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H.R. 3110 -- LEASING "REFORM" THREATENS CITIES

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INTRODUCTION

President Ronald Reagan and Treasury Secretary Donald T. Regan claim to be adamantly opposed to additional tax increases. Yet just two weeks ago, the Treasury's number-one tax man, John E. Chapoton, Assistant Secretary of the Treasury for Tax Policy, testified before the House Committee on Ways and Means that the department generally supports the proposed Government Leasing Act of 1983 (H.R. 3110)--a bill that would increase taxes for private lessors who lease assets to tax-exempt entities.[1] These targeted tax increases, although levied on private lessors, would impose increased costs on financially hard-pressed state and local governments.

While H.R. 3110 probably would have its greatest impact on state and local governmental units, the bill would also have a profound effect on other organizations and activities. For example, aircraft manufactured in the United States are often financed by leases between American lessors and foreign, state-owned airlines. By increasing taxes on these transactions, the costs of these aircraft would increase, making their export much more difficult.

Among the charitable and other tax-exempt bodies (excluding governments) affected by the bill, nonprofit hospitals could be

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[1] Tax-exempt entities are defined for purposes of H.R. 3110 to include: the United States, any state or political subdivision thereof, any possession of the United States, any foreign government, any international organization, or any agency or instrumentality of any of the foregoing, any organization (other than cooperatives as described in Section 521 of the Internal Revenue Code) exempt from taxes, and any person who is not a United States citizen (but only with respect to income derived from property which is not subject to United States taxes).

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severely disrupted. They represent a growing segment of the equipment leasing market, and generally are not in a position to withstand the increase in costs that would be caused by H.R. 3110.

THE CENTRAL PROVISIONS OF H.R. 3110

The bill would end the right of lessors to use the accelerated cost recovery system to depreciate assets used by tax-exempt entities. Instead, straight-line depreciation would be required. In addition, extended recovery periods would be mandated: 5 years for property in the 3-year class; 12 years in the 5-year class; 25 years in the 10-year class; and 35 years in the 15-year public utility and real property classes. Mass transit equipment would be the only type of equipment exempt from the proposed changes in the depreciation rules. H.R. 3110 would also deny investment tax credits for property leased to tax-exempt entities and deny rehabilitation tax credits for buildings, if the rehabilitation was financed by a tax-exempt industrial development bond.

By forcing lessors from the accelerated cost recovery system to straight-line depreciation, from "standard" recovery periods to longer ones, and from tax credits to no credits, the bill would increase the lessors' taxes and hence the cost of providing "public" infrastructure and services.

THE FAULTY LOGIC OF H.R. 3110

The bill is specifically targeted to halt the privatization of state and local so-called public infrastructure and services and to reduce tax "expenditures."

Privatization

When he introduced the bill, Congressman J. J. Pickle (D.-Texas) asserted his objective was to halt privatization, that is, the transfer of public assets into private ownership. The Congressman was alarmed that state and local governments had shown a keen interest in privatization, and he assured the public that his bill would put a stop to these "shaky financing schemes replete with public policy problems."[2]

Mr. Pickle failed to reveal, however, just why states, counties, special districts and cities find privatization so attractive. The reason is simply that financially hard-pressed governmental entities have come to realize that the privatization of "public" infrastructure and services is accompanied by a wide range of advantages, when compared to public ownership and supply:

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2 Hon. J. J. Pickle, "Stop the Governmental Leasing Abuses," Congressional Record, May 24, 1983, p. E2513.

real resource costs are reduced; planning and construction time are saved by avoiding the Washington red tape that accompanies federal grants; local needs are better served by not being tied to Washington's rigid design criteria; the Davis-Bacon Act is avoided; and problems with public labor unions can be eliminated.[3]

Just when state and local governments are learning how to privatize and provide infrastructure and services in a cheaper, more effective, and private way, the Congressman would mandate higher costs, poorer services and more public ownership. Moreover, Mr. Pickle is not alone in pressing for this change. Apparently House Ways and Means Committee Chairman, Dan Rostenkowski (D.-Ill.) has promised prompt action on H.R. 3110, and Senator Robert Dole (R.-Kan.), Chairman of the Senate Finance Committee, is considering the introduction of similar legislation in the Senate.[4]

Tax Expenditures.[5]

Assistant Secretary Chapoton's testimony focuses on the second justification for H.R. 3110: reducing tax "expenditures," closing "loopholes" and eliminating "tax shelters." Leasing to tax-exempt entities alarms him because it "has a tremendous potential for causing unanticipated federal revenue losses."[6] Therefore Treasury believes that "corrective measures should be enacted along the lines suggested in the bill."[7]

The lessors' only alleged sin is that they sell services to tax-exempt entities, since the lessors themselves do not actually

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3 For more information on the advantages of privatization, see: James T. Bennett and Manuel H. Johnson, Better Government at Half the Price: Private Production of Public Services (Ottawa, Illinois: Caroline House Publishers, Inc., 1981); Steve H. Hanke, On Privatizing Urban Infrastructure, A report prepared for The Office of Policy Development and Research (U.S. Department of Housing and Urban Development, Washington, D.C., April 1983); and E. S. Savas, Privatizing the Public Sector: How to Shrink Government (Chatham, N.J.: Chatham House Publishers, Inc., 1982).

4 See: Thomas B. Edsall, "Pickle Moves to Restrict Tax Leasing," The Washington Post, May 26, 1983; Robert Dole, "We Must Curb the Cheating and Special Breaks," The Washington Post, June 12, 1983; "Raids on the Treasury," The Washington Post, May 27, 1983.

5 "Tax expenditures are features of the individual and corporate income tax laws that provide special benefits or incentives in comparison with what would be permitted under the general provisions of the Internal Revenue Code. They arise from special exclusion, exemptions, or deductions from gross income, or from special audits, preferential tax rates, or deferrals of tax liability." Office of Management and Budget, Budget of the United States Government-Fiscal Year 1984 (Washington, D.C.: U.S. Government Printing Office, 1983), p. 5-5.

6 John E. Chapoton, "Statement Before the Committee on Ways and Means of the U.S. House of Representatives," Treasury News, Department of the Treasury (Washington, D.C., June 8, 1983), p. 1.

7 Ibid.

receive any "special benefits" from the Internal Revenue Code. Given the logic of Mr. Chapoton's tax "expenditure" argument, perhaps Congress can anticipate a new Treasury proposal to impose a federal excise tax on all products purchased by tax-exempt entities.

Although tax "expenditures" might be appealing to an accountant's mind, the concept is seriously flawed. It cannot be defined unambiguously and escapes the possibility of measurement.[8] Moreover, the tax "expenditure" concept overlooks the profound lesson of supply-side economics: that tax "reform" aimed at reducing tax "expenditures" increases the overall cost of savings and therefore impedes capital formation.[9]

CONCLUSION

Secretary Regan's public pronouncements to the contrary, Treasury clearly is advocating tax increases in this case.[10] By clinging to the tax "expenditure" concept, the Reagan Administration can maintain a tax-cutting public image while actually supporting many tax increases--as it also did in the 1982 tax act--since officials can always explain away a tax increase as the mere closing of a "loophole" or the reduction of tax "expenditures."[11]

If Congress approves this measure, the result will be devastating to many jurisdictions and charitable organizations. State and local governments then will feel forced to demand more federal aid from Washington, resulting in real increases in federal expenditures. Before that happens, their elected officials should take the time to explain the clear advantages of privatization to the Congress and to the Reagan Administration.

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[8] For a devastating critique of tax "expenditures," see: "Ture's Unreleased Testimony on Tax Expenditures," Tax Notes, December 21, 1981. It is important to note that the Reagan Administration would not clear this proposed testimony by the then Under Secretary of Treasury, Norman B. Ture. It would presumably have undermined their plans to increase taxes under the guise of tax "reform."

[9] For one of the few technically sound and readable treatments of these matters, see: Norman B. Ture and B. Kenneth Sanden, The Effects of Tax Policy on Capital Formation (New York: Financial Executive Research Foundation, 1977).

[10] The contradictions between the Administration's rhetoric and actions appear to be its hallmark. For an analysis, see: Steve H. Hanke, "Would the Real Mr. Reagan Please Stand Up?" Christian Science Monitor, March 3, 1983.

[11] Even the President used the tax "expenditure" logic when he announced to us that "the largest tax reform in history" was not a tax increase; see: Thomas M. Humbert, "The Tax Package: It's Unfair," Heritage Foundation Backgrounder #205, August 18, 1982.

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