H.R.500/S.222: UNLEASHING AMERICA'S SAVERS AND INVESTORS

Letters and complaints from the nation's savers and investors have been flooding Washington. As a result, a majority of House members are co-sponsoring a repeal of last year's requirement that banks and other financial institutions withhold, for tax purposes, 10 percent of the interest and dividend income earned by savers. The withholding provision is scheduled to take effect July 1, 1983. Representative Norman D'Amours (D-N.H.) has been joined by 234 co-sponsors in introducing H.R. 500, which would correct what is one of the worst anti-saving features of last August's $100 billion tax hike. Senator Robert Kasten (R-Wisc.) is leading the effort in the Senate. His companion bill, S. 222, now has 39 co-sponsors. The D'Amours-Kasten initiative gives Congress a chance to unleash, somewhat, the American saver and investor.

It was estimated by supporters of withholding that it would raise $20.8 billion over five years, mostly from tax evaders. But like so many other features of last August's tax, withholding may impose far more costs on honest savers and investors, the dynamo of any productive society, than it raises in tax revenue. The federal deficit will not be reduced, opponents of withholding say, by depleting the nation's capital pool, wrapping savers and investors in a tangle of red tape, and imposing a $1.6 billion paperwork burden on financial institutions.

Banks, credit unions, and brokerage firms are angered at the huge new tax reporting and collecting responsibility for which they will receive little compensation. Small institutions, in particular, are likely to find the paperwork and computer programming costly and perplexing. A Peat, Marwick, Mitchell and Co. study reported that most banks surveyed will pay an initial $200,000 to $400,000 simply to establish procedures for the withholding requirements--this amounts to about $1.6 billion for all lending institutions. Another $1.05 billion a year is to be spent on the actual costs of withholding the tax on interest and dividends. The Treasury claims that banks will be recompensed for these costs with a 30-day "float" on withheld funds. The Peat, Marwick, Mitchell study, however, says that the value of the float ranges from $2,000 for a small institution to $26,000 for a large institution with $300 million in deposits. Compliance costs, therefore, are 10 to 100 times greater than the compensation provided by the law. These costs, of course, will be passed on to savers and investors--further eroding incentives to save and invest.

Withholding also will lower the return on investments by denying investors the use of withheld funds. Example: A savings account paying $1,000 in interest would have 10 percent withheld during the year as a

downpayment on potential taxes. The amount withheld over the entire year averages about $50. The government gets the use of the $50 for up to fifteen months. While the loss may be small to each saver, in aggregate withholding could remove up to $30 billion from the capital markets. Treasury has exempted small savers and will allow financial institutions to withhold at the end of the year for savings and checking accounts. But even if these exemptions reduce in half the total withheld, there will still be a transfer of $15 billion from savers to the government.

Since about 75 percent of all taxpayers receive a tax refund at the end of the year, the withholding measure will give Uncle Sam even more use of money he is not entitled to receive in the first place. Admittedly, those with a tax liability not exceeding $600 ($1,000 for a joint return) can file for exemptions from withholding. But IRS Service Centers could be inundated with at least 37 million certificates of exemptions, according to Chamber of Commerce testimony, in addition to 350 million additional pieces of paper, if taxpayers are required to file information on amounts withheld. Is this paperwork blizzard consistent with the Administration's stated goal to reduce bureaucratic red tape? Clearly not. And it will impose substantial costs on financial institutions and savers alike.

The IRS claims that this is an acceptable price for clamping down on tax cheating. The IRS says a significantly smaller portion of interest and dividend income is reported on tax returns than of salary and wage income which is subject to withholding. The IRS, however, does not have consistent figures on compliance. In a 1981 study, the IRS reported that full information reporting on all dividend and interest income could raise compliance to 97 percent--without withholding. If true, then the IRS already can use a much less costly method of ensuring compliance. Indeed, since the start of this year, all financial institutions have been required to send 1099 forms on dividends and interest to the IRS. This alone will increase compliance. The IRS can increase it further by matching up these 1099 forms on interest and dividends with tax returns. This method is a much cheaper and less obtrusive way to assure higher compliance.

Withholding is not a compliance measure. It is a tax increase--a costly and unnecessary burden on savers and investors, which the economy can ill afford. The Administration and Congress should construct a tax structure which encourages saving and production rather than imposing new burdens on the nation's job creating investors. Withholding on dividends and interest clearly is such a burden.

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For additional information, see:
Leif H. Olsen, "Citibank vs. New Withholding Rules," The New York Times, August 1, 1982, 2F.
Peat, Marwick, Mitchell & Co., "TEFRA: Interest and Dividend Withholding," December 30, 1982.
"Withholding Tax at Banks: Bid for Repeal," The New York Times, February 24, 1983, D1.