BOB PACKWOOD'S LITTLE SHOP OF TAX HORRORS

In the beginning, tax reform was supposed to make the federal tax system more simple, more fair and a more effective stimulant to economic growth. By the time Dan Rostenkowski's House Ways and Means Committee got through with it last year, however, tax reform had been perverted into what become known as the "Rosty Horror Tax Bill Show." This now threatens to be made into a double-feature by Senate Finance Committee Chairman Bob Packwood. Though some aspects of the draft bill that he unveiled recently may have merit and deserve consideration, others are a horror and are certain to damage the U.S. economy severely.

Among the most terrifying contents in Packwood's bag of horrors is the elimination of the deductibility of federal excise taxes and tariffs. Under current law, the federal government imposes excise taxes--sales taxes--on such products as alcohol, tobacco, and gasoline. In fiscal 1986 it is estimated that the federal government will collect $34.6 billion in excise taxes. The government also imposes duties on almost everything imported into the U.S. In 1986 it will collect about $12.4 billion from tariffs.

Businesses collect excise taxes for the government; these taxes are added to the sales price of a product and then turned over to the Treasury. Understandably, therefore, the excise taxes collected by a business (and sent on to Washington) have not been regarded as income or earnings for that business. Understandably, also, a business has not had to pay an income tax on the revenues it collects for and turns over to the government.

For example, if a company produces and sells a product for $1, plus 10 cents federal excise tax, the total sale price paid by the consumer would be $1.10. The business then would declare gross income of $1.10 and then deduct from it the 10 cents federal excise tax that it sends to the Treasury. This is the firm's true income, used to calculate profit upon which income tax is levied. The Packwood plan changes all this in a way that defies reason--and fairness. Packwood wants companies to pay taxes on

their gross income without deducting federal excise taxes. Meaning: the excise taxes which businesses collect for and send to the Treasury are to be treated as corporate profits. Customs duties similarly collected also will be treated as profits. This proposal is estimated to raise federal revenues by $62 billion over five years.

The logic of this proposal is a complete mystery. Packwood compares eliminating the deductibility of excise taxes as no different from eliminating any other tax "loophole." This only proves how muddled understanding of the tax system has become, since the concept of "tax expenditures" become popular. Now, even the most legitimate business expenses are being considered "loopholes," in the same category with such true loopholes as special tax treatment for the timber industry, which Packwood defends strongly. According to Packwood's logic, firms also should not be allowed to deduct, as legitimate business expenses, their outlays for wages and raw materials. Even the Reagan Administration appears to be flirting with this horror; it recently suggested that a portion of advertising expenses be denied deductibility.

The Packwood proposal is unsound economically. It will impose enormous burdens on already hard-pressed firms in the oil industry and among firms engaged in international trade, as well as those producing alcohol and tobacco products. Packwood's proposal is also unfair. However, the worst thing about it is the new principle of taxation it establishes: that legitimate business expenses are to be treated as "loopholes" and denied deductibility.

There is also a protectionist element in the proposal; it will increase the burden of tariffs on companies engaged in international trade. And there are technical questions with the proposal. How will it affect retailers? Will bartenders be required to net out excise taxes on liquor in calculating their taxable income, as the producers of liquor would be required? If so, this proposal could become extremely complex very quickly, with unintended consequences throughout the economy.

Senator Packwood has been careful to present his tax reform proposals as simply the starting point--not the final shape--of his version of tax reform. He should take a hard look at the excise tax matter and make sure that it gets no further than the starting line.

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For further information:

Alan Murray, "Proposals to Scrap Deductions for Excise Taxes Provokes Heated Opposition by Business Groups," The Wall Street Journal, March 17, 1986, p. 46.

David Rosenbaum, "Senators on Committee Assail Excise-Tax Idea," The New York Times, March 20, 1986.

Bruce Bartlett, "The Rosty Horror Tax Bill Show," Heritage Foundation Executive Memorandum No. 100, December 2, 1985.