Cutting through the tax debate

Kathy Burdman shows why cuts can fuel inflation—unless the whole upside-down taxation system gets an overhaul.

One of the single most important tasks confronting the new U.S. administration will be to shape a tax policy to reverse America's industrial decline and rebuild the economy. President Reagan is personally committed to reducing the crushing tax burden on American industry and families, and the Reagan transition team, in a recent fact sheet, proposed a sweeping $22 billion tax cut for fiscal 1981 on the model of the Kemp-Roth tax bill. The program, sponsored by Rep. Jack Kemp (R-N.Y.) and Sen. William Roth (R-Del.), would cut personal income taxes 10 percent a year through 1985, and provide accelerated tax measures intended to stimulate corporate investment.

Kemp-Roth is often denounced as too sweeping by the liberal Republicans and Democrats in Congress. But the major alternatives on the table, two separate tax-cut proposals by Senate Finance Committee Chairman Robert Dole (R-Kans.) and Senate Finance Committee minority leader Russell Long (D-La.), contemplate a similar $20 billion range of tax cuts for fiscal 1981.

The American people and American business know only too well that the current tax burden endangers the future of the American System. But the major cuts proposed by Reagan, Dole, and Long, while not "too large," are, in fact, too sweeping in a fundamental way. By cutting taxes across the board, with little or no regard to *what* taxes are being cut, they run the risk of greatly increasing inflation, without helping in any way to increase the nation's tax base.

Under conditions of double-digit inflation and soaring interest rates, a premium is placed on fast-buck speculative investment to the detriment of long-term industrial capital formation. Under such conditions, any non-selective tax cut, failing to distinguish between incomes generated from productive and speculative sources, will only increase the funds available for that inflation-feeding, nonproductive use of capital fostered by inflation and interest-rate conditions.

Moreover, the American tax system itself makes speculation a tax shelter; the fact is that the entire American tax system is constructed upside-down. It does more than merely discourage capital formation in industry and other goods-producing sectors. It actively forces investment out of long-term, productivity-increasing outlays, into real estate and similar speculative investments that make no contribution to the tax base.

For this reason, the aggregate value of real-estate holdings in the American economy, estimated at over $3.5 trillion by *EIR,* is more than five times larger than the value of all plant and equipment in American manufacturing industry. The value of New York City real estate alone is larger than the producing assets of the nation's manufacturing corporations.

If this real-estate income, for example, were properly taxed, *EIR* estimates *an additional $45 billion could have been recouped for the U.S. Treasury in 1980.*

To expand the U.S. tax base, by expanding the economy as a whole, tax cuts must therefore attack the root of economic decay: the decline of productivity in manufacturing, construction, transportation, agriculture, mining, and utilities.

The American family, too, needs a specific kind of tax break. Current tax rates on households with incomes of $20,000 per year and under, 80 percent of U.S. households, actually *prohibit family formation,* and must be greatly reduced for this bracket.

To rebuild the economy, tax cuts for the 1980s must be *targeted* to provide incentives for family formation and to increase corporate investment specifically in new industrial capital, and to dissuade speculative investment. In effect, the productive industrial sector must be made the only "tax shelter."

The flaw in Kemp-Roth is fundamentally one of ideological blindness, blind adherence to the same British principles of political economy the Carter administration used to wreck the U.S. economy. As William Fellner, the American Enterprise Institute economist who worked on the Reagan transition team task force with Representative Kemp, Art Laffer, and the other well-intentioned supply-side tax-cutters, put it in a recent *EIR* interview, "We cannot imagine that we can determine what is productive and what is not. Who are you, or I, to say that steel mills are more productive than high-rises or gambling casinos? Whichever is more profitable is more productive."

This is simply bad economics. For example, the Kemp-Roth proposal to merely cut personal income taxes across the board by 10 percent will continue to allow large-scale personal speculation in real estate by individuals who should be encouraged to put their money into industry or savings of real economic benefit to the nation. In particular, the proposal may even contain provisions to reduce the top tax rate on individual capital gains from 28 percent to 20 percent, thus greatly encouraging individuals to engage in investments in real estate with a view to taking speculative capital gains.

Similarly, Kemp-Roth may also eventually include provisions to reduce corporate capital gains from 28 percent to 20 percent, which would be a huge inflationary windfall to the financial institutions' $100 billion-plus annual real-estate income. The other aspect of the business tax reduction component of Kemp-Roth, the so-called 10-5-3 accelerated depreciation for business investment, would allow productive industry to write off buildings in 10 years, machinery in 5 years, and vehicles in 3 years. But its heavy emphasis on real-estate writeoffs would be another windfall to the real-estate speculators.

The National Democratic Policy Committee, a conservative Democratic Party policy-making organization, has proposed a 1981 tax-cut plan that addresses this need for tax restructuring for national industrial growth. Entitled "A Taxation System for Capital Formation," the plan was devised by the committee's Advisory Board Chairman Lyndon H. LaRouche, a 1980 Democratic presidential candidate. It contains four basic elements:

"1. Increase the personal income-tax exemption to remove all tax liability for families at or below $20,000 per year gross pre-tax income.

"2. Maintain present progressive income-tax schedules but with substantial exemptions for productive investment of household income.

"3. Grant a 20 percent investment-tax credit for corporations on the margin of new investment above 1980 levels coupled with accelerated depreciation of industrial, agricultural, mining, and utilities structures and equipment.

"4. Generate additional revenues by increasing tax schedules on income and capital gains on nonproductive investment, principally commercial real estate."

The Policy Committee's proposals amount to a $51 billion tax cut for fiscal 1981, and, although twice the size of other tax cut plans on the table, would be much less inflationary.

The question of U.S. *business-tax cuts* boils down to the question of where we invest capital in America's future: in steel mills and other heavy industry, or in gambling casinos and other "postindustrial" real-estate speculation.

There are so many loopholes in the tax structure for investment in real estate and related speculation at present that the tax structure in effect encourages real-estate speculation. Even where tax laws for real estate and related investment parallel taxation of industrial production, the *turnover* in real-estate holdings of condominiums and land, the sheer resale market, which rises logarithmically, far exceeds the resale market for lowly industrial plant and equipment in the United States, which declines each year because of economic recession. Resale value alone is enough to guarantee a flight of investment money into the real-estate markets.

The major holders of speculative real-estate investment, defined as the large commercial banks, insurance companies, and real-estate corporations, and excluding the savings and loans who finance most of the nation's homebuilding, paid taxes on less than 7 percent of their income in 1980, according to *EIR*'s estimates.

Taxable income for this "financial sector" amounted to $18 billion or less in 1976, out of $310 billion in total income, according to the Internal Revenue Service's most recently available figures. *EIR* estimates corroborated by the IRS bring the financial sector's 1980 taxable income to no more than $35 billion, compared with total income of at least $510 billion.

Out of this $510 billion income, *EIR* estimates that the financial sector took some $475 billion in deductions in 1980. These include, of course, legitimate deductions for sales costs (salaries and operating expenses) and interest payments, which is the cost of raw materials, i.e., money, to a financial corporation. However, this sector also took some $167 billion in "other" deductions, which the IRS does not separately identify, and which is by far the largest category of deductions.

Most of these other deductions, according to estimates by *EIR* corroborated by the Senate Finance Committee, are related to the financial sector's estimated $120 billion in real-estate income in 1980.

First, the financial sector takes vastly accelerated depreciation on the value of the commercial structures and land holdings to which it holds title, and upon which the institution continues to hold the mortgage. This category is not included by the IRS in its listed minor figures for "depreciation," which merely account for the depreciation, for example, of a bank's own headquarters office, and not for depreciation on the billions in other commercial real-estate buildings whose mortgages the bank holds.

Second, due to the tremendous rise in real-estate and land prices under the current raging U.S. inflation, each year the capital value of the properties to which the financial sector holds investment title rises substantially. When these properties are sold, generating income and profits, the proceeds are taxed, not at the regular standard gross U.S. corporate income-tax rate of 48 percent, but at the capital-gains tax rate of 28 percent or less.

Considering the financial sector's total taxable income was only $35 billion in 1980, it is safe to assume that at least $100 billion of its $120 billion real-estate income went tax free. If that $100 billion were taxed at the normal corporate-tax rate of 37 percent after depreciation, this sector alone would generate an additional $37 billion in U.S. tax receipts on real estate.

In addition to the financial sector's 1980 real estate-related income of $120 billion must be considered the real-estate income of industrial corporations, estimated by *EIR* at $50 billion in 1980, and by individuals, whose non-homebuying real-estate income is estimated to be at least $25 billion for 1980. It is almost impossible to tell from IRS figures how much of this income is currently being properly taxed. It is likely that industrial corporations are entitled to most of the depreciation they take on their real-estate investments, much of which is, unlike in the financial sector, directly related to producing plants and equipment.

Much of the private individual sector's real-estate income, on the other hand, is probably not being taxed adequately due to the same vast acceleration and capital gains deductions provisions being taken, as in the financial sector. In all, out of this additional $75 billion in industrial and individual real-estate income, *EIR* estimates closing tax loopholes would generate an additional $5-$10 billion in tax revenue.

Rebuilding the American family

The American taxpayer in general needs a break, but the most glaring danger to our nation in the entire tax structure is the fact that it at present virtually forbids family formation by the 80 percent of the American population with an average working-man's income today. Unless this insane bias in the tax structure is reversed, America's productive workforce will be greatly reduced, its living and educational standards destroyed, and our national productivity per worker correspondingly reduced, to the long-term detriment of the economy.

In 1977, the latest IRS figures available, 79 percent of the personal income-tax returns filed were filed by households with gross income of $20,000 or under, a gross-income figure regarded as the "higher income level" end of the spectrum for the average working family by the U.S. Department of Labor. But of these returns, only 17 percent of families with incomes of $20,000 or under filed with four or more exemptions. That is, only 17 percent of households with this gross income could afford to have two children. In fact, only 28.5 percent of households in this income bracket filed with three exemptions, that is, could afford to have even one child.

These figures exaggerate the number of children now affordable to the "average" American working family, since these exemption categories include in many cases exemptions for students and other two-exemption-per-household-member exemptions.

The fact is that with four exemptions, a $20,000 higher-level income was taxed in 1979 and 1980 at an average rate of 11.3 percent, for a net income available to the family of $17,735. As any urban American citizen can tell the fools at the Department of Labor, this is no higher-budget living standard.

An actual gross income necessary to provide for a two-child family today may be closer to $25,000. As the National Democratic Policy Committee has proposed, families of four in this income category should be completely tax-exempt. Even if this were done, so few such families now exist that the cost to the Treasury of such a well-targeted tax cut would be a mere $17.2 billion, assuming no economic recovery and present employment levels.

For the rest of the taxpayers, current progressive income schedules are so burdensome that even the most responsible well-off citizen is virtually forced to seek tax shelters in real-estate capital gains, tax shelter writeoffs, and other subterfuges. While these ease the tax burden on the individual taxpayer, they cause grave damage to the national economy, because the national total of such funds is a large, lump-sum channeling of vital credit into some of the least-productive sectors.

An alternative proposal put foward by NDPC Advisory Board Chairman LaRouche in his recent book, *A "Gaullist" Solution for Italy's Monetary Crisis,* is that the progressive income-tax schedule for the 20 percent of households in higher tax brackets should continue to have highly graduated basic tax rates, but that legal writeoffs, some quite extensive, should be widely provided to encourage these households' investments into the nation's capital-formation needs. Direct investment in capital improvements in manufacturing, transportation, and agriculture should qualify for substantial tax writeoffs, the NDPC suggests.

The Democratic group further calculates that a total tax exemption on savings accounts at all thrift institutions, including savings banks, savings and loan associations, and credit unions, would raise the volume of savings in the economy from $85 billion to $120 billion. This would provide a real basis for new construction in the home- and other building industries, and would return about $8 billion to individuals, mainly in the higher tax brackets.