

Tax Reform: Why All the Whining?

BY PHILIP WEBRE

Science and technology came out of tax reform pretty much as most taxpayers did: they won a few and took their share of hits. Technology (meaning high-technology industries) did somewhat better than science (meaning university-based research). Both, however, should benefit from one major change. Reduction in tax shelters should, in the long run, drive economic assets out of unproductive investments and into fruitful areas like research. Real estate's loss is science and technology's gain.

Then why all the whining, especially from universities? Universities did lose some nice benefits, although these losses and their significance have been overstated. The provisions that hurt educational institutions include a \$150 million limit on the total amount of tax-exempt bonds any private university can issue, changes in the tax treatment of gifts of appreciated property, taxation of fellowships, pension reforms and the drop in tax rates for individuals.

The last three are red herrings. Many, if not most, students already pay taxes on their fellowships; the change would merely extend this to all students. Changing university pension structure is simply a matter of equity. Universities cannot continue to treat their staffs as second-class citizens. The change in the marginal rates is unlikely to affect much. More than 90 percent of taxpayers' rates will be changed by fewer than 5 percentage points. Furthermore, in 1981 the top marginal rate dropped—and giving rose.

The real issues are the cap on tax-exempt bonds and the tax treatment of gifts of appreciated property. Currently, 24 major research universities are at or near the limit of \$150 million in outstanding bonds. Finding ways around the cap may prove difficult. Some affected schools may try to enter into agreements with institutions that haven't hit their caps, or with state institutions. On

the other hand, tax reform gave university-issued tax-exempt bonds a new benefit: the interest paid on these bonds is not subject to the alternative minimum tax (a provision designed to ensure that everyone pays some tax), although interest from other tax-exempt bonds *does* fall under the minimum tax. Thus two dozen major research institutions may suffer, but the rest are better off.

Changes in the treatment accorded gifts of appreciated property may also have significant effects. Forty percent (by value) of the gifts to universities worth over \$5,000 are gifts of appreciated property, usually stock or real estate that is worth more now than when originally purchased. Until now, this gift has been deductible against ordinary income. However, under tax reform, once such gifts equal a large fraction of total income, they trigger the alternative minimum tax. In order to avoid this tax, some donors may have to spread their gifts over several years, which could cause some problems.

In addition, this provision may make charitable contributions move in tandem with the stock market because people will be able to give more when they are making more money. This shift could hurt universities; declines in the market will reduce both the value of their existing endowments and the amount of money would-be donors can give without triggering the minimum tax. Still, private sources represent only one-tenth of university income, and are declining in importance.

By contrast, science-oriented industries are clearly better off under tax reform, despite grumbling about loss of the investment tax credit. Congress largely eliminated tax shelters and lowered the marginal rate; this should discourage the search for the tax-driven deal, which was rarely found in the technology sector anyway. (The tax shelter business had gotten so big that the partnership sector as a whole, where tax shelters have been concentrated, was experiencing

losses for tax purposes.)

Wall Street and industry commentators have predicted that the demise of the investment tax credit will lower demand for high-technology goods. However, demand for computers and other high-technology goods is not tax-driven. Between 1981 and 1985 the demand for computers soared, despite the fact that computers had largely been exempted from the increase in capital depreciation benefits passed in 1981. What drove the increase was the fact that the user cost of computing was falling dramatically, and practical applications were devised for microcomputers. Other equipment is in a similar situation; firms buy high-technology equipment to keep from falling behind.

Furthermore, R&D kept its privileged tax status in the new bill; other investments now have less generous depreciation treatment, especially real estate, while R&D costs can still be deducted in the year they are incurred. The R&D credit was retained, although reduced, but in reality that issue is overblown. Because of the credit's complex structure, its value to the companies was and remains minuscule. Furthermore, the recent upturn in private R&D came before the passage of the R&D tax credit, and probably was not much influenced by it.

On balance, the demise of preferential treatment for capital gains benefits high-technology companies. While venture capitalists argued it was crucial to their success—an assertion I don't accept—it was also central to most tax shelter design. It may have helped direct a few hundred million dollars toward high-technology investments, but it directed *billions* toward unneeded office buildings and shopping centers.

Tax reform wasn't perfect; it was a very political endeavor. By reducing some of the distortions wreaked on the tax system (mainly since 1978), tax reform will help most by ensuring that the tax system does not hinder new technical developments. But

it will not address the structural and economic problems that plague universities, science or high technology. Institutions must solve those problems in other ways. ■

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There has been considerable discussion lately about the many ways in which "tax reform" adversely changes the ground rules of operation of independent colleges and universities. Still greater reliance on direct government appropriation is not a good answer: that would further erode the pluralism and independence that have been the genius of the U.S. system of higher education and scholarship.

In one respect, however, tax reform may encourage private philanthropy. The charitable deduction against taxable income is no incentive to philanthropy when that income is already sheltered by myriad other devices. If tax reform really does fairly expose that income to taxation, prospective philanthropists will be less distracted by the innumerable schemes for tax avoidance whose concoction now occupies a substantial part of our gross national product.

In the last analysis, the most important impact of tax reform will be on the health of the U.S. economy. So many factors impinge on this that it will be difficult to dissect what part tax reform will have played. It cannot be said that this was profoundly analyzed and discussed during the congressional debate. ■

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