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SUMMARY OF ADMINISTRATION PROPOSALS RELATING TO TAX REDUCTIONS AND OTHER ECONOMIC PROGRAMS

PREPARED FOR THE

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AND THE

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INTRODUCTION

This pamphlet provides a brief summary of the President's economic and tax reduction program announced on August 28, 1980.

The first part is a summary of the tax reduction proposals, divided into individual and business tax provisions. It includes the Treasury Department's estimated revenue effects for the provisions for 1981–1985.

The second part is a brief summary of the nontax aspects of the President's announced economic program.

I. TAX REDUCTION PROPOSALS

A. Individual Tax Provisions

1. Social security credit

Under present law, there is no income tax credit for social security taxes paid by employers or employees. However, employers receive a business expense deduction for their share of social security taxes. In 1981, the social security tax rate is scheduled to increase from 6.13 percent to 6.65 percent both for employers and employees. This rate is scheduled to increase further, in 1982, to 6.70 percent. Also, in 1981, the maximum amount of earnings subject to the social security tax is scheduled to increase from $25,900 to $29,700. (This exceeds by $1,500 the increase which would have resulted from automatic indexing.)

Under the Administration proposal, employers and employees would be entitled to a credit equal to 8 percent of social security taxes paid in 1981 and 1982. (The Administration indicates that, for years after 1982, there would be other tax reductions equivalent to the 8-percent credit.) The credit for employers, including State and local governments and nonprofit institutions, would be refundable (that is, payments would be made to the employer to the extent the credit exceeds tax liability). The employer's business deduction for social security taxes paid would be reduced by the amount of the credit. For individuals, the credit would not be refundable.

2. Earned income credit

Under present law, taxpayers with dependent children are entitled to a refundable credit equal to 10 percent of the first $5,000 of earnings (for a maximum credit of $500). The amount of the credit phases out, at a rate of 12.5 percent (i.e., a reduction in the credit of 12½ cents for each additional dollar of income), as income rises from $6,000 to $10,000. Thus, no credit is available for families with incomes of $10,000 or more.

Under the Administration proposal, starting in 1981 the earned income credit would be increased to 12 percent of the first $5,000 of earnings (for a maximum credit of $600). In addition, the credit would be phased out, at a rate of 15 percent, as income rises from $7,000 to $11,000.

3. Marriage penalty deduction

Under present law, a married couple generally is treated as one tax unit which must pay tax on its total taxable income. While couples may elect to file separate returns, the law is structured so that filing separate returns almost always results in a higher tax than filing joint returns. In addition, different tax rate schedules apply to single persons and to single heads of households. Along with other provisions of the law, these rate schedules give rise to a "marriage penalty" when persons with relatively equal incomes marry each other and a "marriage bonus" when persons with relatively unequal incomes marry each other. In general, if a couple's total income is allocated between the two individuals more evenly than 80%–20%, then the couple's income tax liability will increase when they marry.

The Administration proposal would retain the present system which encourages most married couples to file joint returns. It would reduce the marriage penalty through a deduction for two-earner married couples equal to 10 percent of the first $30,000 of the earnings of the spouse with the lower amount of earnings. The maximum deduction would be $3,000. The new deduction would be available regardless of whether taxpayers itemize their personal deductions. It would begin in 1981.

4. Income earned abroad

Under present law, Americans working abroad generally are eligible for deductions intended to reflect the excess costs of living abroad if they are bona fide residents of a foreign country for an entire taxable year or if they are physically present in a foreign country for 510 days (approximately 17 months) out of 18 consecutive months. The excess foreign living cost deduction consists of separate excess housing, education, home leave, and general cost of living elements. An additional $5,000 hardship allowance is allowed to taxpayers working in hardship areas. Taxpayers residing in hardship area camps may claim a $20,000 annual earned income exclusion in lieu of the excess living cost deductions. For purposes of the $5,000 allowance and the $20,000 exclusion, hardship areas are places where U.S. government employees would be entitled to a hardship pay differential of 15 percent or more.

The Administration proposes that Americans employed abroad in certain areas be exempt from tax on the first $25,000 of foreign earned income plus 60 percent of the next $60,000 (a total exemption of $61,000 for persons earning $85,000 or more). No credit or deduction would be allowed for foreign taxes on the exempt income. The exemption would be provided for places where U.S. government employees are entitled to hardship pay differential of 10 percent or more. The special deductions of present law would continue for Americans working abroad in areas where the new exemption does not apply.

B. Business Tax Provisions

1. Depreciation revision

Under the Administration proposal, a new system of depreciating personal property and industrial and commercial buildings would be substituted for the present law systems, including the Asset Depreciation Range (ADR) system. This new Constant Rate Depreciation system (CRD) would be effective as of January 1, 1981.

Although details have not been released, this new depreciation system would be designed:

(1) To increase the allowable depreciation rate by up to 40 percent (although such rate will be adjusted to ensure that the allowable depreciation plus the investment credit—full 10 percent for all qualifying property with a useful life of more than one year—will not provide benefits that are greater than deducting the cost of the investment in the year it is made);

(2) To allow approximately equal liberalization of depreciation for all assets;

(3) To simplify the procedures for using accelerated depreciation (which permits a taxpayer to deduct investment costs more rapidly than ratably over the assigned life);

(4) To provide for a constant annual rate of depreciation for each asset class in lieu of the current rules requiring selection of a useful life and method of depreciation; and

(5) To reduce the number of asset and industry classes to 30 or less from the present 130 classes under the ADR system in a manner which would result in most taxpayers using no more than 2 or 3 classes.

Under this new system, all assets purchased (other than buildings) would be added to one open-ended account for each class. Also, the Treasury is requesting the authority to adjust the rates of depreciation for each class periodically.

2. Investment tax credit

Under present law, a credit against income tax liability is provided for a taxpayer's investment in certain types of depreciable business assets. To be eligible for these credits, property must have a useful life of at least three years. If the property has a useful life of three or four years, a credit of 3⅓ percent of qualified investments is allowed; if the useful life is five or six years, a credit of 6⅔ percent is allowed; and if the useful life is 7 years or more, a full 10-percent credit is allowed. An additional percentage is available if the property is certain energy property or if certain contributions are made to employee stock ownership plans (ESOPs).

The regular and the ESOP investment credits may be used to offset the first $25,000 of tax liability plus a percentage of tax liability in excess of $25,000 (70 percent in 1980, 80 percent in 1981 and 90 percent thereafter). If the taxpayer has any energy investment credits, they may be used to offset the tax liability remaining after reduction by the regular and ESOP credits. Unused credits from a taxable year may be carried over to be applied against tax liability for the three preceding and seven succeeding years.

Reduction of useful life of property eligible for full investment credit

The Administration proposes that all new qualifying property with a useful life of more than one year be eligible for the full 10-percent investment credit. This benefit would be offset by less accelerated depreciation for short-lived property.

Refundable investment tax credit

Under the Administration proposal, 30 percent of a taxpayer's unused investment tax credits for investments placed in service during a taxable year would be refundable. The remaining portion of the unused credits would be added to the taxpayer's investment credit carryover and could be used under the rules provided under present law.

Targeted investment tax credit

In addition to the investment tax credit provided by present law, the Administration proposal would provide an additional 10-percent investment credit for qualifying investments for which the Commerce Department has issued certificates of necessity. This targeted investment credit would be fully refundable. The depreciable basis of certified property would be reduced by the amount of the targeted investment credit.

Under Commerce Department authorization, certificates would be issued for eligible investment projects in localities of high unemployment. Such areas would be designated for the targeted investment credit for a period of 5 years. The certificates of necessity would expire 5 years from the date of issue if the qualified property has not been placed in service. They would be limited to $10 billion of investment each year ($1 billion of credit).

Effective date

The refundable investment credit and the reduction in the useful life of new property eligible for the regular 10-percent investment credit would be effective for assets placed in service after December 31, 1980.

3. Amortization of business startup costs

Under present law, costs incurred prior to the commencement of a business normally are not deductible because they are not incurred in carrying on a trade or business. These startup or preopening costs must be capitalized and often cannot be depreciated or amortized because no ascertainable useful life can be established for these costs. However, the capitalized costs may be recovered for purposes of measuring gain or loss upon the disposition or cessation of the business.

The Administration proposal would allow business startup costs to be amortized over a period of not less than 60 months, beginning when the new business starts. To be eligible for this deduction, an expenditure would have to be incurred in creating or acquiring a trade or business, and it would have to be an expenditure which would be deductible if incurred in the expansion of an existing business.

4. Subchapter S shareholders

Under present law, qualifying small business (subchapter S) corporations and their shareholders can elect to be taxed under rules similar to those pertaining to partnerships (i.e., no tax at the corporate level and taxation of both dividends and retained earnings at the shareholder level). One of the requirements that a corporation must meet in order to be eligible to elect to be treated as a subchapter S corporation is that it have no more than 15 shareholders.

The Administration proposal would provide for an increase in the maximum number of shareholders in a subchapter S corporation from 15 to 25. In addition, audits of subchapter S corporations with more than 15 shareholders will be binding on the shareholders. (Presently, audit changes at the corporate level may be challenged separately by shareholders.)

C. Estimated Revenue Effects of Administration Tax Reduction Proposals, 1981–1985

(Billions of dollars)

Provision	1981	1982	1983	1984	1985
	Calendar Years				
Constant rate depreciation—40 percent (January 1, 1981)	−6.3	−12.4	−16.5	−20.6	−24.2
Refundable investment tax credit at 30 percent	−2.4	−2.6	−2.5	−2.5	−2.3
Targeted investment tax credit	−0.2	−0.9	−0.8	−0.8	−0.7
Income earned abroad	−0.2	−0.3	−0.3	−0.3	−0.4
8 percent social security credit [1]	−12.8	−14.5	−16.2	−18.0	−21.0
Earned income tax credit [2]	−0.9	−0.8	−0.8	−0.7	−0.6
Marriage penalty relief (10 percent deduction up to $30,000)	−4.7	−5.6	−6.6	−7.7	−8.9
Amortization of startup expenditures	−0.1	−0.1	−0.2	−0.2	−0.3
Increase allowable number of Subchapter S shareholders to 25	(*)	(*)	(*)	(*)	(*)
Total	−27.6	−37.2	−44.0	−50.9	−58.3

Footnotes on next page.

C. Estimated Revenue Effects of Administration Tax Reduction Proposals, 1981–1985—Continued

(Billions of dollars)

Provision	1981	1982	1983	1984	1985
	Fiscal Years				
Constant rate depreciation—40 percent (January 1, 1981)	−2.8	−9.0	−14.3	−18.4	−22.2
Refundable investment tax credit at 30 percent	−0.2	−2.4	−2.6	−2.5	−2.5
Targeted investment tax credit		−0.7	−0.9	−0.8	−0.8
Income earned abroad	−0.1	−0.3	−0.3	−0.3	−0.3
8 percent social security credit [1]	−3.8	−19.3	−15.7	−17.5	−20.1
Earned income tax credit [2]	(*)	−0.9	−0.8	−0.8	−0.7
Marriage penalty relief (10 percent deduction up to $30,000)	−0.3	−5.2	−6.0	−7.1	−8.0
Amortization of startup expenditures	(*)	−0.1	−0.1	−0.2	−0.3
Increase allowable number of Subchapter S shareholders to 25	(*)	(*)	(*)	(*)	(*)
Total	−7.3	−37.9	−40.7	−47.6	−54.9

[1] The social security credit expires at the end of 1982, and will be replaced by other proposals with tax reductions equal to the 8 percent credit.
[2] Includes outlay portion of earned income credit.
*Less than $50 million.

Note: Details may not add to totals due to rounding.
Office of the Secretary of the Treasury, Office of Tax Analysis, August 27, 1980.

II. NONTAX ECONOMIC PROGRAM

A. Creation of Industrial Development Authority

An industrial development authority would be established. The Authority would provide Federal money to assist industrial development in areas affected by industrial dislocation or high unemployment. Advice about the Authority's responsibilities, activities and funding would be given to the President by the President's Economic Revitalization Board, another new organization. In addition, the Board would advise the President on increasing labor productivity, modifying governmental regulations, dealing with problems of labor and capital mobility, and other aspects of economic revitalization.

B. Extension of Eligibility for Unemployment Compensation

The eligibility period for unemployment compensation payments would temporarily be extended by 13 weeks in States with high unemployment, thus extending the eligibility period for certain unemployed persons in those States to one year. This additional spending is estimated to be approximately $0.5 billion in fiscal year 1981.

C. Additional Spending

The administration proposes additional spending for industrial revitalization or economic assistance as follows:

(1) For economic and industrial development programs (including the Urban Development Action Grant and Economic Development Administration programs), $1 billion in fiscal year 1981 and $2 billion in fiscal year 1982.

(2) For energy conservation programs (including the Solar and Energy Conservation Bank, conservation in investments in federally-owned housing, improvements in the efficiency of federally-owned power plants, and weatherization of schools, hospitals and low-income housing), $1.2 billion over two years.

(3) For research and technological development, $0.6 billion for fiscal years 1981 and 1982.

(4) For the highway system and other modes of transportation, $0.6 billion for fiscal year 1981 (plus up to $0.2 billion more for railroads if the Railroad Restructuring Assistance Act is enacted).

(5) For payments under the Comprehensive Employment and Training Act (CETA), $0.3 billion in fiscal year 1981.

(6) For countercyclical revenue sharing, $1.0 billion in fiscal year 1981 (which replaces $0.5 billion of transitional assistance payments).

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