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NEWS RELEASE

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SEIDMAN RECOMMENDS USING DIVIDEND TAX CREDIT IN EFFORT TO CURB CORPORATE DEBT FINANCING

The best way to reverse the tax code's corporate debt bias without substantially reducing tax revenues is to create a dividend credit for use by shareholders that would reflect the tax their corporations paid, Federal Deposit Insurance Corporation Chairman L. William Seidman today told the House Ways and Means Committee.

"This suggestion is almost like a withholding tax on dividends, to be credited to shareholders when received. The same system could be used for interest, thereby providing complete equality in the tax treatment of dividends and interest," Mr. Seidman said.

Mr. Seidman recommended that Congress continue to seek ways to reverse the tax system's bias towards debt. He pointed out that corporations now are carrying more debt than they were in every year during the 1970s, and he observed that debt burden normally rises during a recession, not an economic upswing. The current preference for debt suggests that as businesses increase their debt load during the next recession, the added burden will call into question repayment capabilities and add to the severity of the recession, he added.

With respect to leveraged buyouts (LBOs), Mr. Seidman said LBOs have produced some desirable benefits, such as removal of entrenched managements and closer market scrutiny of debt laden corporations. "Unfortunately," Mr. Seidman commented, "we never know if the level of debt to debt servicing ability is too high until it is too late."

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Those banks involved in LBO financing have had a relatively stable exposure and do not treat LBO loans as high grade investments, Mr. Seidman said. "We have been specifically monitoring LBO lending for several years and will continue to monitor it," he added. Mr. Seidman noted that "very few LBO transactions have been adversely classified by examiners."

Although LBO transactions have not been a problem for banks, Mr. Seidman said he is not comfortable with the overall level of debt or the tax system's bias in favor of debt financing. Ending this bias with a corporation tax-paid credit would have a less drastic effect on tax revenues than allowing full deductions of dividends. Moreover, he observed that if dividends were deductible, corporations would be prone to avoid tax exposure by paying out all their earnings as dividends. "This is not desirable as it reduces funds available for investment," Mr. Seidman said.

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