

[COMMITTEE PRINT]

DIGEST OF TESTIMONY ON THE
MINIMUM TAX ON TAX PREFERENCES

AT THE
1973 PUBLIC HEARINGS
ON THE
GENERAL SUBJECT OF TAX REFORM
HELD BY THE
COMMITTEE ON WAYS AND MEANS

PREPARED FOR THE USE OF THE
COMMITTEE ON WAYS AND MEANS
BY
THE STAFF
OF THE
JOINT COMMITTEE ON INTERNAL
REVENUE TAXATION



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**DIGEST OF TESTIMONY ON THE MINIMUM TAX ON TAX
PREFERENCES DURING 1973 TAX REFORM PUBLIC
HEARINGS**

The Committee on Ways and Means held public hearings on the general subject of tax reform during February, March, and April 1973. A panel of witnesses testified on the minimum tax on February 20, 1973 (Panel No. 6).

Summarized below are the comments of witnesses at the tax reform public hearings, as well as written statements received by the committee during tax reform hearings, on the subject of the minimum tax on tax preferences.

Professor Dan Throop Smith, Hoover Institute, Stanford University (February 5):

Indicates that the minimum tax is a complicated and indirect way of dealing with situations which might better be approached directly or left alone.

J. Waddy Bullion, Dallas, Texas (February 20):

Application of minimum tax to corporations.—Objects to the application of the minimum tax to corporations. Feels that the minimum tax as initially imposed was not intended to apply to corporations because the 4 tax-exempt items involved would appear in a significant degree only in a few industries and it would be more appropriate to deal with them with respect to the tax structure of those industries after an analysis of their particular economic and competitive positions.

Percentage depletion as a preference item.—Opposes the inclusion of percentage depletion as a tax preference item in the minimum tax. Points out that percentage depletion as a preference item has a great impact on corporations and although affecting all corporations owning nature recourses, it has a great effect on small corporations. Notes that the percentage depletion deduction was reviewed and reduced in the Tax Reform Act of 1969 and that the inclusion of it in the minimum tax has the effect of further reducing the percentage depletion deduction. Believes that since the percentage depletion deduction is peculiar to natural resources industries, it should be dealt with at the industry level rather than relating to all taxpayers generally. Points out that there currently is an energy crisis and that incentives must be provided to assist the industry.

Intangible drilling and development costs as a preference item.—Points out that although intangible drilling and development costs presently is not a tax preference item, it is suggested by others that it should be added as a preference item on which the minimum tax is computed. Strongly opposes the inclusion of these costs as a tax pref-

erence item. States that the deduction for intangibles has application only to the oil and gas industry and should be dealt with in relation to the needs and requirements of that industry and not considered separately as an item of tax preference. Asserts that the intangible deduction gives impetus to exploration and is a needed tax incentive.

Credit the minimum tax against the regular income tax.—Points out that an amendment to the minimum tax in 1970 allows a 7-year carry forward of the excess of regular income tax over tax preferences items of the particular year. Indicates that the converse of this is not true; that is, where a taxpayer in earlier years pays little or no regular income tax and a high minimum tax, there is no adjustment in a later year where he may pay a low minimum tax and high regular income tax. Proposes that the minimum tax be carried forward for an unlimited period as a credit against the regular income tax and that it should be retroactive to the first year of the imposition of the minimum tax.

Wayne E. Chapman, Attorney, New York, N.Y. (February 20):

Opposes suggestions to tighten the minimum tax provision. Believes that the use of such provisions in general is not desirable because this mechanism avoids the question of whether the benefits that society obtains from particular tax preferences are worth their cost. States that if Congress does not believe that current tax incentives in a particular area justify the cost to the Treasury, it should repeal those incentives rather than attacking them indirectly through means of the minimum tax.

Indicates that any change in the tax incentives in the housing area would reduce the construction of housing, and would drive housing costs upward.

Martin D. Ginsburg, Attorney, New York, N.Y. (February 20):

Impact of minimum tax.—Summarizes the legislative history of the minimum tax and discusses the impact of the minimum tax on taxpayers with high gross income. Concludes that, in general, the exclusion of tax-exempt interest and special deductions, such as intangible drilling expenses, still permits a large number of individual taxpayers with substantial gross income to report a comparatively low adjusted gross income and incur indefensibly minor Federal tax liability. Describes, for example, one case described in the 1968 Treasury Study where taxpayer had a real income of \$935,000 and an effective rate of tax of 14.7 percent; under present law, this effective rate was increased to 17.5 percent. Another case was a taxpayer having approximately \$1,500,000 of income from oil and gas operations (after reductions for exploration and development, intangible drilling and other costs), \$670,000 of long-term capital gains and \$120,000 of miscellaneous income. Under prior law, this individual paid no Federal income tax. Under present law, the effective rate measured against this income was increased to only 6.7 percent.

Tax planning tools.—Explains the methods that tax advisors use in planning for the minimum tax—a formula has been devised to determine the maximum amount of tax preferences taxpayers, at different gross income levels, may incur and pay no minimum tax. (For example, a taxpayer with an ordinary gross income of \$300,000 may incur

approximately \$131,000 of tax preferences and pay no minimum tax.) Points out further that the large number of preference items not included in the minimum tax base permits taxpayers to obtain the benefits of many tax shelters (such as farming) without being subject to the minimum tax. Notes that while many of the preferences have defenders who advocate their retention for reasons of economic and social policy, some of the preferences are difficult to defend on such a basis. (For example, cites taxpayers who use plant nursery operations as a shelter.)

Effect on capital gains.—States that the preference for one-half of long-term capital gains has little impact since a taxpayer in the 70-percent bracket incurs 3 cents of minimum tax for each \$2 of long-term capital gain that he realizes. Indicates that this is due to the fact that the 70-cent regular tax is an exclusion on the dollar of preference income, leaving a 30-cent preference; thus, the minimum tax is not likely to have much impact on investors seeking long-term appreciation capital gains.

Proposals

Makes three specific suggestions with respect to the present exclusions in the minimum tax: (1) the \$30,000 exclusion is too high and should be reduced to not more than \$20,000; (2) the exclusions for current and past income taxes should be eliminated; (3) the net operating loss rule should be repealed and the Treasury should be encouraged to reexamine its complicated proposed regulations which contain administrative limitations on the definition of tax preference in order to provide a tax benefit rule. Suggests also that the minimum tax base be expanded to include the significant preference items that were enumerated in one or another of the 1968 Treasury Studies, the 1969 Nixon Administration proposals, and the 1969 House Bill, which are not included in the present definition of tax preferences.

Kenneth A. Goldman, Attorney, Los Angeles, Calif. (February 20):

Minimum tax concept.—Indicates that the minimum tax is a sound concept but needs to be strengthened to accomplish what the public thought was being effected in 1969.

Suggests that goals of minimum tax are the following: (1) assurance that each person or corporation above a minimum income level contribute meaningfully to the cost of government; (2) imposition of a significant tax on persons otherwise paying a relatively smaller share of taxes than those similarly situated; (3) reduction of the disparity of tax burdens among persons having similar economic incomes; (4) imposition of a meaningful tax upon those who accumulate so many tax preferences that they pay little or no regular tax; (5) increased revenue; and (6) reduction of the attractiveness of "tax shelter deals."

States that if Congress retains any tax subsidies, then "minimum tax is essential to lessen * * * distortion" that results when "a taxpayer has so overly accumulated so many of the tax preferences and tax subsidies that he has reduced his tax consideration to the government to such a low relative rate that it is so dissimilar to similarly situated

taxpayers, wage earners, persons with similar incomes, and it creates the disparity" shown in examples in which taxpayers, each with \$300,000 of economic income, pay taxes ranging from 0 percent (municipal bond interest) to 9 percent (income sheltered by accelerated depreciation) to 27.09 percent (capital gains) to 47.35 percent (wages) to 60.33 percent (dividends and interest).

Notes that wage earner with \$32,000 of salary pays taxes at about the same effective rate as individual with \$300,000 of capital gain income, even including present minimum tax.

Recommendations

Urges scope of preferences be expanded to include:

- (1) municipal bond interest;
- (2) intangible drilling costs;
- (3) difference between effect of credit for foreign income taxes and effect of deduction of those taxes;
- (4) tax subsidy effect of farm deductions deferral;
- (5) unrealized appreciation on property donated to charity, to extent it gave rise to charitable contribution deduction;
- (6) life insurance proceeds;
- (7) prepaid expenses where prepayment not required for valid business purposes; and
- (8) research and development costs that otherwise should be capitalized.

Proposes progressive minimum tax rates not less than half the regular tax rates (i.e., from 7 percent to 35 percent); if this is done, then present \$30,000 floor could be left intact. Believes stock option should not be treated as preference until the stock is sold, exchanged, or hypothecated; but amount of preference should be calculated as at present. Urges retention of present interrelationship between minimum tax and section 1348 maximum tax. Suggests revival of allocation of deductions proposal, in addition to present minimum tax; concludes that, with appropriate floor, the provision would not be complex to administer, particularly in relation to the logic and equity behind it. Finally indicates that, since for many tax devices the major tax benefit is the deferral, the value of the deferral should be included in the minimum tax base.

Professor Paul McDaniel, Boston College Law School (February 20):

Background

Points out that the minimum tax adopted in the Tax Reform Act of 1969 was based on the view of Congress that it did not wish to change the tax rules that provide the basis for tax shelters nor entirely prohibit the syndication of these tax shelters. But Congress did wish to put some overall limit on the extent to which any individual could take advantage of the tax shelters. That is, individual and corporations should not be able to combine tax preferences in such a way as to completely escape liability. Contends that the minimum tax needs to be strengthened, however. The way in which this can be done is revealed by a review of the development of the minimum tax.

The 1968 Treasury tax reform studies and proposals proposed a minimum tax as an *alternative* to the regular tax. Under this approach

an individual included his tax preference income and his regular income and applied a rate schedule with rates half those of the regular rate schedule. If this resulted in a higher tax than the regular tax, the taxpayer then paid *this* minimum tax. In effect, the minimum tax was both *progressive and comparative*.

In April 1969, the Nixon Administration proposed an alternative minimum tax called a Limitation on Tax Preferences (LTP.) Under this, the taxpayer could not have tax preferences in excess of one-half of his expanded income (AGI plus defined tax preferences). Any excess over one-half would be included in income and subject to the normal rates. The House adopted this LTP concept in its version of the Tax Reform Act of 1969. It, too, was a *comparative and progressive* tax. Combined with both of these minimum tax proposals, went an allocation of deduction system wherein the proportion of deductions equal to exempt income was disallowed.

In 1969, the Senate Finance Committee substituted a flat 5-percent rate on preference income in excess of \$30,000 exemption. This changed the structure of the minimum tax considerably in that it became a *proportional* tax and an *additive* tax as compared to a progressive and comparative tax. A Senate floor amendment which the conference agreed to provide a comparative aspect by making the rate 10 percent applicable to preference income minus the regular tax liability.

Expansion of the Minimum Tax Base

Recommends that the following items should be immediately included in the minimum tax base:

- (1) Intangible drilling and development expenses;
- (2) Interest on tax-exempt bonds;
- (3) Construction period interest and taxes;
- (4) Investment credit; and
- (5) Accrued gain on property transferred at death or by gift.

Suggests that the following should be studied further for possible inclusion in the minimum tax base:

- (1) Exclusion of interest on life insurance savings;
- (2) Net imputed rental income from owner-occupied housing; and
- (3) Social security benefits.

Changes in the Rate of the Minimum Tax

Indicates that while the \$30,000 exemption does provide some progressivity in the minimum tax, the deduction for regular taxes produces a progressivity in the minimum tax that is inverse to the progressivity of the regular tax: that is, the higher the regular taxes, the lower minimum tax and conversely. The result is that two people with identical tax preferences may pay different amounts of minimum tax—a result that is at variance with the additive nature of the minimum tax although consistent with the comparative approach. Therefore, maintains that the minimum tax rate structure should be changed to one-half the normal tax rates. For corporations, suggests that a corresponding change would be to increase the flat rate to about 20 percent. To insure that the proposed progressive minimum tax rates for individuals operate as a direct supplement to the progressivity of the regular tax, contends that the deduction for regular taxes from the minimum tax base should be eliminated.

Change in Exemption

Feels that the present \$30,000 exemption is unjustifiably large, although some exemption is necessary for administrative conveniences. Therefore, recommends that a \$5,000 vanishing exemption should be provided—phased out so that it disappears once tax preferences equal \$10,000. For corporations, asserts that no exemption should be provided.

Structural Changes in the Minimum Tax

Treatment of deferral items.—A problem with respect to deferral items arises that does not occur in the case of exemption items. In the case of deferral items, the minimum tax may be imposed on an amount which itself is later subject to regular tax, but present rules do not permit any adjustment in the subsequent year for the minimum tax previously paid. While the minimum tax may be viewed as an interest charge on the deferral when the rate is 10 percent if the rates were increased to a maximum of 35 percent, this degree of inaccuracy would be unacceptable. Therefore, the best solution under higher rates would be that upon disposition of deferral property a tax credit be provided for minimum tax previously paid. A similar result can be obtained by a basic adjustment but this is much more complex.

The averaging device.—Under the present minimum tax, a carry-over of regular tax previously paid is permitted in determining the base for the minimum tax. Under the proposal to eliminate the deduction for regular taxes, the question is whether an averaging device should be provided. The need for such a device depends on one's view of the minimum tax. If it is seen as a special tax structure against which an individual's tax preference income is to be checked each year, then an averaging device is probably not appropriate. Such an approach seems especially justified under the present minimum tax structure. After the proposed revision of the minimum tax, averaging for minimum tax seems appropriate. A 5-year averaging device similar to the present income averaging might be appropriate.

Supportive Provisions for the Minimum Tax

Suggests that even a strengthened minimum tax still leaves some shelter areas untouched. For example, special itemized deduction areas and the farm loss problem. Therefore, contends that the additional steps are needed: (1) adoption of the allocation of deductions provision as enacted by the House in 1969 with an expanded list of preference items; (2) limitation on interest deduction, with the limitation on the extent to which the interest deduction can be taken against noninvestment income being strengthened by reducing the present \$25,000 exemption to \$5,000 and disallowing the entire excess deduction rather than one-half; and (3) for farm losses rather than the present EDA account approach, the suggestions of the 1968 Treasury tax reform studies and proposals should be adopted which is the disallowance of all deductions for farm "loses" to the extent they exceed farm income plus \$15,000.

Wallace O. Sellers, Merrill Lynch, Pierce, Fenner & Smith, Inc.
(February 23):

Contends that the inclusion of tax-exempt municipal bond interest in the minimum tax base would disrupt the tax-exempt bond market and offset the option benefits.

Willis B. Snell, Attorney, Washington, D.C. (February 26):

Believes that the primary effect of the minimum tax may well be the reduction of percentage depletion. Points out that two corporations which have exactly the same gross and taxable income from mining are entitled to the same percentage depletion deduction and are otherwise entitled to exactly the same tax preferences. However, if one of these corporations has nonmining income in addition to its mining income, that corporation will pay less minimum tax than the nonintegrated mining company since the income tax paid on other income reduces or eliminates the minimum tax. Suggests that the benefit of percentage depletion is significantly less for independent miners. Considers that integration and mergers of mining and nonmining companies will be encouraged.

Recommends that Congress should revise the minimum tax insofar as it relates to corporations. Believes that such revision should consist of repeal of such tax as to corporations or elimination of percentage depletion as a preference item or converting the tax to a true minimum tax from the additional tax which it is today.

Financial Executives Institute, William H. Horne, Jr., Chairman, Committee on Taxation (March 5):

Minimum tax for corporations

Advocates elimination of the minimum tax for tax preference items or corporations; or, if the minimum tax cannot be repealed, suggests the provision of a five-year carryback of the excess of ordinary income tax payments over tax preference items as an offset against earlier tax preferences. Notes that the rationale for the minimum tax, which was to impose a tax burden upon wealthy individuals who would otherwise not pay any tax, does not apply in the same degree to corporations, which do not have the same capability of avoiding the progressiveness of the tax system by structuring income and deduction items.

Minimum tax and recapture

Charges that inequity results when the minimum tax is charged for accelerated depreciation or amortization and, subsequently, the entire amount of the depreciation or amortization is recaptured.

Tax preference items involving stock options

Proposes that section 57(a)(9) of the Code be amended to provide that, for purposes of that paragraph, long-term capital gain arising from sale of a share of stock acquired through exercise of a qualified or restricted stock option be reduced by the amount of tax preference previously recognized under section 57(a)(6) upon exercise of the option. Argues that this would avoid treating the same gain as a tax preference item twice.

Advocates amending the proposed income tax regulations to provide for the inapplicability of section 57(a)(6)—item of tax preference on exercise of a stock option—if there is a disposition of stock or a modification of the plan in any taxable year, not just the taxable year of the exercise, which renders section 421(a) inapplicable. Claims that this would end the inequity of requiring that the disqualifying disposition must be in the year of the exercise of the stock option.

Minimum tax and the maximum tax on earned income

Suggests amending section 1348(b)(2) to provide that any portion of the tax preference offset calculated under subparagraph (B)(ii) which has reduced earned taxable income subject to the maximum tax rate for that taxable year shall not be taken into account in any subsequent year in calculating the average of the taxpayer's tax preferences for that year and the four preceding taxable years under subparagraph (B)(i). Maintains that this would prevent another duplication of tax preference.

American Textile Manufacturers Institute, Inc., Roger Milliken (March 5):

Feels that the minimum tax should be made inapplicable to *bona fide* industrial corporations. Alternatively, recommends that accelerated depreciation on industrial buildings held by industrial corporations be eliminated as a preference item.

The Manufacturing Chemists Association, Matthew P. Landers (March 5):

Proposes that the minimum tax be modified to permit a deduction of the regular income tax otherwise payable from the additional tax imposed by Section 56.

Tax Policy Committee, John C. Davidson, President and J. R. Greenlee, Chairman (March 5):

Urge removal of amortization of pollution control facilities as a tax preference item.

National Association of Manufacturers, E. A. Vaughn, Chairman, Committee on Taxation and John R. Greenlee, Vice-Chairman (March 6):

Believe that the minimum tax should not apply to corporations. Recommend that amortization of pollution control facilities not be preference item.

American Paper Institute, William J. Steinmetz, Chairman, Financial Management Committee and Thomas R. Long, Chairman, Subcommittee on Tax Affairs (March 6):

Argue that corporations should not be subject to the minimum tax. View the minimum tax as a surcharge or a penalty tax on the utilization of socially-oriented tax incentives by corporations.

AFL-CIO, George Meany, President (March 7):

Recommends substantially increasing the 10-percent minimum tax rate.

David N. Mills, Attorney, Detroit, Michigan (March 7):

Contends that the special 10-percent tax on preferential income should be repealed, with the preference items to the extent unjustified being taxed in the same manner as other forms of income.

Chamber of Commerce of the United States, Walker Winter, Chairman Taxation Committee and Robert R. Statham, Taxation and Finance Manager (March 8):

Urge repeal of the minimum tax on tax preferences. Suggest review of specific provisions and deduction to see if they should be limited instead. Maintain that elimination of the deduction for regular income

taxes paid and a reduction of the \$30,000 exemption would be detrimental. Assert that the extra "minimum tax" serves only to complicate the tax law.

Americans for Democratic Action, Leon Shull, National Director (March 8):

Favors use of graduated rates on the tax preferences instead of the flat 10-percent rate. Recommends that the \$30,000 exclusion and the tax carry-forward provision be repealed.

Common Cause, Jack T. Conway (March 8):

Considers the 10-percent rate too low and the coverage of preference items too limited.

Council of State Chambers of Commerce, George S. Koch, Chairman, Federal Finance Committee (March 12):

Recommends that the minimum tax not apply to corporations. Alternatively, suggests that provision be made for the carryback of tax preferences as well as the present carryforward in order to prevent inequities.

True Drilling Co., H. A. True, Jr., Partner (March 19):

Contents that the 1969 law treatment of depletion as a tax preference item (along with reducing the percentage depletion allowance) is partially responsible for the 20-percent decline in exploratory activity between 1969 and 1971. Recommends removal of depletion as a tax preference item.

Sun Oil Co., Robert G. Dunlop, Chairman, Board of Directors (March 19):

Indicates that the inclusion of depletion as a preference item reduced the effective rate of percentage depletion for oil and gas to 18 percent (as contrasted to the statutorily-reduced rate of 22 percent). Feels that inclusion of depletion undermines the effectiveness of the allowance as an incentive. Maintains that the depletion deduction should not be a tax preference item because it is limited to 50 percent of net income from the property, and hence cannot reduce tax liability to zero.

Asserts that inclusion of the intangible drilling cost deduction as a tax preference item would inhibit domestic exploration even as more petroleum energy is urgently needed.

Exxon Corporation, Emilio G. Collado, Executive Vice President (March 19):

Opposes making the foreign tax credit a tax preference item. Contents that this would constitute double taxation and harm the competitive standing of U.S. business abroad.

American Mining Congress, Fred W. Peel, Chairman Tax Committee (March 20):

Urges repeal of the 10-percent "minimum" tax, or make it applicable to corporations. Alternatively, proposes that percentage depletion be removed as a tax preference item.

National Coal Association, E. B. Leisenring, Chairman, Tax Committee (March 20):

Believes that the minimum tax should be repealed, at least with respect to corporations. Considers the tax to be inequitable and to fall

heavily on the coal industry because of the inclusion of percentage depletion as a preference item.

Ronald S. Tucker, Kingery Drilling Co., Newport Beach, Calif. (March 20):

Feels the minimum tax should be amended to exclude percentage depletion from the tax.

American Council on Capital Gains and Estate Taxation, Leroy H. Simpkins, Jr., and George S. Smith (March 21):

Assert that the minimum tax is primarily an additional tax on capital gains. Urge removal of capital gains from the minimum tax base.

View the capital gain differential rate not as a tax preference but instead as a partial alleviation of a tax penalty on savings and long-term investment.

Forest Industries Committee, Arthur W. Nelson, Vice President (March 22):

Requests removal of timber income from the definition of tax preferences under the minimum tax.

Honorable Edmund S. Muskie, United States Senator, Maine (April 16):

Proposes reducing the \$30,000 exclusion to \$10,000, imposing a graduated rate from 10 percent to 20 percent, and eliminating the deduction for regular taxes paid along with the 7-year carryforward of taxes paid. Indicates that such a revised minimum tax would produce \$300 million in 1975.

Honorable Charles E. Bennett, Member of Congress, Florida (April 16):

Suggests that persons who have incomes of \$25,000 or more pay a minimum 10-percent income tax regardless of deductions or foreign tax credit.

National Association of Home Builders, George C. Martin, President, and Carl A. S. Coan, Jr., Staff Vice President and Legislative Counsel (March 26):

Offers no objection to a reasonable increase in the minimum tax as the most equitable method of reducing so-called "loopholes". Believes, however, that utmost caution should be used in further extending the items of tax preference subject to the minimum tax so that true business expenses such as interest and taxes during construction are not included.

National Association of Real Estate Boards, Howard M. Benedict, Vice Chairman, Federal Taxation Subcommittee, and Edwin L. Kahn, Special Tax Counsel (March 26):

Contend that the minimum tax adversely affects real estate.

National Realty Committee, Albert A. Walsh, President, and Lewis R. Kaster, Counsel (March 26):

Assert that the minimum tax on capital gain from the sale of depreciable property is a double penalty to the extent that there was a minimum tax on the accelerated depreciation. Argue that the mini-

imum tax is complicated; indicates that a preferable approach would be a direct consideration of the various "tax preferences."

International Council of Shopping Centers, Kenneth Tucker, President, and Albert Sussman, Executive Vice President (March 26):

Believes that any increase in the minimum tax rate or reduction in the exclusions would adversely offset the real estate industry more than any other segment of the economy.

Securities Industry Association, Frank Smeal, Public Finance Division (April 2):

For the House Ways and Means Committee even to report favorably a recommendation that tax-exempt interest be subjected to the minimum tax would cause investors immediately to demand a greater yield to compensate for increased uncertainty. Predicts the result would be a cost to State and local governments at least two to three times the gain to the Treasury.

Honorable Louis L. Goldstein, Comptroller, State of Maryland and Treasurers Committee on Tax-Exempt Bonds (April 2):

Claims that State and local governments' bondholders would suffer an unjustifiable double burden if, in addition to the lower yield they receive with State and local obligations, they should also have to pay a minimum tax on their yield from "exempt" obligations. Cautions that true tax preferences are creations of Congress to further Congressional policies, whereas the tax exemption derives from the constitutional policy of sovereignty of State and local governments, a policy that Congress is not free to discard.

Honorable Grady L. Patterson, Jr., State Treasurer, South Carolina (April 2):

Calls the minimum tax system a punitive measure for punishing those who would otherwise owe little or no tax. Notes that application of a minimum tax to interest from otherwise exempt local bonds would necessarily mean that such bonds were no longer tax exempt, with severe results for the bond market.

Honorable Edward M. Kennedy, United States, Senator, Massachusetts (April 17):

Recommends the addition of new categories to the list of "tax preference" items subject to the minimum tax: intangible drilling and development expenses, interest and taxes incurred during real estate construction, the 7-percent investment credit, tax-exempt interest on State and local government bonds, and appreciation in value of property given to charity and of property transferred at death. Suggests removal of capital gains as an item of tax preference but provide that a higher percentage (60 percent) of capital gains be included in ordinary income.

Proposes the following structural changes in the minimum tax: reduce the exemption from \$30,000 to \$15,000; allow the exemption only for individuals, not for corporations; phase the exemption out when \$10,000 in preference income is reached; repeal the provision allowing current income taxes to be deducted from preference income; and pro-

vide graduated rates of 10, 15 and 20 percent for the minimum tax, instead of the current flat rate of 10 percent.

Honorable George P. Shultz, Secretary of the Treasury (April 30):

Minimum tax concept

Maintains that some pay no Federal taxes because they make large charitable donations, but that the large majority of persons with high incomes are paying lots of tax. Indicates that some taxpayers, however, have combined certain tax incentives to avoid paying taxes. Asserts also that widespread use of "tax shelters" introduces distortions into the economy by causing preoccupation with tax manipulations and artificial "losses" that often obscures economic realities.

Recommends repeal of the present minimum tax on tax preferences for individuals and substituting two new provisions: "Minimum Taxable Income (MTI)" and "Limitation on Artificial Accounting Losses" (LAL).

Minimum Taxable Income (MTI)

States that the MTI proposal would prevent the combination of exclusions and itemized deductions from offsetting more than one-half of a taxpayer's income; and every individual would be required to pay tax on at least the balance. The exclusions involved are (1) one-half of capital gains, (2) the bargain part of a stock option at the time of exercise, (3) percentage depletion in excess of cost, and (4) income earned abroad and presently excluded under section 911. A taxpayer's MTI will be computed by adding this exclusion to his adjusted gross income. From that sum, he subtracts his personal exemptions plus \$10,000; the resulting amount is divided by two to produce his minimum taxable income, upon which is the minimum amount he must pay tax at regular rates.

Limitation on Artificial Accounting Losses (LAL)

Notes that a number of tax accounting rules permit current deduction of some prepaid items that are associated with the production of income in a future year. Proposes that if such deductions create a loss from the activity to which they relate, that loss may not be used to offset or shelter other unrelated income—i.e., the loss is suspended until the property commences to produce income.

Estimates that the MTI and LAL proposals would in combination raise an additional \$1 billion in revenue less about \$200 million lost from repeal of the minimum tax on individuals, or a net gain of about \$800 million.

AFL-CIO, George Meany, President (written statement):

Recognizes that the Treasury's proposals for a new minimum tax to replace the 10-percent minimum tax are an improvement over the existing provisions, but criticizes the proposal because the formula for calculation of the minimum tax does not take into account such loopholes as interest income from tax-exempt municipal bonds or income offset by excessive deductions on real estate.

Objects to the Treasury's limitation on artificial accounting losses proposal because it does nothing to repeal the existing tax accounting or accelerated deduction provisions, and because phantom bookkeeping losses are not permanently or completely disallowed.

***American Industrial Clay Company, Freeport Kaolin Division of
Freeport Minerals Co., Georgia Kaolin Co., J. M. Huber Corp.,
and Thiele Kaolin Co. (written statement):***

Historical development of the minimum tax

State that the "minimum tax for tax preferences", imposed by Sec. 56, evolved from various proposals aimed at meeting criticism of the tax system for permitting wealthy individuals to pay little or no federal income tax. Call attention to recommendations of Treasury Department which expressly declined to recommend that minimum tax on tax preferences be applied to corporations. Argue that the distinctions as drawn by the Treasury Department were based upon the difference in corporations' and individuals' roles as investors. Claims that the ability of individuals to combine preferences and avoid paying any income tax or impair the progressivity of our income tax system is simply not available as a practical matter to ordinary business corporations. Asserts that the few corporations that would be significantly affected by the minimum tax were generally engaged in businesses which called for the intensive use of a particular preference item which Congress had deliberately legislated as an incentive measure for the development of that business.

Contents that the decision to apply the new minimum tax to corporations as well as to individuals was based upon a desire to increase revenue rather than upon a thorough analysis of the affect of the minimum tax on corporations. Declare that the only reason given by the Senate Finance Committee (that the possibility of avoidance through merger had been eliminated) for the proposition that its minimum tax version was readily applicable to corporations was itself negated by an amendment to the minimum tax provision on the floor of the Senate.

Application of the minimum tax to corporations

Point out that three of the preference items, excess investment interest, accelerated depreciation on personal property subject to a net lease, and stock options, are inapplicable to ordinary business corporations, and that a fourth, reserves for losses on bad debts of financial institutions applies only to financial institutions and not to ordinary corporations. Add that four other preference items, accelerated depreciation on real property, amortization of certified pollution control facilities, amortization of railroad rolling stock, and amortization of on-the-job training in child care facilities, affect the timing of deductions and are not nearly as important for corporate taxpayers as they are for individual taxpayers whose rates are truly progressive. Assert that the ninth tax preference item, capital gains, is of much more significance in the case of individuals than in the case of corporations because the tax rate differences are more significant for individuals and because most business corporations are engaged solely or primarily in the active conduct of trade or business which generally produces ordinary income rather than capital gains. Agree that the final preference item, percentage depletion, does have a substantial impact on corporate taxpayers, but assert that the corporations so affected are usually relatively small, non-diversified mining corporations. Indicate that the minimum tax probably reduces the effective depletion deduction below that intended by Congress.

Criticizes the actual application of the minimum tax on tax preferences to corporations on the grounds that it produces haphazard, capricious, and inequitable results, and that the impact of the minimum tax upon corporations in many cases is dependent upon factors totally unrelated to the actual amount of tax preferences they enjoy.

Recommend that the minimum tax should be repealed at least in so far as it applies to corporations, and if complete repeal as to corporations is not considered desirable or practicable, then, alternatively, one or more of the following modifications are suggested:

- (1) The amount of percentage depletion in excess of cost should be removed from the list of tax preference items;
- (2) The tax could be made a true minimum tax, rather than an additional tax, by providing that a corporation's tax will be the income tax, or the minimum tax, whichever is greater, but not both;
- (3) The amount of minimum tax paid could be carried forward for a reasonable period as a credit against future ordinary income tax (or ordinary income tax paid could be carried back for a reasonable period); and
- (4) The income tax liability before, rather than after, reduction by credits could be subtracted from the items of tax preference in order to obtain the tax base.

Impact of minimum tax on clay producers.—Charge that in the specific case of the china clay producers submitting this statement, the minimum tax has had the effect of reducing the benefit of the incentive intended by Congress in granting the percentage depletion allowance to china clay. Contend that the china clay industry is small but extremely important to the economy of the rural area of Georgia and South Carolina where it is located, and that the reduction in the applicable percentage depletion resulting from the minimum tax adversely affects the continued ability of the industry to grow and to compete with foreign producers.

American Iron Ore Association, John R. Greenlee, Chairman, Tax Committee (written statement):

Urges repeal of the 10% minimum tax as to its applicability to corporations. Notes that the original expressed purpose of the minimum tax on tax preferences was to impose some tax burden on the very limited number of individual taxpayers who were legitimately paying little or no Federal income tax, and that the amendments including corporations were adopted by the Senate without any opportunity for public hearings. Claims that the minimum tax applied to corporations has resulted in anomalies and has imposed excessive burdens on the extracting industries.

Building Stone Institute, Frank P. Tufaro, Executive Vice President (written statement):

Outlines the economic and financial difficulties of the natural stone producing industry, and claims that the percentage depletion allowance is essential to the survival of these companies and to the development of natural resources. Criticizes the application of the minimum tax on tax preferences to corporations because this tax seriously reduces the benefits that might be derived from the depletion deduction. Urges that percentage depletion be eliminated from the list of items subject to the tax on tax preferences.

David W. Richmond, Attorney, Washington, D.C. (written statement):

The interaction of minimum tax and maximum tax with the short-swing profit rule of the Securities Exchange Act of 1934.

Describes a situation in which a taxpayer, upon the exercise of qualified stock options, must pay minimum tax and reduce the portion of his earned income eligible for the 50% maximum tax, but in which he the taxpayer is unable to realize any income at all on the subsequent sale of the stock because of the six-month waiting period of Sec. 16(b) of the Securities and Exchange Act of 1934 (in which the period the stock price has dropped below his exercise price). Claims that it is inequitable for the taxpayer to pay the minimum tax and reduce his eligible maximum tax base in cases where the taxpayer sells his option stock at less than the exercise price. Requests the Committee to consider the retroactive amendment of Sec. 57(b)(6) to remove this inequity.

John W. Oswald, American Council on Education and Related Associations of Colleges, Universities, and Schools (written statement):

Indicates that the Treasury proposal with respect to the "minimum taxable income" could have a deleterious effect on charitable contributions because it would in many cases substantially reduce the effective limitation on individual charitable contributions. Points out that under the minimum taxable income proposed the only way a person could obtain a deduction of 50 percent of his adjusted gross income for charitable contributions would be if he (1) had no other deductions and (2) had no exclusion income. Asserts that to the extent that the taxpayer had any deductions and any exclusion income the 50-percent limitation on charitable contributions would be reduced. Maintains that the minimum taxable income proposal would have a drastic effect on the bulk of contributions to colleges, symphonies, hospitals and like institutions. Notes, also, that the Treasury proposal appears to allow no carry-over for charitable contributions thus lost by reason of application of the minimum taxable income provision. Suggests that donors should be entitled to obtain a deduction of 50 percent of their adjusted gross income, regardless of the effect on the minimum taxable income provision.

Southern States Industrial Council (written statement):

Opposes any increase in the minimum tax.

Leo J. Benjamin, Syosset, New York (written statement)

Suggests a flat 36-percent tax rate for corporate income as well as for all preference income.