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NDPC Proposal

An alternate plan for productive. tax 'shelters'

The following is a policy statement by the National Democratic Policy Committee (NDPC) which reflects, in condensed form, the views NDPC Advisory Council Chairman Lyndon LaRouche expressed in his book A "Gaullist" Solution to Italy's Monetary Crisis.

President Ronald Reagan's commitment to reduce taxes to get the nation's industrial might producing again is among the best goals of the administration. However, the supply-side mix of untargeted, marginal tax cuts with tight money will have precisely the wrong effect.

The supply-side mix is in fact intended by some of the President's worst advisers to deliberately shut down much of basic heavy industry, and push the U.S. into the "postindustrial"' society. Since across-the-board marginal tax cuts are expressly designed to go with an extreme policy of high interest rates, supply-siders freely admit that only the new "information-age" industries that already have high cash flow, such as computers, services, and real estate will get the tax breaks. Already in deficit, America's basic heavy industry—auto, steel, homebuilding, and savings institutions—deliberately receive no tax benefit, and can make no capital improvement given rocketing interest rates.

There can be no economic recovery in fact without reversing Federal Reserve Board Chairman Paul Volcker's high interest-rate regime. Once the Volcker Fed's monetarist policy is accepted as given, the Washington debate on tax policy is reduced to an academic argument, while the Fed goes on leveling our industrial economy.

The monetarists simply lie when they say credit—lower interest rates—would create inflation. The Fed must introduce a "two-tier" credit system, in which basic heavy industry is given preferential credit, while real estate and other speculative markets are "hung out to dry" at continued double-digit rates. As described in the Federal Reserve Reform Act [drafted in 1980 by the NDPC—ed.], this can be done by making loans for the creation of tangible wealth in capital goods, transport, agriculture, homebuilding, and other strictly productive activity *discountable* at the Fed discount window up to 50 percent of the value of the loan.

We contrast this with the "directed credit" proposals of House Banking Committee Chairman Henry Reuss, whose industrial policy is identical to that of the supply-siders. Reuss would use a two-tier credit system to promote the "postindustrial" model, by excluding auto, steel, and other distressed industry from the preferential lower tier, and encouraging "postindustrial" sectors.

Accordingly, any Democratic tax policy must emphasize *targeting* of tax cuts to explicitly promote new capital investments in basic heavy industry. Also needed are deep personal tax cuts on the lower-income scale, to promote family formation.

The recent tax proposals of House Ways and Means Chairman Dan Rostenkowski and the Senate Democratic Conservative Caucus reject across-the-board supply-side tax cuts, and note in theory the need to revitalize basic industry. In practice, however, they fail to establish targeting, and adopt marginal tax cuts just as in Kemp-Roth.

The duplicate tax credit

The present U.S. tax system actively discourages capital formation in productive industry and encourages investment income into real estate and other speculative tax shelters which make no contribution to the tax base. Undifferentiated lowering of marginal tax rates only exacerbates this situation.

Rather, we propose the *duplicate tax credit,* under which, while maintaining high progressive personal tax rates, we create extremely large new "tax shelters" for income invested productively.

The duplicate tax credit works on the individual income side by providing significant tax exemption on income from investment in equity in industrial and agricultural corporations, and other specified production activities creating new tangible wealth.

The duplicate tax credit works in tandem with a targeted 20 percent ITC for every dollar spent specifically on new, high-technology productive investment. This would exclude diversification of steel companies, for example, out of steel and into real estate.

Investors in the equity of such corporations would receive a percentage tax exemption on their investment income calculated based on the corporation's capital spending as a rate of total income. That is, if a company spent a sum equivalent to 100 percent of taxable income on specified capital investment, its stock would pay dividends that were 20 percent tax free. Hypothetically, a company which borrowed to expand investment, such that it spent, for example, a sum twice its income on capital investment, would be entitled to pay dividends that would be 40 percent tax free. That is coupled with a hefty R&D tax credit.

We thus create a situation in which every Wall Street stock analyst finds that his job is now to identify those

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companies who plan to move aggressively into new high-technolgy investments, and recommend their stocks. This in turn will put most corporate finance officers into the position of advocating major capital improvement programs.

For distressed industries such as auto and steel, the program would allow unused investment tax credits to be carried back to be used against 100 percent of tax liability. Again, the credits would be required to be used for targeted, high-technology capital improvements. Equity dividends of such companies would be granted a flat 50 percent tax-free rate to the investor.

This deals neatly with the problem of double taxation of dividends. In short, dividends of stock in a company making approved production investments are taxed neither on the corporate nor on the investor's side—double untaxed. Other corporations will have to suffer with double taxation.

The result could be one of the biggest capital investment booms in the nation's history.

Specific proposals

A. Individual tax cuts

1) No reduction in the top marginal tax rates. Maintain current progressive income schedules, and deal with the fact that an estimated $25 billion in revenue in the 50 to 70 percent tax bracket now escapes taxation by shutting down current tax shelters.

2) Provide the duplicate tax credit available for all taxable income accruing for investment in capital expansion industries. This includes not only corporations, but also investment in agriculture and small business. This should capture the investment flow above, now sheltered unproductively, and guarantee its productive use. Mere reduction in the marginal tax rate would allow income in the 50 to 70 percent brackets to continue to flow into speculative investment.

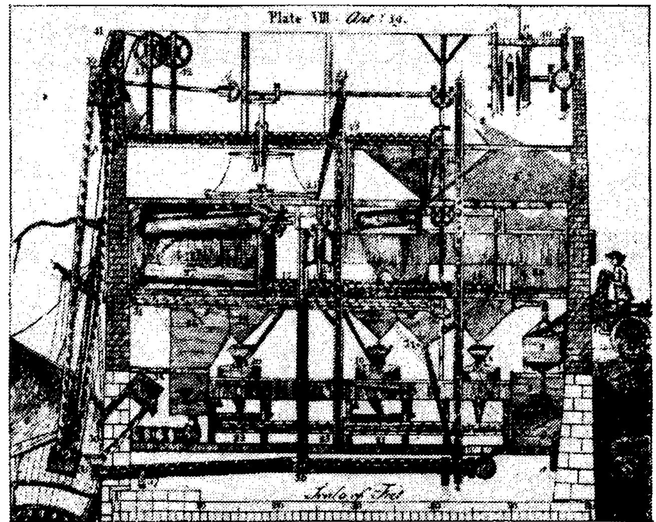
3) Reduce taxes in the lower income brackets to encourage family formation. This requires a much more dramatic reduction than most current tax discussion acknowledges. Present IRS data show that while 79 percent of all households file returns at gross incomes of $20,000 or under, only 17 percent of these families have four or more exemptions—that is, only 17 percent can support two children. The actual net income of $17,735 available to a family of four in 1980 at these levels is not in fact sufficient to support a family.

We propose increasing the personal tax exemption to remove all liability up to $20,000 gross income, a tax reduction in absolute terms of only $19.3 billion.

4) Eliminate the marriage penalty.

B. Savings and investment incentives

1) Provide investment tax credit of 20 percent on the margin of new investment above 1980 levels, for targeted productive investment as described above.



Oliver Evan's 1795 automated gristmill: Hamiltonian fiscal policies promoted inventions.

2) Provide accelerated depreciation targeted to productive assets. Simplify the depreciation schedules through classification of all assets into a limited number of recovery periods. Reject 10-5-3 and other supply-side formulations as untargeted and likely to encourage speculative writeoffs of real estate.

3) Provide savings investment modeled on the targeted duplicate tax credit. For deposits in savings institutions and banks, the bulk of whose assets are invested in long-term mortgages and who avoid speculative investment in money market funds and commercial real estate, allow an exemption of 50 percent, or $1,000, whichever is higher, on savings income.

4) Introduce a dividend reinvestment plan for public utilities. Study the possibility of expanding this plan to auto, steel, and other distressed industries.

5) Provide research and development incentives. A nonrefundable credit would go to business for 25 percent of the amount contributed in cash to a research and development reserve. Limit the maximum credit to 10 percent of the corporate business income. This is liberal compared to current average corporate R&D investment levels of 2 percent of income.

6) Provide unused investment tax credits. Allow credits that are carried back to be used against 100 percent of tax liability, provided that the credit is targeted into new productive capital investment.

7) Reject the rehabilitation tax credit. That program by itself will serve to encourage real estate speculation and diversification of heavy industry into new "postindustrial" fields, in the present high interest-rate environment. It should be replaced by the provisions for duplicate tax credit system outlined above, as specifically applied to new productive investment in the rehabilitation of structures.