CAMBRIDGE CITY COUNCIL

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David E. Sullivan
City Councillor

January 17, 1985

To the Honorable, the City Council:

I attach for the information of my colleagues the text of a recent address to the Massachusetts Business Round Table by Ira A. Jackson, Massachusetts Commissioner of Revenue. I also attach a Boston Globe article summarizing the speech.

Mr. Jackson's remarks endorsing the federal Treasury's tax reform proposal contain significant information of interest to the Council in its consideration of Calendar No. 11, the proposed resolution endorsing this tax reform plan.

Sincerely,

David E. Sullivan

David E. Sullivan

BUSINESS

State revenue boss backs Dukakis on US tax plan

By Chris Black
Globe Staff

State Revenue Comr. Ira A. Jackson yesterday said that the US Treasury Department's tax simplification plan would represent a net gain for Massachusetts and an average $149 federal tax savings for individual Bay State taxpayers in 1990.

More than a month after his boss, Gov. Michael S. Dukakis, embraced the plan as "extraordinary" and "progressive," Jackson revealed the results of a lengthy in-house analysis of the tax scheme that backs up Dukakis' position.

Jackson said that full implementation of the proposed overhaul of the tax code would save state taxpayers more than half a billion in tax payments to the federal treasury. Although the tax bill for businesses would increase under the plan, Massachusetts corporations stand to pay only about half the increase of the national average because of the mix of Massachusetts businesses.

In late November, the US Treasury Department made public a dramatic overhaul of the federal tax system which includes reduction of tax brackets from 14 to 3, full taxation of capital gains, reduction of charitable tax deductions, increased corporate taxes, reduction of individual taxes and elimination of state and local tax deductions.

Jackson delivered the findings of the analysis at the monthly meeting of the Massachusetts Business Roundtable at the Hancock Institute yesterday. The meeting was closed to the public but Jackson's office released a text of his remarks later in the day.

The Revenue Department analysis concluded:

- An estimated 100,000 residents whose incomes fall below the poverty line would be exempted from any federal tax obligation.
- Individuals would pay $555 million less in federal taxes in 1990.
- The plan would mean lower or the same taxes for 76 percent of all Bay State taxpayers.
- Massachusetts corporations would face a 16 percent or $463 million increase in federal taxes in 1990. This represents less than half of the US average corporate tax increase because Massachusetts industries make below-average use of several of the tax breaks scheduled for elimination.
- While the net effect of the state individuals' cuts are partially offset by corporate increases, the state will realize a net tax reduction of $72 million in 1990.

Dukakis was the first major Northeastern state governor to publicly endorse the tax plan early last month, a posture that put him at odds with his ally in neighboring New York state, Gov. Mario M. Cuomo.

Cuomo and other New York officials lambasted the proposal because of the provision eliminating the federal tax deduction for state and local taxes. New York state officials have estimated that provision would cost New York $6 billion.

Jackson took a shot at unnamed "public officials" who criticized the plan because of that provision. "Many public officials whose judgment might have been a bit more considered and less prone to jerking knees have looked at this part of the plan in isolation," he said. "They have failed to view the plan in its entirety, and they have fallen victim to the predictable trap of looking from a parochial perspective when the plan can only be fairly viewed in terms of its broader sweep and overall effect."

TAXES, Page 36

Revenue chief backs tax plan

■ TAXES
Continued from Page 34

Jackson acknowledged that the existing federal tax deduction for state and local taxes benefited Massachusetts taxpayers. But he said that the relative decline in the state's revenue burden blunted the impact. "Our revenue burden in Massachusetts is 8.4 percent below the national average today and by 1990 there is every reason to believe it will be even lower," he said.

He added, "On balance we believe that the loss of the state and local tax deduction may well be an acceptable price to pay for a simpler tax system which is ultimately fairer and clearly benefits all our taxpayers."

Jackson argued that it would be a mistake to view any single provision in isolation. Taxation of capital gains, a concern for a state where venture capital has funded growth in the high-technology industry, would be offset by sharp cutbacks in tax shelters that are beneficial to other states, he said.

In his view, the timing of major changes in the tax code is good for the state. "While no state economy is invulnerable to the potential adverse effects of the plan, the Massachusetts economy is likely to remain more resistant and resilient than most in the face of sweeping tax reform," he said.

He also recommended that the federal government step up tax collection and enforcement procedures. "If the IRS could pull off a 3 to 4 percent increase in voluntary compliance as we have, they would be picking up 20 to 30 billion dollars in new and recurring revenues," he said. "Cutting losses from tax evasion in half would generate well over $50 billion annually."

REMARKS BY
IRA A. JACKSON
COMMISSIONER
MASSACHUSETTS DEPARTMENT OF REVENUE

MASSACHUSETTS BUSINESS ROUND TABLE
JANUARY 8, 1984

It's an honor to speak to you this morning -- not only am I pleased by the invitation itself, but I'm also flattered by your request that I discuss the proposed Treasury tax reform plan. For those of you who know me, I'm more of a manager than a tax expert or an economist. Fortunately, I do have some hard-working staff in our recently created Bureau of Analysis, Estimation and Research who have considerably more expertise and patience in these areas than I -- and they've provided some initial analysis of the impact of the Treasury tax plan on Massachusetts for me to share with you. Grady Hedgespeth, our chief economist, is here with me this morning.

After my staff had spent a few ten-hour days pouring over the 700-page Treasury plan, they shared with me a cartoon from the Globe. The cartoon, hopefully not too sexist to still be funny, shows the standard breakfast table scene -- man reading the paper and wife making conversation. She says, "Edgar, would you explain the new federal tax simplification plan to me?". His response: "No, it's too complicated."

I'll leave it to you to decide which seat at that breakfast table I deserve.

Simply stated, the Reagan Administration's tax plan broadens the tax base by **closing loopholes** and **lowering marginal rates.** Generally, the plan is **progressive** and it does **simplify** the tax code.

Filling out personal returns would be less burdensome. In fact, it's estimated that by 1990, about **two-thirds of all** individual income tax returns could be computer-generated by the IRS. That, alone, has to qualify the Treasury proposal as the single most significant effort at regulatory relief and reform -- and the most ambitious effort yet to relieve the paperwork burden of complying with government's insatiable need for data -- in history.

Progressivity among income classes and between corporations and individuals would be improved and fewer of the poor or working poor would pay any taxes at all. Approximately 3.5 million people would no longer have to pay any federal taxes nationwide. In Massachusetts, we estimate almost 100,000 poor and working taxpayers who fall below the poverty line would be exempted from any federal tax obligation. In that respect, the Treasury plan would bring a long-overdue element of common sense and equity to our federal system, and would represent a major step forward in terms of tax policy and the poor.

Incidentally, this is quite nicely linked with a change in the Massachusetts personal income tax which becomes effective with this year's tax return. That is an increase in the no-tax status -- enacted as part of Governor Dukakis' Revenue Enforcement and Protection program. It virtually doubles the minimum income level for a state tax liability. When it's completely phased in next year, it's expected to relieve 150,000 low income citizens from the obligation to pay Massachusetts taxes.

In aggregate, Massachusetts individuals would pay more than a half billion dollars **less** in federal taxes if the Treasury plan is fully implemented in 1990. We in Massachusetts don't fare quite as well as the rest of the nation on average because we make more use on average of the state and local tax deduction. But benefit we would -- to the tune of $555 million in total. That works out to $149 per taxpayer, nearly $300 per married couple filing jointly.

The elimination of that deduction for state and local taxes is perhaps the most controversial part of the Treasury tax plan. Many public officials whose judgment might have been a bit more considered and less prone to jerking knees have looked at this part of the plan in isolation. They have then jumped to the conclusion that individuals who use this deduction will suffer a huge tax increase. But they have failed to view the plan in its entirety, and they have fallen victim to the predictable trap of looking out from a parochial perspective when the plan can only be fairly viewed in terms of its broader sweep and overall effect.

It's true that we in Massachusetts tend to itemize and therefore use the deduction for state and local taxes more heavily than taxpayers in other states. In addition, Massachusetts relies most heavily in its revenue portfolio on the most commonly deducted taxes -- income and property taxes. So, we get more benefit from being able to deduct these taxes from our federal tax bill.

But two factors mitigate the impact of eliminating this deduction. First, our total revenue burden in Massachusetts is declining compared to the national average. In fact, our revenue burden in Massachusetts is 8.4% below the national average today, and by 1990 there is every reason to believe it will be even lower. And the Master Tax Commission may yet effect a set of state tax reforms that lower our reliance on personal income taxes, which are deductable, in exchange for other revenue sources which are not. So, by 1990 the impact of loss of federal deductability of state and local taxes for Massachusetts taxpayers may be considerably less than we can calculate today, based on current data.

Since 1981, property tax collections in Massachusetts have decreased 10%. Nationwide they've increased 22%. Moreover, many states have raised their income tax rates in the past few years. Massachusetts has not. In fact, our personal income tax was cut in 1982, when the personal exemption was raised from $2000 to $2200.

Secondly, the elimination of the state and local tax deduction is just one portion of a much broader and more comprehensive plan. Viewed in its totality, that plan would mean reduced or the same taxes for 76% of all Massachusetts taxpayers. Again, the average reduction overall is $149 for each Massachusetts taxpayer. So, yes, it's true that this specific provision hits Massachusetts harder than certain other states. Still its effect is only a reduction in the net result -- from 78% nationally who would benefit or face no change in taxes, to 76% in Massachusetts. A reduction in benefits and in numbers who benefit, but not a penalty that totally negates the positive overall effect.

If tax reform is to be successful, compromises must be made. And it is in the nature of compromise that some people benefit while others may be asked to give something up. On balance, we believe that the loss of the state and local tax deduction may well be an acceptable price to pay for a simpler tax system which is ultimately fairer and clearly benefits all our taxpayers. And that includes even those in our business community.

Since I've broached the issue of compromise, it's fitting to discuss the impact of the Treasury plan on corporations. There can be no debating the fact that the Treasury plan would increase corporate taxes nationwide some 36.5%, or $44.8 billion by 1990. Our analysis, however, shows some interesting results for Massachusetts corporations.

Given our industrial mix, it appears that Massachusetts' corporations would face less than half of the U.S. average increase. Our calculations show the final increase here would be about 16%, or $483 million in 1990. That's because our industries make below-average use of several of the tax breaks scheduled for elimination, especially ACRS.

I should note at this point that, overall, the Treasury plan still means a tax reduction for Massachusetts taxpayers. Although individual cuts are partially offset by corporate increases, the net effect is a tax reduction of $72 million in 1990.

That's $72 million more in disposable income in Massachusetts -- for consumption, investment and economic growth.

And, although somewhat out of context, the subject of investment under the Treasury Plan deserves a few words.

The treatment of capital gains may well be the linkage between business and individual taxation. On first glance, the Reagan Administration plan might appear to adversely affect the supply of venture capital by abolishing the current preferential treatment of capital gains. And that would have to be a legitimate concern for a state where venture capital has played such a key and catalytic role in spawning, incubating, and establishing new technology-based businesses that are the key to the future.

Seen in isolation -- even with the indexing provision -- this is probably true. But the Treasury plan also makes real estate and oil and gas investments less attractive, as well as sharply curtailing existing tax shelters.

If the plan were to pass, much of the capital invested in these areas would go elsewhere, and because capital gains will still receive somewhat preferential treatment, a significant amount of that capital will flow to venture capital firms.

In short, while the venture capital game will not be quite as attractive as it was, it will be one of the only games in town.

There are three other considerations that affect the supply of capital available to industry.

First, it will still be possible (although more difficult) to structure venture capital investments in such a way that investors can avail themselves of tax advantages retained in the Treasury plan. These include the R&D credit, expensing of R&D expenditures, amortization of start up costs, and loss carryover provisions.

Second, the increase in savings stimulated by reductions in individual and marginal rates, and expansion of IRAs, should increase the supply of capital available to industry.

And third, roughly one-half of the funds committed to venture capital firms comes from tax exempt entities such as pension funds, endowments, and foundations, or from foreign investors. The equity capital from these sources will not be significantly affected by the plan.

I might add, parenthetically, that my understanding of the miracle of the Massachusetts economy is that our strength lies not so much in the availability of **investment** capital, but in our abundance of **human** capital and ingenuity and risk-takers and innovators. Investment capital will continue to seek out human capital in Massachusetts -- because in Massachusetts we create ideas and new products, not just wealth or a steady return based on conventional industrial production.

All the same, the Treasury Plan would raise taxes on corporations by a significant margin. It's certainly a surprising, if not astonishing, outcome from a conservative Republican Administration which has consistently leaned towards the reduction of corporate taxes -- and from a President who, not so long ago, proposed the abolition of the corporate income tax altogether. What, you may well ask, is going on?

I can't presume to know the whole story, but I suspect that the answer starts with Secretary Regan's observation that our corporate tax code is really a national industrial policy in disguise. Under current law, certain industries are accorded huge tax breaks, while others bear the brunt of a high nominal corporate tax rate. As you well know, some industries have an effective rate double that of other industries. And many large and profitable corporations pay no tax at all. In fact they are rewarded with tax refunds that result in a negative tax burden, to coin a phrase.

The Reagan Administration's plan would virtually eliminate these wide variations in effective tax rates. (Ironically, this disparity was widened by provisions enacted or previously supported by his Administration.) Instead, the proposed plan would place all industries on a more equal tax footing.

I can only surmise that the Treasury in part responded to a 30-year trend of decreased reliance on corporate tax revenues federally, and sought to reverse it, while restoring lower marginal rates and achieving greater horizontal equity.

I'm not an unquestioning advocate of the free-market approach. I believe there is an appropriate role for government in stimulating economic growth and supporting private-sector endeavors. But now that I am a tax administrator, I am especially troubled by the number and scope of explicit and implicit government subsidies of business that have, over the years, found their way into the tax code.

It's not that they aren't important or even effective in providing economic incentives for certain types of investment decisions. What's troubling is that their revenue impact -- in other words, what they cost -- is rarely quantified, their continuing effectiveness is almost never reviewed, and they remain in the code -- frequently years after the initial need they once addressed has been fully accomplished -- without the kind of prudent cost-benefit analysis that anyone in this room would require of any major business decision. Their effectiveness is subject to little of the scrutiny that a direct expenditure program receives on an annual basis.

And we can end up with the situation Charles McClure, the Treasury's authority on tax policy, has aptly described as: people making investment decisions based on federal tax consequences and not on the profit or growth potential of the investment itself. The current code is an invitation for people to invest money to avoid taxes, not to earn money. And that, long term, is not a very healthy set of incentives in a capitalist economy which should be driven by profit, risk-taking and real return on investment.

So I'm not at all sure that what we now have is very good for economic growth. That's particularly true when those federal tax consequences are mostly comprised of economic activity which generates a loss, at least for tax purposes. Economists call that "perverse" economic behavior.

Federal tax law has long been considered a tool with which to achieve important changes in fiscal or social policy. The Treasury plan is designed largely to take the tax code out of this business. In the long run, this will increase the stability of the tax code. In the past the code has changed almost every time that economic conditions or social policy goals have changed. But stability and predictability, I hear from my friends in business, is the single most positive attribute any tax system can have from a corporate and investment perspective. The Treasury, at a minimum, would bring us closer to that elusive goal.

More stability means greater certainty. It also means that economic decision-making can be made with less consideration of tax policy scenarios. But in the context of a tax code which currently has strong overtones of industrial policy, neutrality becomes, at least initially, a goal with significant potential for short-term economic and even social dislocation. So it will take time to wean ourselves from the concept of an economy built around the tax system. Without a cautiously crafted transition, the Treasury tax plan could harm the structure and viability of our economy. I think we should support the plan and applaud the Administration which has proposed it; but even ardent enthusiasts must be concerned about avoiding any traumatic changes in one fell swoop, or proceeding with haste without consideration of perhaps some unintended consequences. Not that that is likely to happen!

In any event, we in Massachusetts might well be in better shape to handle transition effects than other states.

While all state economies would have to make their way through the transition period, the Massachusetts economy should have an easier time than most. We have a very large non-profit sector, which, while threatened by changes in the treatment of charitable contributions and the taxation of fringe benefits, may not be adversely affected by the plan, and a large service sector, which should on balance benefit from the plan. These sectors could help to cushion any adverse effect in sectors which may be hard hit. While no state economy is invulnerable to the potential adverse effects of the plan, the Massachusetts economy is likely to remain more resistant and resiliant than most in the face of sweeping tax reform, just as we have become more resistant and resiliant than most to business cycles, economic recessions, and even growth recessions.

The Massachusetts economy is booming -- which makes it a relatively advantageous time to change the tax code. If the Reagan Administration plan causes some industries to be less able to attract capital and retain workers, there already exist strong mechanisms -- such as plant closing legislation; our model employment training and Bay State Skills Corporation; our Centers of Excellence -- to soften the impact, to help stabilize the economy, to absorb a retrained workforce, and to attract new industries based on state-of-the-art technologies.

Because of our vibrant economy, the growing sectors are better able in Massachusetts to absorb dislocated capital and workers. This puts Massachusetts in an enviable position compared to, say, the still struggling Midwest, and other states that have not enjoyed Massachusetts' success in attracting new businesses, and are today only entering that increasingly competitive marketplace, playing catch-up ball with Massachusetts at what might be the wrong time.

The kind of effective state, local, business, and labor leadership that exists in Massachusetts can ameliorate transition problems even further. A city like Taunton exemplifies this sort of leadership and the benefits of the public-private partnership that has a firm foundation in this state. A year ago, Taunton was desperate for jobs and an economic future. Now, only months after the potential of Taunton was brought to the attention of business leaders, that city has ten new plants under construction by private industry, and an unemployment rate that has been cut from 13% to 5%.

This turnaround has occurred without the benefit of the direct infusion of public funding -- the kind of funding that was crucial 10 years ago in bringing 26,000 new jobs to Lowell, and reducing that City's unemployment rate from virtually the highest in the nation to virtually the lowest today. Presumably, Taunton's turnaround -- and other transitions in the future -- could be achieved without extensive tax subsidies as well.

Optimism notwithstanding, transition effects are a serious caveat when analyzing the Treasury plan. And as long as we're considering caveats, I should mention one rather distinct disappointment with the plan. What's missing -- beyond direct relevance to the federal deficit -- is any direct reference or concern about the equity of tax administration. And a tax system can never be equitable if it collects from those who choose to pay without collecting from those who should pay. With that let me detour briefly to the Massachusetts scene and the part of the tax problem I'm most deeply involved with.

In Massachusetts, our goal is fair but firm tax administration. That means being as friendly and helpful as we can be with the average taxpayer wrestling with a problem -- in essence, treating him or her as a customer, not a victim. But it also means being tougher with delinquents and even tougher with evaders.

We've steadily and effectively increased our enforcement against delinquents and evaders. With the leadership of Governor Dukakis and the help of our Legislature, we forged what has become known as the Revenue Enforcement and Protection program -- REAP for short. That gave us broad new powers to go after those who had been holding out on us and thus penalizing the honest, prompt-paying taxpayers among you.

Included in our REAP program was authorization for our tax amnesty. That succeeded -- in fact succeeded beyond our wildest dreams -- because we had been tough on enforcement going into it.

Our collection of delinquent taxes has increased more than 100% over the past two years; our audits yielded a 92% increase; the number of egregious tax violators whose property we've seized has increased more than 300% in the same two-year period. In another phase of the enforcement drive, our referrals to the Attorney General for criminal prosecution increased 59% last year alone.

All of that is good news for the vast majority of the State's taxpayers who pay on time and in full. Much of the Amnesty and enforcement story has been well covered by the media. But there is one other element which hasn't gotten the attention it deserves. And in fact you won't find it in our monthly reports because we can't neatly measure it. But we know it's there in the bottom line, and we hope to keep it growing.

That's voluntary compliance -- more and more individuals and businesses are reporting and paying us taxes due before we detect, audit or bill them, because our enforcement efforts are more sophistocated, the penalties are more severe, and our resources are greater than ever before. We estimate the total from increased voluntary compliance to be as least $165 million last fiscal year, approximately 25% of our overall revenue gain -- and that doesn't count the $80 million from our Amnesty program.

With a $200 plus billion federal deficit and a $112 billion federal tax evasion problem, it strikes me as not only ironic but mystifying that the Treasury tax plan in no way addresses the need for tougher and more effective tax enforcement. If the IRS could pull off a three to four percent increase in voluntary compliance as we have (including our Tax Amnesty), they would be picking up 20 to 30 billion dollars in new and recurring revenues. Cutting losses from tax evasion in half would generate well over $50 billion annually.

Secretary Regan may be right in his opinion that simplifying the tax code and giving it more of an aura of equity will reduce evasion. Certainly there will be fewer games to be played -- fewer abusive tax shelters to attract attention and dollars.

But I think the problem goes deeper -- down to very basic public attitudes. And that's another reason why I'm happy to have this podium with this audience today.

Change won't come quickly or easily. But like drunk driving, it's a problem which society has to take on, with a mix of enforcement and public education. The very act of tough enforcement is itself a teaching tool. And we in the Revenue Department will continue doing all we can. The crackdown on evaders will be stepped up. But in the end, we need your help, your involvement to make changed attitudes about tax evasion a reality.

I realize this is a brief meeting with a great deal of business on the agenda. So I won't take any more of your time this morning on the Department of Revenue story. But I will leave a report for your perusal -- one which goes into greater detail about our enforcement efforts and their results.

The tax code is the key to equitable taxation. So we can, on balance, support the Reagan Administration's proposal for tax reform. We can, and in fact have, made changes in the Massachusetts tax structure such as Proposition 2½ and the new increases in the no-tax status. More comprehensive reform can also be contemplated and proposed by the Massachusetts Special Commission for Tax Reform. But the most equitable of laws are meaningless if they are not firmly and fairly enforced. I hope you'll give me the opportunity in the near future to share more of our goals and specific plans in this area as well. To continue our success, we need your partnership and accelerated individual and corporate involvement.

In closing, let me return to the Treasury plan for a moment.

As a progressive Democrat in an Administration led by a progressive Democrat named Mike Dukakis, let me restate what he has already said regarding the conservative Republican Reagan Administration effort for tax reform. That is, "Congratulations." It's terrific that one of the most intractible and controversial issues of our time has been taken on. Their reform proposal is as substantial and as fair a try at tax simplification as any President in American history has ever come up with.

But like most good ideas in the public sector, one thing is certain about the Treasury's tax plan. If and when it becomes law, it is very likely to look quite different from the present proposal. Certainly there are modifications to the plan that would make it more attractive for the citizens of this State.

However, one might hope that just once the special interest forces that are largely responsible for the Byzantine complexity of our current code might fail in their attempts to undermine what could be the most sweeping and progressive change in our tax laws since their inception.

Alas, the realist in me understands how improbable it would be for our elected representatives to rise above parochial concerns. I would only hope that as tax reform gains more attention on the national agenda, we can all look beyond where we currently stand in tax policy and look at where we need to be in order to have a viable, fair and equitable tax system. Let's keep the national aim on the real target -- a tax system that will serve us well into the twenty-first century without the need for major tinkering every few years.

The principal benefits of the Reagan Administration's plan cannot be ignored and should not be understated:

The plan would simplify a system that now defies the experts.

It would restore fairness where there are now thousands of preferences.

It would achieve equity and neutrality in a system which now encourages people to invest their money to avoid taxes not to invest money to make money.

Since taxes are one of the two unavoidable certainties in human existence, it would be nice to know that at least one of them has some fairness to it -- and predictability in terms of knowing the rules and rates and timing in advance.

 F-26

Comm. from Councillor David Sullivan trans. for informational purposed the text of a recent address by Ira A. Jackson, Commissioner of Revenue Re: the proposed tax reform plan.

In City Council,

January 21, 1985

1/21/85

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