taxes paid to foreign governments. He refers to his fear of "double taxation" in cases where income of a U.S. taxpayer is taxed by a foreign country". Yet the President's proposal fails to recognize the "double taxation" which would result from taxing the income used by U.S. residents to pay their state and local taxes.

Effect on State and Local Governments and the Services they Provide to the Public

I have discussed the impact of the loss of the state and local tax deduction in New York City, on its competitive position and on its ability to provide basic municipal services. The consequences would be severe and punitive. As many have observed, the harm this proposal would cause New York City is more serious than any other jurisdiction, and some are suggesting that this is a political strength of the proposal. This is foolish, cynical and shortsighted. Implicit in this view is the assumption, expressed in the document explaining the President's proposal, that taxpayers in other jurisdictions are "subsidizing" a rich mix of services in New York. Presumably, if we didn't live so well our taxes would be lower and the deduction for these taxes would not be as important to us. This is, of course, a ridiculous argument that assumes we like to tax ourselves. As I have said here today and many times before, our taxes are high because our needs are great. If these needs were distributed more evenly, the relative tax levels would be too.

The notion that this proposal isolates New York -- that is, it hurts New York most, so it must be good or at least tolerable everywhere else -- is foolish because it fails to examine the <u>actual</u> effects of the loss of this important deduction on other jurisdictions. For example, while it is true that New York City's competitive position -- defined as the disparity in our tax burden versus elsewhere -- would be hurt by the loss of this deduction, many other jurisdictions will also lose significant competitive ground to lower tax neighbors which will bleed them of jobs and economic opportunities long before they ever welcome a firm relocating from New York. For example, families in Los Angeles with incomes of $50,000 pay over $900 more in combined federal, state and local taxes than similarly situated families in Houston. Deductibility's repeal would heighten this difference by about 50%, to nearly $1,400. For families with incomes of $100,000 the existing differential of $3,825 would be increased by 72%, to almost $5,000. These are the kinds of disparities that influence business and individual location decisions.

In fact, a similar widening of existing tax differences will affect every state and every locality. Every city levying the higher taxes necessary to support local services for relatively high concentrations of needy population would see its competitive position severely damaged relative to its suburban neighbors and other cities with lower taxes.

And how could these negatively effected jurisdictions respond to the threat to their tax bases posed by such an erosion in their competitive position except by cutting their taxes and the local services they support?

The loss of this deduction will also have negative effects that go far beyond the nation's cities. We have been told that there will be more taxpayers who "win" under the President's proposal than those who will "lose". But this is not the only, or even the right, measure of tax reform. When undertaking radical changes in tax laws upon which every fiscal decision of every state and local government has been based, it is not enough to simply construct a strategy calculated to leave enough extra cash in enough pockets of individual taxpayers to make the proposed changes popular. They must also be responsible in light of all of their other effects on the public and on the state and local governments that exist for one reason -- to provide services to the public.

Let's look at the effects of the loss of this deduction for state and local taxes, including the effects on those we have been told are "winners" under this proposal. Those who think this proposal is a free lunch should look beyond their tax returns, because they do not tell the whole story.

Effects on the Working Poor

The President should be commended for his proposals to reduce tax rates and to increase the personal exemption, which will be enormously beneficial for the working poor. The federal tax system has for too long been a rice bowl for the wealthy; tax reform that helps the poor is long overdue. However, it is true that to the extent that the poor do not itemize deductions against their federal taxes they do not benefit directly from the deduction for state and local taxes. So why should the poor care about this deduction? First, many of the working poor do itemize and, as such, are directly benefited by this deduction. Nearly one fifth of the families filing tax returns with AGI of $12,000 itemize. About one quarter of the tax filers with an AGI of $15,000 itemize.

Second, the most important reasons for preserving this deduction lie beyond the individual tax return. The poor receive a higher than average per capita share of state and local services, and the cost of these services is far in excess of the taxes they pay. This comes as no surprise. Most state and local tax structures and budget priorities are quite properly designed to collect more revenues from the wealthy and redistribute a portion of these resources to the poor in the form of needed health and social programs and benefits. While some may argue that even more should be done for the poor, one thing is clear. If the state and local tax deduction is eliminated, a chain reaction will set in that results in reduced state and local taxes in regions with high concentrations of needy residents, commensurately lower state and local expenditures, and fewer programs and benefits for the poor. For state and local governments, which must balance their budgets every year, there would be no choice.

The President's overall tax proposal helps the poor in some important ways, but deals the poor a terrible blow as well. The state and local tax deduction is needed to enable the preservation of even minimally acceptable service levels for the poor in the face of deep cuts in federal support for these services. Most importantly, since genuine tax reform can afford to preserve this deduction, it should be preserved.

Effects on the Middle Class

The inevitable reductions in state and local services would, of course, affect all income classes. However, the middle class will be especially disturbed when they learn that the elimination of the deduction for state and local taxes will reduce the value of the family home, and may even make the purchase of the first home more difficult to afford.

According to an analysis by Senator Moynihan, property values would fall by 3 to 5 percent in New York City and by 5 to 7 percent statewide. This statewide estimate obscures far more dramatic effects in parts of the State where property taxes are higher, such as Nassau County, where it is estimated that property values would fall by 10 to 14 percent.

The loss of property values would obviously not be confined to New York State. In forty-two states more than a third of all state and local revenues are derived from real property taxes. In nineteen states the state and local governments derive more than half of their revenues from this source. Many cities are even more reliant on the property taxes. Boston derives 98 percent of its tax revenues from the real property levy; Memphis 78.8 percent, Jacksonville 68.6 percent and Atlanta 53.2 percent. These and other jurisdictions that rely heavily on the property tax would either have to diversify their tax structures to accommodate future revenue needs or cause further depression of property values as their property taxes rise.

Let's look at the average American homeowner. According to the U.S. Census, the average value of homes sold in the United States in 1985 is about $100,000. The average property taxes paid by homeowners nationwide is $1,500. Even assuming the proposed marginal tax rate of 35 percent, the deduction for property tax of $1,500 would save this typical homewoner $525 -- a tax savings which would be lost in <u>every</u> year after this deduction was eliminated until someone had the wisdom to restore it. Assuming their home had a 30-year useful life, the present value of the lost tax savings would be $5,000. This means that the typical American homeowner would suffer a 5 percent loss in the value of their home which, for a vast majority of people, is the most substantial asset they will ever acquire. In many states -- such as New Jersey, Michigan, Massachussetts and others that rely substantially on property taxes -- the loss in home value would be even more dramatic.

The effects of the elimination of this deduction go beyond the middle class family that already owns a home. It would also be onerous for families aspiring to purchase their first home. While it is true that a reduction in property values may bring the first-time purchaser a step closer to homeownership, this would be more than offset by the effective increase in the cost of annual property taxes resulting from the loss of their deductibility. This would place the first home more out of reach in that a higher purchase price could be amortized over a thirty year mortgage ($467 average annual cost), whereas higher annual property taxes must be paid each year ($525 annual cost) and are almost certain to grow over time.

Of all the state and local services which this deduction currently helps to fund, none has received as much well-deserved national attention as public education. Although it is the most critical public service affecting the future economic and social vitality of our nation, the level of direct federal support for public education has never been significant and has sharply declined in recent years. State and local funding sources, however, now contribute over 90 percent of the resources available for public education. The repeal of deductibility would make it harder than ever for our public schools to raise the money they need to educate America's poor and middle-class children, because it would dramatically increase the after-tax cost of each local tax dollar levied. Currently, the net cost of an additional dollar in school taxes is reduced by as much as 50 cents for some taxpayers because of the deduction allowed for it against federal taxes. Even with this deduction many school districts meet strong resistance to increases in their budgets -- even those which are made necessary by increased enrollments or the attempt to maintain services in the face of inflation.

Only the wealthy, who can afford to be indifferent to the quality of public education because they have the option of sending their children to private schools, could possibly benefit from the repeal of deductibility.

These are some of the effects that do not come to light when proponents of President's proposal merely tally those who win and lose on their individual tax returns.

And so, Mr. Chairman, after looking beyond the tax returns, I believe it is clear that the loss of this deduction would cause significant long-term harm to state and local governments, and to most of those who rely on us for services everyday. This deduction is not needed only by the high-income taxpayers in high-tax states, as the Administration would have us believe, but by middle-class taxpayers and homeowners, whereever they live, as well as by the poor who depend most on the services we provide. What disturbs me is that anyone is taking seriously the proposition that singling out this deduction for elimination is necessary. It, quite plainly, is not. I have enumerated several far less onerous ways the needed revenues could be found. I know that the Congress will be considering these and others in the weeks ahead. I urge the President and the Congress to rise above the short-sighted game of short-term tax winners and losers and produce real tax reform that is in the best long-term interests of the public.

Mayor KOCH. May I introduce Clair for a couple of comments?

Senator D'AMATO. Certainly.

Ms. TOWNSEND. To give some of the examples that the Mayor spoke about, we calculated the combined Federal, State and local taxes of families at various income levels in New York City plus elsewhere. Let's look, for example, at Bridgeport, CT. If you make $50,000 here, you will pay in total Federal, State and local taxes $1,900 more per year than if you lived in Bridgeport. If we lose deductibility, even given the lower tax rates under the President's proposal, the New York City families' tax burden would be $2,800 more than that Bridgeport family.

It is even worse at upper income levels where right now the New York City family pays about $4,700 more in taxes at $100,000 combined income from two earners, and that A, that difference, the greater amount they would pay grows to $8,100 per year more without deductibility than a family in Bridgeport.

We believe that that would cause one of two things to happen: Upper income people would leave the city, taking their jobs and taxes with them. Or we would be under considerable pressure, without regard to service consequences, to dramatically and drastically reduce our taxes much further and faster than we had planned in an orderly fashion.

Mayor KOCH. May I add one other comment and take your questions, if you would like to pose them.

Well, the other side always says: Well, look, you told us the problem. Why don't you give us an answer? That's fair because I tell that to people, too.

And the problem, they say, is we have to come up with money. If we are going to be doing this shifting, where is the money going to come from? Well, we have an answer to that. It should not come out of the hides of middle income America, which is what this bill does. It shouldn't come out of the hides of the States and the cities that are undertaking to do the things that the Federal Government should be doing. So where should it come from?

Well, the estimate is that in 1990, if the President gets his way and devastates the cities and the States, as I have outlined to you, they will raise in 1990 or save $40 billion. We think they can save $65 billion if they addressed the provisions that now give billions of dollars in tax benefits to the businesses of this country; such as, the accelerated depreciation allowances and the oil industry deductions.

Senator D'Amato, you made a point outside which I don't think people recognize as well as they should.

Isn't it an obscenity that an oil company pays the King of Saudi Arabia—God knows where he puts his money; he has it on a plane in case of a revolution—pays the King of Saudi Arabia hundreds of millions of dollars in taxes and then is given a privilege which you and I don't have? We simply, under the existing law, deduct the local tax. They get a credit.

Now, if you are sophisticated, and you don't have to be too sophisticated, you understand that a credit is worth much more on your tax deduction, net tax that you pay, than a simple deduction. It's an obscenity that the President, as you pointed out, would allow that benefit to a company paying a foreign potentate and, on the other hand, wants to deny us not even the deduction—we are not asking for the credit anymore——

Senator D'AMATO. Why not?

Mayor KOCH. Well, I mean after what he has done to us at this point, and others——

Senator D'AMATO. Why shouldn't people have a tax credit if corporations do?

Mayor KOCH. I am a pragmatist. I believe if you are involved in a survival battle to preserve what it is that you have, that to ask them to increase it, while it may be a good tactic——

Senator D'AMATO. The best defense is a good offense. If you want to point out the inequity, Mayor, and if the principle of double taxation is one that is sacrosanct and, therefore, if a person pays taxes to foreign government we give them a credit, which is worth maybe about double what the deduction is, then shouldn't a citizen who pays taxes to a school district receive the same treatment.

Mayor KOCH. No question about it from a philosophical, equitable point of view that should be done.

I think it becomes an even more obscene illustration in that they continue the tax credit for the oil company paying to foreign potentates and we, on the other hand, they want to take just simply the deduction away. It is even more obscene.

Senator D'AMATO. People who pay New York City income taxes are not allowed to deduct those taxes from their State income taxes, correct? That would save them roughly $80 million. Now, shouldn't they really be allowed to deduct it?

Mayor KOCH. Sure. Obviously I would be for it. You can distinguish between the relationship of a locality in a State and the State government, which is not a federalist relationship, and the relationship of a State to the Federal Government. But putting aside that legal distinction and all that flows from it, obviously I think it would be fairer if we could.

Senator D'AMATO. I am going to ask that of Senator Marchi as well, because I think that really should be the principle here, that people should have that ability to deduct it.

Mayor KOCH. I agree with you.

Senator D'AMATO. One other aspect. You touched on the social services and Medicaid impact. I believe you said it was $1.5 billion. That is the city's share?

Mayor KOCH. Our 25 percent of the total amount, that's our share. Locally paid for.

Senator D'AMATO. How much could you reduce the budget and how much could you cut city taxes if the Federal——

Mayor KOCH. If you take $1.5 billion, that would be terrific.

A $1.5 billion is almost our total personal income tax.

Senator D'AMATO. So that we would say very gladly: Federal Government, if you want to take away the deduction, fine, you fund that obligation of social services and Medicaid, we would be happy to make that switch.

Mayor KOCH. We would be happy and seek to reduce our taxes without question.

Senator D'AMATO. You could almost eliminate your city income tax?

Mayor KOCH. Almost eliminate that or apply it to business taxes, but there would be that pool of money available.

Senator D'AMATO. Thank you. Senator Moynihan.

Senator MOYNIHAN. I think, just for the record, it is useful to know where this set of proposals came from. The Treasury, Treasury I as it is called, is really a long last triumph of a great man, now dead, Stanley Surrick, who was Assistant Secretary of the Treasury for tax policy under President Kennedy and President Johnson. And it was a serious proposal that he wanted to get all of the distinctions out of the Tax Code that tax the same income at different levels. Particularly those that subsidize activities such as State and local government, which he would say very openly—he was a New Yorker, went to college in New York—he wanted to put those subsidies in the budget, up front and clear.

And he would be horrified to find that his proposals, having been adopted by the administration, want to take out the provisions of the Tax Code that make local government's activities impossible, but also to take out even those little bits of the budget that reduce those as well. It is just the opposite of what he hoped to happen.

I have to say two things, Mr. Mayor: One is don't overestimate the foreign tax credit. All of the foreign provisions in the code come to about $5 billion a year.

Mayor KOCH. Five billion?

Senator MOYNIHAN. Yes; and the particular one is about half that. The problem is we are going to have a major change in the tax rates if you have to have revenue.

And of the $106 billion in the proposal that is to be changed, shifted around to the personal income tax, $34 billion comes from this provision. And how we are going to work it out I don't know.

But I would like to ask you and Ms. Townsend, since you are involved in it, indirectly at least, there can't be any question but that the President's proposal will add significantly to the deficit. The revenues under the proposal are estimated to come in on a real growth rate of 4 percent a year for the next 4 years and then dropping to 3.89 percent on the fifth. Now, that's not going to happen.

Mr. Stockman, on Friday, gave to Members of the Senate a revised estimate of the budget deficit which agrees exactly with the projections we have been making for this tax balance. If Mr. Stockman is right about the deficit and the budget, then he would also have to be right about the revenue coming in under this tax proposal, which would, in effect, be that it will add $200 billion to the deficit in the next 5 years, to be borrowed and paid as interest indefinitely.

And that kind of borrowing and that kind of deficit had made it even—at one level it was a simple device to say we haven't got any money to help you, but now in municipal government you are really feeling the price of the deficit, aren't you?

Mayor KOCH. Yes.

Senator MOYNIHAN. Would not a deeper deficit mean a higher price?

Mayor KOCH. No question about it. I agree with you completely as it relates to their approach.

When we went to Washington several—I think it's several months ago—to talk about a fair Federal budget, we talked about increased taxes that would be only used to reduce the deficit.

We believe, for example, the so-called minimum tax, and I was in the Congress when it was voted for and everybody thought they were voting for a minimum tax and they, in fact, were not. That's basically what happens when it comes out of Ways and Means. When I was in the Congress, you really don't fully grasp the technical aspects. You have to rely on the committee's report. It's a very complex matter. Everybody thought there was a minimum tax. We now know that there are tax shelters that remove the minimum tax and that there are corporations that pay no tax and that there are individuals who pay no tax, wealthy people. That has to be changed.

You are quite right about the oil allowances, it's about $5 billion, but in other accelerated business benefits it is about $60 billion. That all has to be looked at.

While I am no expert, I am told that Treasury I was far more equitable than Treasury II and that they took out from Treasury I those things that would have hurt the more wealthy.

What we are seeing is a President who is extremely skilled in making a presentation and who is selling a bill of goods to the public that it is fair. There is no question there are major parts of this legislation that I am for, but it is the parts that we are against that are doing us in, and I don't mean just the city of New York; I mean the country. Unfair.

Senator MOYNIHAN. Thank you. Before you leave, despite the ambiguities, I think I got your point.

Senator D'AMATO. It would seem that people should be outraged when they see the example you just talked about. A major corporation, for example, which has earned $6 billion in 3 years and doesn't pay a penny in taxes. How do you square that up with the working middle-class family of America crying out for reform.

That is the kind of issue that gets so many Americans saying: We want tax fairness.

Mayor KOCH. Sure.

Senator D'AMATO. And we should have it. So we are not arguing against that. I think why some of those in the Congress are reluctant to speak out is because today we run Government by polls. People are afraid to take a position because it may fly in the face of what is perceived as being popular at the particular moment. So many of my colleagues who may agree with us, say: My gosh, 70 percent of the people want this change.

Let me for the record indicate that the foreign tax credits that reduced the tax burden in the United States in 1980—we don't have it later than that although we are attempting to get one—saved $22 billion in 1980. In Treasury II, the Treasury proposes to reduce the credit by $3.5 billion over 4 years. When they talk about the State and local deductibility, they wipe it out in 1 year. So they are even more conscious of what they might do to corporations in phasing that down to $3.5 billion, whereas with us they just wipe it out.

Mayor KOCH. Senator, you know what comes to mind in all of these cases, it's the rich get richer and the poor get poorer. And the problem always is that what the wealthy want is done with high-priced lawyers coming up with technical language so that when you think you were voting for a minimum tax 10 years ago, you were not voting for a minimum tax at all. And the people who were supposed to pay a fair share didn't pay it then, aren't paying it now, and if the President's bill goes through will continue not to pay a fair share. And it's wrong.

Senator D'AMATO. Thank you very much, Mr. Mayor. Clair, thank you. Senator Marchi, please proceed.

STATEMENT OF HON. JOHN J. MARCHI, NEW YORK STATE SENATOR, ACCOMPANIED BY ABE BLACKMAN, DIRECTOR OF FISCAL STUDIES

Mr. MARCHI. At my right is Abe Blackman, who is our director of fiscal studies, and we are delighted to be here and God bless both of you.

Senator D'AMATO. Thank you for the eloquence of your previous remarks with respect to federalism. I think that it is important to have it in this record so that we can disseminate it to our colleagues. It is a very cogent presentation.

Mr. MARCHI. Senator, I feel that whether we produce a mathematical majority of any given body, the unacceptability of many thinking people will have a persuasive value in making institutional changes as distinguished from programmatic or other less structured changes.

Senator D'AMATO. Senator, please continue.

Mr. MARCHI. Well, we feel that State governments would become an anachronism for the reasons, some of which I stated before. I did file a statement and, of course, I certainly adopt and stand by it completely. But we feel that the Federal Government and the Federal system, which is a partnership, which Senator Moynihan has pointed out, could be irreparably shattered by the vulnerability that our revenue efforts are exposed to. It points unerringly in one direction, and that direction is that—and it is only a mild disagreement that I had before with what the Mayor had stated—those problems will be met and those problems will be met because the political process provides for that avenue, but it will be met by the strong central State. It will be met by big brother. It will be met by people who will only have one point of recourse.

I think that would be tragic in terms of our institutions. What is felt and what is part of the spirit that gives light and not the letter that kills in our system is that question of federalism. And I had said facetiously this is Federal Plaza but it might as well be King Tut Plaza or it might as well be the last remaining Wall of the Temple, the Wailing Wall where lamentations and prayers are brought for what was once.

And so it is a very serious systemic and institutional crisis that we are facing.

It is not fair, in my estimation, with respect to any of the 50 States of this country, simply because it violates in such a significant way our basic institutions. And as I have alluded to before, Mr. McLoughlin, a few decades ago, said this was the most significant amendment, without being clairvoyant about something like this happening.

It was just 15 years ago we were talking about revenue sharing, and revenue sharing measured on the basis of tax effort, that we attempt to do for ourselves and which the Congress of the United States, and I believe, Senator, you had also a large role in drafting some of that, that the Congress of the United States and the President of the United States tendered to the American people. And we had preceded and anticipated that in the State of New York, as you will remember, Senator, in our own State.

Now to say that we are going not only to do away with that but go in the other direction, and the only invitation we had is to move, becomes, I would like to believe, ill-considered and not fully considered thinking which will yield to other considerations when it is engaged in.

D'Toqville, in the American system and the dead hand of a uniformed centralized system, makes the observation and comparison that he elicited from travelers from China, the China before China was opened up to the world, where you had the perfection of administration but you also had public order without public morality, you had stability without strength. You had so many factors that a dry structure that is not animated by that lively spirit we all understand should be premises of a great people.

And we are the envy of the world. The American dream is a real thing. It is not a fiction. And I don't propose to see the disbanding of that. That would be a substantial step, a very decisive step toward a centralized government, a big brother type government. That certainly should be unacceptable—not because people are opting on a poll saying that they support this or that. But have they considered, have they considered robbing the spirit that animates our institutions of government? The spirit of partnership?

I would respond to questions, Senator. I know there were several before that I wouldn't be hesitant to address.

[The prepared statement of Mr. Marchi follows:]

Prepared Statement of Hon. John J. Marchi

Senator D'Amato, Ladies and Gentlemen:

Thank you for inviting me to appear before you this morning on the subject of federal tax revision.

First, let me say, that this matter is viewed in Albany as one of such gravity as to prompt an appeal intended to produce a constitutional amendment to make tax-deductibility permanent in the United States Constitution.

My colleague, Senate Majority Leader Warren M. Anderson and I, both Republicans and both strong supporters of President Reagan, have introduced a resolution to this end. It would have the New York Legislature urge Congress to offer an amendment to the Sixteenth Amendment of the United States Constitution--the amendment that authorized the federal income tax.

It is Senator Anderson's intention--and mine--that this resolution be passed in the Senate this week and we hope that the Assembly will follow suit promptly. We are informed that Speaker Stanley Fink is interested in the resolution, and we hope that the leaders of the other 49 states, to whom we are sending copies of the resolution, will consider it and urge their Legislatures to follow suit.

Senator Anderson and I took this action because we believe the threatened loss of deductibility in the various tax plans subverts the very existence of the federalist system of government in America.

We are, in fact, talking about double taxation. Inevitably the loss of deductibility would squeeze the local and state governments dry and force them to turn to Washington. The result would be an explosion of national government spending, taxes and power, and ultimately, the loss of our cherished federal form of government.

In their zeal for tax reform, the advocates wrote proposals which contain the seeds for the destruction of our federal system of government. Members of the Congress, the Treasury Department and the President have offered various proposals which would ultimately make the states impotent, economically unable to respond to the people's needs because our revenue sources will be exhausted. Our state and local governments would be so fatally crippled that they would have to point out that appropriate response could only come from the now super strong central state. Those needs could only be met in Washington because only Washington would have the resources to meet those needs.

As Senator Anderson said last Thursday, those who would fall under the 35 per cent bracket would live to see that 35 per cent maximum raised. The 35 per cent maximum will be the earliest casualty. Is there any chance that New York, Mississippi or any other state could then respond to educational or social needs of its citizens? The answer is no.

The response therefore must come from Washington. The proposals now before Congress may, at first blush, appear to be bad news only for New York and California. But eventually, it will be depressing for the Arkansas and the Alabamas.

The most troubling aspect of this matter is that it involves a disruption of a basic institution. Thus far, most if not all of the discussion of these plans for so called tax reform have concentrated on the fairness of the proposals. In my judgment the consideration of fairness is entirely meaningless and irrelevant when compared with the question of institutional survival--of the survival of the federalist system conceived by the genius of our Founding Fathers.

Our sovereign states many years ago entered into a covenant with the other states and with that was developed a system of federalism that is the envy of the world. We have the oldest, effective system of federalism in the history of the world. It is the American dream. It is a dream cherished and admired around the world, even in beyond the Iron Curtain, and in troubled nations everywhere. This American dream fulfilled here, allowed us to absorb millions of people from throughout our planet into an amalgam of citizens and states who can aspire to realize their own potential to a degree not experienced anywhere in the history of the world.

But now, the plans before Congress would propose to destroy in one fell swoop this glorious federalist system and replace it with a central government.

That is utterly unacceptable. Income taxes, when they were first proposed to raise revenue were keyed to the premise that this was going to operate on a floor that excluded locally and state raised revenue.

It reduces to ashes the role that states and localities have. It would snuff out the inner vitality that enables us to be active agents in a cooperative relationship, a partnership, between the states and the national government.

This is an institutional question. Even if we in New York were to gain enormously on a financial level from the various tax plans, I would still be implacably in opposition to it.

We in New York want to proclaim a call to other states around the country, if they are proud of the American tradition--to join us in a fight to save and preserve the federal system. We must make this a national call. Otherwise, in a few years the role of the people to make decisions for themselves in their localities and in their states will become an anachronism. And Big Brother will emerge as the nightmare forecast by George Orwell. That kind of monstrous central government will respond but only on the basis of insensitivity and remoteness.

Our American people deserve better and we must fight to protect their rights and freedoms.

Senator D'AMATO. Thank you again Senator Marchi. You have a valid point. So often we just look at the practicality of how this affects me, my State, my people as opposed to looking at the concept of federalism and what this Nation is about.

Mr. MARCHI. That's it exactly. We start out from a so-called revenue neutral posture, which is debatable, but accepting it hypothetically; then we move on. What happens when the first ill wind blows and you have 15, 25, and 35, and those are your only havens, and you have a whole country disturbed? We may have effects that no one here can possibly forsee of a destructive nature which would have long-term adverse effects on our development.

Senator D'AMATO. Senator Marchi, on just the issue of fairness, regarding double taxation, shouldn't the people who pay city income taxes also be entitled to deduct that from their State taxes?

Mr. MARCHI. I am going to have to be the devil's advocate a little bit here, Senator. I know that you will indulge me that because I feel that the policy that we have in this State has been fairly and fully considered. It goes back to Al Smith, equalization of opportunity for people throughout the State, and to bring that minimum level of services and ability to move and to progress to all of the people for the State of New York. And with great fidelity I would say each administration, give or take the play that occurs quadrennially at elections, there has been a fidelity to that system, and every Governor has respected that.

Now, we have in place, a question of double taxation, what happens if you don't allow—if you get into that business of increasing or decreasing an income by reason of tax that's been paid?

One person earlier I believe mentioned the fact that the city of New York has $80 million involved in this equation.

Senator D'AMATO. Taxpayers do.

Mr. MARCHI. Yes.

Senator D'AMATO. If you were to allow the deduction, the taxpayers who, by the way, don't all live in New York City, would save $80 million.

Mr. MARCHI. Right. So those of us that come from the city of New York it is very heavy. But regardless of where we live, we also have a program of $900 million of unrestricted revenue sharing. This is above and beyond programmatic appropriations that are made.

I am glad the mayor mentioned the fact of aliens. We have 24 percent of the aliens, over half of whom are illegal. And we are shouldering it as well as our impulses and our means permit.

But of the $900 million, that's close to 5 percent of the State levy. If we took 5 percent reverse from the Federal Government, there would be a tremendous amount of revenue available.

Beyond that, $80 million of that $900 million that we distribute in unrestricted aid beyond the programmatic aid, beyond the categorical aid for schools and for various needs, we give $500 million, or one-half of a billion dollars, back in unrestricted assistance, and we build it on three criteria: social services, when they are onerous and heavy; tax effort, which also includes equalization and factors that both of you are so fully acquainted with; and the third one is unemployment.

So I ask you, having sophisticated factors, having this income arrive to the State and then returning it to the localities based on these three factors, and they may vary, you don't have a uniform development in all three. But you have a sophisticated method of sharing that which we take in on the basis of need—need I emphasize. So for $80 million that we collect today, there may be more later, we are distributing one-half of a billion dollars. So it's seven, eight times as much as we collect.

We have 40 percent of the population but we have 55 percent of the unrestricted assistance, again beyond the categorical, again beyond the programmatic.

You want to offer something like that, I would say hallelujah, we are in heaven. But then again I simply go back to my basic argument that the question of fairness should be determined after we build a platform that doesn't penalize local effort and initiative. So that we are undermining our very ability to identify need and to do the things that were entrusted to us under our system.

The spirit, the spirit that gives life and not the letter that kills. So that the $80 million in relation to one-half of a billion dollars is a ratio of 8 to 1. And I don't think that on very serious consideration anybody would want to suggest something different, because the percentages may even shift and the ratios may shift as needs changed.

As we all know in Government, those are not predictably projected on the basis of present experience with any degree of accuracy.

Senator D'AMATO. Thank you very much, Senator Marchi.

Senator Moynihan.

Senator MOYNIHAN. Senator Marchi, you have given us some truly luminous remarks. We know you as a scholar, a constitutional scholar, and we especially welcome you to the hearing where we of necessity talk dollars and formulas, but you have wanted to talk principles.

And as you do know, the first of our income taxes ever was in 1862, a 1-year tax to finance the Civil War. It was repeated a second time. The chairman of the Committee on Ways and Means was a gentleman named Morrill from Vermont, who came to Congress as a Whig and stayed forever. And he brought the bill to the floor which was just meticulous in saying that under no circumstances will any Federal tax be levied on a tax paid to a State or a subdivision thereof.

That's the issue of federalism, an issue which was at a time when we were having a great and tragic war.

But the point that you make, and it seems to me that in the long run the most important one, and maybe you could spell it out a bit, that this is a centralizing measure, that by depriving State and local governments of the resources that they have historically had, revenue resources, it is to inevitably move power in the federal system to the National Government in a way that has not otherwise, not ever previously been the case. It compounds Mr. McLoughlin's position on the 16th amendment.

Do we take your meaning correctly in that regard?

Mr. MARCHI. Yes, Senator. I believe that you have defined it perfectly when Justin Smith Morrill made those assurances and all of those circumstances that followed in 1894 where Grover attempted something, and there were cases, and finally culminated it in the 16th amendment. But that was a given. Until before breakfast literally, this was a given.

But what happens when States are unable to respond and their revenues are vulnerable? You have, in effect, an institutional change, a revolution that takes place where localities, the mayor of the city of New York, Mayor Koch, what is he going to tell people? What can he do?

What can we in the States, the 50 States, what are we able to do? We can only say one thing: We will give you the direction to Washington.

Now, centrality of responsibility already exists in this country. D'Toqville said that Louis XIV may have had the most centralized government in the world, but he didn't really have the centralized authority to deal with problems that are presently found in the United States.

Centrality of administration, however, gives you that dull, unresponsive, or if it becomes responsive it becomes overly responsive. Then we get very deep considerations of our freedoms; our freedoms, our existence as a free society.

So we have something much more powerful here than even a constitutional change. People are saying let's change the Constitution, on, that, or another subject. This is the substance of it. You want to change the Constitution profoundly, irrevocably? Pass this measure and the States are destroyed. Local government and States are destroyed and are paralyzed in any relevant way to meet the problems of the American people. And there will only be one place those answers will be had: They will be had in Washington. Not a federal government but a strong central government.

So that the equitable becomes inequitable and we are destroyed and paralyzing the State and local governments.

This is the factor I believe that both of you have done a great deal to air and to articulate. That's why we are taking the step of passing this resolution and sharing it with all 50 States, all 50 majority leaders and all 50 speakers and all 50 Governors, and all those at that level, to get excited: Look, we are all in this. This is much bigger than a few winners and losers on the bottom line.

You don't judge the spirit with a CPA at your side. America is a little bit more than that. A million Americans didn't die throughout our history on a balance sheet. This is not an institutional address to the problems of the American people. It is an outrage, as Mayor Koch answered earlier when you were looking for a live expression.

I believe that some of the other alternatives have been offered by some or all of that principle, and we are all talking about fairness. We are not talking about spirit, we are not talking about the very profound objective and consideration that you are spotlighting. Justin Smith Morrill knew very well what was going to happen and he wanted to reassure those States: No, that's the furthest thing from our mind. It was a given, until just the other day, and then we propose to refashion it and to turn our flag upside down and to change our whole system of federalism under the guise of tax reform? My God, reform, reform from what? That was rhetorical.

Senator MOYNIHAN. Thank you very much, sir. We very much appreciate that. The U.S. Constitution was not drafted by accountants, not yet tax lawyers. Thank you, Senator Marchi.

Senator D'AMATO. John, let me express my profound thanks for your incisiveness, and let me suggest that I am also going to see to it that we take out that part of the transcript that reflects your thoughts and circulate it to all the Members of the Congress. I think they would do well to reflect upon the observations that you have made in your testimony today. We thank you.

Mr. MARCHI. On behalf of the people that at least I run into, we count our blessings that both of you are there because you are strong voices of reason in a period of uncertainty. Thank you very much.

Senator D'AMATO. Phil Caruso, president of the New York City PBA.

STATEMENT OF PHIL CARUSO, PRESIDENT, PATROLMEN'S BENEVOLENT ASSOCIATION OF THE CITY OF NEW YORK, INC.

Mr. CARUSO. Good morning, Senators. My name is Phil Caruso, president of the New York City Patrolmen's Benevolent Association. I am also the chairman of Uniformed Forces Coalition which comprises approximately 50,000 uniformed workers within the city of New York.

We appreciate the opportunity to express our views relative to President Reagan's tax proposal and how it would affect police officers in particular, middle class wage earners in general.

We have submitted a prepared statement that is indepth concerning our position. However, I will speak briefly and concisely on our position.

Perhaps it would be beneficial to illustrate the practical impact of how this tax proposal would impact adversely on police officers, but it would also typify the impact on middle-class workers in America.

The economic profile of the statistically average police officer is such that he is married, is part of a family of four, owns a modest home, earns about $30,000 in police pay, which is augmented to a large extent by a second job or spousal income, that tends to increase gross income to approximately $45,000 a year.

This family does not pursue a luxurious lifestyle. Luxury to us consists of an infrequent night out for dinner, followed by a movie. By disallowing a deduction for State and local taxes, which take three basic forms: The property tax, income and sales taxes, the average police officer will sustain a loss of approximately $1,500 a year under the proposed Tax Code revisions.

Consequently, the President's dream of enhancing the quality of life in America becomes a nightmare to many of us struggling at the middle income level. And we constitute the backbone of middle America which makes America work.

I would like to address several specific issues that have a very negative impact on our position. No. 1, to place a tax on fringes, such as health insurance, which make up a major component of our compensation package, would further erode our income and further erode our ability to purchase goods and services within the economy.

In addition we are currently negotiating for a tax deferral program that is more specifically given the nomenclature of 401K, which gives us the ability to shelter, in a very small way, some income for future purposes. That will be dispensed with. We don't have the tax shelters afforded the very wealthy in this country. We don't have the disposable income to put away and to inflate our total monetary status.

And last, but perhaps most pernicious of all, it would be placing a tax on disability pensions which would disrupt the financial equilibrium of people who have been shot, knifed, people who have been crippled, paralyzed. To do this would be wholly unconscionable. These are people who have sacrificed, to the ultimate extent, to protect the people of the city of New York, and now we are imposing a tax upon their income which was obtained in a highly unique way.

Senator D'Amato, you are currently protecting through Federal legislation that compensation of disability retirees, and we are grateful to you, sir, for that position that you have taken. This would fly in the face of what you are attempting to do.

I would like to point out to the two Senators from the State of New York, that if a police officer is shot, wounded and receives a disability pension, that individual cannot then go out and earn additional income because it becomes impaired, dollar for dollar, for outside income that's earned. This is a penalty that is imposed upon that individual. And now what we are saying is beyond what we will tax that income.

[The prepared statement of Mr. Caruso follows:]

PREPARED STATEMENT OF PHIL CARUSO

As President of the Patrolmen's Benevolent Association of the City of New York, I am pleased to speak before you today on the matter of President Reagan's tax proposal.

In theory, the main thrust of the proposal is to decrease corporate and individual tax rates, offsetting this loss in revenue by a concurrent removal of certain deductions that have previously been available to individual wage earners. Obviously, I would like to dwell upon the effects the proposal would have on New York City Police Officers in specific and middle class wage earners in general. To begin with, it is important to keep in mind who we are talking about. It is not about people who live off the fat of the land, about people who consume but don't contribute. The tax plan Mr. Reagan has proposed will have a pernicious impact on those people who really make up America. The middle class worker is the basic element of the tax structure and is unfortunately left without the protections afforded to those of the higher and lower tax brackets.

By now, it is almost a cliche to point out how the middle class is denied the free government services available to the poor and is unable to afford the consumer services and goods that are very often available only to the wealthy. It may seem like a cliche, but a truth that is repeated often enough can become a cliche and still be the truth.

Regrettably, the people who will be hurt most by this tax plan are the people who are the most deserving of tax relief. Police Officers are involved in every aspect of life. They are the workers who deliver the services society needs to function in an orderly manner, in addition to being consumers of the services of others. They comprise families that make up the electorate, and they are the workers that make America work. But the Reagan tax plan, because of the way it removes the tax deduction for state and local taxes paid, is particularly devastating to police officers.

Police officers perform a vital service, and they take the money they are paid and use it to purchase the services and goods produced by others. Because they are locked into the consumer grid, they are the most hurt by a tax code that disallows deductions for consumers. They are hurt by a tax code that disallows a deduction for taxes paid. In very plain terms, by removing the deduction for local taxes, a wage earning police officer is forced to pay his taxes twice: once, when he spends his money on taxes at a rate fixed by local and state statutes, and then again when he spends it at a tax based on his annual income. Because he is not in any sort of position to invest his income (because he needs it for his living expenses), he is unable to take advantage of the tax shelters available to other segments of the society.

From the statistical material available to us, we find that an average active New York City Police Officer earns between thirty and forty five thousand dollars, gross income, per year. This is a rough figure, and it includes monies earned as overtime, and from part-time jobs the officer is allowed to work as well as income of his spouse. It is not unusual for the spouse of an officer to be forced, by the financial necessities concomitant with the raising of a family, to take a salaried job outside the home. It should be noted that the income figures used for New York City police are for the average length of service, which is approximately four years, and for a statistical family of four. Further, approximately 90 percent of the officers employed by the New York City Police Department own their own homes. In the New York Metropolitan area, the property tax on a home suitable for a family of four is usually between two and three thousand dollars per year for residents of New York City and three to five thousand dollars for non-residents.

Each year, the Commerce Clearing House and The Wall Street Journal offer adjusted gross income group statistical figures for medical, tax, interest and charitable gift deductions which they compile, this time having used the IRS, S.O.I. Bulletin, Volume 4, No. 3 for the winter of 1984-85. The average deductible expenses under the existing tax code for persons in the thirty to fifty thousand dollar income bracket were approximately thirty four hundred dollars for state and local taxes, an amount that had previously been deductible, as well as forty seven hundred dollars for interest costs that had also previously been deductible. Part of this interest expense would still be deductible, since it is presumably mortgage interest, but these figures nonetheless represent ball park amounts that would no longer be deductible under the proposed tax plan.

Furthermore, the removal of the "two-earner deduction", which presently allows a ten (10%) percent deduction of gross income to the marriage spouse making the lower income, will no longer be allowed. The progressive tax rate structure of current law often results in a higher tax rate for couples whose income are combined as a consequence of marriage. This result contributes to the so-called "marriage penalty," i.e., the increase in a couples' aggregate tax liability that may occur due to their marriage. To limit the marriage penalty, current law provides a special deduction for married couples in which both spouses earn personal service income. Thus, 2-earner married couples who file joint returns may deduct from gross income the lesser of $3,000 or 10% of the qualified earned income of the spouse with the lower qualified earned income for the taxable year. Under the Reagan proposal, the deduction for 2-earner married couples will be repealed.

A list of the taxes and approximation of their amount which will now be non-deductible are as follows:

	NYC Resident	NYC Non-Resident
State and Local withholding	$4,800.00	$3,900.00
Sales Tax	704.00	650.00
Sales Taxes (new car or major applicances)	825.00	800.00
Real Estate Taxes (property, school, etc.)	1,700.00	4,600.00
	$8.029.00	$9,950.00

Because our New York City police officer loses the current allowable deductions, there will be an approximate net tax increase to him of between three hundred and fifteen hundred dollars, the major contributor, as indicated, being the disallowance of state and local taxes. This is true even though a majority of our members would be in the 25% bracket of the President's proposal because of the loss of so many deductions. Furthermore, the disallowance of state and local taxes more than offsets the increase in the personal exemption as allowed in the President's proposal.

Another detrimental effect of the proposed tax code is the way the interest deduction on mortgages on second homes would be eliminated. The dream of the middle class police officer is to build a better life for his family. He spends his extra money on comforts for his wife and children. He is a consumer, whose primary goal is the betterment of the quality of his family's life. When he earns extra money, it is usually not spent on investments. If he does make a major investment, it is likely to be in real estate; not commercial real estate, which offers income that can be protected, but rather the purchase of a summer home, a more modest investment. Under the proposed tax code, the interest paid on this mortgage would not be deductible. The effect this would have is to raise the cost of the money the officer borrows to better his family's life. It is ironic that in a tax plan allegedly designed to foster economic growth through investment and personal initiative, the tax to be levied on the interest paid on mortgages on real estate excluding the primary residence would act toward precisely the opposite goal.

Personal initiative is supposed to be promoted by the revisions of the tax code. People are supposed to use the increased available capital to reinvest in America, to aid in American economic growth.

The problem is, though, that the way the code is proposed, the road to conventional rewards of success are being blocked by obstacles. The code helps investors, but not spenders. Of what use is an investment to a given individual if it does not enhance the quality of his life? The Reagan tax plan proposes to alter the rate at which various segments of the nation are taxed. It would drop the corporate maximum tax rate by thirteen percent, and allow a deduction for ten (10%) percent of the dividends paid out. The President intends the simple tax code to stimulate the economic growth of the nation. Whose growth? Not the economic growth of the working police officer. He is the sort of person not usually thought of as a large corporate stock holder or large scale investor. The tax shelters that are available to corporations and large investors are not available to him because his income is spoken for by the needs of his family. Corporations can afford to invest extra funds in enterprises that can become tax shelters.

The one tax shelter that is readily available for police officers is the IRA. The amount a person can put into an IRA would be increased under the proposed plan, and, for that, working people will be grateful. The proposal would allow a four thousand dollar annual contribution for a married couple with a non-working spouse, which represents an allowance which is almost double of that which had previously been permitted. In effect, if the tax proposal is passed as submitted, people would have a tax deductible way to invest more of their extra income. The underlying assumption here is that there is some extra income. Police officers with working spouses, who need to take part time jobs to maintain a middle class lifestyle for their families, simply don't have that kind of surplus income to put in an IRA. Should the tax proposal be passed, it would cause a serious drop in the funds available to persons to spend as extra income because it would remove so many of the existing tax deductions. Therefore, more of the earned income would be subject to taxation. Simultaneously, the tax plan seeks to remove the benefit of a number of deferral plans which are presently available to municipal employees based on an agreement with their employer; in particular, Section 401-k of the Internal Revenue Code. The loss of that type of deferral program is far more detrimental to the interests of police officers and other similarily situated public employees than the gain to be found from the increase in the IRA deduction.

The bottom line is that the proposed tax code is structured to give further advantages to those already having money to invest, while failing to institute reforms to keep money in the hands of middle class wage earners. Proposals such as the IRA reform are pointed to as evidence of affirmative acts made for the benefit of the working classes, but, as indicated, for every benefit granted, there seems to be a corresponding detriment.

I do not want to cover each and every detrimental aspect of the tax proposal, but I must emphasize that certain of them will cause irreparable financial harm not only to our active members, as indicated by the above examples, but to our disabled retired members, as well. First, for both active and retired members, the first $300 of family health insurance and health and welfare benefits will be taxed. All active and retired members and their families will be taxed for a benefit which simply does not put any additional compensation in their pockets but merely provides protection against injury and illness. Also, the reference to that portion of the Internal Revenue Code regarding the right of accidental disability pensioners to have their disability income tax exempt is horrendous. For a member to be injured in the line of duty and be left without the ability to earn a living and then be taxed on income which is paid to him because of his disability flies in the face of common sense and reason. How you can justify taxing a member who is totally disabled and unable to earn a living is inexplicable. To provide corporate relief and reduced taxes to the rich on the backs of your disabled workers is completely unconscionable.

The Reagan Administration has always wanted to have the federal government give greater responsibility to local governments to care for its own needs. This tax proposal subverts that basic philosphy. Through the efforts of U.S. Senator Alfonse D'Amato, this City and State have seen unprecedented progressive movement in the areas of taxes and jobs coming to New York State. This Reagan tax proposal will totally neutralize any efforts made by Senator D'Amato in these areas and cause a total reversal of all the good he has done and the progress which has been made for our State.

On behalf of the Patrolmen's Benevolent Association of the City of New York and its over 35,000 active and retired members and their families, we urge you to continue your efforts to eliminate the detrimental effects of this misguided tax proposal and allow a middle class wage earner to have a fair chance to survive in these most difficult times.

Senator D'AMATO. So this is not just some little thing; this is his main sustenance?

Mr. CARUSO. This is his total main sustenance, yes.

Senator D'AMATO. Let me ask you something, Phil. We talk about fringe benefits. Do you consider health insurance for a family a fringe benefit, or is it a necessity?

Mr. CARUSO. It is a fringe benefit but it is also a vital necessity of life. Again it would be absolutely wrong to impact on that.

Senator D'AMATO. I think I know the answer, but it would seem to me that the largest asset that the typical patrolman or police officer has, in terms of dollars, would be his house.

Mr. CARUSO. Absolutely.

Senator D'AMATO. You have heard Senator Moynihan and others speak on this issue. What about the value of his home if he can no longer deduct his real property taxes?

Mr. CARUSO. Well, the value of his home would disintegrate virtually.

Senator D'AMATO. Senator Moynihan.

Senator MOYNIHAN. Let me just pursue that. There are a lot of tax economics about real estate valuation. There are a lot of people who have worked at it. In the language of the tax economists, by removing the deductibility of property taxes for a house, the demand curve for houses moves downward and to the right, which is a technical term. And that's pretty abstract.

But the reality is very serious if that happens. Let me put it this way: I would expect, and you help me, that the average police family has a house that has a market value of about $90,000. Would that be about right?

Mr. CARUSO. That's accurate, sir.

Senator MOYNIHAN. And we can show as a pretty direct proposition—we can't say with certainty that will happen but you can be pretty sure of this in terms of just the bank lending practices, if you take mortgage lending practices and you increase the real cost of carrying a house because you can't deduct the property taxes, you can predict what mortgage bankers that look this up on a chart will say, and they don't have to figure out each case that comes along: You have so much income, so much cost, this is how much of a mortgage we will give you. It would take the value down about 20 percent, the resale price would drop 20 percent. So you go from $90,000 down to 72—let's just say 75, because we will say it isn't quite as much as they say. That takes $15,000 off the resale value of the house.

Would you want to give me an estimate of how much the average police family—how much equity they actually have in that house, how much they own and how much the bank owns? It wouldn't surprise me much if the average house had an outstanding mortgage of about $70,000, $75,000.

Mr. CARUSO. That's correct. Paticularly with our new officers who are experiencing very high prices for homes.

Senator MOYNIHAN. We have been married 30 years and we still haven't gotten rid of that mortgage payment.

Could I give you the thought, then, that if this legislation would pass, that family has, say, $15,000 equity in that house, that's probably the most savings they have. Pass this legislation and those savings are wiped out in one event. Just bang. There is just no way around it.

And whose plan is this? The savings that your fellows and ladies have really are the savings they build up with the equity in their house. You don't build up the equity in automobiles; it goes down every year. What you have is your house. That's just wiping out a lifetime of savings.

And on what principle? I agree with you and thank you for testifying.

Mr. CARUSO. Thank you, sir.

Senator D'AMATO. Phil, let me thank you for being here. As always, you represent New York's finest in the best tradition I have ever seen.

Mr. CARUSO. Thank you, Senator, and thank you, Senator Moynihan. I appreciate the opportunity.

Senator D'AMATO. Next panel, Martin Barell, chancellor, New York State Board of Regents; Sandra Feldman, executive director of the United Federation of Teachers; and Hugh Mahoney, special assistant to the county executive of Nassau County.

Senator D'AMATO. Martin, how are you today?

Mr. BARELL. Good morning, Senator.

Senator D'AMATO. Were you growing impatient?

Mr. BARELL. Not at all. May I make a statement, Senator?

Senator D'AMATO. Martin, we would be delighted.

STATEMENT OF MARTIN C. BARELL, CHANCELLOR, NEW YORK STATE BOARD OF REGENTS, UNIVERSITY OF THE STATE OF NEW YORK

Mr. BARELL. My name is Martin Barell, chancellor of the board of regents of the State of New York which, as both of you gentlemen know, has jurisdiction over all education, public and private, from prekindergarten to university. Probably, the largest policymaking authority of any school board in possibly the world. Spends more money on education than does the Federal Government; spends more money on education for its children at elementary and secondary levels than any other State in the Union; provides more assistance to public colleges and universities than any other State in the Union; and probably provides as much aid to private colleges as do all of the other States combined.

I appreciate the opportunity to testify before you. I want to stress the importance of our view, that this is a nationwide and nonpartisan problem to which I am addressing myself. I commend the leadership both of you have shown on these critical issues.

My remarks deal with the proposed elimination of the State and local tax deductibility and the effect they would have upon education throughout this country.

State and local tax deductibility is a long-term standing provision which has served as a staple form of indirect aid to the State and local governments. The State and local government tax practices have been established and developed with the assumption that the deductibility priority will continue. That provision has offered stability and indirect assistance in the face of a steadily declining share of the Federal Government in direct expenditures on education.

Elimination of this deduction would have a devastating effect on education throughout the land. There would be two immediate impacts and two long-term impacts.

The first immediate impact would be to put enormous pressure on local and State jurisdictions to reduce their taxes so as to offset, to some extent, the $35 billion in the year 1986 that we would incur by way of added Federal taxes.

The largest part of our State budget and local budget is committed to education. The pressure would be greatest, therefore, on educational revenues. Furthermore, local school budgets, which many of us regard as the last repository of democracy, are those which most directly are controlled by local votes and most vulnerable to taxpayer actions for reductions.

Please bear in mind, as you undoubtedly know, that the States in the Midwest and the States in the Northeast are growing older. They are producing less children. There are more nesters, particularly the area in which Senator D'Amato and I live, we know that as people get older and have homes, they are less and less interested in voting for local school budgets. Add to that the fact that they—if this bill passes—will not be in a position to deduct those amounts; and speedily figure out that you have just worked the end of the public school system which has produced so many fine citizens in this country.

The Congressional Research Service estimates that service cuts for local and State jurisdictions will be approximately 15 percent because of these State and local tax decreases.

The second immediate impact would be a decline of school district and other local credit ratings. I have had some discussions about this and they would be seriously impacted. The result, of course, is as credit ratings drop, the cost of borrowing will increase, to shift the school expenditures away from the instruction program to carrying debt service, much as we do in our own Federal debt structure.

It is important to recognize the widespread impact on both States and individuals of the proposed elimination.

In the prepared statement I have submitted there are two tables which display the scope. The first table illustrates the extent to which education relies on revenue produced by property. And it encompasses all States: Arkansas, Oklahoma, Vermont, and West Virginia. It is not a New York phenomenon.

Second, individuals in all States and all local jurisdictions will be losers under this proposed arrangement. It is not a New York impact.

The third and longer term impact would be to stifle local, State incentives and initiatives to reform and improve education. This Nation's established policy of tax deductibility has encouraged local school districts to make extra efforts and services to provide exemplary public services. The loss of this deductible will result in double taxation and will kill this incentive. The deadening blow will come just at a time when State and localities are responding to the drive for excellence and effort to overcome the education condition described in "A Nation at Risk."

The fourth impact is also long term. It will involve the loss of nationwide support for direct Federal assistance for education that would accompany a loss of tax deductibility. Federal help for education has two parts: Direct grants or loans for programs and services; and indirect assistance through tax deductibility. The former is focused on low wealth, low tax jurisdictions for individuals who are poor and who have special needs. The latter is on those jurisdictions willing and able to make extra commitments for education.

Both parts have resulted in a balanced educational budget that would go out the window.

In conclusion, I want to reemphasize the point that the effects of these eliminations will impact all States, all localities. We have to have a national coalition to support this continuity of deductibility. We are part of such a coalition. We have caused to be called on June 13 in Washington, at the Rayburn House Office Building at 10 o'clock, 19 nationwide education organizations, bringing together representatives from all over the country for this purpose. The meeting is going to be moderated by Representative Hawkins of California and Jeffords of Vermont. Speakers will include Senator Simon of Illinois and Durenberger of Minnesota. There will be other speakers from Alabama, Pennsylvania, Missouri, and Massachusetts, and we will have representatives or have in person a whole series of secretaries of education.

We will help to bring out the grassroots belief of the American people on this issue in just the way they are identified in the USA Today poll of June 3, 1985. The majority in that poll favor tax simplification and fairness. They explicitly opposed the elimination of tax deductibility for State and local taxes, property taxes and income taxes. Our goal is to insure that majority view be adopted by the U.S. Senate and House of Representatives. Thank you.

[The prepared statement of Mr. Barell follows:]

Prepared Statement of Martin C. Barell

Mr. Chairman, I am Martin Barell, Chancellor of the New York Board of Regents, the governing body for the University of the State of New York. I appreciate the opportunity to testify before this Committee today, representing the perspective of State and local education board members. I stress the importance of this perspective as nationwide and non partisan. I commend the leadership you have shown on one of the most critical issues of the current tax reform proposals. My remarks today are focused on the impact the proposed elimination of state and local tax deductibility would have on education throughout the country.

State and local tax deductibility is a long-standing provision which has served as a stable form of indirect aid to state and local governments. Unlike direct federal grants-in aid, the unconditional nature of deductibility has been in keeping with governmental practice that encourages maximum state and local initiative and discretion to set spending levels and priorities. State and local government tax practices have been established and developed with the assumption that the deductibility priorities would continue. That provision has offered stability in indirect assistance while the federal share of direct education expenditures has been steadily declining from a high of 9.2 percent in FY 1979 to 6.2 percent in FY 1985.

Elimination of state and local tax deductibility would have a devastating effect on education across the land. There will be two immediate impacts and two long term effects.

The first immediate impact of the assumption of this part of the State and Local tax base by the Federal government will be to put enormous pressure on local and State jurisdictions to reduce their taxes as an offset to the increase of some $35 billion in FY 1986 of added Federal taxes. The largest part of State and local budgets is committed to education. The pressure will be greatest, therefore, on education revenues. Furthermore, the local school budgets are those most directly controlled by local votes and most vulnerable to taxpayer actions for reductions.

The Congressional Research Service estimates that service cuts for local and state jurisdictions will be approximately 15 percent because of these state and local tax decreases.

The second immediate impact will be a decline of school district and other state and local credit ratings because of the weakening of the state and local revenue base. As credit ratings drop, the cost of borrowing will increase with the shift of school expenditures away from the instruction program to carrying debt service.

With respect to these two points it is important to recognize the widespread impact on both states and individuals of the proposed elimination of tax deductibility. The two tables attached display this scope.

Table I illustrates the extent to which education relies on revenues provided by the property, income and sales taxes in the various states. States as dissimilar in many ways as Arkansas, Oklahoma, Vermont and West Virginia, but which all devote approximately 70 percent of their property tax revenues to education, will realize a significant shift in their education funding base if the deduction for property taxes is eliminated.

Individuals in all states and local jurisdictions will be losers under this proposal. Table II displays the projected tax increases to be be borne by itemizers as a result of the proposed elimination of deductibility. The Congressional Research Service has estimated these increases even though the Administration's proposed tax bill would make "offsetting" tax cuts for individuals such as the drop in marginal rates.

The third and longer term impact of the proposal on education will be to stifle local and state incentive and initiative to reform and improve education. This nation's established policy of tax deductibility has encouraged those local school districts and states that would make extra efforts and sacrifices to provide exemplary public services. The loss of deductibility with the result of double taxation or, tax-on-tax, will kill state and local incentive to increase taxes (which must be increased constantly to keep even with inflation just to maintain services). The deadening blow would come just at a time the States and localities are responding to the drive for excellence and the effort to overcome the education condition described in A Nation at Risk. The President has said States and local school districts must carry education reform and expenditures. The proposal to eliminate tax deductibility is completely contrary to that posture. It would have the opposite result of that advocated in A Nation at Risk. Our Nation looks to local and State initiative and commitment in education to meet national economic and social security objectives. National tax policy must support that position.

The fourth impact on education is also long term. This impact will be the loss of nationwide support for direct Federal assistance for education which would accompany a loss of tax deductibility. Federal help for education has two parts--direct grants or loans for programs and services and indirect assistance through tax deductibility. The former is focused on the low wealth/low tax jurisdictions or individuals who are poor or have special need for publicly supported education services. The latter is focused on those jurisdictions willing and able to make extra tax commitment for education. The two parts provide a balanced and broad nationwide base of constituent support for Federal aid to education.

If the loss of deductibility wipes out indirect aid, that will force constituent pressure to reallocate existent direct aid away from those most in need or it will erode constituent support for continuing existing patterns of Federal aid. The President has, of course, tried consistently to reduce or eliminate Federal aid for education. Both the Senate and House have just as consistently refused to reduce or eliminate the Federal role. To maintain Federal direct aid, the Congress must maintain the indirect aid and reject the proposed elimination of tax deductibility.

In conclusion, I reemphasize the point that the effects of the proposed elimination of tax deductibility will impact all States and all localities. They will affect all levels of education. We must have nationwide coalitions to support continuation of deductibility. We are part of such a nationwide education coalition. On June 13 in Washington at the Rayburn House Office Building at 10:00 A.M., nineteen nationwide education organizations bring together representatives from all over the country to work for this purpose. The meeting is moderated by Representatives Hawkins of California and Jeffords of Vermont. Speakers are Senators Simon of Illinois and Durenberger of Minnesota. Other speakers are from Alabama, Pennsylvania, Missouri and Massachusetts. We will help bring out the grass roots beliefs of the American people on this issue in just the way they were identified in the USA Today poll of June 3, 1985. The majority in that poll favored tax simplification and fairness; the majority also explicitly opposed the elimination of tax deductibility for state and local sales taxes, property taxes and income taxes.

Our goal is to assure that the majority view expressed in that poll is the majority position of the U.S. Senate and House of Representatives.

Thank you.

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TABLE I

Education Shares of Unrestricted Revenue, by Category of Government, and Education Shares by Type of Tax, All Levels of Education, FY 1980

STATE	STATE CODE	EDUCATION SHARE OF UNRESTRICTED REVENUE						EDUC SHARE OF EACH TYPE OF TAX		
		STATE	LOCAL	SCHOOL DISTRICT	COUNTY	MUNICIPAL	TOWNSHIP	PROPERTY	INCOME	SALES
ALABAMA	1	0.564	0.186	1.000	0.112	0.037	0.000	0.589	0.528	0.430
ALASKA	2	0.186	0.269	0.000	0.522	0.149	0.000	0.252	0.186	0.269
ARIZONA	3	0.464	0.393	1.000	0.100	0.000	0.000	0.630	0.464	0.387
ARKANSAS ✓	4	0.434	0.476	1.000	0.000	0.000	0.000	✓ 0.727	0.434	0.433
CALIFORNIA	5	0.468	0.198	1.000	0.030	0.000	0.000	0.390	0.468	0.384
COLORADO	6	0.469	0.360	1.000	0.000	0.000	0.000	0.644	0.469	0.289
CONNECTICUT	7	0.285	0.535	1.000	0.000	0.439	0.637	0.556	0.285	0.285
DELAWARE	8	0.392	0.372	1.000	0.000	0.000	0.000	0.623	0.375	0.000
DISTRICT OF COLUMBIA	9	0.000	0.218	0.000	0.000	0.222	0.000	0.222	0.222	0.222
FLORIDA	10	0.489	0.271	1.000	0.005	0.000	0.000	0.481	0.000	0.489
GEORGIA	11	0.505	0.291	1.000	0.000	0.019	0.000	0.505	0.505	0.410
HAWAII	12	0.386	0.002	0.000	0.000	0.000	0.000	0.000	0.386	0.386
IDAHO	13	0.512	0.316	1.000	0.138	0.000	0.000	0.472	0.512	0.512
ILLINOIS	14	0.400	0.372	1.000	0.001	0.011	0.000	0.576	0.400	0.329
INDIANA	15	0.504	0.410	1.000	0.039	0.011	0.206	0.523	0.464	0.504
IOWA	16	0.511	0.461	1.000	0.024	0.000	0.000	0.535	0.511	0.511
KANSAS	17	0.459	0.385	1.000	0.017	0.000	0.000	0.556	0.459	0.433
KENTUCKY	18	0.507	0.248	1.000	0.000	0.000	0.000	0.474	0.420	0.507
LOUISIANA	19	0.373	0.294	1.000	0.064	0.001	0.000	0.386	0.373	0.427
MAINE	20	0.383	0.421	1.000	0.000	0.359	0.348	0.466	0.383	0.383
MARYLAND	21	0.334	0.458	0.000	0.554	0.197	0.000	0.458	0.393	0.334
MASSACHUSETTS	22	0.302	0.403	1.000	0.000	0.308	0.538	0.418	0.302	0.302
MICHIGAN	23	0.380	0.490	1.000	0.005	0.010	0.000	0.654	0.343	0.380
MINNESOTA	24	0.438	0.310	1.000	0.000	0.000	0.000	0.484	0.438	0.436
MISSISSIPPI	25	0.464	0.336	1.000	[illegible]	0.000	[illegible]	0.616	0.666	0.666
MISSOURI	26	[illegible]	[illegible]	1.000	[illegible]	0.026	[illegible]	[illegible]	0.876	0.344
MONTANA	27	0.366	0.351	1.000	[illegible]	0.062	0.000	0.846	0.368	0.000
NEBRASKA	28	0.289	0.514	1.000	0.372	0.000	0.000	0.666	0.280	0.253
NEVADA	29	0.515	0.185	1.000	0.000	0.000	0.000	0.313	0.000	0.445
NEW HAMPSHIRE	30	0.237	0.494	1.000	0.000	0.404	0.000	0.477	0.237	0.000
NEW JERSEY	31	0.376	0.452	1.000	0.223	0.265	0.084	0.591	0.376	0.376
NEW MEXICO	32	0.371	0.269	1.000	0.000	0.000	0.000	0.533	0.371	0.346
NEW YORK	33	0.338	0.267	1.000	0.105	0.154	0.000	0.414	0.296	0.256
NORTH CAROLINA	34	0.535	0.388	0.000	0.575	0.000	0.000	0.411	0.535	0.544
NORTH DAKOTA	35	0.431	0.336	1.000	0.222	0.000	0.000	0.570	0.431	0.431
OHIO	36	0.511	0.366	1.000	0.000	0.000	0.000	0.672	0.288	0.463
OKLAHOMA ✓	37	0.428	0.386	1.000	0.154	0.001	0.000	0.697	0.428	0.250
OREGON ✓	38	0.389	0.514	1.000	0.155	0.000	0.000	0.703	0.389	0.000
PENNSYLVANIA	39	0.356	0.405	1.000	0.035	0.024	0.000	0.630	0.317	0.356
RHODE ISLAND	40	0.354	0.464	1.000	0.000	0.426	0.549	0.472	0.354	0.354
SOUTH CAROLINA	41	0.498	0.449	1.000	0.016	0.000	0.000	0.585	0.498	0.498
SOUTH DAKOTA	42	0.320	0.482	1.000	0.000	0.000	0.000	0.625	0.000	0.283
TENNESSEE	43	0.461	0.414	1.000	0.593	0.198	0.000	0.427	0.461	0.474
TEXAS	44	0.492	0.409	1.000	0.000	0.002	0.000	0.547	0.000	0.414
UTAH	45	0.591	0.501	1.000	0.000	0.000	0.000	0.592	0.591	0.485
VERMONT ✓	46	0.314	0.567	1.000	0.000	0.000	0.000	0.679	0.314	0.314
VIRGINIA	47	0.419	0.451	0.000	0.563	0.313	0.000	0.463	0.419	0.425
WASHINGTON	48	0.537	0.251	1.000	0.208	0.008	0.000	0.484	0.000	0.495
WEST VIRGINIA ✓	49	0.451	0.454	1.000	0.000	0.000	0.000	0.692	0.451	0.451
WISCONSIN	50	0.362	0.421	1.000	0.024	0.235	0.000	0.554	0.362	0.362
WYOMING	51	0.329	0.472	1.000	0.275	0.000	0.000	0.620	0.000	0.321

U.S. TREASURY DEPARTMENT 1985 TAX REFORM PROPOSAL
TAX DEDUCTIONS DISALLOWED AND FEDERAL TAX INCREASE PER ITEMIZER,
BY STATE
(1980 Tax Data/1984 Tax Rates/1987 Dollars)

TABLE II.

STATE	TOTAL STATE/LOCAL DEDUCTIONS IN MILLIONS	ITEMIZER TAX INCREASE
U. S. Total	$69,404.277	$ 927.49
Alabama	659.453	557.31
Alaska	88.720	695.32
Arizona	789.110	614.07
Arkansas	305.506	629.58
California	11,054.109	1,099.82
Colorado	1,101.204	777.50
Connecticut	1,088.707	1,039.88
Delaware	231.047	1,293.92
District of Columbia	382.342	1,433.82
Florida	1,185.252	447.96
Georgia	1,224.082	767.89
Hawaii	440.347	1,048.84
Idaho	225.536	689.37
Illinois	3,410.435	846.36
Indiana	838.185	538.70
Iowa	758.120	811.47
Kansas	584.728	758.36
Kentucky	724.438	756.81
Louisiana	367.739	388.97
Maine	218.870	856.94
Maryland	2,208.516	1,207.53
Massachusetts	2,855.646	1,246.16
Michigan	4,041.799	1,074.68
Minnesota	1,867.964	1,132.27
Mississippi	297.173	559.44
Missouri	961.370	678.17
Montana	171.522	616.23
Nebraska	402.150	893.54
Nevada	126.930	366.78
New Hampshire	184.708	697.53
New Jersey	3,058.250	1,128.51
New Mexico	203.100	583.89
New York	10,820.293	1,646.15
North Carolina	1,328.588	850.84
North Dakota	83.054	514.85
Ohio	2,231.270	701.66
Oklahoma	575.054	665.05
Oregon	1,001.826	907.93
Pennsylvania	3,085.115	872.98
Rhode Island	302.856	1,095.46
South Carolina	671.974	683.69
South Dakota	57.695	458.37
Tennessee	403.005	409.40
Texas	1,568.524	462.19
Utah	469.074	665.88
Vermont	121.034	1,003.29
Virginia	1,731.210	958.18
Washington	684.668	462.31
West Virginia	181.597	685.53
Wisconsin	2,075.884	1,128.44
Wyoming	50.577	322.81

Senator D'AMATO. Thank you. Sandra, please proceed.

STATEMENT OF SANDRA FELDMAN, EXECUTIVE DIRECTOR, UNITED FEDERATION OF TEACHERS, AND VICE PRESIDENT, AMERICAN FEDERATION OF TEACHERS, AFL-CIO

Ms. FELDMAN. Good morning, Senator D'Amato, Senator Moynihan. I am Sandra Feldman, executive director of the United Federation of Teachers and vice president of the American Federation of Teachers. I am testifying on behalf of both organizations on what we think will be the devastating effects of the repeal of deductibility.

Before I concentrate on what we think is going to happen to education under this proposal, I just want to second what Phil Caruso said earlier about the effects on middle-class people whom we represent. A maximum teacher's salary in New York City, after 15 years of service with a master's degree and 30 credits beyond that, is $34,000. So you know that these are families which have a difficult time making ends meet. And certainly the inability to deduct their State and local taxes is going to have a devastating effect on them incomewise.

As far as education is concerned, I agree with my colleague, Mr. Barell, that we see this as a national problem, although New York State is at the top of the list when it comes to the seriousness of the consequences. We figure that of the approximately $40 billion that is going to be lost as a result of this, that fully a third, more than $16.5 billion, is money that now goes to fund elementary, secondary, and higher education which is more, by the way, than the entire contribution of the Federal Government to education at this point.

As has been said, there is just no doubt that the education tax, the school tax in most communities that stands out separately, that residents vote upon, they see it separately on their bills, and for a number of years now school budgets have been in trouble. We have an aging population. We are at the point where barely 25 percent of adults are parents of school age children. Americans are living much longer. So we have a huge population that doesn't have a direct connection and interest in the school system. And they have to be convinced that the Nation will be in trouble if we don't replenish the supply of educated and talented people who made our country great, that democracy itself is threatened if we don't have a literate, comprehending populace. And we can't do that without schools that are adequately funded.

If this particular tax change goes through, school budgets are going to be in even more trouble than they presently are. When people do vote to tax themselves to do what is required for the children of the community, they do so in the knowledge that the tax increase will result in some reduction in their Federal tax liability. This is true with the property tax that funds education directly and it's true where State and local and income and sales taxes also supply money to education.

Education is in fact, as has been said, the largest single expenditure by State and local government. And if the tax deduction repeal goes through and taxpayers in effect are to be taxed twice on the same money with no Federal relief, many will vote to reduce school budgets, casting the only ballot they can to their dismay.

I think we have to take a look at what the President is doing to education. He agrees with his own National Commission on Excellence in Education that the Nation is at risk because our schools, to put it mildly, are in great need of improvement. Then he cut the Federal budget for education, and with your help and the help of others we managed to stave off some of those cuts. But he has been saying that education is principally a State and local function. With this aspect of his tax reform he is going to make it virtually impossible for the States and the localities to fullfill the mission that he says is properly theirs, which is a pretty terrible contradiction. And I hope that the Congress will see the logic and merit in our argument and help the President get back on track and get into supporting education.

I want to give you some figures that show what money now remains in the State to support education would be lost if this regressive proposal passes. It would be the States where education is accorded high priority. The priority, by the way, which the President's own commission recommended. California would lose $2.9 billion; New York, $2.1 billion, 20 percent of the State budget, by the way, according to our commissioner; Michigan, $991 million; Illinois, $858 million; and New Jersey, $836 million.

Per pupil in New York we would lose about $588; New Jersey, $586; Maryland, $541; Minnesota, $509; and Connecticut $508. And it's not just the Northeast or a few States like California in the West that would be hurt. Oregon would lose $319; Utah, $254; and Nebraska, $242.

I can go on. I have a tax table with this kind of information in my prepared statement which I will share with you.

If you see it overall, you would see that nearly $13 billion would be lost to elementary and secondary education alone, and add to that the losses to higher education, it gets to be just a tremendous loss.

Right now, according to every poll, education is on the upsweep. Our citizens are willing to put tax dollars behind improvements if they can be assured of improvements in education. But a rebellion against a separate school tax as a consequence of the loss of deductibility will result in a reversal of the healthy trend that we are now seeing in support of education.

If you think about what it will mean to lose $588 per pupil in New York State, as it is we are facing a tremendous teacher shortage. We are having a lot of trouble interesting the best and brightest into teaching. A major reason is because the salaries are so low.

Senator D'Amato. What's the average starting salary for a teacher?

Ms. Feldman. $14,500 in New York City. Throughout the State it is a little above that, 16, 17. Very low.

Senator D'Amato. How do you attract the math teachers we want?

Ms. Feldman. It's becoming impossible to attract any teacher, let alone those with specialties in science and math.

Senator D'AMATO. I think that's important for the record. There are many people who say you overpay your people, and $14,500 is the average starting pay for a teacher in New York City.

Ms. FELDMAN. It is absolutely impossible to attract quality people. And if we lose money, which this deductibility proposal will make happen, it is going to be impossible to make salaries competitive.

Once you have uncompetitive salaries and you also have a deterioration of working conditions, which makes it even less attractive for a college grad with a master's degree, with enormous ability, an educated ability, why would they come into a school system?

Now, in New York City, for example, if we lose $588 per pupil, that purchases the services of a teacher for a class of 34 kids. And if we lose a teacher and the class size goes up, that's just one example of the kind of deterioration of conditions. We already have the highest class size in the State right here in New York City. This will make it even more difficult to attract teachers. I think there will be a more general decline in the quality of education in our state.

Just at a time, as I have said, when prodded by the reform reports and the heightened awareness of the business community, we are getting more support on the part of the taxpayer to spend money on education to make the schools better.

I just want to end on this note. We in the UFT and AFT do not oppose tax reform. We are in favor of a simplified and fair tax scheme which is in the interest of all Americans. But as the Congress considers the President's proposals it must make sure that our tax system remains progressive and that the burden is not borne unfairly by those who can afford it least. And in the case of repeal of the deductibility of State and local taxes, those who would bear the burden are the children of America, and that is not tax reform. That's cutting your nose off to spite your face. Thank you.

[The prepared statement of Ms. Feldman follows:]

Prepared Statement of Sandra Feldman

SENATOR D'AMATO, MEMBERS OF THE JOINT ECONOMIC COMMITTEE, LADIES AND GENTLEMEN--

MY NAME IS SANDRA FELDMAN, AND I AM SECRETARY AND EXECUTIVE DIRECTOR OF THE UNITED FEDERATION OF TEACHERS HERE IN NEW YORK CITY AND A VICE PRESIDENT OF THE AMERICAN FEDERATION OF TEACHERS, AFL-CIO. THANK YOU FOR THIS OPPORTUNITY TO TESTIFY IN BEHALF OF BOTH ON THE SERIOUS CONSEQUENCES OF THE PRESIDENT'S PROPOSAL TO END THE FEDERAL DEDUCTIBILITY OF STATE AND LOCAL INCOME, PROPERTY AND SALES TAXES. OTHERS ARE SPEAKING TO YOU ABOUT THE NEGATIVE IMPLICATIONS FOR NEW YORK CITY AND NEW YORK STATE, SO I WILL CONCENTRATE ON THE AREA WE KNOW BEST: PUBLIC EDUCATION.

THE SERIOUS CONSEQUENCES FOR EDUCATION AFFECT NOT JUST NEW YORKERS BUT ALL AMERICANS, IN EVERY STATE. OF THE 40 BILLION DOLLARS THAT TAXPAYERS WOULD LOSE TO THE FEDERAL TREASURY AS A RESULT OF REPEAL, FULLY A THIRD--MORE THAN 16.5 BILLION DOLLARS--NOW GOES TO FUND ELEMENTARY, SECONDARY AND HIGHER EDUCATION.

IN NEARLY ALL OF THE 15,000 LOCAL SCHOOL DISTRICTS, THE SCHOOL BUDGET IS THE ONE TAX-RELATED ITEM THAT RESIDENTS OF A COMMUNITY HAVE AN OPPORTUNITY TO VOTE ON. FOR A NUMBER OF YEARS NOW, SCHOOL BUDGETS HAVE BEEN IN TROUBLE, LARGELY BECAUSE WE ARE A SOCIETY THAT'S GROWING OLDER. FROM A TIME WHEN A MAJORITY OF OUR ADULT POPULATION HAD CHILDREN IN SCHOOL, WE ARE NOW AT THE POINT WHERE BARELY 25 PERCENT OF ADULTS ARE PARENTS OF SCHOOL-AGE CHILDREN; A COMBINATION OF LOW POPULATION GROWTH AND AMERICANS LIVING MUCH LONGER HAS REDUCED THE PROPORTION OF THOSE WITH AN IMMEDIATE AND DIRECT INTEREST IN SCHOOLS. AND TOO FEW HAVE REACHED THE CORRECT JUDGMENT THAT WE ARE ALL IN TROUBLE, THAT THE NATION IS IN TROUBLE, IF WE DON'T REPLENISH

THE SUPPLY OF EDUCATED, TALENTED PEOPLE WHO HAVE MADE OUR COUNTRY GREAT, THAT DEMOCRACY ITSELF IS THREATENED IF WE DO NOT HAVE A LITERATE, COMPREHENDING POPULACE.

IF THIS PARTICULAR TAX CHANGE GOES THROUGH, SCHOOL BUDGETS WILL BE IN STILL MORE TROUBLE. BECAUSE WHEN PEOPLE DO VOTE TO TAX THEMSELVES TO DO WHAT IS REQUIRED FOR THE CHILDREN OF A COMMUNITY, THEY DO SO IN THE KNOWLEDGE THAT THE TAX INCREASE WILL RESULT IN SOME REDUCTION IN THEIR FEDERAL TAX LIABILITY. THIS IS TRUE OF THE PROPERTY TAX THAT FUNDS EDUCATION DIRECTLY, AND IT IS TRUE WHERE STATE AND LOCAL INCOME AND SALES TAXES ALSO PROVIDE FUNDS TO AID EDUCATION. EDUCATION, IN FACT, IS THE SINGLE LARGEST EXPENDITURE BY STATE AND LOCAL GOVERNMENT. IF THE TAX DEDUCTION REPEAL GOES THROUGH AND TAXPAYERS, IN EFFECT, ARE TO BE TAXED TWICE ON THE SAME MONEY, WITH NO FEDERAL RELIEF, MANY WILL VOTE TO REDUCE SCHOOL BUDGETS, CASTING THE ONLY BALLOT THEY CAN TO EXPRESS THEIR RESENTMENT AND DISMAY.

SO WE NOW HAVE A CASE WHERE THE APPROPRIATE REACTION ONCE AGAIN IS: WILL THE REAL RONALD REAGAN PLEASE STAND UP. THE PRESIDENT AGREED WITH HIS OWN NATIONAL COMMISSION ON EXCELLENCE IN EDUCATION THAT THE NATION IS AT RISK BECAUSE OUR SCHOOLS NEED MUCH IMPROVEMENT. THEN HE SET ABOUT TO CUT THE FEDERAL BUDGET FOR EDUCATION, SAYING OVER AND OVER AGAIN THAT EDUCATION WAS PRINCIPALLY A STATE AND LOCAL RESPONSIBILITY. NOW, WITH THIS ASPECT OF HIS TAX REFORM HE WILL MAKE IT VIRTUALLY IMPOSSIBLE FOR STATES AND COMMUNITIES TO FULFILL THE MISSION HE SAYS IS PROPERLY THEIRS. THIS IS A TERRIBLE

CONTRADICTION, AND I HOPE THE CONGRESS WILL SEE THE LOGIC AND MERIT IN OUR ARGUMENT AND HELP THE PRESIDENT GET BACK ON TRACK IN SUPPORT OF EDUCATION.

LET ME GIVE YOU SOME OF THE FIGURES THAT SHOW WHAT MONEY THAT NOW REMAINS IN THE STATES TO SUPPORT EDUCATION WOULD BE LOST IF THIS REGRESSIVE PROPOSAL PASSES. HARDEST HIT, OF COURSE, WOULD BE STATES WHERE EDUCATION IS ACCORDED THE PRIORITY IT DESERVES--THE PRIORITY THE PRESIDENT'S COMMISSION RECOMMENDED. CALIFORNIA WOULD LOSE 2.9 BILLION DOLLARS; NEW YORK, 2.1 BILLION; MICHIGAN, 991 MILLION; ILLINOIS, 858 MILLION; NEW JERSEY, 836 MILLION DOLLARS.

PER PUPIL, NEW YORK WOULD LOSE $588; NEW JERSEY, $586; MARYLAND, $541; MINNESOTA, $509; CONNECTICUT, $508. MOREOVER, IT'S NOT JUST THE NORTHEAST AND A FEW STATES LIKE CALIFORNIA IN THE WEST THAT WOULD BE HURT. OREGON WOULD LOSE $391 PER PUPIL IN ELEMENTARY AND SECONDARY SCHOOLS; UTAH, $254; NEBRASKA, $242; WISCONSIN, $383; NORTH CAROLINA, $237; KANSAS, $263. THE AVERAGE PER PUPIL LOSS WOULD BE $271, AND EVERY TAXPAYER IN EVERY STATE WOULD BE AFFECTED. I AM ATTACHING A COUPLE OF PAGES TO THIS TESTIMONY WHICH WILL GIVE YOU THE FIGURES FOR ALL THE STATES. YOU WILL SEE THAT NEARLY 13 BILLION DOLLARS WOULD BE LOST TO ELEMENTARY AND SECONDARY EDUCATION ALONE.

RIGHT NOW, ACCORDING TO EVERY POLL, OUR CITIZENS ARE WILLING TO PAY TAXES TO IMPROVE EDUCATION. REFORM PROGRAMS ARE BEING SUPPORTED THROUGHOUT THE STATES. BUT A REBELLION AGAINST THE SEPARATE SCHOOL TAX AS A CONSEQUENCE OF THE LOSS OF DEDUCTIBILITY WILL RESULT IN A REVERSAL OF THE HEALTHY TREND WE NOW SEE. THE LOSS OF $588 PER PUPIL IN NEW YORK STATE, FOR EXAMPLE, WILL RESULT IN THE INABILITY OF SCHOOLS TO COMPETE FOR TALENTED TEACHERS FROM AMONG THE BEST AND BRIGHTEST COLLEGE GRADUATES, FOR TEACHER SALARIES WILL REMAIN AT THE

CURRENT UNCOMPETITIVE LEVELS THE NATIONAL COMMISSION AND SUBSEQUENT REPORTS DEPLORED.

ANOTHER RESULT WILL BE MORE KIDS PER CLASS IN DISTRICTS WHERE THIS CONTINUES TO BE A PROBLEM. IN NEW YORK CITY, FOR EXAMPLE, $588 PER PUPIL FOR A CLASS OF 34 PUPILS PURCHASES THE SERVICES OF A TEACHER; IF WE LOSE THAT MONEY WE WILL LOSE A TEACHER, AND CLASS SIZE, ALREADY THE HIGHEST IN OUR STATE, WILL GO HIGHER. WE WILL BE FORCED TO HAVE FEWER ADVANCED COURSES, GIVE LESS HELP TO THE CHILDREN WHO NEED IT MOST, MAKE DO WITH EVEN LESS BY WAY OF SUPPORTIVE SERVICES SUCH AS GUIDANCE COUNSELING, WHICH WERE DECIMATED IN OUR FISCAL CRISIS.

THERE WILL BE A GENERAL DECLINE IN THE QUALITY OF EDUCATION IN OUR SCHOOLS, JUST AT A TIME WHEN, AS I'VE SAID, PRODDED BY THE REFORM REPORTS AND THE HEIGHTENED AWARENESS OF THE BUSINESS COMMUNITY, STRONG EFFORTS HAVE BEEN UNDERTAKEN TO MAKE THEM BETTER. WE URGE YOU TO UNDERSTAND AND TO COMMUNICATE TO YOUR COLLEAGUES IN THE SENATE AND THE HOUSE THAT THE NATION CANNOT AFFORD TO LET THIS HAPPEN--AND I HOPE YOU WILL INVITE AS WITNESSES DURING THE WEEKS AND MONTHS OF HEARINGS AHEAD SOME WHO SERVED ON THE VARIOUS REFORM COMMISSIONS AND CAN SPEAK FROM CONCERN AND KNOWLEDGE.

WE IN THE UFT AND AFT DO NOT OPPOSE TAX REFORM. A SIMPLIFIED AND FAIR TAX SCHEME IS IN THE INTERESTS OF ALL AMERICANS. BUT AS THE CONGRESS CONSIDERS THE PRESIDENT'S PROPOSALS, IT MUST MAKE SURE THAT OUR TAX SYSTEM REMAINS PROGRESSIVE AND THAT THE BURDEN IS NOT BORNE UNFAIRLY BY THOSE WHO CAN AFFORD IT LEAST. IN THE CASE OF THE REPEAL OF THE DEDUCTIBILITY OF STATE AND LOCAL TAXES, THOSE WHO WOULD BEAR THE BURDEN--THE BURDEN OF NOT RECEIVING THE EDUCATION THAT THEY AND THE NATION DESERVE--ARE THE CHILDREN OF AMERICA. THAT IS NOT TAX REFORM; IT IS CUTTING OFF YOUR NOSE TO SPITE YOUR FACE.

State	Loss in Taxes for Elem. & Secondary (in millions of dollars unless otherwise noted)	Loss per pupil (in dollars)	Ranking for per pupil loss
Alabama	105	145	36
Alaska	13	146	35
Arizona	130	255	21
Arkansas	71	164	32
California	2.062 billion	507	6
Colorado	239	439	11
Connecticut	247	508	5
Delaware	42	452	8
D.C.	40	440	10
Florida	214	144	37
Georgia	262	249	23
Hawaii	49	302	18
Idaho	39	192	29
Illinois	684	364	14
Indiana	155	155	34
Iowa	152	301	19
Kansas	107	263	20
Kentucky	116	178	31
Louisiana	67	86	46
Maine	39	184	30 (tie)
Maryland	378	541	3
Massachusetts	450	495	7
Michigan	785	446	9
Minnesota	364	509	4
Mississippi	53	113	42
Missouri	195	243	24
Montana	24	158	33

State	Loss in Taxes for Elem. & Secondary (in millions of dollars unless otherwise noted)	Loss per pupil (in hundreds of dollars)	State Ranking Per pupil Loss
Nebraska	65	242	25
Nevada	18	119	41
New Hampshire	37	231	27
New Jersey	687	586	2
New Mexico	38	141	38
New York	1.600 billion	588	1
North Carolina	260	237	26 (tie)
North Dakota	15	128	39
Ohio	440	237	26
Oklahoma	116	195	28
Oregon	175	391	12
Pennsylvania	586	328	16
Rhode Island	48	345	15
South Carolina	112	184	30 (tie)
South Dakota	13	105	44
Tennessee	78	94	45
Texas	380	127	40
Utah	94	254	22
Vermont	24	264	19
Virginia	312	320	17
Washington	121	164	32
West Virginia	41	109	43
Wisconsin	301	383	13
Wyoming	8	75	47
	$12.7 billion total loss in taxes for elementary/secondary education	$271 average dollar loss per pupil	

State	Loss for Education (Elementary, Secondary and higher ed.) (numbers in millions of dollars unless otherwise noted)	Ranking
Alabama	171	25
Alaska	14	47 (tie)
Arizona	185	23
Arkansas	83	34
California	2.949 billion	1
Colorado	289	16
Connecticut	285	17
Delaware	61	38
D.C.	50	41
Florida	259	18
Georgia	339	15
Hawaii	78	35
Idaho	57	39
Illinois	858	4
Indiana	216	21
Iowa	205	22
Kansas	144	29
Kentucky	167	26
Louisiana	87	33
Maine	46	42 (tie)
Maryland	496	9
Massachusetts	515	8
Michigan	991	3
Minnesota	458	10
Mississippi	74	36
Missouri	241	20
Montana	36	44

State	Loss for Education (Elementary, Secondary and higher ed.) (numbers in millions of dollars unless otherwise noted)	Ranking
Nebraska	94	32
Nevada	21	46 (tie)
New Hampshire	40	43
New Jersey	836	5
New Mexico	46	42 (tie)
New York	2.068 billion	2
North Carolina	379	14
North Dakota	21	46
Ohio	540	7
Oklahoma	156	28
Oregon	247	19
Pennsylvania	681	6
Rhode Island	64	37
South Carolina	180	24
South Dakota	14	47 (tie)
Tennessee	102	31
Texas	451	11
Utah	126	30
Vermont	28	45
Virginia	432	12
Washington	164	27
West Virginia	54	40
Wisconsin	425	13
Wyoming	12	48
Total Loss	$16.5 billion	

Senator MOYNIHAN. Senator, I ask that we have order in the room. Our witnesses are speaking against a little bit of a background.

Senator D'AMATO. I would ask if people have any conversations, we have our witnesses, please take it outside.

Mr. Barell, let's hear from Mr. Mahoney, and if there are any observations you would like to make, we will give you the opportunity.

STATEMENT OF HUGH MAHONEY, SPECIAL ASSISTANT TO COUNTY EXECUTIVE, NASSAU COUNTY, NY

Mr. MAHONEY. Hugh Mahoney, special assistant to Francis Purcell. I bring greetings of the residents of Nassau County and commend both of you for the difficult job you are doing, but thank God both of you are trying to assist us.

I think the U.S. Treasury Department is trying to tell us the Federal income tax deduction for State and local taxes is a loophole, a tax shelter in the same category as entertainment and the three martini lunch. What the Treasury is really proposing is to tax us twice. To make us pay taxes on taxes. For the average Nassau County homeowner with a home assessed the $7,000, the Treasury Department proposal will mean up to and even more than $1,600 a year in additional Federal taxes.

In a very real sense the deduction of State and local taxes from the Federal income tax is a social compact between homeowners and the Federal Government and between the State and the Federal Government, a compact that has been part of the Federal Tax Code since 1913 when the income tax was first adopted.

The deductibility had a dual purpose. First to prevent an inequity of double taxation by exempting taxes paid to the State and local governments from being taxed again by the Federal Government. And second, to encourage, to facilitate homeownership by Americans.

Deductibility is woven in the fabric; to take it away would usurp the physical resources of the State and local government and would break the social compact with millions of homeowners throughout the Nation.

I think that's important in this State and that we have to look at it. I know we have the finest educational system on the Island and in the State of New York, and I believe that one of the problems we are faced with is that we are losing our young people. We spend the money, we educate the people; we have an unemployment on the Island of 4 percent, we have corporations moving into the State. Indeed we may be facing a labor shortage. And I think what would be a problem here if this goes through, how can the young afford ever to purchase a home?

It is the ability of these States to export, and I think the thing right now is we have to look at the entire situation. We believe it would be disastrous on Long Island if this goes through. We have seen in the last several weeks where our real estate people have been talking that there is almost a halt now in the construction business. There seems to be a problem of people now believing that this may go through, and indeed it would be to the detriment of what we are trying to do on the Island to figure out how our youth and young can stay on the Island after their education, and this is a key factor.

The President's press secretary was quoted recently as saying that a homeowner in Westchester County makes $80,000 a year and would save $1,247 in Federal taxes under the President's plan. I can assure you that $80,000 is not the average in Westchester nor indeed in most parts of the State.

The average middle-class homeowner, no matter where he or she lives, is a wage earner. He gets all his income from his salary. He does not have a lot of business deductions, he does not have any sophisticated tax shelters. All he has is his mortgage, loan interest, donations, and his state and local taxes. I think the key now to take away his State and local taxes, and he has little left. He will be plucked clean whether he lives in New York or New Mexico.

I believe when you analyze this code, not only will we have several States that will be hit the hardest, but you will have some 42 other States that will have a $500 increase.

So I believe that we must all work together in Congress to convince those congressmen in those other States that indeed the residents of their States are also going to be affected by this tax code. Thank you very much.

Senator D'AMATO. Mr. Barell.

Mr. BARELL. Senator, in connection with this conference to which I have alluded, I assumed the responsibility of calling all of the lay chief officers in about 40 of the States. I think there seems to be a perception, I think it is a misconception, that this is a problem that is peculiar to New York or to California and perhaps one or two States in the Midwest.

I think I can tell you that in this area, as Ms. Feldman has indicated, where there is a perception that in order to increase the level of education we have to increase the level of the teacher, and as you indicated quite properly, that's a very serious problem in this State. But I want you to understand based on all these conversations I have had, that problem is endemic throughout the States of the Union. And that's the place of beginning.

And I can tell you in talking to these people in such far off places as Lousiana, for example, and in Mississippi, I was met with the argument that if in fact you do this to us, we are not going to be able to hire teachers at decent salaries, we are not going to be able to cut down on the size of our classes, and the place of beginning is going to be truncated before it starts.

It is not, I repeat again, a problem peculiar to New York. And I think any stress that we do lay ought to emphasize the nationwide bipartisan nature of the problem.

Senator D'AMATO. Let me suggest to you that's the only way we are going to win this battle. I think we are going to win it when people begin to see the serious consequences that will befall them. Many people were conscious of preserving the deduction on the interest paid on mortgages. Once they heard of its safety, then everything else seemed to be OK. They did not realize, when they were talking about the State and local taxes, that they meant the local real property taxes, of which the school tax comprises——

Mr. BARELL. 70 percent, Senator. Incidentally, I might also tell you, and I took a poll of the people who hold the same position I do, we have a problem in education. The lack of knowledge concerning the impact, the lack of knowledge of the content of this bill is extraordinary. And we here in New York have had a great deal of discussion and publicity. The word has not gotten out to the hinterlands.

In many cases I was met with a statement that said: Yes, we heard something about it. It has not been the subject of discussion and we really don't know what the impact is on our state.

Ms. FELDMAN. I would like to just add something to that. The debate over this issue has been a debate over "fairness" in terms of high tax States having been subsidized by the Federal Government, which, of course, you have had witnesses this morning I think who have made mince meat out of that argument.

What hasn't been talked about is what the effect will be on the little guy out there in the small communities throughout the Nation. It isn't just a question of high tax States being subsidized at all by the Federal Government. It is a question of whether or not the average middleclass and lower middle class working family in the United States is going to be able to have some relief from taxes, the property tax, the school tax, in every little hamlet in every State of this Nation.

And I think that is the word that has to get out so that it doesn't appear to be what it is shaping up to be now, a battle between the high tax States and the lower tax States.

Senator D'AMATO. I have just one question, and let me commend you, Martin, for your undertaking. It is very important, and that's what is going to carry the day. Senator Marchi is reaching out to the various State legislatures to deal with them on the basis of the Federal compact being done away with, federalism.

Sandra, are you undertaking that same kind of mission with the various teacher groups throughout this nation?

Ms. FELDMAN. Yes, we have a large umbrella organization at the national level which encompasses all of the teacher unions, all of the supervisory groups, the school board associations, the superintendents, the chief State school officers, and all of the various civic organizations that are interested historically in schools.

Senator D'AMATO. Do you sense the momentum beginning to build in that area?

Ms. FELDMAN. Yes. We are getting the word out. We have a petition campaign going on in school districts throughout the Nation. We are asking people to write letters and we are getting them now before school closes so there will be some feeling of response to the Congress soon, we hope.

Mr. BARELL. I am sure you do know there is an organization that is comprised of local legislators at both the State, county and municipal level. They are going to have representatives at this conference as well on Thursday, and I hope to talk with them on Thursday afternoon. Because they are, of course, immediately sensitive to the need for revenue to keep their school systems going.

The NEA and the AFT will be represented at this conference, as will every single national educational association from kindergarten teachers up to university professors.

Ms. FELDMAN. And parent groups.

Senator D'AMATO. Senator Moynihan.

Senator MOYNIHAN. I want to thank our witnesses. But just as a matter of balance, and I think of fairness also, as we described the President's proposal, let us keep in mind there are these enormous costs that we can see and record and calculate. But remember that by proposing to restore partially the value of a personal deduction in the income tax raises from $1,090 to $2,000. President Reagan has made the most powerful proposal on behalf of low income persons in this country that has been made since Social Security, by comparison efforts—well, I won't go quite that far perhaps.

Let us say one event of the 1960's was comparable, and that was Medicare-Medicaid. The personal exemption was set in 1948 at $600, and were we to just maintain the value as a percentage of per capita income of that 1948 deduction, that exemption would now be $45,000 personal exemption. A family of four would take $23,000, deduct that from income, and you would need almost $30,000 before you would even begin to pay taxes.

If you just kept the plain CPI, it is about $2,600. We have a situation where we are taxing people into poverty. And the Treasury and the President have said that's wrong.

We are going to have a big problem. We are going to start hearings in the Finance Committee tomorrow. The State and local deductions will bring in revenue almost precisely the amount that increasing the personal exemption will give up. Those are the two biggest items on either side.

Ms. FELDMAN. But one translates into services, very direct services.

Senator MOYNIHAN. I don't have to tell Ms. Feldman, there is nothing simple in Government.

May I say to the Chancellor that we have calculated the probable loss per pupil by State, and we come down to $605.55. The largest, interestingly, is New Hampshire, at $1,010. I guess the largest is Wyoming at $1,069. These vary according to the incidents of property tax. New York isn't that much above average. A little bit but not much.

We use a rule, in the standard tax economists' judgments, of what is the tax price. The tax price for school taxes would increase 40 percent. The Congressional Research Service estimates—I don't know how they estimate this, but it is obviously a matter of experience—that the elasticity of demand for school services is at 0.5.

Mr. BARELL. At what, senator?

Senator MOYNIHAN. At 0.5. You will lose half the increase that's proposed. It is a tax calculation and made with some exactness. And it is suspicious because it comes out in a round number just at about 20 percent.

Mr. BARELL. The differential is at 40?

Senator MOYNIHAN. You can project 10 years out that you will be spending 20 percent less on education than otherwise you would have done.

Mr. BARELL. Senator, if I may, what this sort of ignores, and I think is true of every large urban area, and I am not now talking about New York, is that given the fact that many of these large urban States, such as our own, provide a significant amount of services, and we have continued in this State, despite the services, to spend a great deal of money on education. State aid to education in the last 2 years in this State increased by $1 billion.

What I think average numbers fail to take into account is there will be affluent districts that hopefully, or at least theoretically, will summon up the sums to make up the swing. The problem is that in those districts where the pressures for services are the greatest, the effect upon the school budget to the extent that it is voted on by the locals, is going to throw the average out of kilter. These people are simply not going to vote for the budget.

And what is going to happen is you are going to have either of two things happening: The schools will be only for the disadvantaged and the poor, and/or you will have a thrust for private schools which I think will kill the whole concept, which in New York in the common school history, goes back well over 100 years, and which is true, incidently, of all of the States in the midwest that grew up under what the Senator knows was the Northwest Ordinance, which provided in their Constitutions the same arrangements for schools.

So averages really don't help you here. It is the fellow that hasn't got it that is going to get hurt the most, and the schools in the districts that haven't got it that are going to get hurt the most.

Senator MOYNIHAN. I agree. That's why I told you last January.

Mr. BARELL. And I told you we were going to try and do something about it.

Senator MOYNIHAN. And you did. I thank you very much, Chancellor.

Senator D'AMATO. Let me thank the Chancellor not only for his being here today, but more importantly for the work he has begun. I think it will play an important role in enlightening more Americans. I don't believe the average American wants to do away with the deductibility of the State and local taxes.

Sandra, thank you so much for your job, and Hugh, thank you.

Mr. BARELL. Thank you, gentlemen.

Senator D'AMATO. We are going to take a 3-minute recess and give the reporter an opportunity to relax his fingers.

[A short recess was taken.]

Senator D'AMATO. The meeting will come to order. At this time, we will hear from our Governor, Governor Mario Cuomo. We thank the Governor for taking his time and effort in being here. We are appreciative of the fact that he will testify.

STATEMENT OF HON. MARIO CUOMO, GOVERNOR, STATE OF NEW YORK

Governor CUOMO. Thank you, Senator D'Amato and Senator Moynihan, and thank you for the opportunity. And beyond that, as the Governor of the Empire State, let me thank you on behalf of all of our people for the excellent efforts you are both making to enlighten the American public as to the implications of this tax reform plan, not just on the deductibility issues, which concerns us a great deal but doesn't concern us exclusively.

I think I heard Marty Barell say that one of the difficulties is getting the message out. Indeed that has been my experience as well. No one is trying harder or doing it better than both of you, and we are very pleased and very grateful.

Let me first say that I support tax reform. There is no doubt that the present system needs to be overhauled and replaced with a Tax Code that is more simple and more fair. In fact, I not only support tax reform, I am proud to say that here in New York State, as you know, we have just enacted tax reform, with a package that lowers rates, removes 500,000 poor taxpayers from the rolls, and reduces disparities between households and among households with comparable incomes.

Our tax reform program does one thing more. It treats all regions and people of the State fairly. We didn't pick and choose who should receive relief and who should receive an additional burden. We didn't pit New York City against Buffalo or a Watertown against Elmira. It's not a tax reform program that starts with a winners' and losers' list. Under our tax reform program everyone benefits. It is a fair plan, which is the essential ingredient, it seems to me, we all agree, of true tax reform.

Unfortunately, I think the same cannot be said for the President's tax package. It has a superficial and rhetorical appeal, but the more it is analyzed, the less attractive it appears.

Let me address my comments, if I may, to one key component in the President's tax proposal; namely, his proposal for tax on a tax. His plan to eliminate the deductibility of State and local taxes. I have several objections to the proposal.

First, the plan overturns or seeks to overturn the central idea at the heart of this Republic, that we are one nation, not 50 nations, and that we are stronger when we stand together and help each other than when we stand alone and fight each other. This plan, if it is enacted, would pit State against State and region against region. Nothing could have been farther from the goals of our founders when they created this Union.

Instead of coming up with a plan that treats all States fairly, the President has decided to pay for lowering tax rates by eliminating a deduction which is particularly valuable to the residents of certain States, which, for reasons beyond their control, have greater needs than others.

To justify this plan, he points out that the deductibility benefits, he says, 15 States more than it does 35 other States. He has asked why should 35 States subsidize 15 States? Let me answer with some questions of my own. Why do the residents of New Jersey help pay for farm subsidies used by Iowans? Why do Iowans contribute to mass transit in New Jersey? Why do people in Alabama help build dams in the Northwest? The answer is because in the Federal system we protect our own rights by recognizing the rights of others. We serve our own needs by helping our fellow members of this Republic meet their needs. That is the idea of our Republic system; not that each State and city and individual is on his own to sink or swim.

Let me remind everyone that if that were the case, if it were a matter of everybody sinking and swimming on their own, New York would do the swimming and others would do the sinking, because in 4 years, as Senator Moynihan points out, regularly we contributed $12 billion more to the treasury than we got back.

The other day I was on a television program with the Governor of Pennsylvania. He said, parroting the President's position that it's not right that the people of his State should subsidize the people of New York State. First of all, as I have just pointed out, no one subsidizes New York State. Moreover, I would remind him that just recently a ferocious tornado devastated western Pennsylvania and destroyed the town of Albion. Among others, the Governor of Pennsylvania immediately asked for Federal disaster assistance, and he got it. He was right to ask for it and it was right to give it to him.

The rest of this country has a stake in seeing that the people of Albion get a chance to rebuild their lives. Speaking for the taxpayers of New York, I say I would never, ever suggest that Pennsylvania should fend for itself against tornadoes. And in turn we in our State do not like being told that we are a drag on the other States when, in fact, as I have already said, we contribute more than we get.

We don't begrudge helping the victims of disaster, nor have we suggested seceding from the Union because we contribute more than we get from the Federal Government. For we understand that when a State is permitted to join this Federal Union, it cedes a portion of its independence to the larger Nation.

Government in a Federal system is a process of tradeoffs. Giving and taking in the interest of each of the parts and also the interest of the whole. It was never the idea of the founders that down to the last dollar a State should get back what it put into the system, nor that if at some point in time a State could not pull its own weight it should be left out in the cold.

We created a Union for a reason: To help each other and to build a stronger Nation.

Every great president has understood that basic principle. Lincoln said, "A house divided itself cannot stand." The most dangerous thing, it seems to me, about this President's tax program is that it would divide our house. It would split the family that is America into rival regions and hostile States. I regret this very much. I would prefer to see the President use his fundamental role as a leader to unify our people, not to set us one against another.

Second, the rights of the States. In 1862, when the Congress took up the very first Federal income tax to finance the Union Army, the chairman of the House Ways and Means Committee explicitly required that State and local taxes be deductible when computing Federal taxes. Senator Moynihan has pointed that out for all of us to see and to learn from. That tax quickly expired and it wasn't until 1913 that the Federal Government enacted a permanent income tax. And once again the deductibility of State and local taxes was assumed to be protected by the Federal income tax law. And it has remained so ever since.

That's why, for 72 years, every suggestion that there be a tax on a tax, a double tax, has been rejected, repudiated, until now. No one has even tried seriously to eliminate this feature of our tax law.

Why has the whole history of Federal tax law included the deductibility of State and local taxes? Because we have always believed in supporting State and local governments in their efforts to finance public affairs and provide services for the people. State and local governments are closer to the people they serve than is the Federal Government. And they can provide services more efficiently and less expensively than the Federal Government can.

Isn't that the principle of subsidiarity that even the President has spoken of? They also have a prior claim to revenue raising. States were financing public services, I would remind everyone, for 90 years before the Federal Government enacted the first Federal income tax law.

For all these reasons, State and local governments have a special role to play and I thought frankly that if anyone understood that role, it would be President Reagan. It was this President, after all, who launched the so-called New Federalism during his first administration by which he hoped to shift, he said, additional responsibilities from the Federal Government to State and local governments.

Today with his tax plan President Reagan would nullify New Federalism. He would make it harder, not easier, for the States and counties and cities and school boards to do the work they have to do, the work he wants them to do. The President is all for the rhetoric of States rights but he seems to want to take away the revenues that make these rights a reality. Not only does he take them away by cutting Federal assistance, but by impeding now the States' capacity to raise their own revenues as well.

In the last few days you may have read reports where the President and his spokespeople have employed what I have called, and I think fairly, demagoguery, in trying to explain this embarrassing inconsistency in their position. They were quoted as saying that the response of high needs States, this attack on their fundamental right to help themselves by putting a tax on their tax, should be responded to by the States by their cutting their taxes. And I have said that the President is suggesting, in effect, that he will excuse his failure to supply us bread and his interference with our ability to produce our own, by requiring that we starve altogether, as though there were no need for education, no need for housing, no need for police, no need for roads, for hospitals, for nurses to care for children with cerebral palsy.

Here is another stunningly, I think, irresponsible segment of the weekend quotes. It was said that the disallowance of the deduction is designed to hurt, and that was the word I read, to hurt the States who are trying to meet these needs because they are neo-socialistic. And also to keep women in the house with their children where they belong, instead of trying to help them provide for their children by working.

Now, if this isn't a new low, it is certainly going to be a tough record to beat. I take these specious arguments to be a measure of the President's position here, and, frankly, every day it becomes clearer to me that this is a position not based on the merits or history or fairness, but a hope that the American people can be fooled by simplistic and even ugly rhetoric, because that's what this was.

These recent statements make another point. They contradict what the President said was the basic rationale for reform. I think he claimed the tax system should not be used to make social policy. Don't they all say that. Now they say these reforms are desirable because they will force States to reduce services by reducing taxes.

The precedent is saying it will help create a new world in which the middle class and lower economic class will get less help, and according to the spokesperson, the plan would operate to encourage traditional lifestyles by presumably discouraging nontraditional lifestyles.

Whether you like it or not, and some of us I guess are traditionalists, that sounds like social engineering.

And I thought the President would pay attention to the testimony of a Governor that I know he respects admires and I think trusts. The Governor of the so-called high-tax State who, when he was elected, pledged to reduce State taxes because the polls told him that people wanted them lowered. And once elected, however, he was confronted by the needs of his people that were not being reasonably attended to and he felt compelled to raise taxes. And his first increase just happened to be the largest tax increase in the history of his State.

He explained his change of position by pointing out there was no other way that the people's reasonable needs could be met since the Federal Government was refusing to do its fair share for his State. He begged the people's understanding for his change of position, pleading that the need for services for his people was greater than the need for him to keep his campaign promises. That Governor's testimony puts the lie to this President's position today. His name, of course, Ronald Reagan, Governor of California, 1967 to 1974.

I wonder if the President has forgotten, or perhaps the truth changes when one enters the Oval Office. I wonder if he agrees with Buchanan that California is a neosocialistic State and its women should be made to stay at home, by the tax planners, where they belong.

For these two main reasons, the idea of our Republic and the rights of States under our Federal system, I would be opposed to this plan even if New York were a low-tax State. For these are questions of basic principles, and when it comes to the principles of our Government I think you should not contemplate compromise.

There is a third objection. The President uses the word fair more than any other in describing his plan. The truth is that it's fair only if the rich deserve to be treated better than the middle class. Those earning between $30,000 and $50,000 get a reduction of about 6½ percent, according to the Treasury Department calculations. Those earning between $50,000 and $100,000, 4.1 percent. And now everybody knows that by the time you get to the big hitters, over $200,000, they get a bonus for being already blessed. Apparently to give them an incentive to work harder, they get a 10.7 percent tax cut.

So that in 5 years the President will have managed to reduce the tax rate on our richest Americans by 50 percent. I believe that as middleclass Americans in my State learn this, they are becoming more and more unhappy with the plan, and I don't blame them. Apparently Mr. Rostenkowski and others who are looking at a fourth bracket, I am told, fourth bracket for the wealthy, they agree, and I think that's good too.

There is a fourth objection. And that is the practical consequences for high-need States like New York would be disastrous and unfair. Here in New York we have our own special needs, as you know so well. You have been working so hard to help us with them. And these special needs are not unlike the special needs of farmers in the Midwest or drought victims in the Southwest or tornado victims in Pennsylvania. Only I would argue that many of the burdens we carry in New York are in reality national problems, that we bear the burden of because the national Government, as President Reagan pointed out when he was Governor Reagan in 1967, has not done enough, has not done the right thing by us.

Here in New York illegal drugs add a huge burden to the cost of law enforcement. We pay for it in our taxes, in the cost of our prisons, in health care and unemployment, undocumented workers. We live on the ocean, undocumented workers pour through our ports and they put an additional strain on our prison system, and poverty puts a tremendous financial burden on our State and cities. And is there anyone who would deny that welfare is a national problem? In each of these cases, New York is contending with a problem that is national in dimension. Illegal drugs enter this country because the Federal Government has failed to interdict them at the border. Undocumented workers are here because the Federal Government has failed to write and enforce a sensible immigration policy. And poverty was long ago identified as a national problem requiring national solutions, including sound management of the Nation's economy.

So New York is paying a high price for national problems, and the Nation has a high stake, both moral and self-interest, in seeing that our State continues to carry essentially national burdens on State and local shoulders. It would be a disaster for all of the people of our State if we could not continue to bear these burdens, not just for the nearly one half of our residents who deduct State and local taxes, most of whom are not rich, but for the millions of beneficiaries of State and local services in New York. I think it would also be a disaster for the rest of the country if we were prohibited from providing these services. Caring for the poor, feeding the hungry, clothing the ill clothed, sheltering the homeless, these are national responsibilities. Human conscience does not recognize political jurisdictions.

This administration I think is counting on the indifference of people. I think they have miscalculated. I think the American people will not be party to penalizing those State and local efforts that try to help the middle class and the weakest among us wherever they live.

Now, these are the central issues. What does the administration say? They say, "it seems to me, and I hope not to be unfair, that regardless of whether it is fair or not we must eliminate the deductibility of State and local taxes because that's the only way we can come up with the $40 billion we need to pay for the lower tax rates." That's what Secretary Baker said when asked. He says it very clearly: "I will compromise on every part of this plan except deductibility." Why is deductibility so strong a matter of principle? So imperative a matter of logic? So much stronger than all the rest of it? It is pure pragmatism.

What does Buchanan say? "The purpose of the deductibility disallowance is for the revenue, but an ancillary purpose is to hurt those neosocialistic States." He admits two things: "It isn't a matter of principle, fairness; it is a way of where we grab $40 billion, get a way with it politically and at the same time work your only ideological will and configure and conform the soul of this Nation as you wish it to be. A nation with less government for people, a nation that leaves more to chance, a nation that leaves more to inscrutible fate that makes some of us strong and some of us not so strong."

That, it seems to me, is what Mr. Buchanan has now made clear. And I think this is increasingly a transparent and cynical argument. Of course, there are other ways to come up with $40 billion. The administration itself already has proposed some ways. As you know so much better than I do, the Treasury Department's first plan would have decreased the depreciation writeoffs by $68 billion by 1990. The President's plan changed that and would decrease those writeoffs by only $15 billion. So in six months the President's plan produced $53 billion. it didn't take a lot of ingenuity.

In other words, because of that corporate give-away, as some people would call it—that's conclusory but let's use the word anyway—Mr. Baker now says there is an arithmetic requirement to take away $40 billion—from whom? From middle income families, from local governments. He wants to cripple State and local governments and curtail service to our neediest people? And now Mr. Buchanan has told us that was the purpose all along, to require you to do less for your people because we think you should. That, at the same time, the people above $200,000 will get a 10.7-percent decrease and the people who do capital gains will be treated well.

There is an infinite array of possibilities for making up the money you need for restoring State and local tax deductibility. The hemorrhage from intangible drilling, depletion allowance amounts to $7 billion by 1990. The foreign tax credit, as Senator D'Amato has pointed out, may reach $30 billion by 1990. We can argue about the numbers but it is certainly somewhere in that range. If you cut out the deduction for corporations paying dividends, there is another $8 billion or so. Or you could add a fourth rate at the top, which people are talking about, and that would recoup many billions of dollars more.

What I am suggesting is that the President and Secretary Baker are wrong to allege that tax reform must depend on eliminating deductions for State and local taxes. Frankly, what it seems to me they are saying is: Look, this is our best bet politically. Let's make a handful of States pay for all the rest of us. Let's divide and conquer. Let's run against the minority. That's precisely what they are doing, and they do it unabashedly.

The administration says that only one-third of the taxpayers itemize their income taxes. But the fact is, as you know, more people use the State and local tax deduction than use any other deduction in the Federal Code. So if you want to play the numbers game, it's a very good game for our side. It is used by more people than the deduction for charitable contributions, but of course you will insist on that. Or medical expenses or home mortgage interest or the professional cost of the tax returns.

Over half of those Americans who use the deduction for State and home taxes have incomes below $30,000, and more than 87 percent of them have incomes below $50,000.

By contrast, only 7 percent of the taxpayers benefit from the capital gains exclusion. But what do you say to that, Mr. President? Well, they are important? Why? They will generate the engine of the economy. How about people who provide nurses for sick people in beds? How about roads and prisons, colleges that teach children to count and how to run computers, don't you need that in the national interest? Or is all you need an investment system.

Four percent use the foreign tax credit. Fewer than 1 percent benefit from the expense of intangible drilling costs. But, of course, we know that while we can do without educating our children, do without feeding the homeless in the interest of national security, you couldn't do without taking care of the oil companies, otherwise our national security will be jeopardized.

If the criterion for keeping a tax deduction is how many people benefit from it, then a deduction for State and local taxes wins hands down.

Let me put a final misconception to rest and I will conclude with this, and I thank you for your patience. The administration has said that this deduction is taken by only a third of all taxpayers. I have just pointed out more taxpayers take advantage of the deduction for State and local taxes than any other thing in the code.

I have been told, and I hope it's not true, although I see some evidence to confirm it frankly, that the President's advisers have instructed him to personalize his attack by running against our State, New York State. But he is not running against just New York. The reality is all State and local governments will be losers if this plan becomes law. Recent studies suggest the State and local governments will lose as much as 15 percent of their income. Governments around the country will lose the capacity to finance essential services. Low-income families all over America will be losers without these services. And every middle income family that sends their children to public schools or use public parks or relies on the police and fireman, drives on public roads, will be put in jeopardy by this proposal.

Now, of course, New York and New Jersey and Wisconsin and Minnesota and those other States where there are more than 40 percent of the American people—that handful of States that he would run against as the minority, overwhelming them with 35 against those 15, in those States are over 40 percent of the American people. Of course they are hurt disproportionately. But the President is running against even more of those States and all of their people. He is running against Lincoln's idea of the Republic. He is running against the intentions of the writers of the constitutional amendment that imposed the Federal income tax. He is running against 70 years of history. He is running against his own rhetoric and he is running against just plain fairness.

That's why not just New York is deeply concerned here; that's why the National Association of Counties, the National League of Cities, the National Conference of Mayors, and the National Association of State Legislators are among the many national organizations working to preserve deductibility of State and local taxes.

And members of both political parties have joined the fight. In this State the Republicans have been at least as clear in their opposition. So profound is that opposition that a person who can fairly be described as the head of the Republicans politically in this State, Senator Warren Anderson, and our good friend John Marchi, joined together to say this calls for a constitutional amendment. That's how profound an attack it is on the idea of the Republic. That's how far from a purely parochial concern this issue is.

We want true tax reform. This plan, I am sorry to say, is a ripoff, in my opinion, dressed up as reform. It would, I think, divide this country. It would certainly intrude on States rights. It would single out certainly people for relief and other people for pain, and that's not reform. That's retreat.

Thank you very much for listening.

Senator D'AMATO. Thank you very much, Governor. Let me thank you for your cogent argument. I have heard none better. Let me also say to you on the brighter side, I think that some of our colleagues in Government in the so-called low-tax States that might appear initially to be winners, have joined with Senator Moynihan and myself in cosponsoring our resolution that calls for the preservation of this deduction. I think as more begin to see how devisive and disruptive that particular provision can be, they will become more outspoken.

Although it may appear that this provision is for the overspending, overindulging, high-tax States, in time it will become evident that this is a devastating move. The only possibility of a compromise occurring would be if the Government agreed to support all social services for States.

Governor CUOMO. I would like to respond, if I may. I have been assiduous in my refusal to deal with any possibility of compromise. Let me tell you why. That's not a tactical position because I think any politician now who would count votes who say that we are behind. I think as you do that this is going to change as the American people focus on the discrete portions of this plan.

I can't bring myself to discuss compromise, even one that sounds as attractive as that one, because it denies me all the logic of my position. My position is that this is a fundamental constitutional concept. No matter how good a deal you make for the $40 billion today, you change the nature of this Republic when you say you can tax a tax. That's what Lincoln had in mind. That's what they had in mind when they wrote the amendment. That's what they had in mind when they ratified it. That's what they had in mind for 70 years. That's why no one thought to do it because it violates the essential predicate, which is at this time not a matter of tit for tat. It is not a matter of getting back everything. It is a matter of mutuality. It is a matter of family. It is a matter of sublimating yourself to the whole.

Otherwise the States ought not have created a Republic. If what the States wanted was a system where they got back everything they give, why make the trip to Washington? Why put it in an envelope, send it to Washington, only to get it back?

And so when people come to me and say Governor, you are taking a risk, I have had some commentators say this, that you may wind up with nothing here. It won't be I and the State; it will be the Nation that gets its Republic notion distorted.

So if you said we will give you $50 billion for the $40 billion, Governor, we will make a deal with you. What's deductibility worth to you? $2 billion? We will give you two and a half. I would have to say no to it because that's not the basic objection. So I can't compromise. It seems to me that you can't take the position I have taken and then say but we can compromise for a little relief or we can phase it in.

Senator D'AMATO. Let me put it another way. I am suggesting the absurdity of the position of forcing States and counties and local jurisdictions to undertake obligations from the Federal legislative perspective, with respect to social services and Medicaid and others, and then by the same token deny that State and local government the ability to raise those revenues unimpeded.

Governor CUOMO. There is so much here that needs saying and I hesitate to take your time. A couple of things that come to mind that weren't in the text that we wrote. The President is able to suggest to the American people, as he did over the weekend, perhaps those Governors ought to take a poll. Now he knows full well if you go to the people of this country and say how would you like your taxes reduced, of course they are going to vote yes. My mother would vote yes twice.

But if you said to them did you like the tax cut that the Federal Government gave you? They would say of course we like the tax cuts that the Federal Government gave us. Did you know it cost you a $200 billion mortgage, or at least contributed to that and they are asking your grandsons to take care of by not going to college or now they are threatening you with a cost of living increase and did you know that was part of the price for a tax cut? It is easy for the President to suggest a tax cut is something that easy to manage. He fails to point out that we weren't able nationally to manage a really big tax cut without putting ourselves in a terrible deficit situation. And at the State level I can't do it. I can't run a $200 billion deficit. I can't cut taxes and borrow all the money I need to make up for it.

Also it is very easy in the public's mind to make a high tax pejorative. Of course that stigmatizes us and that is the political strategy of those who would sell this plan against so-called high tax States. But when you ask them to tell Senator D'Amato and tell Senator Moynihan and tell the Republican and Democratic Congress people, Mr. President, what part of the services that New York is delivering would you cut back on? Because we have to go to our people and explain, Mr. President. Would you cut back education, would you cut back money for the homeless, which we still have more of than at any time since the depression? We are at the poverty rate with our welfare. It is barely above it with States ahead of us. Would you ask them to cut back on welfare for women and children? Mr. President, what do you suggest? What do you say to them?

When we ask the newspaper editors, who are so fond of talking about taxing, and when we ask even the different political parties in this State to come forward with suggestions for tax cuts, and I made that invitation this year, what suggestions did we get for cuts in my budget? I remember one Republican senator standing up and saying that we are spending too much money in this State, and at the New York Post Forum I invited him to my office with a list of the things that I should go to the leaders to withdraw from the budget. No list ever arrived and I never heard from him again.

So they can talk about high tax States. What they ought to do is send us a list of where they think we are luxuriating.

Senator D'AMATO. Let me suggest one thing, that I just happen to have a piece of raw data that came off a ticker tape. Apparently, it was a poll conducted by Media General, June 4 and 5. It was a national poll saying a majority of Americans don't want to give up their deductions for State and local taxes, but they support other major aspects of President Reagan's tax plan. Apparently, it goes on to say 61 percent oppose the measure and only 31 support it. That's with respect to deductibility.

Governor CUOMO. I have said over and over that I don't rely a whole lot on polls and I don't really believe in them, but I may have to develop a new wisdom here because that one sounds right.

Senator D'AMATO. Senator Moynihan.

Senator MOYNIHAN. Governor, just as a preliminary observation, last Friday Mr. Stockman gave to Members of the Senate the new estimates for the budget deficit, given the budget resolution the Senate had passed. And the $200 billion deficit, as far as the eye can see, is still as far as the eye can see. Using a more realistic set of GNP growth estimates, we are right back to the that intractable $200 billion deficit, which has become very clear.

Has it ever occurred to you that this great enterprise at tax reform is an effort to distract attention from the absolute failure of the administration to take care of its own immediate problems and responsibilities to the Nation, to the political economy of the Nation?

Governor CUOMO. Senator, I hesitate to make a guess as to the motivation but there is an interesting array of facts here. Everyone, it seems to me, agreed that the deficit was the first problem to be dealt with. Of course we didn't agree in the campaign year, last year, but after the election we all came to agree that the deficit was the major problem. Senator Dole, it seemed to me, was eager to attend to it at first. And not a whole lot has been heard about the deficit here recently.

Tax reform as a notion is a lot more popular than dealing with the deficit. There does appear to be on the surface of things an eagerness to talk about tax reform and a reluctance to talk about deficit. I think, and I wouldn't be surprised at people concluding that this is a kind of distraction from an otherwise unhappy scenario that they might have to deal with.

I think it is all for naught, however, because obviously you are going to be dealing with the deficit before much longer. You have to. You can't leave Washington without addressing it. And once you do that, then it gets a lot tougher to do tax reform for a whole additional set of reasons you pointed out yourself. As the plan is now written it may increase the deficit.

Senator MOYNIHAN. If I can say that if you take the economic growth projections that Mr. Stockman used on Friday and addressed it to the President's tax proposal, you add another $200 billion to the deficit in 5 years.

Governor CUOMO. Beyond that, the New York Times, and this is one of the great newspapers of the country certainly, they did an economic analysis that suggested there would be no growth until 1992 at the earliest, and then maybe 1.5—and even Secretary Baker—and that growth is a result presumably of this magic generating of the economic engine that was going to occur after the last great tax cut.

You recall we were told if you cut the tax $750 billion that would so inspire the entrepreneurs, that the economy would surge in such a way as to balance the budget in three years. They were off a little bit: $200 billion. What reason do we have to suspect that they are right about a 1.5 projection in 1992?

The only thing you are sure of is capital gains gets better treatment, people over $200,000 get better treatment, the President gets better treatment, the Governor of the State of New York, who does not make as much as the mayor of New York, I get $200. These things are for sure.

And I have a guess as to what is going to happen politically, Senator D'Amato out on Long Island. I was thinking about a property owner somewhere in Nassau being told the following: Joe, I have some news for you. Some bad news and vague news. Here is the bad news. You are going to lose your property tax deduction. He says: What do you mean? What are you talking about?

You know your property tax and then you get 40 percent back because you get the deduction? He said: but I needed that when I bought the house, maybe even when I had the baby I was figuring on that, and when I took the mortgage. We are going to take that away. However, the rest of the plan is going to treat you great. But where? The whole thing together. But can you be more specific? No, don't worry. Take my word for it. You are going to come out ahead.

He is going to have two things: One thing he sees for sure that's a negative and your word for the other one. How do you think—not you, Senator.

Senator D'AMATO. Not mine.

Governor CUOMO. Our word, the political word.

Senator MOYNIHAN. Thank you, Governor. No matter what anybody says, even if it is Pat Buchanan, it seems to me your lifestyle, I am sorry to say, is pretty traditional.

Governor CUOMO. Thank you.

Senator D'AMATO. We are going to go right on to our last panelist. Time is running short, Jean Rousseau, Merrill Lynch Capital Markets. Please proceed, Jean.

STATEMENT OF JEAN J. ROUSSEAU, SR., VICE PRESIDENT, MERRILL LYNCH CAPITAL MARKETS

Mr. ROUSSEAU. Senator, thank you. I have a tough act to follow, several tough acts.

Senator D'AMATO. Certainly.

Mr. ROUSSEAU. I speak from the perspective of the marketplace, the municipal bond market, where the capital needs of State and local governments are met, the capital financing projects that make government possible.

There are several ways to look at the effect of the loss of State and local tax deductibility on municipal bond issues and on the municipal bond market.

Simply put, they all come out very badly, damaging to all State and local governments. This may seem surprising because it has been said the State and local deductibility affects six or eight high tax States. But that's not true. It may be true that the tax paying citizenry of a low tax State are positively affected by this. But the State and local governments themselves, whether they are low tax or high tax, don't get any of the benefit of that bracket reduction. State and local governments are all affected negatively. Their ability to sustain, let alone to raise their tax rates, is impaired and, therefore, their ability to provide vital services and service their outstanding debt is reduced and the impact on their credit ratings and on the bond market is consequently sure to be negative.

In effect, this new proposal for the first time would treat income and property taxes paid by individuals to State and local governments as taxable income for Federal tax purposes. There would be no phase in and this would begin rather abruptly with calendar 1986 taxes. Allowing the deductibility of State and home property taxes paid by individuals has enhanced the stability of local taxing structures for thousands of general obligation issues by governments across the country. Political flexibility of State and local governments to raise tax rates during recessionary periods with temporary tax increases has always been viewed by investors as a strong credit feature of general obligation bond security.

If this change is enacted into law this flexibility will be eliminated or seriously reduced and investors will be concerned that many State and local government obligation bonds will have new vulnerabilities which could give you credit deterioration.

The more stable bond issuers would be dramatically reduced and a less stable financial environment would develop for many heretofore strong credits. Clearly in the future, bond investors would expect higher yields to compensate them for the higher risks thus created. In short, the loss of State and local deductibility would hurt the entire general obligation municipal bond market.

There are several different ways in which the negative effects can occur, several different levels, at the State level and also at the local level that this occurs. I won't go into them in detail. They are in my prepared statement. Let me say that in enumerating the vulnerabilities that are created in the market, the third that we come to is those that affect issuers which might not reduce their taxes as a result of the deductibility elimination. For them the tax burdens could dramatically increase vis-a-vis neighboring States and communities. In the long run those communities would be economically less attractive and their bonds could become of lower credit quality. That is the so-called high tax State problem. It is a problem, as all have agreed here, and it is a serious concern but please note that we put it third after all the concerns that affect all issuers in all jurisdictions, as has been discussed earlier.

In sum, we believe that the loss of State and local deductibility would adversely affect all municipal credits and therefore would seriously impair the municipal bond market at large.

[The prepared statement of Mr. Rousseau follows:]

PREPARED STATEMENT OF JEAN J. ROUSSEAU, SR.

The Effect on the Municipal Bond Market of Eliminating the Deductibility of State and Local Taxes

TODAY I WILL DISCUSS THE POTENTIAL CREDIT PROBLEMS AND NEW ELEMENTS OF UNCERTAINTY ARISING FOR THE MUNICIPAL BOND MARKET IF THE DEDUCTIBILITY OF STATE AND LOCAL INDIVIDUAL INCOME AS WELL AS PROPERTY TAXES ON FEDERAL TAX RETURNS IS REPEALED. THIS PROPOSAL WAS PUT FORTH BY THE U.S. TREASURY DEPARTMENT IN NOVEMBER, 1984, ADOPTED BY THE PRESIDENT IN HIS TAX CHANGE PROPOSAL TO CONGRESS THIS MAY, AND IS CURRENTLY UNDER CONSIDERATION BY CONGRESS. UNDER THE PROPOSED REPEAL, THE U.S. TREASURY IS PROJECTING $33.8 BILLION IN ADDITIONAL REVENUES BY 1988. THE PROPONENTS OF THE REPEAL CITE THIS AS A REASON FOR THE CHANGE AS WELL AS THEIR BELIEF THAT IT WOULD ALSO BE "FAIRER" FOR MOST TAXPAYERS.

ESSENTIALLY, THE PROPOSAL WOULD REVERSE A TRADITION LONG EMBEDDED IN INTERGOVERNMENTAL RELATIONS. UNDER CURRENT U.S. TAX LAW, INDIVIDUALS CAN

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DEDUCT THE FOLLOWING STATE AND LOCAL TAXES FROM THEIR TAXABLE INCOMES:

-- STATE AND LOCAL REAL PROPERTY TAXES

-- STATE AND LOCAL INCOME TAXES

-- STATE AND LOCAL PERSONAL PROPERTY TAXES (IN SOME STATES, PAYMENTS FOR REGISTRATION AND LICENSING OF AN AUTOMOBILE ARE WHOLLY OR PARTIALLY DEDUCTIBLE AS A PERSONAL PROPERTY TAX).

-- STATE AND LOCAL GENERAL SALES TAXES.

IN EFFECT, THE NEW PROPOSAL FOR THE FIRST TIME WOULD TREAT MOST INCOME AND PROPERTY TAXES PAID BY INDIVIDUALS TO STATE AND LOCAL GOVERNMENTS (I.E., THOSE NOT INCURRED IN BUSINESS RELATED ACTIVITY) AS TAXABLE INCOME FOR FEDERAL TAX PURPOSES. THERE WOULD BE NO PHASE-IN AND THIS WOULD BEGIN WITH CALENDAR YEAR 1986 TAXES. ALLOWING THE DEDUCTIBILITY OF STATE AND LOCAL INCOME AND PROPERTY TAXES PAID BY INDIVIDUALS FROM

THEIR FEDERAL TAXABLE INCOMES HAS ENHANCED THE STABILITY OF LOCAL TAXING STRUCTURES FOR THOUSANDS OF GENERAL OBLIGATION BOND ISSUERS ACROSS THE COUNTRY.

THE POLITICAL FLEXIBILITY OF STATE AND LOCAL GOVERNMENTS TO RAISE GENERAL TAX REVENUES DURING RECESSIONARY PERIODS WITH TEMPORARY INCOME, SALES AND PROPERTY TAX INCREASES, HAS ALWAYS BEEN VIEWED BY INVESTORS AS A STRONG CREDIT FEATURE OF GENERAL OBLIGATION BOND SECURITY.

IF THIS CHANGE IS ENACTED INTO LAW, BOND INVESTORS WILL BE CONCERNED THAT MANY STATE AND LOCAL GOVERNMENT GENERAL OBLIGATION BONDS WILL HAVE NEW VULNERABILITIES WHICH COULD RESULT IN SIGNIFICANT CREDIT DETERIORATIONS. THE MORE STABLE AND RELIABLE FINANCIAL RESOURCES CURRENTLY AVAILABLE FOR STATE AND LOCAL GOVERNMENT BOND ISSUERS COULD BE DRAMATICALLY REDUCED AND A DESTABILIZING FINANCIAL ENVIRONMENT COULD OCCUR FOR MANY HERETOFORE STRONG CREDITS. CLEARLY, IN THE

FUTURE, INVESTORS SHOULD DEMAND HIGHER YIELDS TO COMPENSATE THEM FOR THE HIGHER RISKS INVOLVED BY PURCHASING SUCH BONDS.

IN SHORT, THE LOSS OF STATE AND LOCAL DEDUCTIBILITY WILL HURT THE MUNICIPAL BOND MARKET. OUR CONCERN IS BASED UPON THE FOLLOWING:

FIRST, WITH STATE AND LOCAL GOVERNMENT TAXES NO LONGER DEDUCTIBLE FROM TAXABLE INCOME, MANY JURISDICTIONS RESPONDING TO LOCAL POLITICAL PRESSURES MAY VERY WELL BE FORCED TO REDUCE THEIR INCOME TAX AND PROPERTY TAX RATES. SUCH ACTIONS COULD RESULT IN BUDGETARY CRISES AND FISCAL SHORTFALLS, WHICH OF COURSE ARE OF GREAT CONCERN TO BONDHOLDERS. THE FACT THAT THE PROPOSAL IS TO TAKE FULL EFFECT ABRUPTLY FOR THE TAXABLE YEAR BEGINNING ON JANUARY 1, 1986 INCREASES THE LIKELIHOOD THAT SUCH BUDGETARY CRISES WILL OCCUR FOR MANY GENERAL OBLIGATION BOND ISSUERS. ADDITIONALLY, WITH FEDERAL REVENUE SHARING FOR LOCAL

GOVERNMENTS POSSIBLY BEING ELIMINATED AT THE SAME TIME, MANY STATES WILL BE UNDER PRESSURE TO INCREASE AID PAYMENTS TO THEIR LOCAL GOVERNMENTS. FOR THEM, 1986 COULD BE A DIFFICULT YEAR.

IT SHOULD ALSO BE NOTED THAT NOT JUST "HIGH TAX" STATES HAVE THIS VULNERABILITY. SOME STATES, EVEN THOUGH THEIR RESPECTIVE TAX BURDENS ARE LOW, ARE HEAVILY DEPENDENT ON INCOME TAXES FOR GENERAL BUDGETARY PURPOSES. THE SAME LOCAL POLITICAL AND ELECTORAL PROCESSES THAT HAVE KEPT THEIR TAX RATES RELATIVELY LOW MAY FORCE THEM EVEN LOWER IF TAXPAYERS CANNOT DEDUCT LOCAL TAXES PAID FROM THEIR FEDERAL TAXABLE INCOMES.

NOT ONLY ARE THERE SHORT-TERM CREDIT CONCERNS, BUT THERE ARE LONG-TERM ONES AS WELL. IN PARTICULAR, ALL STATES THAT LEVY INCOME TAXES COULD LOSE THE POLITICAL FLEXIBILITY OF BEING ABLE TO TEMPORARILY RAISE INCOME TAXES AS THEY TRADITIONALLY HAVE DONE DURING

PAST RECESSIONS. GIVEN THEIR RELATIVELY MODEST BUDGET SURPLUSES EVEN DURING GOOD ECONOMIC TIMES, THIS REPRESENTS FOR THEM A SIGNIFICANT LONG-TERM CREDIT WEAKNESS. INITIALLY, IT WOULD APPEAR THAT IN A RELATIVE SENSE THE HIGH TAX STATES STAND TO LOSE THE MOST. IN AN ABSOLUTE SENSE, HOWEVER, ALL STATE CREDITS BECOME WEAKER BECAUSE THEY LOSE A GREAT DEGREE OF FLEXIBILITY IN INCREASING INDIVIDUAL TAXES.

THE SECOND VULNERABILITY PRIMARILY AFFECTS GENERAL OBLIGATION BONDS THAT ARE SUPPORTED BY LOCALLY RAISED PROPERTY TAXES. THESE WOULD INCLUDE GENERAL OBLIGATION BONDS OF SCHOOL DISTRICTS AND SMALLER COMMUNITIES ACROSS THE COUNTRY.

MOST OF THESE LOCAL GOVERNMENT BOND ISSUERS ARE HEAVILY DEPENDENT ON PROPERTY TAXES AND HAVE LITTLE IF ANY ALTERNATIVE REVENUE SOURCE. THERE ARE USUALLY STATE CONSTITUTIONAL RESTRICTIONS THAT LIMIT THEIR REVENUE-RAISING ABILITY TO THE PROPERTY TAX. IF

THE DEDUCTIBILITY ISSUE IS ENACTED INTO LAW, LOCAL "TAX REDUCTION" FORCES COULD SUCCESSFULLY LOBBY TO REDUCE THE LOCAL PROPERTY TAX RATES IN THOSE COMMUNITIES WHERE THERE ARE LARGE NUMBERS OF HOME OWNERS WHO DEDUCT PROPERTY TAXES FROM THEIR FEDERAL TAX RETURNS. SUCH OCCURRENCES COULD CREATE SERIOUS FISCAL PROBLEMS AND SIGNIFICANT CREDIT PROBLEMS FOR MANY GENERAL OBLIGATION BOND ISSUERS. THIS IS PARTICULARLY THE CASE WITH LOCAL SCHOOL DISTRICT GENERAL OBLIGATION BOND ISSUERS, MOST OF WHOM ARE DEPENDENT SOLELY ON LOCAL PROPERTY TAXES FOR REVENUE.

ANOTHER RELATED CONCERN IS THAT THE ELIMINATION OF DEDUCTIBILITY COULD ALSO AFFECT NEGATIVELY THE ECONOMIC ATTRACTIVENESS OF RESIDENTIAL REAL ESTATE AND CONSEQUENTLY REDUCE LOCAL REAL ESTATE VALUATIONS. OF COURSE, THE TREND OF REAL ESTATE VALUATIONS IS A MAJOR FACTOR IN DETERMINING THE CREDIT WORTHINESS OF A LOCAL GENERAL OBLIGATION BOND. IT

SHOULD BE NOTED THAT A DOUBLE VULNERABILITY FOR GENERAL OBLIGATION BOND ISSUERS WHOSE COMMUNITIES HAVE SEASONAL AND TOURIST CHARACTERISTICS RESULTS FROM STILL ANOTHER PROPOSED TAX CHANGE. IF MORTGAGE INTEREST PAYMENTS ON SECOND HOMES ARE NO LONGER DEDUCTIBLE, REAL ESTATE VALUATIONS IN THESE COMMUNITIES COULD SUFFER THE MOST.

THE <u>THIRD</u> VULNERABILITY AFFECTS THOSE ISSUERS WHO DO NOT REDUCE THEIR TAXES AS THE RESULT OF THE DEDUCTIBILITY ELIMINATION. FOR THEM, THE TAX BURDENS COULD DRAMATICALLY INCREASE VIS-A-VIS NEIGHBORING STATES AND COMMUNITIES. IN THE LONG-RUN THEIR COMMUNITIES WOULD BE ECONOMICALLY LESS ATTRACTIVE, AND THEIR BONDS COULD BECOME OF LOWER CREDIT QUALITY.

THERE ARE YET OTHER WAYS TO LOOK AT THE EFFECT OF THE LOSS OF STATE AND LOCAL TAX DEDUCTIBILITY ON MUNICIPAL BOND ISSUES AND THE MUNICIPAL BOND MARKET. SIMPLY PUT, THEY ALL COME OUT NEGATIVE, OR DAMAGING TO

ALMOST ALL ISSUERS. THIS MAY SEEM SURPRISING, BECAUSE IT HAS BEEN SAID THAT STATE AND LOCAL DEDUCTIBILITY ONLY AFFECTS 6 OR 8 HIGH TAX STATES. THIS IS NOT TRUE!

IT MAY BE TRUE THAT THE TAXPAYING CITIZENRY OF A LOW-TAX STATE ARE POSITIVELY AFFECTED BY ELIMINATION OF DEDUCTIBILITY IN RETURN FOR A LOWER MAXIMUM RATE, BUT THE STATE AND LOCAL GOVERNMENTS - LOW TAX OR HIGH TAX - DO NOT GET ANY OF THE BENEFIT OF THAT BRACKET REDUCTION. STATE AND LOCAL GOVERNMENTS ARE ALL AFFECTED BADLY. THEIR ABILITY TO SUSTAIN, LET ALONE RAISE, TAX RATES IS IMPAIRED. THIS ABILITY TO PROVIDE VITAL SERVICES AND TO SERVICE THEIR OUTSTANDING DEBT IS REDUCED AND THE IMPACT ON THE BOND MARKET IS CONSEQUENTLY SURE TO BE NEGATIVE.

Senator D'AMATO. Jean, let me thank you. I am sorry that the media weren't here to get the thrust of your statement, because I think it is important to know that, once again, the homeowners would be impaired, because your statement goes into the essence of municipal financing.

So that consequently, those local borrowing costs will be increased as a result of the doing away with the deductibility for state and local taxes.

In an ongoing dialog on this subject, I would appreciate you submitting your statement in its entirety. Perhaps in the days ahead we can include teachers, school boards, and municipal governments from all 50 States in this discussion.

Mr. ROUSSEAU. Indeed, Senator. If I may add, as you certainly very well know, this is one of two very serious attacks on State and local governments which is embodied in the tax reform proposal.

The other restrictions on the ability of State and local governments to issue debt for public benefit purposes is something that I hope your subcommittee will look into.

Senator D'AMATO. We are going to have a specific hearing on that because there are a number of the States that I think will care very much about this.

Mr. ROUSSEAU. I would certainly be happy to help with that, too.

Senator D'AMATO. Thank you so very much.

This subcommittee stands in recess, with the thanks of the subcommittee to all who participated, including our strong and gracious reporter.

[Whereupon, the subcommittee recessed, to reconvene at 10 a.m., Monday, June 24, 1985.]

THE IMPACT OF REPEAL OF THE DEDUCTIONS FOR STATE AND LOCAL TAXES

MONDAY, JUNE 24, 1985

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON MONETARY AND FISCAL POLICY
OF THE JOINT ECONOMIC COMMITTEE,
Washington, DC.

The subcommittee met, pursuant to recess, at 10:15 a.m., in the Federal Court House, Rochester, NY, Hon. Alfonse M. D'Amato (member of the subcommittee) presiding.

Present: Senator D'Amato and Representative LaFalce.

Also present: Robert Salomon, legislative assistant to Senator D'Amato.

OPENING STATEMENT OF SENATOR D'AMATO, PRESIDING

Senator D'AMATO. Good morning. This is a hearing of the Subcommittee on Monetary and Fiscal Policy of the Joint Economic Committee. This hearing is being called to analyze the impact of the Treasury's plan to repeal the Federal tax deduction for State and local property, sales, and income taxes.

I would like to thank our distinguished witnesses for taking the time to testify today. Our first witness will be the Comptroller of the State of New York, Ned Regan. I am going to summarize my opening statement in the interest of time.

Repeal of this vital deduction will have a devastating impact on the education of our children and on our economy. What will the impact be in the Rochester area?

According to the IRS, in 1982 the people of Rochester deducted $90.7 million in State and local taxes and saved $1,093, on the average, from their Federal taxes. For these people, tax reform will be a euphemism for a tax increase.

Throughout the Nation, according to IRS data, over 33 million people will lose $35 billion from repeal of the deduction for State and local taxes.

Over 28 million—85 percent—of these people make between $22,000 and $40,000. These are middle-income families that cannot afford to pay more Federal taxes.

Treasury would force individuals to pay taxes on income already spent on State and local taxes. I call this double taxation. Since the current Tax Code was passed in 1913, individuals have been protected from the evils of double taxation.

But Treasury is not consistently against double taxation. Treasury would still permit the foreign tax credit to be used by individuals and corporations to reduce their U.S. tax liability.

For example, if a multinational company pays $100 million of taxes in Japan, this company can reduce its U.S. taxes by $100 million. Treasury allows this to avoid double taxation.

I define tax reform as trying to instill consistency to the Tax Code. I think double taxation is wrong in all cases.

Treasury, however, believes double taxation is wrong for companies that pay taxes overseas, but not for people who pay taxes to the Rochester school system.

Interestingly, Treasury spent months trying to devise a new and fairer tax system, but their final product is frought with contradictions.

Think about it. A company that pays taxes overseas would receive a full U.S. tax credit, but under Treasury's plan, an individual would not even receive a tax deduction.

This is disgraceful. Treasury claims that their purpose is neutrality in the Tax Code, but then they propose that people and corporations be treated differently.

On top of this, Treasury proposes that companies no longer incur full double taxation on the dividends they pay. This would be accomplished by allowing companies to deduct 10 percent of their dividends paid to stockholders from their corporate income.

By proposing this change, Treasury clearly has indicated its belief that double taxation of corporate dividends is evil, but if double taxation is evil for companies, why is it not also evil for individuals?

When Treasury admits that double taxation is wrong, they are right, but it is Treasury's thirst for additional revenue that has resulted in them ignoring this obvious contradiction and proposing repeal of the deduction for State and local taxes.

There is an important principle at stake in this debate: Is double taxation right or wrong? This is an issue for all the Nation, not just one or two States.

This is why I will vigorously fight any attempt to repeal the deduction for State and local taxes. Congressman LaFalce.

OPENING STATEMENT OF REPRESENTATIVE LaFALCE

Representative LaFalce. Thank you very much, Senator. I am delighted to be here today to hear testimony from my fellow New Yorkers and residents of my own 32d Congressional District on what has become the most controversial and fiercely debated proposal in President Reagan's tax reform plan: The elimination of the deductibility of State and local taxes from the Federal income tax.

This proposal is nothing less than a frontal assault by the Federal Government on the most essential power of State and local governments. It strikes at the heart of our Federal system.

Since the imposition of the first emergency Federal income tax in 1862, and since the creation of our present Federal income tax system in 1913, State and local taxes have been deductible from the Federal income tax.

Deductibility is an explicit recognition that income once taxed by State and local government should not be taxed again by the Federal Government. To do so, as recommended in the President's tax plan would subvert our Federal system of government in a most fundamental way and subject our citizenry for the very first time to double taxation on the same income.

There has been a lot of foolish talk in Washington recently, emanating from the White House, labeling so-called tax States such as New York "neosocialist" governments attempting to "redistribute the wealth."

This is such nonsense that it hardly merits a response, yet it betrays a misperception shared by many about the levels of tax collection and expenditure by States and localities.

It is commonly believed that New York and California, in particular, are high tax, high-spending, big government States. Yet according to the Bureau of the Census, the States with the highest per capita State and local tax collections in fiscal year 1983 were Alaska and Wyoming, not normally thought of as bastions of governmental activism.

Alaska and Wyoming were also the States with the highest per capita State and local government expenditures in fiscal year 1983.

My point here is not to hold the States up to ridicule. On the contrary, my point is to demonstrate the critical role each and every State and local government in our Union plays in the lives of our citizens.

The fact is that States like Alaska and Wyoming are able to raise and spend large amounts of revenue on a per capita basis, because they enjoy immense mineral resource endowments which they can tax.

These corporate taxes allow those States to impose relatively low income, property, and sales taxes on their citizens while permitting the State to enjoy high levels of public spending.

There is nothing wrong with this, but other States such as New York, which don't happen to enjoy those natural resource endowments, should not be penalized, much less branded "neosocialist" for imposing State and local taxes to meet essential public needs.

The fact is that New York is not collecting more taxes on a per capita basis than such States as Alaska and Wyoming, nor is it spending more on its citizens. The size of government is not the issue. The issue is the particular revenue base of the States.

It is important to note that corporate taxes such as severance taxes on minerals would remain deductible under the President's tax plan, whereas, income, property, and sales taxes would no longer be deductible.

In other words, States with rich natural resource endowments to tax will continue to enjoy deductibility, while the rest will be penalized. This is unfair and makes no sense.

I am submitting a list of the 50 States and the District of Columbia ranked by tax collections per capita and direct general expenditures per capita for fiscal year 1983 to set the record straight on which States are "neosocialist" and which aren't.

I would also hope that this kind of divisive, demagogic politicing on the deductibility of State and local taxes would come to an end and that the debate would focus on the merits of the issue. If that happens, I am confident that deductibility would be retained in the Federal Tax Code.

In hearings before the Subcommittee on Economic Stabilization of the House Banking Committee, which I Chair, spokespeople for the National League of Cities, the U.S. Conference of Mayors, and the National Association of State Budget Officers, representing States and localities from every region of our country, testified to the devastating effect the end of deductibility would have on State and local governments.

The elimination of State and local tax deductibility would raise taxes for the residents of every State and locality in America. The resulting pressures on State and local governments to reduce taxes would jeopardize the financial stability of many State and localities, and deny essential public services for people in need.

It could also result in a migration of taxpayers from high tax to low tax States, further eroding the tax base of States dependent on deductibility.

It is important to note that not only so-called high taxed States will be affected. Even States with relatively low income tax rates, for example, depend on those income taxes for a relatively high portion of their general revenue. Even a small reduction in the State income tax could have a major impact on the finances of the State.

Further, the costs to the States would go beyond the simple loss of tax revenue. Many financial analysts are concerned that pressures for cuts in State and local taxes could weaken the credit-worthiness of State and local governments and force them to pay higher interest on their bonds.

The additional costs could run into the billions. There could even be dangers of defaults.

Perhaps most troubling is the impact the elimination of deductibility would have on our public school systems around the country.

As a representative of the National Education Association pointed out in testimony before my subcommittee, approximately 36 percent of all State and local expenditures is earmarked for education.

Education is the single largest expenditure by State and local governments and it is usually the only one on which taxpayers vote directly. The pressures for spending cuts that would follow the end of deductibility would probably be felt most keenly by our school systems.

I am pleased to see that we have a representative of the New York State School Board Association here this morning who I am sure will address this critical aspect of deductibility.

There are many other points I could make this morning, such is the complexity of this issue. The fact is that deductibility of State and local taxes has been deeply woven into the fabric of our federal system of government since the inception of the Federal income tax.

To eliminate deductibility would be a violent assault on that system that would cause unknown upheaval and hardship. The fight to retain deductibility is a crucial one, both for New York and for our country.

I am sure the testimony from our distinguished witnesses this morning will provide us further ammunition in this fight.

I would now like to summarize just these following points. I am most anxious to hear the witnesses this morning so that both the Senator and I can gather additional information, additional facts, additional arguments to make our case even better than we have made it in the past.

Based on the knowledge that I have accumulated thus far, it seems to me that we ought to be opposed to that provision of the President's tax reform proposal that calls for the elimination of deductibility of State and local taxes for a great many reasons.

First, I don't think that it reforms the system at all. As a matter of fact, since I have been studying the issue of tax reform, and this goes back to at least my school days in the early 1960's, no one would advance the concepts of tax reform calling for the elimination of the deductibility of State and local taxes. When we were talking about tax reform, we were all talking about something decidedly different.

When individuals included the elimination of the deductibility of State and local taxes, it really caught everyone as a surprise. Never before have we equated elimination of the deductibility of those taxes and the subsequent tax reform.

Second, it is a direct violation of the principles of Federalism, of our citizens and of two governments, State government and Federal Government. In order to have that Federal Government a pact was entered into among the States.

One of the crucial issues that was discussed at the time of the formation of our Union was whether there wouldn't be double taxation of the citizens. We didn't have a Federal income tax then, so that was a relatively simple problem to solve.

We did adopt the amendments to the Constitution permitting Federal income tax explicit in language and implicit in being a concept of Federalism and the Constitution. At the time it was the notion that we before taxing our dual citizens, we being the Federal Government, we would exclude from the taxable base that amount of taxes paid by our dual citizens to the other levels of government, State and local governments.

Now, we are about to violate that in a most flagrant way for the very first time. People call New York State bastions of neosocialism. I think that is most unfair. If you look at the general revenues per capita raised by State and local governments, if you look at the general expenditures per capita by State and local governments, you then come up with some interesting statistics.

For example, New York State's general revenue per capita is approximately $1,800. Wyoming's is $2,400. Alaska's is $4,900. You can hardly call Alaska and Wyoming bastions of neosocialism.

If you look at direct general expenditures, you find New York State is approximately $2,700. You find that Wyoming is almost $3,600. You find that Alaska is almost $8,700 per capita. Those individuals making that argument it seems to me are either ignorant or unfair or both.

Now, they always mention the impact on public education. That is something that I would like to stress. I think although all levels of government are going to get hit hard that public education is probably going to get hit the worst. This is something that we do have to deal with across the 50 States where you have States and local taxes as the primary means of financing public education.

Virtually—I shouldn't say all—I would say almost 90 percent of the school districts in this country have their budgets voted on directly by the citizenry. This is the only place where the local citizenry can have a direct voice as to what their budget will be other than these elections that have to go through the principles and concepts of representative democracy here in America such as we have gone through, Senator D'Amato, myself, the State legislators, local councilmen, et cetera.

In the school budget they vote directly. When they vote for a school budget they invariably vote for a tax increase. Intuitively, it seems to me that you are going to have an avalanche of school budget defeats across this entire United States, because people are going to be far less likely to vote for increases in taxes when they know that those taxes will not be deductible as they previously were, when they knew that those taxes were deductible.

So, of all of the levels and forms of government, I think that education is going to be hit the hardest on this. This will conclude my opening statement. I look forward to hearing from the witnesses that the Senator will call.

Senator D'AMATO. Thank you, Congressman.

Our first witness is the Honorable Ned Regan, comptroller, State of New York.

STATEMENT OF HON. NED REGAN, COMPTROLLER, STATE OF NEW YORK

Mr. REGAN. Thank you very much, Senator, Congressman LaFalce, ladies and gentlemen. First, I would like the record to show that its been Senator D'Amato that's been the lead in New York State in fighting this. I note from personal knowledge that it was the Senator that first organized Governor Cuomo and myself and Senator Moynihan to speak jointly on this in December; and then it was the Senator that organized business groups under the chairmanship of Lou Rudden and Amery Houghton of Corning to lead a bipartisan fight in this. We do owe the Senator a debt of our thanks and a debt of gratitude for his leadership in this.

Now, I am for Federal tax reform. I am for the elimination of shelters and contrivances and the elimination of phony deductions are going to be good for this country and good for this State; and it is going to be good for the economy of Rochester.

I think that getting a dollar invested into a job or into a machine rather than into a phony shelter is now encouraged by the Tax Code. It is going to be good for business, especially the technology-orientated business of which the Rochester area thrives on. It is going to be a healthy thing.

I also believe that cutting taxes as President Reagan proposes up to a top of 35 percent, which is going to save us net, save us money, is also a good thing, but the loss of deductibility will be particularly harmful for New York State and the loss of deductibility of our State and local taxes will hurt both our economy and our governments and school districts.

First, our economy. While everybody's taxes are lowered under the President's plan, and lowered significantly, the disparity between New York State and others will grow.

Now, State government has made a couple of attempts, not enough by opinion, but a couple of attempts to cut taxes; so that the difference between ourselves and the State of Connecticut and ourselves and the Southwest have started to narrow a bit, but under this bill they will widen because those areas where we have in the past have lost our jobs to, in those areas they do not have high State and local taxes. They have very little to lose. The tax and disparities between ourselves, New York State, and our economic competitors will widen and it will hurt our economy.

Business men and women are rational people. They will make their moves, their expansions, their contractions where it benefits the bottom line. This bill is not going to benefit New York State because the bottom line will look different here than it will in the South or Southwest if the deductibility of State taxes is eliminated.

Second, an of particular concern to me as the State's chief fiscal officer and as the fiscal monitor of our local governments, I am very concerned about a fiscal destabilization process that I see occurring with the sudden loss that deductibility will have on our State. As Congressman LaFalce mentioned, once the individual realizes that those taxes that they see when they open a curtain to vote on a school budget or that those taxes that they get from their county in the tax bill or their village or their town or their city or their State are no longer going to be shared by the Federal Government, are no longer going to be deducted, are no longer going to be cocooned, are no longer going to be sheltered by the Federal Government, I then predict a very sudden and a very swift reaction.

I have likened it to a proposition 13 environment or a Massachusetts proposition 2½ environment. We do not have initiative and referendum in this State. Maybe as a result of not having it, the voters and the taxpayers of this State have never really spoke to it in a dramatic way about the level of spending and taxing in this State both at the State and local levels.

Well, my guess is they will hear. In one sense, one can say that it is healthy. If it comes without our fault and if it comes as a result of a Federal bill and if it comes in a rush where school district budgets are voted down and where the mayors and the county executives, those people that are close to the people that see that everyday, they are going to feel pressured and respond to a reaction, a sudden, swift reaction of the voters and taxpayers if the deduction is lost.

To protect the fiscal stability, to protect the school districts, we must continue to have our partner. We must continue to be allowed to deduct our Federal and our State and our local and our school taxes.

We have had a partner for 72 years. There's been no hint or suggestion ever under any tax reform bill, as it's just been pointed out, that the partnership would be terminated. We have relied upon that partnership for better or for worse.

Every single spending decision made in Albany, many of them mandates back down to the county level, every single spending decision made in Albany has been made knowing that at least for the great majority, for the majority of taxpayers, those that deduct, that that spending decision which led to higher taxes would be shared by the Federal Government.

Maybe all of those decisions were not good over the last 20 years. Maybe many of them were good. However, that doesn't make any difference.

They were all made in 100 percent reliance on the fact of a partnership, a partnership with the U.S. Government through the form of the ability to deduct those taxes associated with those spending decisions to deduct them on the Federal tax form each and every year.

That partnership cannot be terminated. That is why I applaud the fight that the Senator and the Congressman, Senator Moynihan and Governor Cuomo, and all of the other State officials and Federal officials representing New York State are going through. I salute them for it.

Let me conclude on the notion that I do not endorse—this is no suggestion that I endorse everything that New York State has done to itself or has forced local governments to do by way of spending on taxes. When this fight is won, Senator, I think that it is going to be won because of you and the people that rallied around you. I am going to tell, as I do now, the Governor and the legislature and the locality that there has been a warning shot fired across our bow.

We can't expect you to defend us every year like this. I know the business in Washington, not as well as you do, but you are trading in chips. You're asking for favors to defend New York State and its local government.

We can't ask you to do that every year. We can't ask you to carry on a fight like this once every 10 years.

So, it is up to us to get our house in order so that the next time when somebody comes at us again then we don't have to come to you and have you carry on this fight. In the meantime, you are carrying on the fight and I thank you for it.

Senator D'AMATO. Thank you, Comptroller. Let me, if I might, make two observations. One you stated most accurately.

It is absolutely incumbent upon our State legislature, its leaders, and our Governor to continue to reduce the tax burden that our people now pay. This has been something going on far too long, that is, the overtaxation.

I know that it is easy to talk about in a demagogic fashion. I don't do it in a demagogic fashion, but rather one in which I applaud the States efforts for beginning to reduce that tax burden. We need more of it. Unless we do, we will make it impossible for jobs and people to stay in this great State.

We should not be deluded by the momentary flushes of success in terms of economic growth that have taken place. This can quickly disappear. We want to enhance it. We want to build on it.

Certainly, it would make us much less the target than we should be. I applaud your efforts in that area. I raised this matter with the Governor. I think that he understands it.

I think that his initial step and that of the State legislature is a good one. I think that we can do more to reduce those burdens. It becomes so essential that we in the Congress can convince our colleagues that we are serious and purposeful and that we are not looking to Washington for the bail-out, so to speak, but that we are doing it and committing our efforts to getting Government spending under control on a local level as well.

I would like to ask just one thing, that is, if you could do an analysis for the Congressman and myself and for this subcommittee with respect to what you calculate the loss of deductions to mean to the individual taxpayers of New York.

Mr. REGAN. We have got those figures.

Senator D'AMATO. Would you be able to supply them? We will keep the record open for the next ten days.

Mr. REGAN. Oh, sure.

Senator D'AMATO. I think that becomes very significant.

Second, if you could give us an analysis, because I think that you touched on something, in terms of the increase in disparity of taxes being levied between States. Instead of leveling off, we create a greater burden. That is the kind of information that would be very useful to this subcommittee.

Mr. REGAN. We have got some information on the latter item, not as good as I would like, but we do have some information. Everything that we have seen indicates—we will get it into the record—it very clearly indicates that the disparities widen. We've got some good figures on that.

We have got some very clear figures on the loss—back to the first suggestion—on the loss of deductibility. A loss of deductibility is, of course, offset by the lowering of margin of rights so that in effect the net going to Washington would be less though. Of course, compared to any other State, we don't benefit as much because the disparities widen. We have got that.

My arguments about fighting this loss of deductibility suggested that even though we pay less total, but if the bill were to pass just like it is today, that these harms that would come about from the loss of deductibility to our economy and the fiscal stability of our school districts in my opinion far offset the less amount of Federal taxes that we would pay and the other States are all better served anyways. We will get you the numbers.[1]

Senator D'AMATO. Congressman LaFalce.

Representative LAFALCE. Thank you very much, Comptroller.

Mr. REGAN. Thank you very much.

Senator D'AMATO. I am now going to ask our second panel to please come on up, which consists of Monroe County, county executive, Lucien A. Morin; mayor of the city of Rochester, Thomas P. Ryan; and Donald J. Riley, supervisor, town of Greece and also chairman New York State Urban Towns Association.

Good morning, Mr. County Executive, how are you?

Mr. MORIN. Good morning, Senator D'Amato. Good morning, Congressman LaFalce.

Representative LAFALCE. Good morning, Mr. Morin.

[1] The information to be supplied for the record was not available at the time of printing the hearings.

STATEMENT OF LUCIEN A. MORIN, COUNTY EXECUTIVE, MONROE COUNTY, NY

Mr. MORIN. Senator D'Amato, Congressman LaFalce, my name is Lucien Morin, and I am the Monroe County Executive.

Thank you for this opportunity to address you on the topic of proposed changes in the Federal tax laws, specifically the impact of repeal of the State and local tax deduction on Monroe County and its residents.

While I applaud efforts toward simplification of the Federal tax laws, I strongly believe that the elimination of these deductions would have a serious detrimental impact on the citizens of our county, as well as on Monroe County government and all local municipalities.

By eliminating deductions for State and local taxes, the Federal Government is, in a very real sense, placing a tax on a tax. People are being asked to pay taxes on income that has already been spent on State and local taxes.

In addition, the average taxpayer in Monroe County would feel the impact of this change much more drastically than his counterparts in other areas of the country.

When compared with taxpayers in States with no or low State and local taxes, the Monroe County taxpayers will be asked to pay a larger percentage of their income to the Federal Government.

For example, the average county resident will pay $1,800 in property and school taxes in 1985, assuming he owns a home with an assessed full value of $76,000, which is an average property value in Monroe County.

If we assume that the resident also has an income of $22,000 (which is an approximate average county income based on slightly inflated data from the most recent U.S. Census) and a total of 4 dependents, he will also pay $1,650 in State income tax and $402 in sales tax. This brings the total of his State and local taxes in 1985 to $3,850.

Under present Federal income tax guidelines, this amount will be fully deducted from his taxable income.

However, the Treasury proposal would not allow this deduction. Assuming no other allowable deductions, and even including increased standard deductions, his income would be taxed in the 15 percent income bracket.

In other words, he will be asked to pay the Federal Government 15 percent of the amount he has already paid to State and local governments.

Although it is difficult to state exactly how much the Treasury proposal impacts his actual Federal income tax payment, it is easy enough to see that he will have a Federal income tax liability that is $580 greater than that of a resident with the same income and little or no State or local taxes to pay.

For some homeowners, the loss of these deductions could mean the end of home-ownership. Certainly, for those who are faced with recent average sale prices of homes in Monroe County—$43,777 in the city of Rochester and $75,601 in the surburban areas of the county—buying a home is out of the question when taxes can no longer be deducted.

The deductibility of property taxes, a deduction which has been in the Tax Code since its inception, has helped many citizens to afford home ownership.

For homeowners, the elimination of this deduction could turn the "American dream" into a financial nightmare.

For many young families, and for those whose income is lower than the average in this area, wishing to own a home, the "American Dream" becomes even more elusive a dream.

There is another serious problem inherent in this proposal, one that attacks the very way our Government is structured.

Throughout the Treasury proposal, the deduction for State and local taxes is referred to as a Federal subsidy. It is a convenient myth that the Federal Government has been asked to subsidize local programs.

In reality, most of the program costs borne by Monroe County are mandated by the State and Federal Governments.

Historically, it might be interesting for your subcommittee to examine the record on how New York State may have been subsidizing other States over the many years.

If Monroe County taxes are higher than counties in other areas of the Nation, it is because its needs are greater. A significant number of county residents are poor and/or elderly. Our aging infrastructure must be maintained and improved. Our larger population puts a greater strain on our services.

For example, according to New York State Department of Commerce projections, the number of county residents 65 and older is expected to increase to 99,450 by the year 2000, to nearly 15 percent of the total county population.

The responsibility to support the elderly and the poor is a national concern. This surely is not an example of the Federal Government subsidizing a local problem.

The Monroe County budget reflects the very real demands of providing services to the citizens. There are no luxuries being supplied our residents. There is no pool of expendibles which can easily be cut from the state or local budgets.

Rather than providing frivolous services, as suggested by the President, Monroe County is overextended just to meet basic needs. Sixty cents of every dollar in the county budget is for human service programs, the vast majority which are mandated by the Federal Government.

The remaining 40 cents per dollar is spent to meet other essential services, again not luxuries.

Monroe County government daily faces the battle of providing the services needed in this community without continually raising taxes. We look hard and long to creative solutions and innovative approaches to resolve local problems and also reduce the cost of government.

For example, in an effort to improve quality care and control rising health care costs, Monroe County is providing health care for individuals and families on public assistance through the Medicap Program.

This cost-containment effort is the first in the country to provide health care with HMO's instead of fee for service.

First-year savings, reflecting the startup population of those in the Aid to Families With Dependent Children and Home Relief categories only, are estimated to approach $1 million.

Monroe County is reflective of urban areas throughout the Northeast—the ones to be hit hardest by this proposal. We recognize that our costs are higher than those faced by counties in other areas of the country.

We are also vividly aware that we can neither cut services nor raise taxes in a wholesale manner in order to provide for the poor, the elderly, the handicapped or children who depend on our services.

To tackle this dilemma, Monroe County has developed an aggressive economic development program to increase our self-sufficiency and broaden our tax base. The loss of these deductions for local taxpayers would thwart our attempts to attract new businesses to the county.

Monroe County could not continue to compete with lower taxed communities for new industries and jobs once the disparity between their taxpayers and ours widened. Our determination to convince existing businesses and citizens to stay here would be undermined.

Creative solutions and fiscal belt-tightening cannot compensate for the havoc that would result from eliminating the deduction for State and local taxes. The Treasury proposal would provide only an illusion of relief, by merely shifting collection responsibility from Federal to local levels.

Taxpayers who have no other deductions to report—no business expenses, no taxes paid to foreign governments, no stock losses—are the vast majority of those who now itemize their deductions. They will simply not have the money to support State and local governments once their Federal tax bill increases considerably. They will demand relief. From where will this come?

In New York State, it can only come from a shifting of responsibility downward—a game of fiscal musical chairs, where eventually everyone is left standing.

The most ironic result is that this shift will come at a time when the Nation seems most concerned about the quality of our education system.

I shudder to think of what will happen to local school districts when, faced with decreasing Federal, State, and local support, they present their budgets to the voters.

Traditionally, local school budget votes have been the only forum citizens have to directly voice their opinions on taxation. Schools will become the frontline combatants in this war to determine who shall get the taxpayers' money.

In other words, the net result of the Treasury's proposal would be that the cost of providing local services would go up at a time when the Federal government wants to shift more responsibility down.

Schools, public safety services, local roads, the poor, and the elderly would feel the impact most. But eventually, everyone in the county would suffer as the very base of local economy would be undermined.

As the issue of tax reform is debated in Congress, I strongly urge you to reject any proposal which includes the elimination of deductions for State and local taxes. For any viable tax reform plan to be effective and equitable, it must preserve the deductibility of local taxes.

Senator, Congressman, I certainly appreciate the opportunity to express the sentiments of the county administration as well as the county legislature today. I commend both of you for your strong leadership positions on this particular matter.

We stand ready to back you and support you in any way that we can. I thank you very much.

Senator D'AMATO. Mr. County Executive, let me thank you for one of the most cogent presentations that I have heard to date. I have attended Congressman LaFalce's hearing that he started in Washington. Ways and Means has taken testimony. I have heard presentations.

Yet, I think that you go right to the nub of what it does to the working, middle-class families here in Monroe County and what it does to home ownership. Your analysis creates a greater disparity between classes of people that live in different areas of this country.

I find your statement interesting with respect to the burden that is thrust upon local governments, particularly as it relates to social services, which 60 percent of your budget is coming from—this aspect deserves very, very careful attention by the Congress. Particularly, Congress must examine the continued ability of State and local governments to meet their mandated responsibilities.

While we say cut spending and cut taxes, there is no one in Washington saying that we will undertake the funding of these responsibilities. You must cut your taxes, but we are going to diminish your taxing ability and capability to pay for the programs that we mandated upon you. It just doesn't add up. You put it in a most cogent presentation.

Mr. MORIN. Thank you, Senator.

Senator D'AMATO. Next, Mayor Thomas P. Ryan, Jr., city of Rochester.

STATEMENT OF HON. THOMAS P. RYAN, JR., MAYOR, ROCHESTER, NY

Mayor RYAN. Thank you, Senator D'Amato. Good morning, I am Mayor Thomas P. Ryan, Jr., I'd like to welcome you to the city of Rochester and to thank you for the opportunity to comment on proposed changes in federal tax law.

The major cities of our Nation have faced, and continue to face, major losses of Federal assistance.

As dramatic as these losses have been, an even more insidious threat results from the proposal to eliminate Federal tax deductions for State and local taxes.

It is widely recognized that such an action would have drastic effects in New York State. It should also be recognized that within New York State, the effects will be most heavily felt within the major cities, where tax burdens are the highest.

Our city's taxpayers, for example, bear a property tax burden which is the highest of any jurisdiction in Monroe County, and which exceeds the metropolitan median by nearly 50 percent.

In terms of local property and sales taxes alone, the loss of deductibility would create an additional Federal tax burden of approximately $46 million on the residents of the city of Rochester.

This, of course, would be in addition to the dramatic effect of the loss of deductibility for State income taxes.

What is most disturbing is the insensitivity with which these changes are being proposed. Virtually no studies were undertaken by the Federal administration of the impacts of these changes on the Nation's local governments.

Instead of detailed studies and valid information, President Reagan has substituted vague and ill-informed attacks on "high tax" governments.

The underlying assumption made by the President is that high State and local tax burdens result not from the demands of needy citizens, and the social conscience to meet these demands.

Instead, the President has simply assumed without research that our State and local governments are fat, or corrupt, or both. Mr. President, you are wrong!

A few statistics will serve to illustrate why we must respond to our citizens' needs. In the city of Rochester, nearly 27 percent of our school-age children live at or below the poverty level; 17.5 percent of all residents live in poverty; 26 percent of our residents do not have access to motor vehicles; our unemployment rate is double that of the surrounding suburbs; and our citizens' income is the lowest in our metropolitan area, equaling only two-thirds of the area median.

In light of these realities, there can be little surprise that our tax burdens are high, to support public education, public safety and other vital services.

While the President's tax proposal is touted as a benefit for the poor, this is a simplistic viewpoint. Although the loss of deductibility of State and local taxes will initially impact middle and upper income taxpayers, there can be little doubt that it will be the poor who, in the long run, are hurt.

Deductibility has been a critical factor in the willingness of middle and upper income groups to support progressive State and local tax structures.

The loss of deductibility will seriously undermine this willingness, resulting in either demands for lower State and local taxes, or flight to lower tax localities. In either case, the poor will be hurt.

Lower tax revenues will result from either reduced rates or eroded tax bases, which in turn will force reductions in service levels. The poor will be hurt directly through reductions in income maintenance programs, and less directly through reductions in vital services.

Urban poverty is a legitimate explanation for high tax burdens, but we do not use it as an excuse.

During my 11 years as mayor, our budget has been scrutinized, studied, examined, and audited relentlessly. This review has been conducted by business leaders, citizens, other governments, and most importantly, by ourselves.

We have achieved a noteworthy record of efficiency and economy. Our productivity efforts have allowed for a reduction in the municipal workforce of 23 percent.

These efforts, combined with modest employee wage increases, selective service reductions and innovative financial management, have produced spending growth well below the level of inflation.

Another troubling aspect of the proposed tax code change is the inconsistant policy direction implied by it.

The current Federal administration has reduced aid to localities dramatically—employment programs, community and economic development, crime control, education aid. And the proposed 1986 Federal budget contains even more significant cuts—general revenue sharing, community development, urban development grants, housing, transportation.

The underlying philosophy behind these changes has been to "turn back" to local governments the responsibility for such needs. And yet, the elimination of state and local deductibility would sabotage this philosophy by penalizing those who respond to the call, and rewarding those who ignore it.

Federal tax reform may be meritorious, but to penalize state and local governments at the same time as the Federal Government is washing its hands of its social responsibilities is unfair and unwise.

Perhaps at the local level we see more clearly the problems of America's needy. At virtually every city council meeting, citizens implore us to help them overcome the problems of unemployment, housing, and crime.

Unfortunately, we have had to cut services to meet budgetary constraints. We have closed schools, libraries, recreation centers and police and fire facilities.

We have 7,200 citizens waiting for public housing and increased public transit fares place a significant burden on our poor.

I have said that the proposed changes are unfair and unwise. They are unfair because they will further encumber State and local governments in their efforts to respond to the needs of the poor. They are unwise because the problems of the poor are real, and cannot be ignored indefinitely.

I would like to thank you, Senator D'Amato, for holding this hearing. You and Governor Cuomo are to be congratulated for your active opposition of the tax proposal.

Also, I would like to take this opportunity to publicly thank you for your support of other issues of concern to the city of Rochester, and particularly for your active role in our Main Street Transit Mall project.

Senator D'Amato. Thank you, Mayor. I want to thank you for your presentation, and again, the troubling aspects that you outlined in your presentation are ones that I know cause great concern to Congressman LaFalce and myself.

I think that we can make a difference as we speak to our counterparts and you, County Executive Morin, Mayor Ryan, and Supervisor Riley, you can speak to your counterparts in bringing these problems to light.

They impact us a little more severely. They certainly impact the ability of the Federal Government to meet the basic responsibilities, not frills, not high-spending, but those basic responsibilities that you have outlined. Thank you again, Mayor Ryan.

Mayor RYAN. Thank you, Senator. Thank you, Congressman.

Representative LAFALCE. Thank you, Mayor.

Senator D'AMATO. Next, Supervisor Donald J. Riley.

STATEMENT OF DONALD J. RILEY, SUPERVISOR, TOWN OF GREECE, NY, ON BEHALF OF THE NATIONAL ASSOCIATION OF TOWNS AND TOWNSHIPS

Mr. RILEY. Good morning, Senator. Senator D'Amato and Congressman LaFalce, it is indeed a pleasure to appear in front of you this morning. Let me assure you local governments throughout the State of New York and throughout the country are greatly appreciative of your efforts and leadership in challenging the proposed elimination of deductibility.

As you know, I am the supervisor of the town of Greece, NY, a suburb of Rochester. This morning I appear on behalf of the National Association of Towns and Townships.

The National Association of Towns and Townships, as you know, represents both large and small communities across the United States in some 20 States with over 13,000 local governments.

If I may, I would like to present the statement in its complete form for the record, but in the interest of time, and hopefully in the interest of focusing on some of the issues this morning, I would like to simply make a half a dozen or so points.

I chair the State Coalition of Urban Towns [SCOUT] of the New York Association of Towns and am an active member of our State association and National Association of Towns and Townships [NATaT].

NATaT, as you know, is the only national organization representing the interests of towns and townships nationwide. Towns and townships are a unique form of general purpose local government—different from counties and municipalities. They exist in 20 States and according to the U.S. Bureau of the Census, serve areas without regard to population.

Therefore, most townships tend to be rural in nature. In addition, the National Association of Towns and Townships represents small, and oftentimes rural governments in nontown and township states.

While I represent one of the larger towns in New York, I am very sensitive as well to the tremendous impact that losing the deductibility of State and local taxes would have on the smaller towns in New York, particularly as 903 out of 932 towns in New York State serve 40,000 people or less.

Therefore, it is on behalf of all 13,000 towns, townships and small government members of NATaT, home to 40 million Americans, that I appear before you today.

While President Reagan's proposed tax reform is aimed primarily at simplifying the numbingly complicated federal tax system, it also addresses needed reduction of the Federal deficit.

The National Association of Towns and Townships certainly agrees that the deficit must be reduced. The Nation's economic goal is sustained growth with continued low inflation and reductions in unemployment.

Our unprecedented deficits threaten this goal, raising real interest rates and making the dollar's value in international money markets artificially high.

To reduce the deficit, NATaT supports an across-the-board freeze on all Federal spending, using by 1986 as the basis for determining budget authorities, and a more concerted effort, administratively and legislatively, to simplify the administration of the Federal Government and cut administration costs.

Senator D'Amato, your Senate Resolution 82, preserving the Federal reduction for State and local taxes, has the strongest support of the National Association of Towns and Townships.

Simplification of the tax system and reduction of the Federal deficit must not be accomplished at the expense of fairness—and ending the State and local tax deduction just isn't fair.

It isn't fair to the millions of Americans who itemize. For the first time since the inception of the income tax system in 1913, the Federal Government would tax the income such individuals pay out in state and local income and property taxes.

It isn't fair to local governments, like Greece, which rely on these federally deductible taxes for their revenue. Eliminating this deduction hits our residents like a property tax hike, yet the town government doesn't see that money: It goes to Washington.

The President's elimination of the State and local tax deduction would have broad economic and social effects that go far beyond mere tax simplification.

Repeal of deductibility would make home ownership unaffordable to millions of Americans, and would penalize families that bought their homes, the biggest investment a family makes, under the existing tax system.

The financial health of State and local governments would be compromised, and services would be cut. School districts reliant on property taxes would face sharp resistance to any proposed budget increases, this at a time when the baby boom's children are just beginning to swell student populations.

Especially in areas with concentrations of poverty or other populations in need, the State and local taxes of these families are not discretionary or optional ways they choose to use their income. They are locally designed means to handle local problems that the Federal Government addresses less and less.

Especially with the proposed end of Federal revenue sharing, taxpayers in these jurisdictions deserve to have the deduction for State and local taxes preserved, and toward that end, I reiterate NATaT's support for Senate Resolution 82.

In New York State alone, 8.5 million workers live in towns. That growth and development continues unabated. As you know, Senator D'Amato and Congressman LaFalce, I represent one of our largest towns for a number of years as supervisor, the town of Greece.

Development of housing is a major industry. It also though is the largest investment that a family will ever make during its lifetime. The elimination of the deductibility of State and local taxes will seriously abridge the development of housing in our communities throughout the country.

Of these 13,000 communities that I represent this morning, some 40 million Americans called those towns and townships home. Not since 1913 has such a challenge to the very fabric of those communities been so significant.

I may add with the threatened elimination of revenue sharing, Senator, the National Association of Towns and Townships graciously expresses its appreciation and thanks to you in leading the fight in preserving general revenue sharing. This is a double whammy, so to speak. It is also added by the burden that the New York State Legislature has granted, that is, of exemptions either for senior citizens, and most recently for the veteran's tax exemption.

So, New Yorkers in towns and cities and other municipalities are not looking at the inability to deduct taxes as a way of getting some repayment for that investment in their communities' local governments, but are now faced with a property tax that is starting to look like a piece of swiss cheese.

The senior citizen and veteran's tax exemption in my community alone costs us $200,000 in loss of revenue.

I may also add that it is our belief that the elimination, the elimination of State and local deductibility is really the death knell of the very fabric of federalism, coupled with the elimination of Federal revenue sharing.

Now, let me put in the record the official position of the National Association of Towns and Townships relating to some 13,000 municipalities in some 20 States, which is to give your resolution total and unreserved support in your efforts to preserve the deductibility of State and local taxes. No one has to tell Senator D'Amato about local governments because that would simply be redundant.

I am at your disposal for any questions or comments that you might have. We greatly appreciate the opportunity not only to represent local New Yorkers, but also those Americans who live in municipalities, in towns throughout the country, and to give you the official and complete support for your efforts to preserve the deductibility of State and local taxes.

Senator D'AMATO. Supervisor, let me thank you for your presentation not only on behalf of the residents that you officially represent in your capacity as the supervisor of the town of Greece, but also for forging the alliance that you have with those supervisors here in the State and nationwide.

For the record, I might say that someone once said to me why do you want to have these local representatives come in? You know what they are going to say. You really don't.

These aspects now allow us to further broaden our perspective and we will get the opportunity to get some of our colleagues to focus in on this. Something that I have not focused in on really is what this elimination does. It also places, it seems to me, a double whammy on a special group of citizens that we have acknowledged nationally, and those are the veterans.

Mr. RILEY. Absolutely.

Senator D'AMATO. Those that are disabled.

Mr. RILEY. Absolutely, yes.

Senator D'AMATO. Those that we have recognized should get a special tax status. If we no longer have the deductibility of State and local taxes, what then takes place to that preference that they are given? Do we not endanger that severely? How will you be able to continue to provide for the exemptions, partial, and in some cases more than partial, for senior citizens and the veterans' groups. The two groups are then placed in peril.

If you have to raise the revenues for your school districts, for the towns, and for the cities, I would have to ask the three of you then what would you do to make up for the loss of revenues and the increasing pressure that might be placed on you? Would one of the areas possibly be to no longer provide the exemptions that you provide for senior citizens and for veterans in your local governments?

Mr. RILEY. If I may, Senator, you do focus correctly. The concept of that was to allow the veterans, the Vietnam veterans to get into homes. While we supported it, even though it was costly for local governments, nevertheless, that was an important group. That elimination wipes it out, it makes the effort on the part of the legislature meaningless.

Senior citizens are on fixed incomes. It wipes out their efforts to stay in modest homes. They will be simply moved out of their homes by the elimination of this deductibility. It will cause a crisis at the local level, the likes of which we have never seen.

Presently in New York State there is a major crisis on insurance in many municipalities, that is, if they can get the premiums, and they have quadrupled. It gives me the distinct impression that the advisers of the President are completely unfamiliar with the way that local governments raise revenue.

Representative LAFALCE. First of all, I would like to associate myself with the remarks of Senator D'Amato and bestow praise on all three of you. I think that it's been outstanding testimony. That is what we do in Congress when we don't want to repeat ourselves when 34 other Members say that we want to associate ourselves with the remarks that preceded me.

I just want to point out, Supervisor Riley, something that you have said as you testified not on behalf of Don Riley, not only as supervisor of the town of Greece, but you are testifying also as a spokesman for the National Association of Towns and Townships.

Mr. RILEY. 13,000.

Representative LAFALCE. That is right. Which underscores a point which I think is very important. This is not a New York State issue. This is not a New York State or a California issue. It is not a high State tax issue. This is a national issue.

Now, when Senator D'Amato testified before the Subcommittee on Economic Stabilization of the House Banking Committee that I chaired, we had representatives from the National Association of State Budget Directors and every single State budget director in the United States has gone on record in opposition to this provision, the National Conference of Mayors, National League of Cities, National Governors' Conference—you name it.

Now, let me give you a little area where I disagree maybe. I am not one that philosophically believes that we ought to give particular exemptions to the individuals particularly because of age, because of nominal service. I am a vet, too. I served from 1965 to 1967. I am a Vietnam veteran.

Second, since 1972, when we had the cost-of-living increase for senior citizens, their cost of living has gone up in comparison to the rest of the population at a far greater rate than any other portion of the population at large. I really do think that this is beside the point, but since it was raised, I want to bring it out; that is, we ought to be looking at a broadening of the base as much as humanly possible with the most progressive type of tax system that we can devise so that individuals would be taxed on ability to pay rather than some aid status that they happen to have.

Mr. RILEY. If I could just respond. We support Senator D'Amato's bringing together an alliance, a very unusual alliance. It is healthy and great to see it. If Governor Cuomo and the legislature exempts the property tax and gives us little or no option to invoke it——

Representative LAFALCE. The local governments do have the option to invoke it or not to invoke it. Legally, you can vote "yes" or you can vote "no." Can you not?

Mr. RILEY. Yes, that is right. There are certain motherhood issues that you generally support at the local level and share at the congressional level. The question is the political will.

Senator D'AMATO. Thank you. We want to thank our three panels. Are there any concluding remarks or points that you want to make?

Mr. RILEY. Just quickly, Senator, the National Association of Towns and Townships did have internal debate on it and because of your leadership and others, they have decided to be so strongly behind its support. These are some States that have some advantages with the new proposal. It was, again, because of your leadership that they have decided to strongly be behind its support. We thank you.

Senator D'AMATO. Thank you very much. We thank you for your time and for your thoughtful presentations that you all made. Thank you, gentlemen.

We are now going to call our third and final panel which consists of Gordon Johnson, executive director, Citizens Tax League of Rochester and Monroe County; John Riedman, president, the Riedman Corp., vice chairman, Rochester Chamber of Commerce; and Louis Grumet, executive director, New York State School Boards Association.

Mr. Riedman, thank you very much for your participation today and that of the chamber's.

STATEMENT OF JOHN RIEDMAN, VICE CHAIRMAN, ROCHESTER AREA CHAMBER OF COMMERCE

Mr. RIEDMAN. Thank you very much for the opportunity to speak before both you and Congressman LaFalce.

John Riedman, vice chairman of the Rochester Chamber of Commerce. My comments regarding the President's proposal to eliminate the State and local deduction for individuals will be brief and to the point.

While we agree with the President's desire to put our Nation on an ascending spiral of business formation, job creation and technological innovation, the elimination of the deductibility of State and local taxes is going to impede that goal in our community.

We recognize that New York State is a high-cost State and have worked with others to reduce its personal income tax. We are working with the New York State Business Council to focus upon State spending. We feel that despite New York State's special needs, that is a high percentage of the Nation's poor, its spending can be brought into line with other States. This would alleviate the present State and local tax burden.

However, in the interim, our businesses must have skilled workers, both technical and managerial. Recruitment and retention of these people will be extremely difficult if they are confronted with the admittedly heavy State and local tax burden that exists here, without the capacity to deduct those taxes from their Federal taxes.

New Yorkers already pay out $12,000 million more to the Federal Government than is returned. So, it isn't that we're not paying our fair share to Washington. If State and local deductions are removed from the Tax Code, New Yorkers would pay $400 billion more in taxes. This comes in the wake of a plan to reduce aid to New York by $1,400 million in the next Federal fiscal year.

This hardly seems fair.

By allowing the deductibility of State and local taxes, we are not saying to the respective governments, spend freely. They should be prudent about the ways and means they raise and spend our money. While the Federal deficit should be reduced, the Congress might look to its own house first before it puts the squeeze on our community and State.

Thank you for this opportunity to express our point of view.

Senator D'AMATO. Thank you very much. We appreciate the time that you have taken to come and be with us this morning.

Mr. RIEDMAN. Thank you very much.

Senator D'AMATO. Mr. Gordon Johnson.

STATEMENT OF GORDON JOHNSON, EXECUTIVE DIRECTOR, CITIZENS TAX LEAGUE OF ROCHESTER AND MONROE COUNTY

Mr. JOHNSON. I am Gordon Johnson, executive director, Citizens Tax League of Rochester and Monroe County.

In presenting his proposal for revision of the Federal Tax Code, President Reagan has stated that his recommendations will reform and simplify the current unwieldy and complex taxing system.

We find that his attempts at reform create as many inequities as the present code and a plan that requires 461 pages of explanation can hardly qualify as simplification.

One of the major points stressed by the administration is the substitution of the three bracket tax rates—15 percent, 25 percent, and 35 percent—for the current structure of rates that gradually increase from 11 to 50 percent in 14 steps.

There is nothing complex about the current structure and we find it much more equitable than the proposal which would have the $30,000 annual earner paying the same tax rate as the $69,000 taxpayer, and the taxpayer earning $70,000 would be in the same tax bracket as the one making $10 million or more.

The administration states that most individual taxpayers would receive some tax reduction but the lowest decrease would be in the middle income bracket.

Reducing the maximum rate from 50 percent to 35 percent and decreasing the tax on capital gains will result in lower taxes for those with higher incomes, thus, again, we will have a system that places the higher burden on the middle-income taxpayers.

A prime example of complication rather than simplification is the "recapture" provision affecting allowable depreciation of assets used by business and corporate taxpayers. Reversing the trend of allowing faster writeoffs on business assets—a definite incentive to increasing capital spending—the new provision not only lengthens the period of asset life, but, also requires business to pay tax at 46 percent on income sheltered in prior years from depreciation charged in accordance with the 1981 law.

The most controversial and unfair provision to New York State taxpayers is the proposal to eliminate the deduction of State and local taxes on income, real estate, and retail sales.

The loss of this deduction would not only substantially increase the tax liability of New York State taxpayers but it would also have a devastating effect on the economy of the State.

The public education system could seriously be impacted by this action. Taxpayers would not be amenable to voting approval of school budgets containing increased property taxes when that tax payment would not be deductible from Federal income taxes.

Reduction in new housing and sale of all real estate could result from this provision. The inability to deduct the property tax and the threat of further decrease in the allowable deduction for interest payments will surely affect real estate sales.

While we express our concern for the inequities of the proposal for individual taxpayers, several provisions will adversely affect business and the country's economy.

Cuts in corporate tax rates will benefit some business, but the changes in the depreciation rates and the elimination of the investment tax credit could outweigh the benefit of the lower rates.

It is difficult to understand the administration's position on these items. In the 1981 revision, depreciation allowances were accelerated and the investment tax credit increased to 10 percent in some instances. This action provided incentives for capital investment with the accompanying increase in employment.

The change in depreciation, the elimination of the investment tax credit along with the recapture provision will surely have an adverse affect on business spending for capital expansion.

Giving all consideration to the inequities and the complexities of the President's proposal, we find that the major fault of the plan is the failure to address the impact on the ever-increasing Federal deficit.

As a result of the 1981 tax reduction without decrease in spending, the deficit has tripled in 4 years to over $220 billion.

We express our concern that if the President's plan is adopted with no apparent plan for meaningful spending cuts, the deficit will continue its upward spiral.

The economy of our country, our business and industry and our position in world trade cannot withstand this type of financial planning. The efforts of Congress must be directed to adoption of a financial plan that will place the first priority on balancing budgets and reduction in the Federal deficit.

Senator D'AMATO. Mr. Johnson, let me ask you what your perception of the code is as it treats foreign tax credits and gives to corporations and individuals the ability to deduct their tax burden to the United States that they have paid to a foreign government. In other words, do you see an inconsistency when we are saying double taxation is not appropriate for corporations and individuals who pay taxes to foreign governments, but it will be something that is brought about for the first time against American citizens who pay taxes to the 50 States and local governments?

Mr. JOHNSON. We see a strong parallel. We see a strong inconsistency there. I am glad to see that you brought it up.

The inconsistency is there with our reservation, that is, our opposition to the elimination of local taxes.

Senator D'AMATO. Well, it seems to me to be another inconsistency whereby in the code and in the tax proposal, they call for eliminating the burden on corporations and double taxation of dividends and they propose to begin to eliminate 10 percent of that. If it is wrong to double tax dividends and it is acknowledged in Treasury 1, they went to great lengths and actually talked to eliminating up to 25 percent of that, then why is it wrong or equally wrong to have double taxation for people that pay taxes to local governments?

Mr. JOHNSON. I don't say that it is equally wrong. I think that it is wrong to give the credit for the payment to foreign countries.

Senator D'AMATO. Interestingly, the last figure that we have in 1980 indicates there was $22 billion worth of foreign tax credits that individuals and corporations took, almost the same amount of money that could be raised by the State and local deductions. I am not suggesting at this point in time that we seek repeal of that provision.

I would have to say if we are going to force people to pay double taxes, then it would seem to me that certainly if you are paying double taxes to a foreign government that that law should be rule of thumb and should be applied evenhandedly.

Mr. JOHNSON. It is a good point, Senator. I am going to get to the bottom line very quickly. We represent individual taxpayers and businesses alike. We are concerned as to what they are doing.

We don't think that the corporate taxpayer is going to make out that great, frankly. We have proposals to reduce the corporate rate. We have a feeling if you throw out the investment credit, which was a proper incentive for taxpayers, if you change the depreciation, then I don't think that it is going to overcome the deduction in the corporate rate.

What our true concern is, and I think that we had the history from 1981, we are for tax reduction. That is our very name. We are also for better financing our government.

You know better than I that the deficit has tripled in the last 4 years. We are facing a Federal deficit of over $220 billion.

Somehow we have the feeling that the individual taxpayer is going to get some relief at a higher and lower level and perhaps corporate will, too. We see a substantial loss to the Treasury, and also, an ever-increasing Federal deficit. That truly bothers us, too.

Temporarily that will save the interest payments that the Federal has to make, something like $16 billion. I am not belittling $16 billion. I think that it is a drop in the bucket as a loss of revenue to the Treasury. I am really concerned about that.

Representative LAFALCE. Mr. Riedman and Mr. Johnson, I want to thank you for your testimony. I think that it was excellent. You make a number of interesting points.

First, I think that we are faced with the enormous budget deficits that we are confronted with today, not for the rest of the decade, but as far as I can see, as far as I can envision. It seems to me that we ought to be talking about a reduction of expenditures and on increasing of revenues in order to reduce that budget deficit and to bring us back to some semblance of fiscal sanity.

Increasing revenues does not mean increasing taxes. It can simply mean broadening the base without increasing any individual or corporate tax rates.

If you are going to talk about revenue, then you want to talk about it honestly rather than dishonestly. It seems to me quite clear that the proposal that we have seen is a dishonest approach and virtually every official, every economist who has studied the issue indicates that this plan is not revenue neutral, but it is a revenue loser. It is a revenue loser as it exists today.

It will be more as a revenue loser as it proceeds down the legislative path not simply because Congress is likely to cave in more than the President caved in from Treasury 1 to Reagan 1, but because there are so many things that were included within the President's plan, which by definition will not be passed.

You mentioned it, both Mr. Johnson and Mr. Riedman. You didn't mention that you are praying for it; that is, the recapture provision. Anybody who has availed themselves of accelerated cost recovery regardless of the effacacy or fairness of AFCIS has to shudder over the thought of having to come up with tax dollars based on the depreciation taken from 1981 to the present despite the fact that it would require no taxable consequence in order to pay that tax.

In other words, if you don't sell the property it will be recaptured. You will write a check based on the depreciation taken from 1981. It is the first time in the history of the Republic that any administration has even proposed some type of retroactive tax of this nature.

It is so inherently unfair, so patently unfair to do this that I don't think that anybody gives it a chance of passage at all. That would raise $60 billion of revenue over the 5 or 6 years and unless you make changes on the other side it is going to add to the net revenue loss once you eliminate that position.

A couple of other points that were raised that are worth repeating; that is, your emphasis on the unfairness of going to a system where you have basically three rates; that is, 15, 25, and 35. I want to underscore that because I think that we have prided ourselves during this 20th century on the proficity of our income Tax Code despite the fact that we think that it can be improved.

We, nevertheless, have the most progressive, equitable tax that I have been aware of. From the time that the Tax Code was enacted at the beginning of the century, individuals, certain individuals have denounced it because of its proficity. They said that we need a flat tax rate.

Now, we are attempting to have a flat rate tax under the guise of reform. When in reality, the modified flat tax is simply another way of describing a more regressive or a less progressive tax.

The President did let the cat out of the bag when he was in Europe when he made a comment to some reporters in Spain. He said what we need in the United States, he said what we are seeking is a less progressive tax. That is what we are confronted with when we go from the 14 or 15 tax rate to a 1 or 3 depending on the plan. I am glad that you pointed that out.

Another thing that is worth underscoring that Treasury 1 said that we question the wisdom or effacacy of the special treatment of capital gains and because of that fact we are suggesting that we treat capital gains as ordinary income after indexing for inflation. Not only did the President's proposal reflect Treasury 1, but the President's proposal said 20 percent as a maximum capital against tax is not good enough. We are going to reduce that effectively to 17½ percent.

Mr. JOHNSON. Congressman LaFalce and Senator D'Amato, we commend both of you for your approach on this issue. We do appreciate your letting us speak on the broader part of the tax. It is extremely important what you are doing on that depreciation.

Senator D'AMATO. Mr. Johnson, let me ask you this: What is your group doing outside of the Rochester area? Are you part of the National Taxpayers Association?

Mr. JOHNSON. No. We are a local organization. I believe they have been in existence since 1935. We have monitored Government expenditures as those three gentlemen that were up here a few minutes ago. Last year we were very helpful to one of their proposals.

We examined the State budget. We do not get involved in Federal affairs too often. We cannot spread ourselves too thin.

Senator D'AMATO. Thank you very much. Let me just ask the question of Mr. Riedman with respect to the chamber of commerce's position that you have articulated here on behalf of the Rochester Chamber of Commerce. Have you made any contact with the National Chamber of Commerce expressing your reservations?

Mr. RIEDMAN. We have not.

Senator D'AMATO. I assume that can be an undertaking that you will consider?

Mr. RIEDMAN. I would assume, yes.

Senator D'AMATO. I think that is terribly important. Mr. Johnson, let me say before I let you out of the hot spot, I think that your observations, particularly as they relate to other aspects of the code, would be wise for us to examine. It seems to me that we want to encourage investment, job creation, expansion. There was tremendous support overall for the 81 proposals.

That is not to say that there might not have been some errors that we attempted to adjust, say, the Harbor Leasing as it was applied in certain cases. Overall that had a very stimulating effect encouraging investment, jobs, plant expansion, et cetera.

There are certain provisions of this bill that would seem to indicate that no longer do we feel that the investment in heavy industry and other activities, economic activities, should be a priority of this government. It might seem almost that if this proposal was enacted in its present form that it goes in to encouraging consumption at a time when many in our economic community are saying that we need more in the way of investment incentives, et cetera.

I will give you my perspective. When people take surveys, they kind of say we are opposed to what we perceive to be unfair aspects, whether it be wealthy individuals or corporations that have large earnings that pay a very small percentage of their taxes. Do you support a real minimum tax on individuals and corporations—I don't want to mention any particular companies—for example, one that earned $6 billion over 3 years and didn't pay a penny. That is the thing that gets so many citizens angry.

I haven't run into citizens that are saying we pay too much, but rather they say, we will pay our fair share of taxes but everyone should pay his or her fair share.

Would you propose a minimum corporate tax as a method of achieving that fairness?

Mr. JOHNSON. We have given it a great deal of thought. That would be the easy way. In lieu of a positive approach, I would say at this point we would favor a minimum corporate tax.

Now, the other approach is the same where the individual would favor a flat or a minimum personal tax. I don't know whether we would or not. We can get into that area then.

Senator D'AMATO. Wasn't that deal with the great body of opinion that says why is it that individuals and corporations that have this kind of income and earnings, why are they allowed to shelter albeit for good purposes. There has been no stronger defender of industrial revenue bonds, municipal bonds than this Senator.

Having said that, isn't it time to reach a point that we will say that everyone regardless of utilization of investment techniques that we acknowledge are important for this country must pay a certain minimum?

Mr. JOHNSON. I think so, Senator. I was going to get into that point about the individual, the individual who could today have two or three shelters.

Senator D'AMATO. The Congressman's suggestion is if their income is at a certain level. We are talking about those glaring examples. We are talking about those wealthy individuals or corporate America that represents a certain income.

Mr. JOHNSON. The individual taxpayer can have a $500,000 income from tax free bonds, so there should be a tax on tax free securities of some type. I don't know the answer. I have been aware of the need to sell the tax free bonds and I know the incentive there. I don't know the answer to that one.

I appreciate what the Senator is saying. We are all concerned about a corporation making revenues in the billions and paying very little tax. The code must need some revision and if a minimum tax is it, then that is it.

In New York State we lived for years with a franchise tax that had a minimum. We kept raising that minimum. Perhaps that is the answer.

Senator D'AMATO. I don't know if it's broad-based enough. It is a step in the right direction. I think that cries out for our attention. It motivates so much of the calls from the individuals and people to develop a fairer code.

I think that this Senator is hard-pressed. I cannot reasonably define a situation where we have glaring examples. Let me liken it to some of the Government spending in certain areas which comes home vividly. I am going to talk about the defense area. I think that there was a basic acknowledgment throughout this country, particularly when the President first came to this office, of the need to see to it that there was a viable and strong defense.

Certainly, nothing undermines that necessity as these outrageous cases and examples of what we hear about, like $12,000 for the coffee-maker or the $4,000 for some other items or $600 for a hammer. That destroys the concensus for that national defense.

I think there is an analogy when working middle-class families are paying 22, 23 percent of their adjusted gross income and then they see an example where corporate America pays no taxes at a particular period of time. That is a thing that gets people's blood boiling and they say that this system is unfair.

We must do something in this area. If we raise revenues from them, we can use the revenues in one of two ways. I am not suggesting which one it should be.

One, as you outlined and as Congressman LaFalce suggested, by broadening the base to use those revenues to reduce the deficit coupled with strong fiscal measures and also restraint in spending. Second of all, perhaps we should increase the personal exemption for people to deal with the marriage penalty as we call it for two workers. There seems that something should be done regarding that. That again brings about a fairer kind of a system or at least it deals with some of the economic problems that would seem to me to be the area that we should be moving into as opposed to saying let's do away with deductions of State and local taxes.

I have to differ with my colleague. We don't differ, however, in terms of the motivation of those who propose doing away with it. Mr. Buchanan's theory was developed thereafter. It was a simple expedient of how do we raise enough revenue to pass out all of those nice goodies and to lower the tax bracket so that we can build public support for it? That is how they came up with it.

Who's going to fight for it and bring on a practical level of the kind of things that will take place? If you are against this, then you are against pro-growth, you are not American. You are not wanting fairness. That is the battle cry.

Now, having said that, this Senator is going to conclude his remarks by saying one other thing. Again, I think that it is terribly important that we do the best for the people at the local level and begin to work to reduce the tax levels in the State, because we cannot kid ourselves that unless we do that there will be a continued erosion of jobs and expansion.

At the very least, we will not meet our potential and be fair to our people if we continue a policy that neglects to focus in on this

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now. The legislature and the Governor made a good start. I would hope to think that they would continue to reduce those levels and share with the citizens of the State the economic growth and the prosperity by devoting a portion of those revenues to reducing the tax burden. I think that it will pay great tax dividends.

Congressman LaFalce, do you have anything else?

Representative LaFalce. No, Senator.

Senator D'Amato. This subcommittee stands in recess. Thank you, gentlemen.

[Whereupon, the subcommittee recessed, to reconvene at 10 a.m., Monday, July 15, 1985.]

THE IMPACT OF REPEAL OF THE DEDUCTIONS FOR STATE AND LOCAL TAXES

MONDAY, JULY 15, 1985

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON MONETARY AND FISCAL POLICY
OF THE JOINT ECONOMIC COMMITTEE,
Washington, DC.

The subcommittee met, pursuant to recess, at 10 a.m., in the Legislative Office Building, Albany, NY, Hon. Alfonse M. D'Amato (member of the subcommittee) presiding.

Present: Senator D'Amato.

Also present: Robert Salomon, legislative assistant to Senator D'Amato.

OPENING STATEMENT OF SENATOR D'AMATO, PRESIDING

Senator D'AMATO. Let me start this hearing and our first panelist witness will be Warren Anderson, majority leader, State of New York Senate.

This is a hearing of the Subcommittee on Monetary and Fiscal Policy of the Joint Economic Committee of Congress. This hearing will analyze the impact of the Treasury plan to repeal the Federal tax deduction for State and local property, sales, and income taxes.

I would like to thank our distinguished witnesses for taking the time to testify today.

Repeal of this vital deduction will have a devastating impact on the economy, not only of our State, but I believe throughout other regions of the country.

The area of the economy that will suffer the most, I believe, is the housing industry. Middle-income families have most of their life savings tied up in their homes and these savings represent the accumulation of a lifetime support. Loss of the property tax deduction will immediately reduce home values and, thus, the equity in homes.

How much will housing values decline? Answering that question is one of the purposes of this hearing. We don't know precisely, however, the impact of the loss of the State and local tax deduction on individual's Federal income taxes. We have a better idea.

According to the Internal Revenue Service, in 1982 the taxpayers of the city of Albany deducted $21.6 million in State and local taxes and saved an average of $449 from their Federal taxes. For these people, Treasury's tax reform is a euphemism for tax increase.

The impact of the loss of deductibility is more startling for people who live in the county of Albany. According to the Internal Revenue Service and the New York State Department of Taxation and Finance, in 1982 tax returns were filed in the county claiming the deduction for State and local taxes. This amounted to deductions of over $74.7 million and average savings on each tax return of $1,591.

In New York State, according to Internal Revenue Service data, in 1982 over 3.2 million tax returns were filed itemizing deductions. Over 99 percent of these claimed the deduction for State and local taxes. Aggregate tax savings amounted to over $4 billion in New York, or $1,292 per tax return.

Throughout the Nation, according to Internal Revenue Service data, over 33 million people will lose $35 billion from repeal of the deduction for State and local taxes; 21 million people or 62 percent of these people make between $22,000 and $50,000 a year. These are middle-income families that cannot afford to pay more in Federal taxes.

Treasury proposal would force individuals to pay taxes on income already spent on State and local taxes. I think this is a clear example of double taxation. Since the current Tax Code was passed in 1913, individuals have been protected from the evils of double taxation.

The purpose of today's hearing is to discover what all this data means to a number of different sectors of society: local school districts; union workers; State and local budgets; and real estate values.

It is vital that policymakers in Washington find out what the impact of tax reform will be, not just on Treasury revenues, but on all segments of society.

Treasury bureaucrats have emphasized the macro impact. This hearing will focus on the micro impact of the loss of the State and local tax deductibility.

How much will the quality of education be hurt? How much will property values decline? What will the impact be on the State's budget and credit rating? These are the questions that must be answered before tax reform is enacted.

Again, I am pleased and delighted to have the distinguished witnesses who are here to testify.

Our first witness, Hon. Warren Anderson, majority leader, the State Senate of the State of New York. Mr. Senator, it's good to have you with us.

STATEMENT OF HON. WARREN ANDERSON, MAJORITY LEADER, NEW YORK STATE SENATE

Mr. Anderson. Thank you, Senator. I am delighted to have this opportunity to appear before you and to discuss the subject of Federal tax revision.

In my view, too many people, in analyzing the proposal, which I am going to refer to as Treasury II, have been describing the trees; evaluating how this or that individual, or which economic group or how some States might fare, assuming, of course, the projected rates of Federal taxation, should, by good fortune, remain constant for some period of time.

The trees have been looked at and described, but too little has been said about the forest. Let me indulge in what might be described as a simple analogy.

When you build a home, you build it with the strongest materials you can get your hands on or can afford. You shape it so it can withstand the most violent forces and protect you and your family currently and into the future.

That's the type of home our Founding Fathers built for us 200 years ago. And those of us attending this hearing today, and our sons and daughters that may be scattered across the globe, know this to be true. So do those that may seek to immigrate here from foreign lands or, at the very least, invest their savings here.

It's no exaggeration to say that the United States is the greatest Nation the world has yet seen. This is why we must be careful when we tinker with the bricks and mortar that make up the foundation of our great Federal system, lest we, for reasons of expediency, erode our country's foundation, so it may not be able to withstand the violent winds and storms of this diverse and often troubled world.

The key to our success has been federalism. Federalism is the rock foundation of this Nation. And any action that weakens or chisels away from that one Nation, should be used with alarm, lest it bring our homes tumbling down.

If I am successful today in directing your attention to one simple but basic fact, the foundation of our home, the federalist system, then I will be satisfied. I will not be satisfied if you or anyone else walks out of this hearing, continuing to add up columns of figures and comparing how much better off some segments of the society may be or how State A fares compares with State B under Treasury II or under any of the proposals, Democrats or Republicans.

Our Nation was built on a foundation more fundamental than any of these proposals. Because I have alluded to our Founding Fathers, I wish you would indulge me further and listen to what those Founders have said about the very subject under consideration at this moment in the history of our Nation.

In the Federalist Paper, James Madison and Alexander Hamilton conditioned a healthy and complimentary competition between Federal and State entities. They emphasized that the Federal and State Governments are not mutual viables and the enemies, but rather different agents and trustees of the people.

Madison asked, what should occur when the Federal Government encroaches upon the economy of the State? He said,

> Ambitious encroachment to the Federal Government on the authority of the States would not excite the opposition of a single State or a few States, they would be signals of a general alarm. Every government would exhaust the common thought, of course; violence would be open. Plans of resistance would be observed. One spirity would antimate and conduct the whole. The same combination, in short, would result in the apprehension of the Federalists produced by the bread of a foreign yoke. And, unless the projected innovations should be voluntarily renounced, the same appeal to the trial of force would be made and one case would be made of the other.

I submit that Madison knew what he was talking about. So far, I have been very disappointed in some of the views that make State governmental leadership around the country. We seem to worry more about the short run, the temporary gain of some States or some segments of society, than the long run or the Federal impact on our system as an institution.

In this respect, these leaders seem to be well behind the public. Public support for the current tax reform records has sharply eroded in the past few weeks. While everyone is for tax reform, Treasury II is now endorsed by only 26 percent of the public, according to a national poll released recently by ABC and the Washington Post.

This represents a drop of 23 percent in support from opinion surveys conducted shortly after the plan was released in late May. Thank goodness, the people, as often happens, are smarter than their leaders.

If I may, let me draw upon Hamilton's comments on the power of taxation to make my point.

Hamilton discussed the relationships between Federal and State powers of taxation in Federalist Papers 31, 32, and 33. He addressed the question of double taxations at least twice. There was, of course, no income tax at that time, but Hamilton wrote of a situation where both the Federal and State Governments might impose a tax on the same object.

My good friend and colleague, John Marchi, made remarks before your subcommittee on June 10, which mirrored Hamilton's view to a large extent.

In Federalist Paper 31, Hamilton wrote,

> Federalism is a requisite to the purposes of the local administrations and to those of the Union. And the former are at least of equal importance to the latter, to the happiness of the people.
>
> It is therefore necessary that the state government should be able to command the means of supplying their wants as the national government should possess the like facility in respect to the laws of the Union.

But the indefinite power of taxation—in the latter, he's referring to Federal Government here, might and probably would in time deprive a former, he's referring to the State and local government now, of the means of providing for their own necessities, in which we subject them entirely to the mercy of the National Legislature.

Hamilton believed that the State should possess an independent and uncontrollable authority to raise their own revenues for the supply of their own wants. Any attempt by the Federal Government to enrich the power would be a violation of power unwarranted by any article or clause of this Constitution.

Let me say at this point, that I think that the President is sincere in his desire to simplify and reform the Federal Tax Code. To do this, I think his advisers have handed him a proposal which in their zeal to avoid big cuts and expenses and at the same time experience the benefits of oil and the other subsidies and yet not raise taxes, have to find a big ticket item, one so big that they hope its contingency would never coalesce. That it contains the seeds for the ultimate destruction of our Federal system of Government was, I'm afraid, overlooked by those, which one of my predecessors, Walter Mahoney, would have referred to as, "pencil pushers."

There is, of course, understandably a public dissatisfaction about tax loopholes. But, the public does not regard State and local tax deductibility as a loophole. I cited a poll earlier in my remarks that bears this out. Public consciously or inherently understands the need for State and local tax deductibility. To tinker with it, is not only bad political science, it's also bad politics.

I will leave it to others to add and subtract the figures to show just who wins or loses in the short run. We already have been innovated by statistics by both sides of the issue.

I will touch on what I think will be the long run result of such an ill-advised change and I will use education as a prime example.

Education, we all know the basic societal responsibility, universally recognized, a great benefit to society. Americans have always known that they must have a quality education for their children to be able to cope and for our way of life to survive.

What happens if States and localities are unable to provide that basic need? The need will be met and eventually have to be met, but it will be after a national public outcry and a national crisis will result and the national Government will have to respond or what will be the result?

National financing will be the only answer and as sure as night follows day, we'll have national control of education. Is that desirable? Is it workable? And what will then happen to what is now touted to be reduced Federal tax bracket? You know the answer to that one.

I could go on and cite other examples in fields such as health and mental health, crime and correction, welfare and social services, housing, interest structure, environment and on and on and on.

If the States and local governments are unable to meet the needs of their citizens, eventually their needs will be met, if not locally, by national Government.

What are now State and local problems will then be national problems. Inevitably, national governmental expenditures. Federal taxes and power will explode and who would want that?

I submit, none of us, including those that are now talking Treasury II because they see only the trees and not the forest.

Is it any wonder that Wall Street looks good to David Stockman? Federalism, as other wiser than I have said, is an essential element of the American system of check and balances which have prevented the concentration of power in any central institution, level or branch of Government. It's an essential element of American freedom and an individual's fulfillment.

I submit, it is not an abstract concept that is only of interest in classrooms and libraries. Nothing can be further from the truth. Federalism describes the way our entire Governmental system was worked, at least up till now.

It's a living dynamic principle that must not be removed from our democracy. There is talk of compromise, some talk of a phaseout of deductibility. There are further compromises as have already been made in certain categories.

I submit that there can be no compromise when the issue is the protection of the principle of federalism. The current tax proposals ending the deductibility of State and local taxes is by, no stretch of stability, reform. It would make real and operative the threats cited by Hamilton in Federalist Paper 31. That, "All the resources of taxation might by degrees become the subject of Federal monopoly of the entire extinction and destruction of State government."

Call it something, tax reform does not make itself. Nor can it be reformed if that ultimately strips the states of their inherent and vast need to be self-sustaining.

And, make no mistake, that's what it would do. It would eventually transform our Federal system into a contemporary futile system. The national Government dominating a network of defendant States whose citizens would have lost the essential protection of the ability of controlling their own destiny.

In 1819, Chief Justice Marshall said, "The power of a tax involves the power to destroy." That admonition is as valid today as it was 166 years ago. Thank you.

Senator D'AMATO. Thank you very much, Senator. I'm deeply appreciative of your being here to testify and very much appreciative of your going to the fundamental problems involving the destruction of State rights because ultimately, that's what it is.

I might leave you with this thought, that a number of my colleagues that are from, so-called, low-tax States who might derive a temporary benefit, are still very much concerned and they are concerned about this not on the basis of the so-called winners or losers, that their citizens might temporarily be advantaged by $200 a year or $300 a year. They are really looking toward the long run as to what we will be doing with the fiber of this nation.

We are tampering with the very structure of it, as you so eloquently described.

Mr. ANDERSON. I am glad to hear that.

Senator D'AMATO. May I suggest to you, some of our colleagues from the South are very much in the forefront of this thinking. They have not as yet endorsed our resolution as to the deductibility of State and local taxes because there are other concerns they have. Some of them don't want to be perceived as being a so-called "high-tax State" and let me, at this point, commend you for your leadership in working to reduce the tax burden.

I think oftentimes people are unaware that it was indeed under your leadership that much of the tax-cutting that was accomplished in this last legislative session emanated and came from you and from your Senate colleagues and that is with the cooperation of the Governor, the assembly, these plans were implemented.

I would only hope and now it's your feeling that these efforts be continued in the years to come.

Let me ask one question, Senator, you and the legislators and the Senate, Stte senate, have passed a resolution asking Congress to pass a constitutional amendment preserving State and local tax deductibility. What has been the response, if any, from your colleagues and sister legislators throughout the country?

Mr. ANDERSON. I have not tabulated that. I have received acknowledgments in most instances. Unfortunately, most of the legislative sessions, fortunately for them, had terminated at the time that the material we sent out was made available. I think the letters generally reflect the philosophy that you and I have both been espousing.

There is a question whether you can move in time under the system that we are talking about, that they raise questions of that sort and that was obviously there. We were trying to dramatize what many of us had thought was inherent in the 16th amendment and to spell it out for the future.

There have been some, frankly, that have taken the opposition that are supportive of what the administration or what some other Members of your House or the other in Washington has been espousing.

Senator D'AMATO. Will you be pursuing this with your colleagues and other State legislators?

Mr. ANDERSON. Yes, we have done that to date. I have made some phone calls to key people, but primarily it was done at the very close of our session when we were involved in a period of problems and as a result, we are just now getting reorganized again and when I get a little better feel on how we respond, it will govern how we vote forward.

Senator D'AMATO. Wonderful, I wonder if you wouldn't share that information with me, that's important.

Mr. ANDERSON. Certainly.

Senator D'AMATO. Thank you very much, Senator.

Mr. ANDERSON. Thank you.

Senator D'AMATO. Next panel, panel 2, is Mayor Thomas Whalen, mayor of the city of Albany.

STATEMENT OF HON. THOMAS M. WHALEN, MAYOR, ALBANY, NY

Mayor WHALEN. Good morning again, Senator, and I too appreciate the opportunity to appear before you to express my views on the subject of certain aspects of the proposed revisions to Federal tax laws by the current administration in Washington.

The proposals, which are of great concern to me, and I am quite sure of concern to other elected officials of New York State and its local municipalities, are the following:

First. Repeal of deductions for State and local taxes.

Second. The repeal for tax exemption for certain State and local bonds

Third. Elimination of arbitrage.

Fourth. Denial of deductions to financial institutions for interest paid to carry tax-exempt bonds.

Fifth. Repeal of the tax credits for historic preservation.

While the first one is the most important, Senator, I do think when we look at a local municipality like the city of Albany, I would like to add to my concern over the deductibility for State and local taxes, the others briefly because they do have an overall impact on the general welfare and citizenry of this great city.

Each of these five proposals would have a grave negative effect on the economy of the city of Albany and I am sure also on the municipalities similarly situated. Let me give you a few examples, for illustrative purposes:

1. REPEAL OF DEDUCTIONS FOR STATE AND LOCAL TAXES

While the city of Albany does not use an income tax, it can clearly recognize the impact that would occur if the deduction for State income taxes were to be disallowed for Federal income tax purposes.

As the Governor and Senator Anderson and other legislative leaders have already pointed out, this would adversely affect New York State's position vis-a-vis other States. Any blow to the economy of New York State would diminish its ability to continue to provide revenue sharing and other forms of State aid to municipalities, aid on which we are exceedingly dependent.

2. THE REPEAL FOR TAX EXEMPTION FOR CERTAIN STATE AND LOCAL BONDS

If this provision were enacted into law, it would be a cruel blow to Albany's economy. We have used IDA bonds to revitalize our downtown area.

Senator, you have been one of the moving forces in the resurgence of economic activity in the downtown area of our city through your aggressive support of our urban development action grant programs in Washington.

I want to publicly thank you for your efforts as they have been instrumental in the great renaissance now underway.

The only way an older city like Albany can compete with the suburbs in attracting businesses to its commercial district, and I would imagine there are some older cities in New York State in similar positions, is to offer extra incentives in order to attract the private sector to either relocate or rehabilitate within the city.

We have been successful in doing so through the UDAG program, the use of community development block grant moneys, and of course, an extremely important area is our very positive attitude toward the issuance of industrial revenue bonds.

If interest on these bonds were to become taxable, the bonds would sell at an interest rate which would make them unmarketable. As a result, our ability to attract new businesses and revitalize an old and eroding infrastructure would be severely damaged.

This same proposal would have a substantially negative affect on our efforts to provide affordable housing for low- and middle-income individuals.

Recently, I formed a neighborhood revitalization and housing task force in order to come to grips with the current problem in Albany relating to home ownership for low- and moderate-income residents.

We are now seeking ways to develop meaningful programs in order that there not be any displacement of people who have been long-term city residents.

I believe that we are on a threshold of developing two or three different modes which will solve the problem.

However, it is imperative that the financial mechanisms used in such programs be as attractive as possible, and certainly the tax-exempt status of the underlying obligations which would permit construction and rehabilitation is absolutely necessary.

Regardless of what form of financing may be involved, a basic element is the ability to sell tax-exempt bonds at an attractive rate. Were this change made, our ability to provide such housing would be seriously impaired.

3. ELIMINATION OF ARBITRAGE

The proposed revisions to the Tax Code would prohibit a municipality from earning any arbitrage under any circumstances. Currently, arbitrage is a very important source of funds for municipalities that are financing projects through the issuance of tax-exempt bonds. Its loss would be another reduction in our available resources.

4. DENIAL OF DEDUCTIONS TO FINANCIAL INSTITUTIONS FOR INTEREST PAID TO CARRY TAX-EXEMPT BONDS

If banks and other financial institutions were not permitted this deduction, they would raise their bids on the purchase of tax-exempt bonds. The net result would be a higher cost to the municipality to borrow money and, of course, a greater burden on the taxpayer.

5. REPEAL OF THE TAX CREDITS FOR HISTORIC PRESERVATION

The city of Albany has one of the largest number of historic buildings requiring preservation in the entire country, since our city is one of the oldest.

A recent Wall Street Journal article indicated that Albany was sixth in the Nation, not far behind the cities of St. Louis and Baltimore, in the number of projects undertaken with the use of historic tax credits.

Not a bad record for a city with only 100,000 residents. As a matter of fact, we will celebrate our 300th birthday in 1986.

The preservation and restoration of historic buildings in Albany is most important to its historic heritage and to its future.

The city, itself, cannot afford to restore historic buildings and, as a result, relies on the private sector to do so. If this incentive were to be denied to the private sector, our greatest heritage would continue to rot instead of flourishing and being revitalized for the benefit of our children and their children.

I appreciate your invitation, Senator, to present these remarks, and I am confident that, as you have demonstrated in the past, you will continue to do your utmost to protect the interests of our cities and our citizens of the great Empire State. Thank you.

Senator D'AMATO. Thank you very much, Mayor. Mayor, let me first state that I am appreciative not only of your addressing the question of deductibility of State and local taxes, but also the very concise remarks regarding the proper use of revenue bonds and the use that has resulted in investments that otherwise would not take place.

Mayor WHALEN. There's no doubt about it, Senator, we have to offer additional tools to make the private sector to want to come into Albany. They can just as easily build in the suburbs, the cost of construction is upward of 25 percent less. We need some additional incentives, the incentives that have been developed in Washington are right now extremely important in providing with the capacity to make the business community want to come back into a city like Albany.

We are on the threshold now in this great city, as small as it is, we are already a center for government and I might say, the second largest center for government in the world behind Washington, right here in Albany, NY.

We are also a center for education. We are now rapidly becoming a center for finance.

The opportunities that are presented to us now are rather exciting. We want to be very aggressive in our approach in attracting the financial community to the business district of Albany. We need certain support underpinnings to make downtown Albany attractive to the financial community. These underpinnings are the various incentives that I mentioned and the elimination would blow us right out of the water.

Senator D'AMATO. Mayor, thank you for the cogent presentation and the time you've taken now. I am hopeful we will be able to preserve many of the areas of concern, tax-exempt financing, bonds and obviously for the kinds of purposes that make sense and the preservation of the tax credit for historic preservation.

I think this is another area in which many throughout the country share your concern. Do we preserve and create or do we allow a blank to come about? Thank you.

Mayor WHALEN. Thank you, Senator. Enjoy your stay in Albany.

Senator D'AMATO. Our third panel will be Mr. William McGowan, president of the Civil Service Employees Association of Albany.

Let me ask David Brown, superintendent of the City School District of Albany, to join you. We'll have on another panel, Howard Bennett, president of the Teamsters Local No. 294 come on up and Harry Apkarian, a good friend, chairman of Mechanical Technology, Inc.

Mr. McGowan, and let me thank you, first of all, for taking the time and being here with us.

STATEMENT OF WILLIAM L. McGOWAN, PRESIDENT, NEW YORK STATE CIVIL SERVICE EMPLOYEES ASSOCIATION, INC., AFSCME LOCAL NO. 1000

Mr. McGOWAN. I am William L. McGowan, president of the New York State Civil Service Employees Association, Inc., AFSCME Local 1000, representing over 200,000 State, county, and municipal employees who work throughout New York State. I am happy to have the opportunity to speak to you about President Reagan's tax plan.

CSEA recognizes the need for tax reform to take the tax burden out of the hands of the working people. It is unfortunate that President Reagan's tax plan does not address this need.

An issue of major concern to New York State workers is President Reagan's plan to eliminate the deductibility of State and local taxes. The average tax savings from deductibility per itemizing household in New York is $1,292, and 51 percent of all New York households are itemizing households.

If deductibility were eliminated and not offset in any other way, this would be the average amount lost per household as a result of the plan. Clearly, working families cannot afford so great a loss.

Clearly, State and local governments can't afford the effect of this plan.

President Reagan claims that States with lower taxes should not have to bear the burden of extravagant States like New York who don't know how to limit their expenditures.

In reality, the average citizen in New York pays $232 more in taxes than he or she receives in Federal spending.

In addition, New York does not spend money extravagantly. Instead, the extra tax burden in New York is based on having a population that needs expensive services and the willingness of the State to provide those services.

New York is willing to provide for the needs of its poor, elderly, school-age children, and others who have particular needs. Eliminating deductibility could severely hurt New York's ability to provide for these needs.

Congress has already cut back Federal grants to local programs, claiming that the programs should be funded locally. How will localities be able to justify expenditures for local programs if the citizens will be paying for it doubly in their taxes?

Furthermore, the argument that New York State is subsidized by other States ignores a major tax subsidy that goes from energy consuming to nonenergy consuming States. Alaska and Wyoming spend the greatest amount per person of all the States, but much of the money they spend comes from a severance tax on oil.

The severance tax is paid by people of other States who use oil like New York residents who heat their homes. So, New Yorkers subsidize the spending in these energy producing States.

Alaska and Wyoming won't be affected as greatly by the elimination of deductibility because the State and local services are funded by this deductible business tax.

Also, New York is not nearly as "extravagant" a spender as Wyoming and Alaska. New York is the third highest spender per person in the Nation but it is a full 22 percent below Wyoming, the second highest spender.

New York, with its major urban center in New York City and other smaller urban areas in Rochester, Syracuse, Albany, and Buffalo, cannot afford the potential flight of urban dwellers to the suburbs that elimination of deductibility would cause.

Because of the greater need for services, the average government spending in the urban areas is 30 to 50 percent greater than the spending in the suburbs and taxes are greater.

Ending deductibility will encourage a move out of these cities so that families can reduce their taxes. This will cause the loss of an important tax base that these cities need to survive.

It is unfair to the taxpayers of this State and contrary to the basic principles of Federal taxation to tax a tax. Since the Federal income tax first began, Congress prevented double taxation by allowing State and local taxes to be deducted. Congress should maintain this policy of avoiding double taxation.

What is even more unfair is that President Reagan is willing to recognize the effect of double taxation upon corporations but unwilling to recognize double taxation for the working family.

Corporations in foreign countries can get a tax credit for taxes paid to foreign countries but New York State workers will be unable to get even a tax deduction for their State and local taxes paid.

This maintains a policy of a tax system with the loopholes for corporations and burdens on working families.

In summary, I do not think that President Reagan's tax plan to eliminate deductibility serves the needs of New Yorkers or any citizens in this Nation.

I encourage tax reform but think that it should keep in mind the working people of our country. States and localities must be allowed to maintain adequate funding for local needs.

I hope that you, Senator D'Amato, will strongly oppose any proposal that eliminates deductibility.

Senator D'AMATO. Thank you, Bill. Mr. Bennett, please proceed.

STATEMENT OF HOWARD BENNETT, PRESIDENT, TEAMSTERS LOCAL NO. 294

Mr. BENNETT. I want to thank you, Senator D'Amato, for the privilege of addressing the forum here today. I am here as the president of the Teamsters local in the surrounding 10 counties. I am wearing another hat, as well, I am representing the New York State Joint Council 18 covering Central and all of the Eastern New York area and the president, Rock D'Pernal, sent his personal regards and wants to be sure I get it in the record.

We join with Bill McGowan and probably all trade unions and all citizens of the State of New York with the presentations by President Reagan with regard to tax deductibility.

I would like to open and very clearly state that the Teamster's position is, and I am sure most of us are, not opposed to tax reform. Obviously, things in years move along and there are necessary changes that happen.

But, we Teamsters, and our families, would be vitally concerned that in this area there was no break, there was no, perhaps, second and third looks that you are attempting to do in this area, and what happens to us in the deregulation of truck transportation? I will say, just in our region of the Northeast, let alone the Nation, sir, it's tied in with the concerns we have and will articulate in a few moments, that it will be catastrophic because of the open entry, if you will, that if we do not oppose the overhauling of that program.

As late as last Friday, we had a large trucking company that did business throughout the State of New York and other States, that remains unnamed, go out of business in a matter of 3 hours, a shock to all of us.

In our community, we have lost the possibility of 100 families their jobs. Hard-working men, women, if you will, from the community that may be faced, along with these catastrophic things, perhaps uncharted waters of the loss of tax deductibility under our present State of procedures.

We have done reviews in this area without respective statistics and, Senator, as we all require to do, and I am sure you have reams in your files with your advisers and assistants to review.

Our organization is predominating the Council 18, umbrella organization of approximately 18 Teamster locals throughout the

Northeast. Along with that, we also have the Buffalo region and the Rochester region in our great State's council, which I am speaking for, as well, in this concern.

We have been established in various, you know, the Teamster make up across the Nation, we move into just about every segment of society you can think of. The same is applicable to our surrounding 10 counties which I am principally here for today and the other cities we have talked about, Syracuse, Jamestown, you name it.

We are involved, as I pointed out to you, the over-the-road trucking, United Parcel Service, warehousing, frozen food industries, construction, grocery chain warehouses, office hires and employees and many other job descriptions which are not even listed and this is the kind of a representative group of workers we represent in the Capital District, to be repeated in most of the other cities through to the Northeast section of New York.

The proposal, in our view, is a measure that will have far-reaching detrimental effects in our many surrounding coummunities and the families of the membership which we represent. Particularly, our membership, we represent working, that I mentioned earlier, in truck transportings, which has been dramatically affected by revolution of the industry and many thousands of our members across the country and locally here, nearly 2,500 people, the untold story of the Northeast, lost their jobs for that particularity and are compounded now with the possibility that these additional losses are in our local tax credits on the State level.

The most severely hurt will be the State and localities that conscientiously live up to their public responsibilities.

We, Teamsters, are active in our communities. We talk about these things in our union halls. We talk about the possibilities of these coming in our regular layman's language as we understand it, what's going to happen to our community. All right, do we get enough from the Federal Government—the unknown question to overcome that. What's going to happen if the communities are then required, with their various boards and so on, to operate those communities, have to go out and get new taxes, just as you pointed out, I believe, in your earlier news conference and articulated by Mayor Whalen just a few moments ago.

We are thinking the very same thing. As I pointed out, we are not opposed to the concept of tax reform. There is no question something has to be done, but we have to watch very, very carefully, obviously.

We conclude, doing away with tax deduction would make economic competition within and among all States more severe. For approximately 5 years, this administration has built upon the concept of federalism. It shirked responsibilities to the States and the States who have tried the hardest to meet these responsibilities will be the hardest hit.

And indeed, our great State of New York has started and tried to meet these responsibilities. It certainly has, because I have been privileged to live in this State and county for the last 34 years and most of us pretty much have a general idea how these things function. It's necessary, as labor leaders in this day and age, to get a handle on the concerns where our families are best going to be served, not only through unions but through the State and Federal Government because we have such a keen interest in it.

Our teamsters and affiliated unions strongly object to also taxing of the employer paid negotiated benefits. Most industrial nations recognize health care as a fundamental to the present understanding and choose to fund such a program publicly through the support of general revenues.

As a Nation, to this day, we have chosen to avoid a national health program and have chosen instead to meet its health care needs through a tightly administered system of tax deductions, for the employer, and tax exempt for the employees.

We are very concerned that taxing benefits begins the erosion of an established social policy without consideration of any alternatives.

Accept my apologies for wandering a little bit, Senator, but I couldn't give up the opportunity to mention that area as well, along with our personal, if you will, "special interest in total—quote, unquote as they say—deregulation of the trucking industry" which has not been solved yet.

Senator D'AMATO. Let me say, Howard, I have always marveled at how you always used various terms. For example, if something is bad, we call it a tax increase, proposed tax increases, but if it is something that we seek, we call it revenue enhancing or closing loopholes. If in the area of attempting to make one's views known we want to take a position in opposition, those who seek to make known their view, to whatever the legislative body, whether it be municipal or whatever council, we call them lobbyists or special interest groups, and if we are favorably disposed to their cause, we say, using the great democratic process to bring forth.

In fact, it's really interesting that you can generally get a feel as to how the media characterizes whatever the activity is that's being espoused. It's special interest and, of course, it's made up of special interest. The strength of that is that the people do have the right to make known their views, to hire those that can assist them in making those presentations, et cetera. I think we do ourselves a great disservice.

Mr. BENNETT. I will be closing. I believe I've taken enough time of the panel. In closing, we respectfully request to convince the President to move away from the concept of eliminating tax deductibility of State and local tax deductions from our Federal tax returns.

In closing also, we want to strongly disagree with President Reagan's position in this, and we also would convey our best wishes to him for a speedy recovery from his recent surgery, and again we thank you on behalf of our State Teamsters in all the upstate areas, for the opportunity to be here today.

Senator D'AMATO. Thank you. Mr. David A. Brown, superintendent of the City School District of Albany. Is Mr. Brown here? I guess not.

Harry, my good friend Harry.

STATEMENT OF HARRY APKARIAN, CHAIRMAN, MECHANICAL TECHNOLOGY, INC.

Mr. APKARIAN. Senator and members of the panel. My name is Harry Apkarian, and I am chairman of the board and chief executive officer of Mechanical Technology Inc. (MTI).

MTI is a high-technology organization headquartered in the Capital District with additional manufacturing facilities in Skaneateles, NY. We employ just under 1,000 people, and our business revenues will be about $65 million this year.

Our products are sold in the defense, energy, and manufacturing productivity sectors, and our large research and development effort encompasses the State of the art in these fields.

I greatly appreciate the opportunity to testify before you today on the subject of tax reform and its impact on New York State business.

As you know, I've lived in upstate New York all of my life and have devoted my career to building and growing New York State businesses. In the past year, we paid in excess of $175,000 in State and local taxes, and our employees paid approximately $1,150,000 in State income taxes. In addition, we are required to pay 10 percent of our net profit in State income taxes, so we are clearly a significant contributor.

At MTI, all of our after-tax income is reinvested in the company. Therefore, our after-tax profits translate directly into productive jobs for people, working on growing our corporation and enhancing our competitiveness, which are the bases of economic growth and job creation. Any increase in taxation simply lessens our capability to do this.

Specifically addressing tax reform, there is absolutely no question that we need it, but the kind of reform presently before the Congress, which would eliminate deductions for State and local taxes while raising corporate taxes, is going absolutely in the wrong direction.

There is nothing wrong with corporations paying taxes. We clearly should pay our fair share, but the present proposal is diametrically opposed to the kind of reform which we need if we are to continue to grow, create jobs, and compete effectively with the Japanese and other foreign entities.

With the massive balance of trade deficits our country is facing, and the fact that the United States is now an international debtor for the first time since 1917, it is abundantly clear that the Government should be doing everything in its power to help American business compete and produce more effectively.

The present tax proposal is clearly not in that direction, especially with respect to New York State business.

There are a number of specific reasons why business in New York State would be hurt more than any other State by the proposal to eliminate deductions for State and local taxes. New York already has a disadvantage in doing business because it has the highest taxes in the Nation.

In my opinion, these taxes are the main reason why we've seen a significant population decline in the State. People go to places where they can find work, and work is provided by business. When business is drained of its investment capital, it cannot expand and grow, and may, in fact, even shrink. As a result, people go elsewhere to look for jobs.

Fundamental to a corporation's capability to do business are its labor and material costs. MTI, being a high-technology corporation, must hire top quality people from throughout the country and must compete for these people on a financial basis.

Already we pay a penalty because the high tax burden requires us to pay these people more than our competition. We do this because we hope that by getting their unique skills, the quality and capability of our products will offset the additional cost.

The present tax "reform" package before Congress, then, will compound our problems even further because the State and local tax provisions will significantly increase the amount we must pay our employees in order to retain them.

Our corporation is presently in a growth mode, with increasing sales and profits; and we are searching for new businesses, markets, and acquisitions to aid that growth. Even though we have a great affinity for the State of New York, the new tax proposals would cause us to think hard about carrying out our expansion in some other State with a lower tax environment.

You can see then, Senator, that the nondeductibility of State and local taxes, when coupled with higher corporate taxes, would clearly be discriminatory to New York business. If the State and local governments really wanted to encourage business competitiveness and growth, they should do the opposite of the present tax package; instead of the IRS making State and local taxes nondeductible, the State should make Federal taxes deductible! That would provide an incentive for economic growth rather than a disincentive!

You can either raise business taxes, or encourage economic growth, but you cannot do both. Growth, economic development, and increased opportunity for employment all depend on the capability of businesses to retain and reinvest a significant part of their earnings.

First, you must have some earnings, which requires that your materials and labor costs be competitive. Then when you have some earnings, you must be able to retain enough of them to provide for investment and growth, all of which provides additional jobs.

A substantial jump in taxation, at this time when business is still recovering from the recession of the early 1980's, could have very negative overall economic effects, especially in New York.

Senator, I know we both love New York State and we both work hard for it. If we didn't, we wouldn't both be here today to discuss this critically important issue of tax reform. But I have to tell you, from a financial standpoint it is punitive now to do business in New York State.

We have been working hard to influence the local and State governments in order to change this, but the onerous New York State tax environment makes our job twice as hard as it should be.

If enacted, the present tax changes before Congress will just increase our burden and make our job even tougher.

In summary, Senator, I want to thank you for taking the time today to come to Albany and hold these hearings. You are truly a public servant we can be proud of, and I am fully supportive of your efforts in the Senate.

I hope that you will be successful in heading off the potentially disastrous effects of the present version of the tax bill, and I look forward to working with you for many more years in our efforts to build and strengthen our State.

Senator D'AMATO. Thank you very much, Harry, and I thank you for coming in for your testimony today.

Let me ask you all one question. It seems to me, as I stated previously, there is great objection by the American public, not to the amount of taxes that they pay, particularly Federal taxes, but rather about the fairness, the fact that they see others who are not paying their fair share, and it seems to me that cries out for reform.

But if you have a healthy, prosperous corporation that pays no taxes, that is the kind of thing that cries out for treatment.

Or if you have a wealthy individual with an income in the six or seven figures that pays no taxes, or almost none, that is the kind of thing the people object to, and that also cries out for reform.

I was wondering if the three of you would comment on this.

Mr. BENNETT. I think your point is very well taken, Senator, for those of us that represent workers in the many thousands throughout the regions and areas.

There's no question constantly on the minds of the average worker. I have found it that for our people, while we grumble about tax, by and large, the fact is that they want to pay their fair share. They want to do that. They want to see their companies prosper because when they do, the manufacturer is there, but it's the old unanswered question, when we read, when we articulate discussions of these things, why is this allowed to happen?

Certainly we hear about the various writeoffs that are necessary in businesses up to a point. But when it gets to the point where there just becomes no support——

Senator D'AMATO. Not withstanding the writeoff, there should be a bottom line, a minimum tax.

Mr. BENNETT. That's correct.

Senator D'AMATO. You have heard the same outcries from your people?

Mr. BENNETT. That's articulated exactly in the matters I was trying to present to you.

Mr. McGOWAN. People have come forward and said they really know it costs money to run this government, no matter what State, county, local or Federal Government, and they realize that. They are all willing to pay for it, but awful, awful tough when you have a person that's making $10,000, $12,000, or $15,000 and you find out people making $100,000 and above are not paying anything and they are paying their fair share. And, they say, well, you know, I would not mind it if there was a minimum they have to pay, but when they pay absolutely nothing and I make $15,000 and I am paying on my measley $15,000 where is the fairness in this and when you stop and think about it, they are absolutely right. Everyone should have the pride to say, I have so much, tax it in the structure.

Senator D'AMATO. Harry, would you care to comment?

Mr. APKARIAN. Yes, certainly as a business man who has made out pretty well in the business world, I certainly understand the criticism and fairness is an important issue, Senator. That's why it's hard to argue against Treasury II.

One of the attempts or current attempts of Treasury II is to introduce more fairness into our tax structure. And the wealthy individuals in businesses are avoiding taxes and in their eyes, it's completely justifiable. It's done within the law. The rich people, they give money away, so they say, how can you argue, we are giving money away, we are doing our bit, but the bottom line, it's certainly illusive to argue that these companies and the rich individuals are being fair.

I think there ought to be, as a businessman, there ought to be a tax and nobody ought to be able to escape taxes, particularly the wealthy individuals should ever be allowed to escape taxes.

I think it's a matter of pride and responsibility to pay taxes. We are enjoying the benefits of this wonderful country, we ought to pay for some of the cost to run it.

Senator D'AMATO. Let me share this with you. If there were to be tax reform that would encompass a minimum tax so not withstanding an individual or corporation that has investment tax credit, then invest in municipal bonds, the bottom line is that not withstanding these tax investments, there would be a minimum tax.

That goes a long way dealing with the frustration that people have spoken about in terms of their perception of fairness in the Tax Code? Wouldn't that eliminate the basic contention so many have about the unfairness?

Mr. APKARIAN. Absolutely.

Senator D'AMATO. Then, it would seem to me if the revenues were raised from that program and then used, say, to increase the personal exemption, the greatest benefit would be going to the person, the working families, to deal with the inequities of the marriage penalty, again, the greatest benefits in those cases helping the working family. It seems to me that's the kind of tax reform that the American people are looking for.

Mr. APKARIAN. Senator, I think it would go along, unfortunately, the way the tax structure is now, you know the American culture, they are always in favor of the underdog. They look at industry and wealthy people as being the fat cats and the working people in a different class.

It creates resentments that are totally unnecessary because labor and business have to be obtained, including Government. We are not going to succeed and improve the quality of life without the cooperative spirit.

So long as we have this source irritating people, that is, the big companies and wealthy people who are avoiding taxes, that will create needlessly the resentment of that.

We don't need that. We have a big job ahead of us to help out the world in general, not just New York State, but the Nation. We can't afford to have needless irritations.

Mr. MCGOWAN. Senator, with all due respect, it's awful hard for my people that make $20,000 to pay income taxes. We read in the paper about a person that has $3 million and pays absolutely no income taxes. They say to me, you talk about fair and justice. Where is it in this country? And it's hard for me to reply to.

Senator D'AMATO. Well, you can't.

Mr. McGOWAN. They went into these bonds that is going to help rehabilitate your city, that's baloney, McGowan, baloney. We have got to have a minimum so everybody feels as if everybody is paying something.

Senator D'AMATO. If that were done, that would really go a long way in dealing with that anger that people feel toward what they see as justice.

Mr. McGOWAN. Well, we wouldn't see it in the paper where somebody has $5 million and they paid absolutely—I mean—there's something there and do away with the free ride.

Senator D'AMATO. Let me leave you one thought. Although this hearing was held primarily to focus in on the issue of deductibility of State and local taxes, it obviously did not and should have precluded the comments and observations and testimony with respect to the other impacts of the various features of the proposal. Whether it be to the local economy, I have to say to you, Howard, that I share in your concern with respect to the proposal as it relates to the taxation of so-called "fringe benefits." You notice I use the word "so-called" because I don't believe that health care for American families is a fringe benefit.

I think if you represent labor, and Mr. Apkarian, who is an outstanding industrialist, would probably agree with it.

Mr. APKARIAN. Absolutely.

Senator D'AMATO. You cannot jeopardize the American family and American businessman by saying that health care is a fringe benefit. It's a necessity.

Mr. APKARIAN. As a businessman, I look at it as something we earned. That's something they have earned, they deserve and when we start taxing that, we are discounting the benefit that they worked so hard to get. They are entitled to it.

And, Senator, if I can introduce another thought in my testimony, I refer to as tax compound. It might be inappropriate at this meeting, but why aren't the Federal taxes deductible from my taxes?

That's the same issue, the other way around.

Senator D'AMATO. I had that as a question for Senator Anderson, but I did not pursue it. In 34 States, there is no deduction for the Federal and the State. If there was, it would wipe out the entire tax. You would not be raising any revenues and deductions would be so great, that is one of the problems and certainly is an argument, by the way, that is raised by Treasury.

Mr. APKARIAN. It's the same argument.

Senator D'AMATO. There's another, I think it's an inequity. I'm not looking to pit one city against another or region against another. No one says we have a perfect system here in the State. Lord knows, I commend the legislature and the Governor for beginning to cut taxes.

But, I have to say to you, we should have started this, and I know Governor Carey started it some time ago. We should have been cognizant of this a long time ago. There would be a lot more jobs today and a lot more prosperity in this State and a lot of businesses that have not expanded, and some closed down, went to other States, a lot of our young people that went elsewhere for job opportunities.

I have a daughter, as you know, Harry, who just graduated from Lehigh School of Engineering and it was a tough thing, I mean, she was interviewing with all the companies from Texas, California, and other regions. We want, I think, our families to stay basically in an area where we have contacts, where many of our young families or young people, after we educate them, leave because jobs and job opportunities are not what they could and should be in our State.

In her case, she is an industrial engineer and she's working up in Rochester with General Motors. I think it's a sore thing when we see plants and commerce and business leave. Let's not kid ourselves, it's a result of a high-tax State.

We need a greater discipline. I believe we have to continue to work on that. I think business and labor recognize that. People want jobs and economic opportunity. But, it shouldn't be the Federal Government that comes and says, we are going to help you lower your taxes. We are going to do away with deductibility of the State and local taxes, therefore, you're going to be forced to do that because that's certainly, as I mentioned, I have not come out and don't advocate rendition here, but at the very least, you don't say tomorrow is when you start.

Mr. APKARIAN. Bill and Howard have a good feel of the difficulty of creating jobs. The fact we are fighting like the devil to keep the jobs, just to keep the jobs we got. We have to work together to better the State, better the Nation we represent.

Senator D'AMATO. Let me thank you gentlemen on this panel in taking your time in sharing your comments to the Joint Economic Committee.

Mr. BENNETT. One footnote, if I may. I would be remiss if I did not comment on Mayor Whalen's remarks and on behalf of Mr. Apkarian's remarks, we are just absolutely so pleased with the efforts that you continue to make by bringing in the appropriations of the city which the mayor articulated earlier is helping to bring us back and continues to bring us back as a viable community and continuing on.

So again, we thank you and all the efforts of Washington getting those Federal subsidies from the administration.

Senator D'AMATO. Thank you.

Mr. APKARIAN. I think you are doing a tremendous job and it's an honor to be working with you.

Mr. MCGOWAN. Senator, on behalf of our membership, we thank you. You have always responded and we appreciate it and we are ready to respond to you.

Senator D'AMATO. Thank you for your generous remarks.

Panel 4 is Charles Staro, president, New York State Association of Realtors, Inc., and Robert Wieboldt, legislative counsel, New York State Builders Association.

STATEMENT OF CHARLES M. STARO, EXECUTIVE VICE PRESIDENT, NEW YORK STATE ASSOCIATION OF REALTORS, INC.

Mr. STARO. Good morning, Senator, first for the record, my good friend, Tom DeBone is still the president of our organization and I am the executive vice president. Tom does extend his best wishes and is sorry he cannot be here to greet you personally, today.

Senator D'AMATO. For the record, give your name.

Mr. STARO. I am Charles M. Staro, the executive vice president——

Senator D'AMATO. Let me ask you this. You are testifying here and I have Robert Wieboldt, do we have Robert here? OK. You decided to testify in your own order. Go ahead.

Mr. STARO. Thank you, Senator. I am Charles M. Staro, executive vice president of the New York State Association of Realtors, Inc. and I appreciate the opportunity to comment on the proposals offered to reform the Tax Code.

Tax simplification is worthy of analysis and our organization applauds the efforts of Congress and the administration to accomplish such endeavors.

The proposals that have come forth under the guise of tax simplification, however, raise serious questions in our minds. First, not only does the proposal complicate the Tax Code for more than 25 percent of the population, but it has an adverse impact on home ownership, savings, investment, and economic growth.

Second, the Treasury's tax reform proposal has been reported to be an opportunity for equality and a revenue neutral program.

Two items presently deductible, if repealed, would create additional revenue of $281 billion for the Treasury: Investment tax credits—$132 billion—and State and local taxes—$149 billion.

Therefore it would appear that the proposal is far from revenue neutral and looking more like a tax raising mechanism as each day passes.

The keystone of the tax reform proposal is undoubtedly the deductibility of State and local taxes. This segment is based on the rationale that the deduction is a subsidy for services provided by State and local governments and that taxpayers in higher-tax States receive a disproportionate benefit, while other States subsidize the benefits provided by the high tax States.

We do not agree. If implemented, taxpayers will have to pay State and local taxes with after-tax dollars which will increase the cost of the taxpayer of the benefits provided. This would now cause double taxation of the same income. Taxpayers will have to pay Federal taxes on income used to pay State and local taxes.

In other words, a Federal tax is imposed on a State tax. The President's proposal rejects this argument, yet the tax credit for foreign taxes is inconsistently maintained in the proposal.

With the additional loss of the property tax deduction, an even greater impact will be felt on low and middle income property owners in New York State.

We recently completed a study of actual tax returns filed for the 1984 tax year. By applying the tax reform proposals and recomputing each return, we have found that the plan would cost low income property owners more in increased taxes, which is contrary to initial reports on the plan.

For the $0 to $30,000 taxable income group—the 15 percent bracket—it was found that these individuals would lose an average of $3,172 in deductions which would result in an average tax increase of $297. All returns that were analyzed included individuals and families who owned their principal residence.

While initial reports indicated that lower income groups—those below a $30,000 adjusted gross income base—would be virtually unaffected or would realize tax savings, the analysis pointed out that this was not entirely true. Our analysis shows that the tax obligation of property owners in this income group depends heavily upon whether or not the increase in exemptions for dependents will outweigh the loss in deductions should State and local taxes be removed.

For example, in one instance where an individual had a taxable income of $18,970, the removal of State income taxes, real property taxes, and State sales taxes totaling $3,126, along with $200 of investment tax credits, created a tax increase of $409.

It is also well to point out that this individual was married with no dependent children. Additionally, in the instance of a single wage earner with a taxable income of $19,000, that individual's taxes increased by almost $700.

On average, elimination of the deduction for property taxes for New York State residents living in a home valued at $85,000, would cause an increase in the annual cost of home ownership of $500. This could result in a $5,000 loss in value and as much as a 10 percent loss in equity. Even if present interest rates decrease by 1 percent, the after-tax cost would increase by at least half as much.

Repeal of State and local taxes could cost the average New York State family that itemizes deductions $1,646—the highest in the country.

The proposal to limit the mortgage interest deduction to a taxpayer's principal residence plus $5,000 of nonprincipal residential interest expense should also be addressed. It is our feeling that such a cap does not enhance fairness in the tax system.

While a middle income taxpayer's interest is capped for his $50,000 vacation cabin, a high income taxpayer is allowed full interest deduction for his $1 million residence.

Even though the $5,000 limit is increased by any net investment income, the opportunity becomes increasingly smaller to middle income wage earners since they do not have the necessary funds to generate investment income to offset their interest expense.

It is well to point out that second homes are not solely a luxury of the rich. A recent Federal Reserve survey shows that of the 7 to 8 percent of Americans who own vacation homes, 50 percent have incomes below the $40,000 level. Taking an average priced $50,000 vacation home, the after-tax cost would rise by $1,500 or about 30 percent and consequently, experience a decline in value of up to 25 percent.

This provision will disproportionately affect not only the more than 30 States where the economy depends on recreational development, but many areas located in virtually every county of New York State.

The New York State Association of Realtors is concerned with a positive climate for savings, investments, and the continued growth of our State's and country's economy. The loss of deductibility of State and local taxes, the loss of full deductibility of mortgage interest on vacation and second homes, and the loss of tax-exempt bonds would harm homeowners, businesses, and communities.

Thirty-seven percent of the gross national product is attributable to real estate and its related industries. Any changes in the present treatment of property ownership would be harmful to the well-being of our economy.

We view the record budget deficit as a major threat to our economy and do not feel that the tax proposal as offered will assist in eliminating our country's primary concern and may, as a matter of fact, serve to exacerbate the dilemma even further.

Thank you very much, Senator, for the opportunity to address this question with you today.

Senator D'AMATO. Thank you. Next, I will ask for Robert Hankin.

STATEMENT OF ROBERT HANKIN, PRESIDENT, NEW YORK STATE BUILDERS ASSOCIATION, ACCOMPANIED BY ROBERT WIEBOLDT, EXECUTIVE VICE PRESIDENT

Mr. HANKIN. Senator D'Amato, I am Robert Hankin, a homebuilder from Poughkeepsie, NY and the current president of the New York State Builders Association. I am joined today by Robert Wieboldt, our executive vice president.

We are a statewide trade association, representing over 2,500 members who are principally engaged in the construction for sale or rental of new homes and apartments.

We oppose removal of the deductibility of State and local taxes as part of any Federal tax reform effort. We oppose this recommended change because of its adverse impact upon the costs of home ownership, local government services, and real estate market distortions.

Home ownership has always carried a burden of direct responsibility for the payment of local real property taxes. Offsetting the burden has been the ability to deduct such payments from gross income for Federal income tax purposes. This deduction, unavailable to renters, has become one of the principal advantages of home ownership, as perceived by the public.

The importance of the real property tax deduction can be measured as a percentage of the after-tax cost of home ownership. The National Association of Home Builders has done a very recent computer analysis using an $84,000 average sale price and a $40,000 annual income with four deductions. The deduction varies between $800 and $1,600 in annual cost and represents an increase of 16 percent in the annual after-tax cost of owning a home.

Here in New York State real property taxes can range up to 8 percent of full value in the New York metropolitan area. But, using 4 percent as a more typical suburban tax rate, we see a 24 percent increase in the after-tax cost of home ownership.

Many New York families will find that their itemized deduction less the deduction of the State and local taxes falls below the standard deduction. Therefore, such a change will affect the deductibility of mortgage interest as well.

Without the deductibility for real property taxes, the family buying a new home will find their purchase more expensive. Lenders will undoubtedly reflect the loss of deductibility in qualification ratio changes, which will make it more difficult for first-time home buyers and home buyers of modest incomes to obtain home ownership. Obviously, fewer housing starts would result, with less employment in the construction trades.

But, the more significant impact goes to the heart of the structure of our local government in New York State. A combination of historical forces has lead to the situation in which the New York resident expects to live in communities which provide a high level of public services delivered by public employees earning relatively high salaries.

With the tradition of home rule, we find that a large number of New York governments leads to an even larger local government tax burden. In much of the country west of New England, there are no towns or villages, or separate school districts. The level of security, convenience, environmental quality, and other public amenities achieved in New York's communities has been made affordable by the deductibility of the tax costs for such public services from Federal income taxes.

Loss of State and local income tax deductibility would create an intense sensitivity to tax increases among New York State's taxpayers. Not far behind would come organized resistance to any increases in local taxes.

The impact of such resistance on home building can be projected from the recent experience of California. Proposition 13, which severely limited local tax levies, produced diminution of local services and great reliance upon fees by local governments for local government revenues. Unfortunately, home builders are prime sources of fee revenue in such situations.

In California, builders saw tenfold increases in the per lot fees for sewer tax, impact assessments, land use approvals, and building permits. All these costs were passed through to the home buyer, which made home ownership even more expensive.

We also project a distortion within the housing market between high and low tax rate municipalities on both an intra-state and inter-state basis. All else being equal, prospective home buyers may well be inclined to choose lower tax communities in New Jersey or Connecticut over those in the New York metropolitan area. Within our suburban counties, real estate values may decline in the higher tax communities as lower tax communities become more attractive.

Aside from the dashed hopes of home buyers and home builders in the higher taxed towns, those communities will find less tax base growth, which will further aggravate the difficulty caused by the loss of deductibility.

We have seen facile arguments in the newspapers that New Yorkers should change their living habits overnight, demanding reduced costs of local government and accepting reduced services. This argument is made because proponents of removing deductibility, who come from less highly taxed States, are arguing that their taxpayers are subsidizing the opulence of New York.

We believe that whatever advantage may accrue to New York because of the deductibility of State and local taxes cannot be taken out of context in the pattern of Federal expenditures in the Sun Belt and other areas of the Nation.

New York is part of a real estate industry which has been targeted for major hits under the President's tax reform proposal. We in New York have examined the impacts of the loss of mortgage revenue bonds, industrial development bonds, the limitations on appreciation, loss of accelerated cost recovery, investment tax credits, reduction in historic tax credits, and other proposed changes, all of which will impact adversely on the production of housing in New York State. We have concluded that the loss of deductibility of State and local taxes is the most serious.

We applaud the efforts of you, Senator D'Amato, and other New York elected officials who early focused dramatic attention on the importance of this issue.

We have successfully urged our colleagues within the National Association of Home Builders to place the issue of the threatened loss of deduction of State and local tax payments from Federal income tax statements high on its list of legislative priorities.

Further, we have urged all of our members with congressional contacts outside of New York State to make their best case for preservation of the deductibility of State and local taxes.

Thank you for allowing us to testify before you today.

Senator D'AMATO. Thank you for your statement. I am going to call on Clarence D. Rappleyea, Jr., minority leader, New York State Assembly.

STATEMENT OF CLARENCE D. RAPPLEYEA, JR., MINORITY LEADER, NEW YORK STATE ASSEMBLY

Mr. RAPPLEYEA. Senator D'Amato, members of the subcommittee, in the past few months, much of the discussion and public comment of proposed Federal tax reform has focused on elimination of the deductibility of State and local taxes.

The concern among State and local government officials about the economic and fiscal impact of that provision is genuine and understandable. It is a concern that I and my Republican colleagues in the New York State Assembly share.

In May, the 56 members of Assembly Republican Conference united in expressing our concern about the issue to the President, in the form of a letter and a conference resolution urging the retention of State-local deductibility.

However, I do believe that this and other disputed provisions of the tax reform plan can and should be resolved.

Assembly Republicans have long contended that New York's heavy tax load have placed this State far out of line with the rest of the Nation. While progress is being made to lower New York State taxes, our State is still far from the mainstream of tax levels in the Nation.

I am not here to defend our high tax status. I deplore New York's distinction as a high tax State. Yet, as distressed as I am about economic disadvantages of our high taxes, I am equally distressed about the economic disruption that would be caused by the precipitous loss of State and local tax deductibility.

It is essential that Congress do all it can to bring sense and sanity to Federal taxes. It is unfortunate that many of the very positive provisions offered by the President's plan have been overlooked as attention has focused on the deductibility issue.

By raising the personal exemption, the zero bracket amount and by expanding the credit for the elderly, blind and disabled, the plan would free those below the poverty level from taxes.

By eliminating many loopholes and shelters, the plan not only makes taxes more equitable, it also makes our Tax Code economically neutral. If you believe in the free market, as I do, you should share my enthusiasm for a tax code that would permit investment decisions to be made on the basis of economic productivity, not simply because they conform with available tax breaks.

By distributing Federal tax burdens more equitably, the proposal would improve the taxpaying public's perception of the tax system, enhancing the voluntary compliance necessary to our tax system.

I, for one, see many positive elements in the tax reform plan. I do not wish it to be sidetracked by protracted acrimony over selected provisions. I encourage Congress to continue to weigh the parts of the plan with a vigilant eye on the whole. To suggest that reform cannot be accomplished because of current disputes would be to accept defeat prematurely.

In the give and take of legislative decisionmaking, we all must be willing to give on certain points in order to get reform accomplished. Yet, as a representative of New York State, I do not wish to do all the giving and let others do all the taking.

In return for any movement on the question of State-local deductibility, I would urge those States that do not require their citizens to pay high State and local taxes to also contribute to the achievement of genuine tax reform. Foremost among those are the States using tax on energy resources to restrain, and in some cases, reduce their own income, sales and property taxes.

It is an irony of the Federal system that many communities in the Northeast struggle to finance even the most basic public services while the State of Alaska hands out checks to each and every Alaskan citizen. The source of Alaska's generosity? Its awesome oil revenues.

In 1982, Alaska sent its citizens $1,000 dividend checks, financed by a fund created with 25 percent of the States revenues from Prudhoe Bay oil fields and other mineral resources. It has been estimated those revenues will total nearly $200 billion over the next 20 years.

Of course, Alaska is not the only State to reap the benefits of its energy resources. Oil severance taxes in Texas produced more than $1 billion in 1979. In that same year, Louisiana's income from oil taxes was $453.7 million and Oklahoma received $244.7 million in oil tax receipts. The State of Montana which has imposed a 30 percent tax on low-sulfur coal, receives $60 million each year from that tax.

The tax revenues derived from the energy resources located in these States provide powerful incentives for people and businesses to move to these States. The revenues provide a source of funds for the essential investments in the road, bridges and other public works that provide the foundation for economic development and business expansion. The energy taxes allow these States to cut or eliminate traditional taxes—property, income, and sales—making them even more attractive relocation sites.

Who pays the energy taxes imposed by these States? The energy consumers of other States. Eighty-five percent of Alaska's oil tax burden is exported to other States. Oil users from other States pay 79 percent of Louisiana's tax, 64 percent of Texas' and 57 percent of Oklahoma's.

By 1987, it is expected that eight States of the Northeast and Midwest—New York, Minnesota, Iowa, Illinois, Indiana, Wisconsin, Michigan, and Ohio—will pay $240.4 million in coal severance taxes each year to Montana and Wyoming.

Nine States rich in energy resources—Louisiana, Wyoming, New Mexico, Kentucky, Alaska, Oklahoma, West Virginia, Montana, and Texas—are on the verge of exploiting the energy crunch to the serious detriment of the rest of the Nation.

One congressional report labeled them the "United American Emerites," suggesting their bounty of energy resources could make them the domestic version of the Arab organization of petroleum exporting countries [OPEC].

The growing disparity between the energy "haves" and the energy "have-nots" presents an issue of especially great concern for the residents of New York and the Northeast. First of all, we import almost all our energy. Second, our energy costs are already greater than the rest of the Nation.

In 1980, the average American household spent $963 a year on energy costs. In New York, that figure was $1,086. In further contrast, the average household in the West spent only $676 a year.

Faced with high unemployment, abandoned factories, a shrinking tax base, deteriorating public facilities and the potential loss of State-local tax deductibility, the residents of New York and other Northeastern States should not be forced to continue to finance the growth of the energy rich States.

Although few would argue with the right of any State to levy its own taxes, consideration should be given to the view that nonrenewable energy resources are national resources, not just the domain of the State in which they happen to be located.

Furthermore, the interstate commerce of energy resources is clearly within the constitutional jurisdiction of the U.S. Congress. In order to forestall an energy war between the States, Congress must act to balance the needs of the energy poor States with the rights of the energy rich.

In recent years, several pieces of legislation have been introduced in Congress to limit the rates of State severance taxation to reasonable levels.

As Congress considers the President's tax reform proposal, I would strongly urge consideration of a national severance tax.

If the goal of tax reform is fairness, what could be more fair than sharing the wealth of our national energy resources.

Those contending that other States are subsidizing high tax States such as New York by paying the costs of State-local tax deductibility are forgetting that energy importing States such as New York are subsidizing the low individual taxes of energy exporting States by paying their high severance taxes on oil, coal, and natural gas.

By adding a national energy severance tax to the Tax Reform Program, Congress might be able to finance all or part of the retention of State and local tax deductibility.

Establishment of a national energy severance tax would allow all who pay the tax benefit from its revenues. The continued subsidization of the energy rich by the energy consumers will only exacerbate the fiscal disparities that exist among the States of our Nation.

Failure to address the issue of energy severance taxes will also frustrate the admirable intent of Federal tax reform.

I urge Congress to address this crucial issue in a responsible, equitable, and expeditious manner.

Senator D'AMATO. We thank this panel for the participation and urge you to continue to carry the message to your colleagues in other States, it's absolutely essential, because this should not be perceived as a New York State problem alone.

It's important that we carry that message to the people throughout the country so they can raise the proper questions to their Congressmen, to their Senators, so we can build a coalition to bring about tax reform but not take away the rights of our people and citizens, the local government and home ownership.

I want to thank you all for your participation here today and at this time, the subcommittee stands adjourned. Thank you.

[Whereupon, the subcommittee adjourned, subject to the call of the Chair.]

[The following information was subsequently supplied for the record:]

TESTIMONY FOR JOINT ECONOMIC COMMITTEE OF THE
UNITED STATES CONGRESS

HEARING ON TAX REFORM PROPOSALS AND THEIR IMPACT
ON NEW YORK STATE

Senator Alphonse Damato, Chair
July 15, 1985

Presented by:
Paul H. Elisha, Executive Director
NEW YORK STATE COMMON CAUSE

I appreciate this opportunity to bring you this message from the approximately 27,000 Common Cause members, in New York, who believe that fairness and the opportunity for participation are still among the most important qualities in our form of government which must be nurtured and protected, if that form of government is to survive.

Common Cause as a national organization is vitally concerned with those issues of fairness and tax equity which have become elements of focus in various proposals which have been submitted for tax reform. Further related to the fairness issue, New York State Common Cause has sought to focus attention on the question of state and local tax deductions, not only because their elimination would constitute a "double" tax but because of the economic imbalance of the resulting tax burden on the high-tax states of the northeast, middle and far west.

Our specific purpose here, today, however, is to call attention to a recently added factor in the President's tax reform proposal; the intention to eliminate the Dollar Check-off system, for public financing of presidential campaigns. We believe such an intent is being misrepresented to the nation as a reform. Actually it is an abuse of a reform initiated with taxpayers' concurrence to give them a greater measure of participation in the electoral system. Perhaps the greatest evidence of that concurrence is shown in the effect of citizen participation, which was substantial enough to provide this president with more than $90 million for his 1976, 1980 and 1984 campaign efforts. But beyond this, since 1974, the simple Dollar Check-off system has provided public financing sufficient to assist 34 of the 35 major party presidential candidates' efforts.

The most important aspect of this public finance system is that it takes the onus of indebtedness to special interests off the consciences of candidates and helps to make them more accountable to the thousands of ordinary constituents, whose best interests are supposed to be their primary concern.

What are the prospects for financing of presidential election campaigns, if Mr. Reagan is successful in his effort? Americans once again may face the spectre of another "Watergate". Hardly an empty threat, since it was the revelations of the effect of special interest peddling on the Presidency of Mr. Nixon which resulted in the establishment of the public financing system in the first place. Who can forget the disclosures of under-the-table contributions, one as much as $2 million, and the subsequent laundering maneuvers of the notorious Committee to Re-elect the President?

It may be argued that specifically, the subject of this hearing is the impact of certain tax reform proposals on New York State. In this case, I would submit that never has the phrase been so apt: "What effects the nation effects New York State."

The President has suggested that acquiescence to his deficit reduction and tax reform proposals would be a welcome "get well gift." While all citizens should wish him well, it also could be successfully argued that he presumes too much on the generosity of his fellow citizens. What he is asking as a boost for his morale is a measure of a birth-right for which too many Americans have already sacrificed life and limb.

The very fragility of a single leader's life, vividly brought home to us in these recent days, makes it imperative that we bend every effort to assure that the succession of power in this democracy be vested in as many hands as possible; never left to the manipulations of an elite few.

That is the message we of New York State Common Cause urge you, Senator Damato to take back to your colleagues, as they prepare to take up the critical subject of tax reform.

Thank you

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