[COMMITTEE PRINT]

COMMITTEE MEMBER SELECTIONS

OF

PROPOSALS FOR CONSIDERATION

IN

FIRST PHASE OF TAX REFORM

COMPILED 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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INTRODUCTION

In its press release of June 17, 1975, the committee announced that it would begin considering tax reform in several phases. It was announced that the first phase would involve and be confined to the following principal subjects: tax shelters and minimum tax; tax simplification and reform of domestic income of individuals; foreign income; administrative provisions; "deadwood" bill; extension of individual tax reductions provided in the Tax Reduction Act of 1975; capital formation (including fast depreciation, investment credit, and integration of corporate and individual taxes); capital gains and losses; and limited technical changes. (It was subsequently decided to consider the limited technical changes separately after completing the first phase of tax reform.) The committee also listed in the press release a series of areas that would be considered in subsequent phases of tax reform.

The committee held public hearings on the subjects listed for the first phase of tax reform beginning at the end of June and continuing through the end of July. These hearings were held in three parts. The first part consisted of discussions of invited witnesses on (1) the objectives and approaches to tax reform, (2) tax simplification, and (3) capital formation. The second part consisted of testimony from Administration officials at the beginning and at the end of the hearings. The third part consisted of testimony from the public arranged in panels on specific areas of tax reform.

In preparation for the committee's markup sessions on the first phase of tax reform Chairman Ullman submitted an outline of possible proposals for committee consideration. He requested that all members submit by August 15 their proposals for tax reform for consideration by the committee in the first phase. He also requested the staff to set forth a description of the decisions made by the committee in its 1974 tax reform bill which relate to the topics included in the first phase of tax reform, and summarize the various proposals of each of the Members with respect to each of these areas. The purpose was to set an agenda for the Members as well as to inform the public as to the proposls to be considered for tax reform by the committee in the first phase.

This document attempts to meet the request of the Chairman as noted above. It describes briefly the decisions made by the committee in its 1974 tax reform bill insofar as those decisions fit within the specified categories selected for first consideration. Second, in each case where the Chairman has made a proposal, this is listed. While in the main the proposals of the Chairman are those he initially distributed to the committee, he has expanded his proposals in some areas and made a few modifications of other proposals. The Chairman's position is followed by suggestions which have been received within the specified areas from other Members of the committee. Suggestions which duplicate those made by the Chairman are not included nor are statements of Members indicating support for, or opposition to, particular provisions. Such listings are unnecessary since this is intended basically as a listing of items to be considered by the committee in its first phase tax reform proposal. In some cases the committee Members presented items for committee consideration expressly reserving their judgment on the items submitted. As a result, where a Member's name is listed beside an item, this does not necessarily mean that he favors the proposal but only that he desires to have it considered by the committee.

The staff plans to have ready for the committee at an early date in September tentative revenue estimates for the proposals in this document. It is planned to also have other informational material available for the committee on these proposals.

I. TAX SHELTERS

A. Real Estate

Limitation on Artificial Losses

1974 committee bill.—Last year the committee applied LAL (limitation on artificial losses) to real estate. LAL in general limits the deduction of specified losses to income from the property involved. In the case of real estate the excess of accelerated over straight-line depreciation and interest and taxes attributable to the construction period of a building would have been allowed as a deduction only against income from real estate, with all properties treated on a consolidated basis. Excess deductions from a property, that could not be taken in a year because of the limitation, would be available to be offset against income in future years. Generally under last year's bill LAL would have been applied to commercial property constructed in 1976 and later years, and to residential property constructed in 1978 and later years. However, the application of LAL to construction period interest and taxes on commercial real estate would be phased in between 1976 and 1978; and its application to construction period interest and taxes on residential real estate would be phased in between 1978 and 1980. Low-income housing built under various Federal, State and local government subsidy programs would have been permanently exempted from LAL.

Mr. Ullman.—He would apply the LAL rule separately for each property and also apply it to low-income housing built under the various Federal, State and local government subsidy programs. He would apply (1) LAL to commercial property in 1976 without any phase-in; (2) to residential property generally beginning in 1977 and phased in over the years 1977 and 1978; and (3) to low-income housing built under various Federal, State and local government subsidy programs beginning in 1978 and phased in over the years 1978 through 1980. The phase-in applies only to interest and taxes attributable to the construction period.

Messrs. Vanik, Corman, Green, Gibbons, Karth, Rangel, Stark, Jacobs, and Mikva, and Mrs. Keys.—They would apply the rules in the same manner as Mr. Ullman, except that with respect to residential housing generally they would make LAL fully applicable in 1977.

Mr. Vander Veen.—He would make the modifications suggested by Mr. Ullman except that he would apply LAL in full to all residential property in 1977.

Messrs. Waggonner, Helstoski and Conable.—The proposal would apply LAL on a consolidated basis in the same manner as provided in the 1974 committee bill. In addition, Mr. Waggoner and Mr. Conable would permit disallowed deductions to be capitalized and recovered through depreciation over some short period of time (e.g., ⅓ of the useful life of the property).

Mr. Vander Jagt.—He would retain the exemption from LAL (as in the 1974 committee provision) for Federally and State-assisted housing for low- and moderate-income families.

Recapture of Depreciation on Real Property

1974 committee bill.—In the case of real estate, except as noted below, the committee bill would have provided for the complete recapture of all depreciation in excess of straight-line depreciation to the extent of any gain involved at the time of the sale of the property. (This rule already applies in the case of commercial property.) In the case of low-income housing assisted under Federal, State or local law, the depreciation in excess of straight-line which is to be recaptured would be reduced by one percentage point for each full month the property is held after the date on which the property was held 100 full months (20 full months if the property was acquired or construction began before January 1, 1978).

Mr. Ullman.—He would apply the general rule for recapture outlined above but with no special treatment in this respect for low-income housing assisted under Federal, State or local law.

Limiting the Depreciation of Equity in Rental Real Estate

Mr. Corman.—He would provide that in the case of a building which the taxpayer rents to others, the deduction for depreciation cannot exceed the taxpayer's equity in the building and the land (the depreciation deductions would be computed on the entire cost of the building, however, and not on the amount of the equity). This would not apply to a building if the primary use is by the taxpayer.

Capitalizing Construction Period Interest and Taxes

Messrs. Corman and Stark and Mrs. Keys.—The proposal would provide that interest and taxes attributable to the construction period in the case of real property may not be deducted, but instead are to be added to the cost of the building involved and recovered through depreciation allowances over the life of the building.

Restrictions on Depreciation for Real Property

Mr. Stark and Mrs. Keys.—The proposal would make the class life system (or ADR) inapplicable to real property. The proposal would also provide that accelerated depreciation allowable on any real property may not exceed 125 percent of the amount that would be deductible under the straight line method.

B. Farm Operations

Limitation on Artificial Losses

1974 committee bill.—Last year the committee applied LAL to certain types of farm operations. Under that provision, LAL would apply in the case of deductions for (a) prepaid supplies consumed in a later period (such as feed or fertilizer), and (b) preproductive period expenditures not treated as capital items which are incurred during the development period in the case of orchards, vineyards and similar farming operations (but not including the breeding or feeding of livestock before reaching the productive stage). The artificial deductions could, in any event, be offset against farm income. In addition, they could be offset against nonfarm income where the taxpayer has $20,000 or less of nonfarm income. If a taxpayer has nonfarm income over $20,000, artificial deductions of the type referred to above in excess of farm income which could otherwise be deducted currently against other farm income would be reduced from the level of $20,000, on a dollar-for-dollar basis, for each dollar of nonfarm income of the taxpayer in excess of $20,000. This means that no artificial deduction in excess of farm income can be taken as deductions currently by the taxpayers with nonfarm income over $40,000. To the extent the deductions may not be taken currently, they could be taken in subsequent years to the extent of farm income. (Livestock were dealt with under the "at risk" provision described below.)

Mr. Ullman.—He would apply the LAL provision as outlined above except that it would be applied separately for each farm, and in addition he would apply it in the case of preproductive period expenditures and depreciation for breeding and feeding of cattle and other livestock.

Mr. Corman.—The proposal would provide that farm losses can be deducted against nonfarm income only to the extent of $10,000 a year. Any amount of a farm loss disallowed under this provision would be treated as an expense of farming in the following year. This limitation on the deduction of a farm loss would not apply to a taxpayer whose nonfarm income is less than $20,000.

Messrs. Waggonner and Conable.—The proposal would apply the LAL to farm activities in the aggregate.

Mr. Helstoski.—The proposal would apply the LAL provision in the case of farm operations on an aggregate basis, and in addition would calculate the limitation (instead of using the flat nonfarm income limit of $20,000) on the basis of a percentage of total income (such as 20%) from nonfarm sources.

Mr. Stark and Mrs. Keys.—For farmers with nonfarm income of more than $20,000, the proposal would phase out the offset of farm losses so that no losses could be applied to such income in excess of $30,000.

Limitation of Loss for Livestock Enterprises to the Amount for Which the Taxpayer is at Risk

1974 committee bill.—Last year the committee bill would have provided that in the case of feeder cattle and other livestock used for breeding, draft, dairy, or sporting purposes, deductions for losses would not be allowed in excess of the amount of capital or credit of the individual which is at risk in the venture. A taxpayer would not be considered "at risk" in the case of a nonrecourse loan or to the extent he has a right to be reimbursed for any loss on the investment, such as by reason of a "stop loss" or a guaranteed repurchase agreement, insurance, or other similar arrangement.

Mr. Ullman—His proposal is the same as that in the 1974 committee bill.

Mr. Pickle.—He would limit the farm income losses to capital at risk. (Presumably this is a substitute for the application of LAL.)

Method of Accounting for Corporations Engaged in Farming

1974 committee bill.—Under last year's committee bill corporations carrying on farming operations, other than subchapter S corporations and family corporations, would, for tax purposes, be required to use accrual and inventory accounting methods for their farming operations. A family corporation for this purpose was defined as one where at least 75 percent of the voting stock and 75 percent of the total stock in a corporation are owned by a single family, including brothers and sisters, spouses, ancestors and lineal descendants, and estates of any of these family members and trusts for the benefit of such family members. A family corporation electing the exception under this provision would be subject to the LAL rules on farm losses.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

Hobby Loss Provision

Mr. Archer.—In giving the taxpayer an opportunity to determine whether the hobby loss limitation under present law applies to him on the basis of his experience in a 5- or 7-year period, the proposal would limit the extent that statute of limitations is waived in these cases so that the waiver does not apply to unrelated items on the taxpayer's return.

Repeal of Farm Excess Deductions Account

1974 committee bill.—Because farm losses were included in the limitation on artificial losses, the 1974 committee bill would have repealed the provisions relating to farm excess deductions accounts.

Mr. Ullman.—His proposál is the same as that in the 1974 committee bill.

C. Natural Resources

Limitation on Artificial Losses

Mr. Ullman.—He would apply LAL to intangible drilling and development costs on a property-by-property basis. As a result, these deductions (except insofar as they represent abandonment losses) could not be taken in any year to the extent they exceed the income derived in that year from the operation of the same property. Excess deductions from a property that cannot be taken in a year because of this limitation would be available to be offset against income in future years from the same property.

Limitation on Deduction of Intangible Drilling Costs to Amount at Risk

1974 committee bill.—Last year the committee limited the deduction for intangible drilling and development costs on a well to the amounts for which the taxpayer was at risk on the property.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

Messrs. Waggonner and Conable.—The proposal would consider a taxpayer to be "at risk" in the case of bona fide nonrecourse loans where the established value of the property securing the nonrecourse loan is sufficient to obtain a loan from an unrelated traditional lending institution.

Gain From Dispositions of Interest in Oil and Gas Wells

1974 committee bill.—Last year the committee provided that any gain on the disposition of an interest in oil and gas wells would be treated as ordinary income to the extent of the excess of the intangible drilling deductions taken with respect to those wells over the deductions that would have been allowed had the expenses been capitalized.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

Messrs. Waggonner and Conable.—The proposal would exclude from the recapture rules provided in the 1974 committee bill taxpayers qualifying for the independent producers and royalty owners exemption for purposes of percentage depletion (i.e., this would make the recapture rules inapplicable in the case of those eligible for percentage depletion).

Option to Deduct Intangible Drilling Expenses of Oil and Gas Wells

Mr. Stark and Mrs. Keys.—The proposal would repeal the option to deduct intangible drilling expenses on oil and gas wells.

D. Motion Picture Films and Similar Property

Limitation on Artificial Losses

1974 Committee Bill.—Last year the committee decided to apply LAL to motion picture films and similar property. Under this provision, the tax deduction for depreciation for motion pictures and similar productions could not be taken currently to the extent it exceeds a taxpayer's income from investments in motion pictures and similar productions. Deductions which cannot be taken currently would be set aside in a deferred deductions account and be deductible in later years when the taxpayer receives income from these investments.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill, except that he would apply LAL on a property-by-property basis.

Limitation of Loss with Respect to Motion Picture Films

1974 committee bill.—In the case of investments in motion pictures and similar productions, the committee last year decided to limit the deduction of losses to the investments "at risk," excluding all nonrecourse loans.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

E. Personal Property (Equipment) Leasing

Limitation on Artificial Losses

1974 committee bill.—Last year, in the deduction of losses, the committee bill would have applied LAL to accelerated depreciation an amortization on personal property subject to a net lease. LAL was applied on a property-by-property basis. Deductions for the excess of accelerated depreciation or rapid amortization over straight line depreciation for each such property was limited to the income from the property and the excess deductions were deferred to future years.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill, except that he would apply LAL to all leases rather than only net leases.

F. Sports Teams (Player Contracts)

Allocation of Purchase Price to Player Contracts in the Case of Sports Enterprises

1974 committee bill.—Last year it was provided that the portion of the amount paid to purchase a team or group of assets which would be allocable to player contracts or sports enterprises must be specified. In addition, the amount allocable to player contracts by a purchaser could not, in any event, exceed the amount of the sales price allocated to these contracts by the seller.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

Recapture of Depreciation on Player Contracts

1974 committee bill.—In the case of player contracts of sports enterprises, last year's bill provided that there would be a complete recapture of all depreciation to the extent of any gain involved at the time of the sale of the player contract or of the sports enterprise.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

G. Prepaid Interest, Accrual Method of Accounting

1974 committee bill.—Last year the committee provided that the deduction for prepaid interest could be taken only in the period to which it relates under an accrual method of accounting. As an exception to this general rule, however, prepaid interest which was properly allocable to the 12-month period following the year in which it is paid could be deducted in the year in which paid to the extent of the net income for that year from the property to which the interest relates.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill, except that he would not include the exception described above.

H. Partnership Provisions

Partnership Syndication Fees

1974 committee bill.—In last year's bill, partnership syndication fees were required to be capitalized.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

Other Partnership Provisions

Mr. Corman.—The proposal would add two provisions relating to partnerships. The first of these provides that a limited partner's share of partnership liabilities cannot exceed the difference between his actual contribution credited to him by the partnership and the total contributions he is obligated to make under the partnership agreement. Second, the proposal would provide that if a registration statement is filed with the SEC, which offers units of participation or other units in a partnership, the partnership is to be treated as a corporation for years ending after the date of the filing of the registration statement.

Mr. Stark and Mrs. Keys.—The proposal would amend the partnership provisions to require that partnership losses be allocated pro rata to partners over the number of days of the partnership year during which the partner was a member of the partnership.

II. MINIMUM TAX AND ALLOCATION OF DEDUCTIONS

A. Minimum Tax for Individuals [1]

1974 committee bill.—Last year the committee decided to replace the existing minimum tax for individuals with a new type of minimum tax. The existing minimum tax is an addition to the regular income tax. The proposed new minimum tax for individuals would have been an alternative to the regular income tax payable by individuals only if it exceeds the regular income tax.

The base of the minimum tax was to be "economic income" less an exemption for certain deductions. "Economic income" was adjusted gross income (as defined in present law) plus most of the existing items of tax preference (the exceptions were rapid amortization of railroad rolling stock, accelerated depreciation on personal property subject to a new lease and accelerated depreciation both on buildings covered under the limitation on artificial losses and on low-income housing subsidized under Federal, State or local government programs). Deductions allowed against economic income were investment interest and expense to the extent of investment income, extraordinary medical expenses and casualty losses, and charitable contributions. The basic exemption was $20,000, but it was to be reduced dollar for dollar as economic income less deductions rises above $20,000. As a result, the exemption would vanish when the excess of economic income over deductions equals $40,000.

The minimum tax rate under last year's committee decisions was to be one-half the regular rates on an equivalent amount of taxable income.

Mr. Ullman.—He would keep, but modify, the existing minimum tax which is imposed in addition to the regular income tax (as contrasted to the 1974 committee decision which would have imposed an "alternative" minimum tax).

He would modify the existing minimum tax by reducing the $30,000 exclusion to $20,000 but provide (in the same manner as under the 1974 committee decision) that it would be reduced on a dollar-for-dollar basis as preference income rises above $20,000, with the result that the exemption would be phased out entirely when the preference income equals $40,000. Second, the deduction for taxes in present law would be limited to one-half of these taxes (which could not exceed one-half of preference income). In addition, there would be no carryover of excess taxes paid to subsequent years. Third, the 10-percent rate of the minimum tax would be increased to 14 percent. Fourth, the preference items subject to this tax would be modified by adding unrealized appreciation where the gift was made to a private or operating foundation, to include intangible drilling expenses in the case of

[1] No change was proposed last year in the minimum tax for corporations, and it was not included in the list of topics for consideration by the committee in phase one of its tax reform consideration.

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development (but not exploration) wells and to exclude any preference items in the existing base to the extent they are dealt with in the tax shelter provisions described above.

Mr. Rostenkowski.—He would concentrate on improving the existing minimum tax rather than imposing any alternative tax on economic income.

Messrs. Vanik, Corman, Green, Gibbons, Karth, Rangel, Mikva, Stark, Jacobs, and Mrs. Keys.—The proposal would retain the present minimum tax provision but reduce the exclusion from $30,000 to $10,000, eliminate the deduction for regular taxes paid, and add intangible drilling expense deductions and appreciation realized by a donor on property donated to private foundations to the list of preference items subject to this tax.

Mr. Fisher.—The proposal would retain the present minimum tax but reduce the exemption from $30,000 to $20,000 and substitute for the present flat 10-percent rate a progressive rate schedule ranging from 10 percent to 30 percent. (The proposal would treat as an integral part of this proposal the allocation of deductions referred to below.)

Messrs. Waggoner and Conable.—The proposal would exclude capital gains as a preference item.

B. Allocation of Deductions

Mr. Ullman.—He would add a provision allocating a taxpayer's itemized deductions between taxable adjusted gross income and nontaxable income. (This is essentially the 1969 House provision.) The proportion of the itemized deductions allocated to nontaxable income could not be taken as deductions from adjusted gross income. All itemized deductions of a taxpayer would be subject to this allocation. The nontaxed items taken into account in determining the allocation would include the type of items included in the provisions relating to tax shelter income but with adjustments in the minimum tax to assure that amounts for which deductions are denied under the allocation provision are not included in the minimum tax base. An exemption from the allocations provision would be provided for the first $10,000 of tax preferences.

III. TAX SIMPLIFICATION IN THE FORM, DOMESTIC INCOME OF INDIVIDUALS

A. Deduction of Expenses Attributable to Business Use of Homes

1974 committee bill.—Last year the committee provided definitive rules for deductions of expenses attributable to the use of a taxpayer's home for business purposes. In general, a taxpayer would not be permitted to deduct any expenses attributable to the use of his home for business purposes. The proposal provides, however, for certain situations in which deductions for such expenses be permitted. A deduction would be permitted if a portion of the home is used exclusively on a regular basis as:

(1) The taxpayer's principal place of business; or

(2) A place of business which is used by patients, clients, or customers in meeting or dealing with the taxpayer in the normal course of business.

In the case of an employee, the business use must be for the convenience of the employer.

A special rule would have covered situations where self-employed individuals may use their home for trade or business purposes on a regular basis but do not use a specific portion of their home exclusively for such purposes. This rule would cover the situations where a trade or business is actively conducted by a taxpayer in his home and is not conducted at any other location. In this case, a deduction for the allocable expenses would be permitted but could not exceed the income generated by the business activities of the taxpayer in his home.

The deductions attributable to the rental of a portion of a taxpayer's home would be subject to the same limitations that would apply to vacation homes.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill, except that he would not include the special rule described above.

B. Deduction of Expenses Attributable to Rental of Vacation Homes

1974 committee bill.—Present law provides that if an activity is not engaged in for profit, the amount of the allowable trade or business deductions (such as depreciation, maintenance, and utilities) cannot exceed the amount of the gross income from the activity less the related personal deductions such as interest and taxes. The determination of whether an activity is engaged in for profit is made by reference to objective standards taking into account all the facts and circumstances of each case. There is a presumption that a taxpayer is engaged in an activity for profit if in two of the five preceding taxable years the activity actually produced a profit.

This provision was enacted as part of the Tax Reform Act of 1969, and among the activities it was intended to cover was the rental of vacation homes used for personal purposes. However, the rules and regulations do not provide definitive rules in the case of vacation homes used for personal purposes.

To deal with this problem the committee last year provided that if a vacation home is used by a taxpayer for personal purposes for more than two weeks or 5 percent of the actual business use (that is, its actual rental time), then deductions would be subject to a limitation whether or not the presumption under present law would otherwise apply. This means that the allowable deductions for trade or business or the production of income relating to the vacation home, which would be allowed if the activity were engaged in for profit, would not be permitted to exceed the gross income from the business use of the vacation home.

If the vacation home is used for less than two weeks or less than 5 percent of the actual business use, then the proposal would not apply.

These special rules would not apply if the vacation home results in a profit for the year or if there is no personal use of the vacation home during the year.

Where there is any personal use of a vacation home, the deductions allowable for rental activities would be limited to the actual rental use divided by the total actual use of the property (that is, the business use and personal use) times the expenses attributable to the vacation home other than expenses which are deductible in any event.

Mr. *Ullman.*—His proposal is the same as the 1974 committee bill. bill.

C. Deduction for Conventions, Conferences, etc., Outside the United States

1974 committee bill.—Last year the committee limited deductions allowable for the expenses of taxpayers attending conventions, educational seminars or similar meetings outside North America. The general rule agreed to by the Committee was that no deduction is allowable for foreign travel expenses (including expenses for transportation, meals and lodging) for an individual with respect to a convention, seminar or similar meeting held outside North America unless, taking into account certain factors, it is more reasonable to hold the meeting outside the North American area. North America is defined to include the Caribbean.

The general rule would not apply to a meeting conducted by an organization which has foreign members to the extent the number and location of its foreign meetings are reasonable in light of the number of foreign members and their geographical dispersion. Present law relating to the allocation of expenses would continue to apply in any case where the travel expenses attributable to foreign meetings may still be deductible.

This rule also is not intended to apply to the expenses incurred in attending a convention, etc., at a location that is uniquely suited to the purposes of the convention, provided that the attendance at the conference by an individual is related to his trade or business. Thus, a deduction would be allowed in the case of an individual who attends a meeting conducted or sponsored by a domestic organization which meets outside North America if there is a compelling reason for meeting outside, taking into account the membership and purpose of the organization.

Mr. Ullman.—His proposal is the same as the 1974 committee bill except that in no event would deductions be allowable for cruises. He also wishes to review possible rules which might be imposed before deductions are allowed for conventions, conferences, etc., within North America.

Mr. Karth.—The proposal would disallow, in the case of professional and other closely held corporations, the expense of attending shareholder or directors' meetings held outside the United States or, if within the United States, not held at the principal place of business of the corporation.

Mr. Helstoski.—The proposal would end business deductions for all foreign held conventions with the following exceptions: (1) individuals attending conventions of international organizations provided that they are members of the organization or they attend as a representative of a U.S. member organization; and (2) conventions, etc., attended by U.S. citizens living abroad as bona fide residents of foreign countries (e.g., an uninterrupted period that includes one full tax year or 510 days during a period of 18 consecutive months—foreign residency rules presently in sec. 911 of the code). The proposal would provide deductions for conventions outside of the United States (not including possessions) only to the extent they meet the criteria set forth above.

D. Retirement Income Credit

1974 committee bill.—Last year the committee increased the size of the retirement income credit and also restructured it to remove many complications in the existing provision. It would become a tax credit for the elderly available to all taxpayers age 65 or over regardless of whether they have retirement income or earned income.

The maximum amount on which the credit is computed would be increased to $2,500 for single persons age 65 or over and to $3,750 for married couples filing joint returns where both are 65 or over. (Under present law, the maximum amount on which a credit is computed is $1,524 for a single person, $2,286 for a married couple where only one has retirement income and $3,048 where both have retirement income.)

The maximum amounts for computing the credit would be reduced, as under present law, by social security benefits and other exempt pension income. Also, the amount on which the credit is based would be phased out above income levels of $7,500 for single persons and above $10,000 of income for married couples in order to limit the benefits of the credit to low and middle income elderly taxpayers. Above these income levels, the amount on which the credit is computed would be reduced by $1 for each $2 of adjusted gross income above the indicated levels.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

E. Sick Pay Exclusion

1974 committee bill.—Last year the committee repealed the temporary sick pay exclusion. However, the exclusion for disability income would continue to be available to taxpayers under age 65 who are permanently and totally disabled. (After that age they would be eligible for the revised elderly credit.) The maximum amount of income that may be excluded as disability income in this case, as under the present law sick pay exclusion, would be limited to $100 a week ($5,200 a year). The maximum amount excludable would be reduced on a dollar-for-dollar basis by the taxpayer's income (including the disability income) in excess of $5,200. For this purpose, permanently and totally disabled means unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months. These limitations would be applicable to both military and civilian retirement disability payments but not to payments by the Veterans' Administration.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill except that he would reduce the maximum exclusion of $5,200 only when the individual's income exceeds $15,000 (instead of $5,200) and would not apply the limitations to individuals receiving military disability payments which are directly related to combat injuries (in addition to the exclusion for payments by the Veterans' Administration).

F. Child Care Deduction

1974 committee bill.—Last year the committee revised the child care deduction to broaden the overall application of the provision and to simplify it. The deduction for child (or disabled dependent) care expenses would be extended to married couples where the husband or wife, or both, work part-time. (Presently both spouses are required to work full time.) The deduction would be limited to the amount of earnings of the spouse earning the smaller amount, or in the case of a single person, to his earnings. The deduction would also be made available in the case of married couples where one is a full-time student and the other spouse works. (The committee's bill last year also would have raised the income level at which the deduction starts to phase out from $18,000 to $30,000, but in the Tax Reduction Act of 1975, this level has already been raised to $35,000.)

Additional child care changes would include eliminating the distinction between care in the home and care outside the home, making the deduction available to a divorced or separated parent who has custody of a child even though not entitled to a dependency exemption for the child, and making a deserted spouse eligible for the deduction where the deserting spouse is absent for more than 6 months rather than an entire year.

Several changes would also be included in the proposal to simplify the tax return form by eliminating the need for a separate child care schedule. One such change would replace the present monthly maximum deduction ($200 for one dependent, $300 for two dependents, and $400 for three dependents) with a maximum annual deduction of $2,400 for one dependent and $4,800 for two or more dependents. Finally, the requirement that the deduction for the taxpayer be reduced by disability income received by his dependent would be eliminated.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

Messrs. Stark and Steiger and Mrs. Keys.—Their proposal would move the deduction for child care expenses from an itemized deduction to a deduction from gross income in arriving at adjusted gross income.

Mr. Jones.—The proposal would allow deductions for payments to family relatives who provide day care for a child.

Mr. Frenzel.—He wants the committee to consider moving the child care deduction from the itemized deduction category to a deduction from gross income. He also would like to see a change in the income cap over which no deductions would be allowed.

G. Deduction for Alimony Payments

1974 committee bill.—Last year the committee moved the deduction of alimony payments from an itemized deduction to a deduction from gross income to arrive at adjusted gross income.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

H. Deduction for Guaranties of Business Bad Debts to Guarantors Not Involved in Business

1974 committee bill.—Last year the committee provided the same treatment for a noncorporate guarantor (or endorser or indemnitor) of certain noncorporate obligations as is presently provided in the case of a person who makes a direct loan to a principal debtor who uses the loan in a trade or business. Under present law, a noncorporate guarantor of certain noncorporate obligations is allowed business bad debt treatment on any payment made by him in discharge of all or part of his obligation as guarantor. Business bad debt treatment allows the guarantor to claim an ordinary loss deduction rather than a short-term capital loss deduction, which would be the case if the guarantor had made a direct loan which was defaulted instead of guaranteeing the loan.

The committee last year eliminated the provision that allows noncorporate guarantors to treat as business bad debts the losses from a guarantee of certain noncorporate obligations. This would mean that the losses of noncorporate guarantors (where there is not a business relationship of the guarantor) would be considered nonbusiness bad debts and treated as short-term capital losses. In addition, the committee made it clear that in all respects where a taxpayer has a loss arising from a guarantee of a loan, he is to receive the same treatment as where he has a loss from a loan which he makes directly.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

I. Deduction for Property Transfer Taxes and Disability Taxes

1974 committee bill.—Last year the committee repealed the deductions for State or local property transfer taxes and for State disability and unemployment compensation taxes.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

J. Simplification of Itemized Deductions Generally with a Simplification Deduction in Lieu of the Revisions

1974 committee bill.—Last year the committee provided a series of simplification revisions which are as follows:

(a) The dividend exclusion would be repealed.

(b) The deduction for State and local gasoline taxes would be repealed.

(c) The casualty loss deduction would be subject to a floor of 3 percent of adjusted gross income, but only casualty losses in excess of $50 per loss (instead of $100 as under present law) would be taken into account for the floor.

(d) Medical, dental, etc., expenses: The deduction for one-half of medical insurance premiums (up to $150) which is allowable without regard to the 3-percent floor applicable to other medical expenses would be repealed.

The 3-percent floor applicable to the medical expense deduction would be increased to 5 percent, and the 1-percent floor with respect to drugs would be eliminated. Expenses for drugs would be covered under the 5-percent floor but the deduction would apply only to prescription drugs.

(e) Deduction for certain employee business expenses: The deduction for miscellaneous expenses (which includes employee business expenses and expenses for the production of income) would be continued, but a $200 floor would be provided so that only the total miscellaneous expenses above $200 would be deducted.

(f) Simplification deduction: To replace itemized deductions eliminated by the proposals outlined above a "simplification deduction" would be provided to taxpayers who itemize their deductions. This special simplification deduction would be taken in addition to a taxpayer's other itemized deductions and would be equal to $350 plus 2 percent of adjusted gross income, up to a maximum of $650.

Mr. Ullman.—His proposal is the same as the 1974 committee bill except that he would make two changes in the deduction for certain employee business expenses. First, he would provide that the deduction for professional fees, union dues, and other similar expenses would be changed from an itemized deduction to a deduction from gross income in arriving at adjusted gross income. Second he would provide that the deduction for miscellaneous expenses (which includes employee business expenses and expenses for the production of income) would be continued, but a $200 floor would be provided so that only the total miscellaneous expenses above $200 would be deducted.

Mr. Vander Veen.—The proposal would provide that mortgage interest and State and local taxes be allowed as deductions (or credits) from gross income rather than as itemized deductions. In addition, the proposal would propose certain revisions in the low income allowance, the percentage and the maximum standard deduction in order to encourage more taxpayers to use the standard deduction.

Mr. Stark and Mrs. Keys.—In the case of the simplification deduction, they would propose a flat $500.

Mrs. Keys.—The proposal would make three modifications of the medical expense revisions: (1) put the deduction for medical insurance premiums within the general medical expense floor, (2) eliminate the one-percent floor for drugs and medicines, and (3) reduce the floor from 3 percent to 2 percent.

Mr. Jones.—In the case of the medical expense deduction, the proposal would eliminate all floors and would also provide for a review as to the possible use of a credit rather than a deduction for medical expenses.

Mr. Schneebeli.—The proposal would provide that professional dues and fees and other miscellaneous expenses would be treated identically.

Mr. Steiger.—The proposal would provide that the inclusion of prescription drugs under the "5-percent floor" should specifically include insulin products.

Mr. Martin.—The proposal would make 3 changes in the simplification provision. First, the proposal would continue the $100 exclusion for dividends and expand it to include interest from savings institutions. Second, the proposal would provide a refundable tax credit for extraordinarily large medical expenses, supplementing or replacing the present deduction. Third, the proposal would make all miscellaneous deductions of income expenses deductions from gross income rather than deductions from adjusted gross income.

Messrs. Bafalio and Ketchum.—The proposal would reinstate the previously deleted provision which allows full medical expense deduction (without a floor) for those age 65 or over, as well as full deductions for prescription drug expenses.

K. Extension of Tax Tables to Enable Individuals to Use the Short 1040–A Tax Form for Taxable Incomes Up to $20,000

1974 committee bill.—Last year the committee revised the tax tables published by the Internal Revenue Service. Under present law, taxpayers having adjusted gross income of less than $10,000 and not itemizing deductions must use the optional tax tables provided by the IRS. (Individuals who itemize the deductions or have adjusted gross income in excess of $10,000 must use the rate schedules.) These 12 tax tables take up 6 pages of instruction and taxpayers often use the wrong table. For simplification, the proposal would base the tax tables on taxable income rather than adjusted gross income and extend their applicability to taxable incomes up to $20,000. Thus, all taxpayers with taxable incomes of less than $20,000 would compute their taxable income by subtracting the amount of their personal exemptions and deductions from their income and then by looking up their tax in the tables.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

L. Accumulation Trusts

1974 committee bill.—For the two alternative methods used in computing the throwback rule for accumulation distributions, the committee last year substituted a single method, a revision of the present "short-cut method." This method would throw back the average accumulation distributions (as determined under present law) to the 5 preceding years of the beneficiary (rather than the 3 preceding years under present law). This average amount would be added to the beneficiary's taxable income for these years (rather than requiring the recomputation of his tax returns as under present law). Of these 5 preceding years, the year with the highest expanded taxable income and the year with the lowest would not be considered; in effect, then, the computation of the additional tax on the accumulation distribution under this short-cut method would continue to be based on a 3-year average basis. In other respects generally, the present rules under the short-cut method would continue to be applicable, except that no refunds would be available.

Income accumulated by a trust prior to the beneficiary's attaining the age of 21 and the years a beneficiary was not in existence would not be subject to the throwback rule (except in the case of distributions from multiple trusts, as described below).

A special rule would be provided for 3 or more trusts which accumulate income in the same year for a beneficiary.

The capital gains throwback rule would be repealed. A special rule would be provided to cover the possible tax abuse where the grantor places in trust property which has unrealized appreciation in order to shift the payment of any capital gains tax to the trust at its lower progressive rate structure.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

M. Limitation of the Interest Deduction for Nonbusiness Interests to a Specified Amount Where It Is Claimed as an Itemized Deduction

Mr. Ullman.—He would limit the amount of interest an individual could claim as an itemized deduction for nonbusiness interest (including investment interest) to $9,000 a year, or to the equivalent of 9 percent on $100,000.

Messrs. Jones and Schneebeli.—The proposal would exclude from the above provision the interest on the mortgage on a taxpayer's place of residence.

N. Moving Expense Deductions

Mr. Ullman.—The moving expense deductions would be simplified and certain problems would be worked out as to their application to the military.

Mr. Burke.—He would make several changes in the moving expense deduction but believes the single most important change is raising the $1,000 and $2,500 limitations.

Mr. Schneebeli.—The proposal would make a series of changes in the moving expense deduction, including the allowing of meals and lodging while in temporary quarters at the "old" place of employment for a period of up to 5 days. and while at the "new" place of employment for up to 60 days instead of 30 days, decreasing the distance an individual must move from his former place of work from 50 miles down to 20 miles, doubling the dollar limitations applicable to the various types of moving expenses, and allowing an exclusion for employer-reimbursed moving expenses, instead of a deduction (see H.R. 8044).

Mr. Duncan.—The proposal would amend the present moving expense provision to provide for the exclusion from income for moving expenses reimbursed by an employer (rather than including them in income and taking a deduction), permitting a deduction for temporary living quarters for 5 days while at the "old" place of work and 60 days rather than 30 days while at the "new" place of work, removing entirely the dollar limitations on moving expense deductions and substituting for the present 50-mile requirement to qualify for the deduction the requirement that the individual's move involve only a move of 20 miles.

Mr. Ketchum.—The proposal would eliminate the requirement that in order to be eligible for the moving expense deduction the taxpayer's new place of work must be 50 miles further from his former residence than his former place of work.

O. Tax Treatment of Scholarships and Fellowships

Mr. Ullman.—A revision would be made of the tax treatment of scholarships and fellowships including the cancellation of indebtedness for student loan programs.

P. Disaster Loan Provisions

Mr. Ullman.—The tax treatment presently provided under this provision would be clarified.

Mr. Schneebeli.—The proposal deals with cases where an individual is allowed a tax deduction in connection with a disaster occurring in 1972 or 1973, which was determined by the President to warrant disaster assistance, and who received a disaster loan. Such an individual is not to be required to take into account in his income (or in determining the deduction otherwise allowable for the loss) any part of the loan which is cancelled except where the adjusted gross income of the individual for the taxable year in question exceeded $15,000. Where the income of the individual for the year in question exceeded $15,000, the cancellation of indebtedness which need not be taken into account would be in the ratio of $15,000 to the individual's adjusted gross income for the year in question (see H.R. 9135).

Q. Qualified Stock Options

1974 committee bill.—Under present law, a qualified stock option is not treated as income when it is granted or when it is exercised. In addition, when the stock acquired under the option is sold or exchanged by the employee, the difference between the option price and the price received by the employee is generally treated as long-term capital gain or loss.

Last year the committee revised this treatment, so that in the future, generally, the value of the option would constitute ordinary income to the employee if it had a readily ascertainable fair market value at the time it is granted (and is not nontransferable and subject to a substantial risk of forfeiture). If the option does not have a readily ascertainable value, it would be treated as ordinary income at the time the option was exercised to the extent of the spread between the option price and the value of the stock.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

IV. FOREIGN INCOME

A. Foreign Tax Credit

Limit on Foreign Tax Credit

1974 committee bill.—Last year's bill contained no limitation on the foreign tax credit of multinational corporations. However, it did contain a limitation on the foreign operations of petroleum companies which was enacted into law as part of the Tax Reduction Act of 1975.

Mr. Ullman.—He would provide that the foreign taxes paid on income from one country which would be allowable as a credit could not exceed 50.4 percent of the taxable income from that country in 1976 and in subsequent years could not exceed 50 percent of taxable income. The source of income rules with respect to interest and dividends would require modification under this proposal.

Mr. Vanik.—The proposal would substitute a deduction for the foreign tax credit.

Messrs. Corman, Green, Gibbons, Karth, Rangel, Stark, Jacobs, Mikva and Mrs. Keys.—The proposal would lower the percentage limitation for foreign oil extraction income in the Tax Reduction Act of 1975 to 48 percent and apply it and all other provisions of section 601 of the 1975 Act to the extraction of all other natural resources.

Messrs. Corman, Karth, Vander Veen, and Rangel.—The proposal would make the foreign tax credit subject to both the per country and the overall limitations.

Mr. Karth.—He recommends that for all foreign income, all excess tax credits be eliminated. To the extent foreign taxes paid exceed the U.S. tax and, as a result are not subject to credit under this recommendation, they would be deductible as a business expense.

Foreign Tax Credit Determined on Overall Basis

1974 committee bill.—Last year's bill repealed the per country limitation on the foreign tax credit for all industries.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

Mr. Waggonner.—The proposal would allow taxpayers engaged in mining to retain the option to elect the per country limitation.

Gross-up of Dividends for Purposes of the Foreign Tax Credit

1974 committee bill.—Last year's bill provided that dividends received by U.S. shareholders from less-developed country corporations are to be "grossed-up" by the amount of taxes paid in the less-developed country both for purposes of computing U.S. income and for purposes of computing the U.S. foreign tax credit applicable to that income (in the same manner as is presently true in the case of dividends from developed countries).

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

Capital Gains for Purposes of Foreign Tax Credit

1974 committee bill.—Last year's bill provided that in cases where a U.S. taxpayer sells a capital asset in a foreign country, the amount of any income received from the sale is not to be included as foreign source income for purposes of computing the taxpayer's foreign tax credit limitation if no substantial foreign tax is paid upon the sale of the asset. In this case and in cases where U.S. source capital gains are realized, the foreign tax credit limitation is to be adjusted to the extent of the capital gains.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

Recapture of Foreign Losses

1974 committee bill.—Last year's bill had a provision that required any foreign losses which offset U.S. income to be recaptured in future years when foreign income is earned.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

Mr. Corman.—The proposal would deal with one aspect of the loss offset problem by excluding income, deductions, and losses from the exploration and operation of mineral property located outside of the United States from the U.S. tax base.

Other

Messrs. Corman and Rangel.—The proposal would deny the foreign tax credit on income exempt from U.S. tax.

B. Deferral of Tax on Foreign Subsidiaries

1974 committee bill.—Last year's bill contained a series of amendments modifying or eliminating exceptions to the rules requiring current taxation of tax haven income (i.e., the so-called subpart F provisions). These amendments were enacted as part of the Tax Reduction Act of 1975.

Mr. Ullman.—He would require that one-half of the income of each controlled foreign corporation would be required to be included in income on an annual basis. The computation would be made on a consolidated basis by including all commonly controlled foreign corporations as one corporation for purposes of this 50-percent requirement.

Messrs. Vanik, Corman, Green, Gibbons, Karth, Rangel, Stark, Jacobs, Mikva, Fisher and Mrs. Keys.—The proposal would eliminate deferral completely.

Mr. Vander Veen.—The proposal would eliminate tax deferral over several years.

Mr. Pickle.—The proposal would deny tax deferral to runaway plants.

C. Amendments Primarily Affecting Individuals

Repeal of Exclusion for Income Earned Abroad

1974 committee bill.—Last year's bill provided that the exclusion from income under present law of $20,000 (or, in some cases, $25,000) for income earned abroad by U.S. citizens living or residing abroad is to be phased out over a four-year period. Also, the committee agreed to a similar four-year phaseout of the exclusion for allowances of government employees based abroad. In lieu of these exclusions, the committee agreed to a $1,200 deduction for tuition expenses of dependents of taxpayers employed outside the United States. Further, the committee agreed to an exclusion from gross income for municipal-type services furnished in a foreign country by an employer on a nondiscriminatory basis.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill except that he also provides that individuals claiming the standard deduction could also claim a foreign tax credit.

Mr. Pickle.—The proposal would limit the exclusion so that it would only apply to an individual for four years.

U.S. Taxpayers Married to Nonresident Aliens

Mr. Ullman.—He would provide that a U.S. taxpayer married to a nonresident alien would be allowed to file a joint return if a binding election is made by both taxpayers to be taxed on their worldwide income. Such an election could only be revoked in case of divorce or separation. In addition, the community property laws would not apply in the case of a taxpayer married to a nonresident alien. A condition of the election would be that the husband and wife must agree to supply all necessary books and records.

Foreign Trusts

1974 committee bill.—Last year's bill provided that income of foreign trusts established by a U.S. grantor which has one or more U.S. beneficiaries is to be taxed currently to the grantor under the existing so-called grantor trust rules of the Code. In the case of accumulated income of foreign trusts which is not taxed on a current basis, an interest charge is to be added to the tax paid by U.S. beneficiaries when they receive accumulated income distributions.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

Excise Tax on Transfer of Property to Foreign Persons

1974 committee bill.—Last year's bill provided that the 27½ percent excise tax which, under present law, applies to transfers of appreciated stocks or securities to a foreign trust or a foreign corporation or partnership, is to be increased to 35 percent and apply to transfers of all types of appreciated property.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

D. Tax Treatment of Controlled Foreign Corporations and Their Shareholders

Repeal of Exclusion for Earnings of Less-Developed Country Corporations

1974 committee bill.—Last year's bill provided that the provisions of present law providing for ordinary income taxation to U.S. shareholders on gains from the sale of stock in foreign corporations (to the extent of the shareholder's pro rata share of the earnings and profits of that corporation) are to be applied in the same manner to less-developed country corporations as they apply to other foreign corporations.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

Investment in U.S. Property by Controlled Foreign Corporations

1974 committee bill.—Last year's bill provided that the provision in present law under which U.S. shareholders of a controlled foreign corporation are deemed to have received dividends from that corporation if it reinvests its profits in the United States is to be limited to cases where the foreign corporation engages in a leasing arrangement or lends money to a related U.S. person.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

E. Special Categories of Corporate Tax Treatment

Western Hemisphere Trade Corporations

1974 committee bill.—Last year's bill phased out over a five-year period the provision in present law which provides a 14-percent lower tax rate for Western Hemisphere Trade Corporations.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

Corporations Conducting Business in U.S. Possessions

1974 committee bill.—Last year's bill provided for several changes in the treatment of possessions corporations. In lieu of the exclusion under present law, a new tax credit is provided for possessions corporations equal to the U.S. tax attributable to the corporation's income from a possession trade or business and from qualified possession investments. Other income of a possession corporation is subject to the normal U.S. tax without any offset by this new credit. The requirements for qualifying as a possessions corporation are to remain the same as under present law except that such corporations are to qualify only if they elect for a period of 10 years to become a possessions corporation. Finally, the committee agreed to permit corporations receiving dividends from possessions corporations to be eligible for the dividends received deduction.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

Mr. Corman.—The proposal would tax the gain upon the liquidation of a possessions corporation.

China Trade Act Corporations

1974 committee bill.—Last year's deadwood bill repealed the China Trade Act Corporation provisions but permitted a tax-free reorganization into a foreign corporation.

Mr. Ullman.—His bill would repeal the China Trade Act Corporation provisions without any exception to the normal rules for the taxation of transfers to foreign corporations.

Mr. Schneebeli.—The proposal would repeal the provision prospectively.

F. Domestic International Sales Corporations

1974 committee bill.—Last year's bill would have made the DISC provisions inapplicable to agricultural and natural resource products and to goods subject to export control. As part of the Tax Reduction Act, DISC was made inapplicable to natural resources (which are depletable) and to goods subject to export control. Also, last year's bill gave the President's Special Representative for Trade Negotiations authority to negotiate the elimination of DISC benefits as part of multilateral agreements on trade.

Mr. Ullman.—He would provide that the tax benefits to DISC's would be repealed and the accumulated benefits of DISC would be recaptured over a 10-year period. The exception to treatment of income as subpart F income for export trade corporations would be repealed.

Mr. Gibbons.—The proposal would repeal DISC (with no phaseout for previously accumulated benefits) to comply with the Congressional Budget Resolution.

Messrs. Karth and Conable.—The proposal would retain DISC but consider limiting dollar amount of benefit in any one year, limiting the number of years of benefits, using a consolidated net export approach, or extending benefits on an incremental approach.

Mr. Pickle.—The proposal would adopt the rules in last year's bill.

Mr. Helstoski.—The proposal would limit deferral benefit to 10 years with recapture beginning after the fifth year on a graduated basis.

G. Money or Other Property Moving in or out of the United States

Investments by Foreigners in the United States

1974 committee bill.—Last year's bill provided that the 30-percent withholding tax on dividends and interest received from the United States by foreign persons is to be repealed except in the case of dividends and interest from investments that constitute a direct investment in U.S. securities rather than a portfolio investment. As part of this provision, the present exemption from the 30-percent withholding tax which applies to foreign deposits held in United States banks (which under present law would expire on December 31, 1976) is made permanent. In these cases where the withholding tax is not to apply, the stock and securities are to be exempt from U.S. estate tax.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

Changes in Ruling Requirements Under Section 367; Certain Changes in Section 1248

1974 committee bill.—Last year the committee agreed to eliminate the requirement in present law (section 367 of the Internal Revenue Code) that an advance Internal Revenue Service ruling must be obtained for tax-free exchanges involving a foreign corporation related to United States taxpayers. In addition, the Committee instructed the staff to set out rules under which no Internal Revenue Service rulings would be required. The effective dates of the provisions in the bill relating to advance rulings under section 367 permit after-the-fact rulings on corporate reorganizations solely involving foreign corporations to be obtained until 183 days after the date of enactment if the exchange was in a taxable year beginning after December 31, 1962, and before December 31, 1974.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

H. MISCELLANEOUS

Shipping Income

Messrs. Vanik, Corman, Green, Gibbons, Karth, Rangel, Stark, Jacobs, Mikva and Mrs. Keys.—The proposal would repeal the reciprocal exemption for shipping and tax as U.S. source income one-half of the income from shipping activities involving U.S. ports.

State Taxation

Mr. Jones.—The proposal would preempt the States from taxing foreign source income.

Allocation of Deductions Between Domestic and Foreign Source Income

Mr. Stark and Mrs. Keys.—The proposal would amend sections 861 to 863 to make it clear that indirect costs (including interest, research and development and home office expense) should be allocated between domestic and foreign source income to most accurately reflect their relationship to the net income earned by multinational corporations from both sources. They do not believe that the "gross-to-gross" allocation method usually reflects an accurate allocation.

V. ADMINISTRATIVE PROVISIONS

A. Income Tax Return Preparers

1974 committee bill.—Last year the committee agreed to a series of provisions dealing with tax return preparers which are designed to assist the Internal Revenue Service in its auditing practices by permitting it to retrieve and analyze by computer all returns prepared by the same preparer.

Tax return preparers who would be covered by these provisions are those persons who prepare, directly or through employees, a return or claim for refund for compensation. These rules were not to apply to persons who render mere mechanical or processing assistance, regular employees who prepare returns of their employer as a usual incident of employment, fiduciaries who prepare returns for trusts or estates, or partners who prepare returns for partnerships.

The provisions agreed to by the committee which were to apply to the covered tax return preparers are as follows:

1. Each prepared return, statement or other document must contain the identification number of the return preparer and other data sufficient to identify the preparer. A $25 penalty is provided for each failure to comply, if without reasonable cause.

2. Each preparer must furnish to taxpayers a copy of the return or claim for refund prepared by the tax return preparer at the time the return is given for the taxpayer's signature. A $25 penalty is provided for failure to comply, if without reasonable cause.

3. Each return preparer or every person employing a tax return preparer must file an annual report listing the name, address, identification number, and place of work of each preparer they employ. This report is to be filed by July 31 for a 12-month period ending June 30. Failure to comply without reasonable cause would result in a $100 penalty for each failure to file an annual return and a $5 penalty for each failure to include a name, identification number and place of work on the annual report. These penalties are not to exceed $20,000 for a 12-month period.

4. Each return preparer or employer of return preparers must retain for three years either a list of taxpayers for whom returns were prepared or copies of their returns and claims for refunds. A $50 penalty is povided for each failure to retain a copy of a return or to list a taxpayer for whom a return was prepared, up to a maximum of $25,000 for all returns in a year.

5. Penalties are also provided for negligence or fraud on the part of the tax return preparer. A $100 penalty is provided for negligent or intentional disregard of Internal Revenue Service rules or regulations by a tax return preparer. A $500 penalty is provided for a willful attempt to evade, defeat or understate any tax by a tax return preparer. A separate penalty may be imposed for each return or claim for refund. The penalties are flat amounts rather than a percentage of understatement of tax (as is the case under present law with respect to negligence or fraud on the part of a taxpayer) in order to avoid the necessity of determining a taxpayer's exact tax liability in a proceeding against the preparer. With respect to all the penalty provisions, the period of limitations for assessing penalties would be three years from the filing date of the return or claim for refund, except that penalties for a willful attempt to evade, defeat, or understate any tax could be imposed at any time.

6. In order to prohibit a tax return preparer from continuing to prepare returns when it is determined that he has engaged in improper conduct with respect to the preparation of tax returns, an injunctive proceeding could be brought against such a preparer. The grounds for such action may include (1) engaging in conduct subject to penalties, (2) misrepresenting qualifications (including eligibility to practice before the Internal Revenue Service), (3) guaranteeing the payment of a tax refund, or (4) engaging in other similar conduct that substantially interferes with the proper administration of internal revenue laws. A tax return preparer who files a bond of $50,000 to guar-

antee payment of further penalties would not be subject to an injunctive proceeding for penalty-type conduct.

7. The Internal Revenue Service would be authorized to provide the names, addresses, and taxpayer identifying numbers of preparers to State authorities charged with enforcing State provisions regulating tax return preparers.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

B. Assessments in Case of Mathematical or Clerical Errors

1974 committee bill.—Last year the committee agreed to clarify the definition and treatment of mathematical or clerical errors made on returns by taxpayers in cases where the Internal Revenue Service corrects the error and makes an immediate assessment if there is an underpayment or reduces the amount of a refund if there is an overpayment.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

C. Application of Withholding Tax Provisions (such as Interest and Dividends, Certain Gambling Winnings, Earnings of Agricultural Employees, and State Income Taxes from Certain Government Employees and Military Reservists)

1974 committee bill.—Last year the committee made revisions with respect to two categories of withholding tax provisions. First, the committee's bill instituted withholding for income tax of 20 percent on gambling winnings of more than $600 when the odds exceed 300 to 1. In the case of lottery winnings, the 20-percent withholding for income tax would have been levied regardless of odds whenever the proceeds exceeded $100. Second, last year the committee extended the provision under present law requiring the Treasury to enter into agreements with States and cities to withhold income taxes from Federal employees who are members of the National Guard and Ready Reserve when they are paid for performing regular training.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

D. Disclosure of Tax Returns and Return Information

Mr. Ullman.—His proposal is that as a general rule tax returns and other tax information would be strictly confidential and disclosure to agencies other than the IRS would be permitted only in limited situations, where there is a proven need and rigorous safeguards exist to protect this information. Among the few agencies to which disclosure would be allowed (to the extent necessary for their job) are the Justice Department for use in tax cases; State tax agencies, solely for tax administration and with the strictest safeguards; and limited information to the Census Bureau, Bureau of Economic Analysis and perhaps a few other agencies, for statistical use only. Also, those agencies which have a need for tax information because their substantive operating rules are tied to the tax laws would have access to the limited information needed to do their job. Examples of these agencies include the Social Security Administration (for administering the social security system), the Pension Benefit Guarantee Corporation, and the Department of Labor (for administering the Pension Reform Act) and the

Renegotiation Board (for reviewing excess profits of government contractors).

The Justice Department in criminal cases, would have access only to the extent that the information did not come from the taxpayer, but was obtained in the course of a Federal investigation which could be made by other Federal agencies. The President (and limited White House officials properly designated) would have access only on his personal written request, which would be reported to Congress.

The tax committees of the Congress and their staffs and other committees specifically authorized by congressional resolution, would have access but only in closed executive session.

Criminal penalties for violating these rules would be increased, and civil penalties would be provided. Each agency that receives tax information would be required to meet safeguards established by the IRS; if the safeguards are not met, disclosure would immediately stop. Full reports of all disclosure would be made to the Congress.

Mr. Pickle.—He would provide new provisions for the confidentiality of income tax returns, particularly guarding against giving income tax returns to any and all local and State officials, regardless of the tax system of the local jurisdiction.

Mr. Schneebeli (*by request*).—The proposal would provide statutory rules to govern the confidentiality and disclosure of tax return and return information to restrict disclosure of such information with respect to all tax returns only to those persons, and for those purposes, specifically authorized by the code.

Mr. Archer.—He wants the committee to consider restricting the authority for inspection of tax returns and the disclosure of informaion in the returns. The inspection would be limited to defined officials and a limitation placed on disclosure of certain information would be specified. Violation of this provision would subject an individual to a $10,000 fine or imprisonment for not more than 5 years, or both, together with the costs of prosecution. (His bill is H.R. 4193.)

E. Private Letter Rulings

Mr. Ullman.—He would provide that private letter rulings would be open to public inspection to the fullest extent possible but with responsible protection of the legitimate interests of ruling applicants to protect the privacy of their financial and personal affairs. For new rulings, procedures would be developed to allow the rulings program to be open to public examination. Procedures would be available to resolve disputes between ruling applicants and the National Office over material to be made public.

For previously issued rulings, a procedure would be devised to allow ruling letters to be made public over a period of time without disruption of the current ruling program. To this end a separate office would be created inside the Internal Revenue Service, with its own budget, with the responsibility to review past rulings under procedures which protect essential personal privacy and keep confidential information which might harm the legitimate business interests of a past ruling recipient.

Mr. Pickle.—He would provide that private letter rulings be published.

F. Jeopardy and Termination Assessments

Mr. Ullman.—He would provide, in cases where a jeopardy assessment is made, that taxpayers would have the right to challenge the findings of the collection agents that such summary procedures are justified. Under such a procedure, the collection agents would have to show that there is reasonable cause for making a jeopardy assessment. To the extent the assessment is found to be unjustified, seized property would be returned to the taxpayer. The Service should be required fully to disclose the basis on which both the assessment of tax and the determination of jeopardy were made.

In cases where the assessment is made by terminating the taxpayer's year and estimating the amount of tax due to that point, the regular tax assessment proceedings would also be applied. A "notice of deficiency" would be sent to permit taxpayers to petition the Tax Court to determine the tax issues raised in their cases without having to pay the full amount of the assessed tax first. If the Service fails to observe these procedural requirements, taxpayers would have the right to obtain from a Federal court an order enjoining the assessment, together with a return of the seized property.

G. Declaratory Judgments in the Case of Tax-Exempt Organizations

1974 committee bill.—Because of the present usual long delay in getting a court test of any adverse determination by the IRS, and the almost certain loss of contributions during this period of delay, the committee last year agreed to provide a procedure whereby an organization may ask the Tax Court for a declaratory judgment as to its tax-exempt status and classification under section 501(c)(3) of the Internal Revenue Code.

Under the declaratory judgment procedure agreed to by the committee, if the IRS fails to issue a favorable exemption ruling (or fails to rule that the organization is a "public charity" rather than a private foundation), an organization seeking exemption under section 501(c)(3) of the Code may petition the Tax Court for a declaratory judgment as to its exempt status, its classification as a private foundation, its classification as a private operating foundation, or its classification as an organization eligible to receive deductible charitable contributions. A similar procedure would be available from a final adverse determination by the IRS as to any of these items.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

H. Tax-Exempt Status of Condominiums and Homeowner Associations

1974 committee bill.—The committee agreed last year to provide that in the case of homeowner associations, condominium housing associations, and cooperative housing corporations, only the investment income and income derived from a trade or business is to be taxable. A deduction would be allowed for expenses directly attributable to any investment income and any income derived from a trade or business. Assessments for the administration, maintenance and operation of the homeowners association, etc., would not be taxable.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

Mr. Karth.—He would agree with the provision in the 1974 committee bill as well as the approach taken in his bill, H.R. 3024.

Mr. Pickle.—The proposal would provide that surplus funds in the hands of a cooperative or condominium at the end of the year would not be subject to tax.

Mr. Duncan.—The proposal would provide a tax exemption for income of condominiums, homeowner associations, and cooperative housing corporations, as proposed in his bill, H.R. 8666, or the provision agreed to last year in the 1974 committee bill in both cases retroactive to 1974.

I. Administrative Summons

Mr. Ullman.—He would provide that taxpayers would be notified and have an opportunity to intervene when the IRS serves administrative summons on a third party in the course of an investigation of the taxpayer. Expedited hearing before a proper forum would be provided in any case where a summons is challenged. In the case of "John Doe" summons, no administrative summons would be issued unless there has been an independent prior review of the basis for the summons.

Mr. Pickle.—He would disallow any use of John Doe summonses.

J. Comprehensive Administrative Package

Mr. Vanik.—He proposes that a separate bill be developed dealing with administrative provisions which have no tax or revenue impact. His proposed legislation:

1. Provides GAO authority to oversee the IRS and report annually on IRS activities;
2. Makes available to the public clear information on taxpayer rights in audits, appeals, etc.;
3. Establishes a taxpayer service and complaint assistance office—a sort of ombudsman to deal with improper treatment by IRS officials and to provide relief in special cases where IRS actions are resulting in unnecessary injury to the taxpayer;
4. Provides a pilot project of independent legal assistance to taxpayers in audits and appeals; this project will be limited to four cities over a three year period;
5. Places limitations on the power of jeopardy assessment and termination of tax year, including an increase in the amount which cannot be assessed but which must be left to the taxpayer for living expenses;
6. Establishes safeguards against the political misuse of the Internal Revenue Service through limitations on non-tax related surveillance and penalties for illegal surveillance;
7. Provides for new limitations on disclosure of tax information and permits taxpayers civil liability recovery for damages caused by disclosure of personal tax data.

In addition, he intends to deal with tax return preparers, declaratory judgments of tax-exempt organizations, John Doe summonses and private rulings.

K. State Conducted Lotteries

1974 committee bill.—Last year the committee would have removed the requirement that the ultimate winners of State lotteries must be determined on the basis of the results of a horse race. The committee also would have exempted vending machines which dispenses lottery tickets conducted and maintained by State lottery agencies from the occupational taxes on wagering. (In addition, as described above, for lottery winnings, the committee would have instituted a 20-percent withholding for income tax whenever the proceeds exceed $100.)

Messrs. Burke, Rostenkowski, and Cotter.—The proposal would repeal both the present excise tax on the receipts of State lotteries and the occupational tax on the seller of State lottery ickes. (Their proposal, however, does not include any provision for withholding.)

L. Miscellaneous

Messrs. Schneebeli and Steiger.—The proposal would require a study of the feasibility of establishing a court of tax equity or other similar mechanism for dealing with tax equity problems by the Joint Committee and/or the Treasury Department.

VI. DEADWOOD BILL

1974 Committee Bill.—Last year the committee agreed to the provisions of the so-called "deadwood" bill (H.R. 25 in the 92nd Congress), which simplify the tax laws by removing from the Internal Revenue Code those provisions which are obsolete or no longer important and rarely used. The committee also updated H.R. 25.

This bill, which has been developed over a number of years, repeals almost 150 sections of the Internal Revenue Code and amends in approximately 850 other sections of the Code. The bill also makes other simplifying changes such as the substitution of the term "ordinary income" for phrases in the present law which obtain this result by referring to the income as "gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231."

The provisions deleted include those which deal only with past years, situations which were narrowly defined and are unlikely to reoccur, as well as provisions which have largely, if not entirely, outlived their usefulness. In some situations, the bill adds provisions to the public laws which preserve the right of persons to continue to receive benefits under code provisions repealed by the bill.

The provisions of the deadwood bill do not attempt to achieve simplification through substantive changes in existing law. Therefore, the provisions do not deal with policy issues or with substantive changes in generally applicable provisions.

Mr. Ullman.—His proposal is the same as that in the 1974 committee bill.

VII. EXTENSION OF INDIVIDUAL TAX REDUCTIONS

1975 Tax Reduction Act.—The Act raised the minimum standard deduction from $1,300 to $1,600 for single persons and to $1,900 for joint returns. It also increased the percentage standard deduction from a rate of 15 percent to 16 percent and the maximum standard deduction from $2,000 to $2,300 for single persons and to $2,600 for joint returns. In addition, the Act provided a tax credit, in addition to the personal exemption, of $30 for each taxpayer, spouse, and dependent. There was also provided a refundable earned income tax credit of 10 percent of earned income up to a maximum of $400, with the amount phased down to zero as the income increases from $4,000 to $8,000. All of these individual tax reductions apply only to 1975.

Mr. Ullman.—He would make permanent the individual tax reductions made by the standard deduction revisions and continue for 1976 the $30 credit.

Mr. Corman.—He suggests that the committee consider substituting a tax credit for the deduction for the personal exemption.

Messrs. Corman, Karth and Rangel.—In the case of the earned income credit provided in the Tax Reduction Act of 1975, the proposal would provide a disregard of the credit (similar to the disregard language applied to the 1974 tax refund) for purposes of determining eligibility for other programs.

Mr. Stark and Mrs. Keys.—The proposal would make the individual tax reductions permanent with the following modification: the $30 tax credit for each personal exemption should be deleted and substituted in lieu would be a tax credit for the personal deduction. For each year between 1976 and 1981, the credit would be increased by $50 and the deduction decreased by $150 so that, by 1981, only a credit of $250 per exemption would be available for all taxpayers.

Mr. Crane.—The proposal would provide adjustments for the personal income tax brackets, the low income allowance and the standard deduction at the rate of inflation (H.R. 1817).

VIII. CAPITAL FORMATION

A. Investment Tax Credit

Tax Reduction Act of 1975.—The Act increased the rate of the investment tax credit for all taxpayers (including public utilities) to 10 percent from 7 percent (from 4 percent in the case of certain public utilities) for a 2-year period (until January 1, 1977). In the case of a corporate taxpayer, a taxpayer may elect an 11-percent credit during this period if an amount equal to one percent of the qualified investment is contributed to an employee stock ownership plan. Also, in the case of public utilities, the limitation on the amount of tax liability that may be offset by the investment tax credit in a year is increased from 50 percent to 100 percent for a 2-year period and then is gradually reduced back to the 50 percent level over a 5-year period. In addition, the limitation on qualified investment in used property was increased to $100,000 from $50,000 for 2 years (until January 1, 1977).

Mr. Ullman.—He would continue the investment credit at the temporary 10-percent rate and the increase in the used property limitation to $100,000 for one additional year; that is, until January 1, 1978.

Messrs. Waggonner and Conable.—The proposal would make the following revisions: (1) increase the investment tax credit to a permanent rate of 12 percent effective January 1, 1976; (2) allow the full credit for any asset having a 3-year life or longer; (3) allow the full amount of the credit to be taken each year without regard to any income limitation; and (4) allow any amount of credit in excess of tax liability of the taxpayer for a year to be refunded.

Mr. Karth.—The proposal would provide for an extension of the 10-percent rate for the investment credit beyond the end of 1976.

Messrs. Pickle, Jones, Schneebeli, Duncan, and Martin.—The proposal would provide for a permanent 10-percent rate for the investment tax credit at the end of 1976.

Mr. Archer.—The proposal would provide for a permanent increase in the investment tax credit rate to 12 percent or possibly 15 percent.

Messrs. Burleson, Jones, Duncan, Crane, Martin and Ketchum.—The proposal would provide for a refund for investment credits which have been earned but which are unused at the end of the carryover period and otherwise would be lost. Mr. Jones would do so if the tax credit is not extended.

Mr. Duncan.—He would give consideration to increasing the investment credit and removing the time limitation for the use of the credit.

Messrs. Corman and Pickle—Investment credit in the case of movie and television films.—Mr. Corman proposes the same provision as agreed to by the committee last year in the 1974 committee bill; Mr. Pickle would allow the investment tax credit for movies made before 1971 by allowing 40 percent of the credit to be taken.

Last year the committee decided to provide different methods to deal with the problems of the proper treatment of the investment credit for motion pictures and television films for the past and for the future. For the past, one of two alternatives would be available. A taxpayer under the first method (in most respects the IRS litigation position) would be eligible to receive the full credit (or any partial credit) for their films if it is demonstrated on a film-by-film basis that the film satisfied both the useful life requirement and the requirement that there must be no predominant foreign use. The useful life of the film is to be treated as ending at the end of the first year in which for depreciation purposes it was estimated that 90 percent or more of the depreciable cost of the film would be recovered. A film is to be treated as used predominantly in foreign markets if, in any year (and not on a cumulative basis), more than 50 percent of the gross revenues from the film resulted from showing the film abroad.

A second alternative method may be elected by a taxpayer for all years prior to 1975 (for which an investment credit was available) or only for years prior to the reenactment of the investment credit on August 15, 1971. Unused investment credits may not be carried over from years in which this method is used to any subsequent years. Under this second alternative, a taxpayer may elect to take an investment credit on the basis of 40 percent of the cost of all of his films without regard to the estimated useful life of the film and also without regard to whether the film is shown predominantly outside of the United States. The credit would be based on the total costs of production, including capitalized production costs, a reasonable allocation of general overhead costs, salaries paid to the actors and production crew, costs of "first" distribution of prints, and the cost of the story being filmed. The cost for this purpose would include so-called residuals, but in the case of participants with respect to actors or others, it would include only those which are guaranteed. Films such as news features which are essentially transitory in nature, as well as films which are produced and shown exclusively in foreign countries, would not be eligible for the credit.

In addition, any taxpayer who has received final judgment on his entitlement to the investment credit for any prior year may elect to have his right to the investment credit for all years beginning prior to January 1, 1975, determined under present law, as interpreted by the courts, rather than by any of the alternatives set forth above.

For future years, taxpayers could elect to take an investment credit on a two-thirds basis for all films (instead of determining useful life on a film-by-film basis). The availability of the investment credit in this case would not depend on whether the film was predominantly used within the United States or in foreign countries; instead, it would depend on where the film is produced, rather than where receipts are derived from the showing of the film. Films, such as news features, which are essentially transitory in nature, would not be included in the base on which the two-thirds credit is computed.

If 80 percent or more of the direct production costs of a film are incurred in the United States, a taxpayer would be entitled to an investment credit, except that the credit base would not include direct expenses for foreign production or for salaries paid for services performed abroad (unless the salaries were paid to U.S. persons and were subject to U.S. tax). In determining whether this 80-percent test is met, only direct costs of production would be taken into account. (Overhead costs and the costs of screen rights, for example, would not be taken into account.)

If less than 80 percent of the production costs are incurred for U.S. production, a taxpayer could still receive a credit to the extent of *direct* U.S. production costs. The credit base in this case would not include such items as general overhead costs or cost of acquiring screen rights or any costs of foreign production except for salaries paid to U.S. persons subject to U.S. tax. The investment credit would be available to the persons who bear the risk of loss if the film is not a successful picture. This rule applies under any of the alternatives set forth above.

Mr. Archer.—The proposal would provide for a 10-percent tax credit for expenditures paid or incurred during the taxable year for intangible drilling and development costs with respect to domestic exploratory oil and gas wells, domestic geological and geophysical costs and secondary and tertiary processes with respect to domestic oil and gas wells (H.R. 7116).

B. Integration of the Corporate and Individual Income Taxes

Administration.—In testimony before the committee on July 31, Secretary Simon proposed eliminating the double tax on distributed corporate earnings through a combination of dividend deductions to corporations and stockholder credits, to be phased in over a 6-year period beginning in 1977.

Messrs. Waggonner and Conable.—The proposal would consider starting on integration in 1976 (rather than 1977) and phasing it in over a 4–5 year period. It was indicated, however, that the committee should consider alternative integration proposals such as the corporate deductibility of dividend payments from corporate income or a credit to stockholders for tax on dividends actually received, or some elimination of the corporate income tax and an allocation of retained earnings to the shareholder. Mr. Conable would include certain credits to encourage small investments in stock as part of any integration scheme.

Mr. Vander Veen.—If the committee should consider capital formation in the first phase of tax reform, it was suggested that consideration of the Administration's integration approach be on a limited basis only. (For example, the committee could decide to make dividends from new equity issues tax exempt until 3 years after enactment of the bill.)

C. Electric Utilities

Administration.—The Administration proposed increasing the investment credit rate to 12 percent for construction of additional facilities (other than power plants fired by oil or gas) by electric utilities, eliminating for these utilities the 5-year phase in for qualified progress expenditure investment credits, extending the provisions for 5-year amortization by electric utilities of pollution control facilities until 1981, adopting 5-year amortization provisions for their fuel conversion costs, allowing depreciation on their construction progress expenditures, and allowing deferral of tax on reinvested utility dividends.

Mr. Corman.—The proposal would allow electric public utilities to exclude from gross income especially designated payments received from customers where the payments are currently applied to qualified capital expenditures.

D. Corporate Surtax Exemption and Tax Rates

Tax Reduction Act of 1975.—The Act provides for an increase in the corporate surtax exemption from $25,000 to $50,000 and reduces the corporate normal tax rate from 22 percent to 20 percent. These reductions apply for one year—for taxable years ending after December 31, 1974.

Mr. Ullman.—His proposal would continue for one more year the corporate tax reductions contained in the Tax Reduction Act of 1975.

Messrs. Waggonner, Conable and Archer.—The proposal would reduce the 48-percent tax rate on corporations, possibly to 42 percent, and increase the corporate surtax exemption, possibly to a permanent level of $100,000. The proposal would accomplish the rate reductions by reducing either the corporate normal tax rate or the surtax rate or some combination of both.

Messrs. Pickle and Ketchum.—The proposal would increase the corporate surtax exemption permanently to $100,000.

E. Capital Cost Recovery

Messrs. Waggonner and Conable.—The proposal would propose several alternatives to liberalizing the capital cost recovery system: (1) broaden the ADR system, possibly by increasing the range from 20 percent to 40 percent or, alternatively, there could be an across-the-board reduction in the guideline lives of depreciable assets, possibly by as high as 50 percent; (2) adopt a price or cost index for depreciation purposes or, alternatively, allow depreciation on the basis of cost plus an arbitrary percentage (for example, 133⅓ percent rather than 100 percent of cost) to take into account estimated increases in replacement costs; and (3) allow the write-off as a current expenses of the cost of any equipment if the installation of such equipment is required by State or Federal law or regulation. Mr. Conable would also provide recapture rules relating to the selling of over-depreciated property to limit the conversion of ordinary income into capital gains.

Mr. Jones.—The proposal would provide for a rapid cost recovery of certain "nonproductive" industrial equipment; for example, a one or 2-year write-off for equipment such as pollution control facilities, adaption of facilities for handicapped employees, and certain safety equipment. The proposal would require expenditures in this category to be specified.

Messrs. Archer, Crane and Martin.—The proposal would provide a rapid cost recovery system as an alternative to depreciation. Under this system there would be a 5-year recovery period for all productive machinery and equipment and for pollution control facilities. There would be a 10-year recovery period for industrial buildings. The taxpayer could use accelerated methods in calculating the depreciation deductions in a given year. In addition, the proposal would provide for a complete writeoff in one year of required but nonproductive pollution control facilities and equipment.

Mr. Crane.—The proposal would provide for the calculation of capital consumption allowances based on actual current replacement costs for plant and machinery.

F. General

Messrs. Waggonner and Conable.—The proposal would increase the amount a corporation may accumulate before its retained earnings may be subject to the accumulated earnings tax from $150,000 to $250,000. In addition, the proposal would allow corporate shareholders to defer tax on dividends paid or payable to them to the extent they reinvest the amount received in the corporation within 45 days from the date the dividend becomes payable. Any tax deferred as a result of this provision would be recaptured on any disposition of the stock.

Mr. Jones.—In the area of energy, the proposal would include geological and geophysical expenses as intangible drilling expenses and would also include geothermal energy both as an intangible drilling expense and as subject to a percentage depletion allowance.

Messrs. Schneebeli and Ketchum.—The proposal would treat pollution control expenditures as an ordinary and necessary expense of conducting a trade or business under section 162 of the code.

Mr. Steiger.—The proposal would permit taxpayers to treat the cost of meeting Federal Occupational Safety and Health Standards for tax purposes in a manner similar to that of costs of pollution control and abatement devices.

Messrs. Archer and Vander Jagt.—The proposal would provide for employee stock ownership plan financing. Mr. Vander Jagt proposes to consider various alternatives to encourage greater employee ownership interest including amendments relating to stock ownership plans, stock bonus plans, and deductibility of certain employee investment in employer securities.

Mr. Crane.—He would allow a reduction of increases in inventory valuation by the rate of inflation.

Messrs. Archer, Crane and Ketchum.—These members asked that H.R. 7240 and H.R. 8053, the "Jobs Creation" bill be reviewed by the committee in its consideration of capital formation proposals. The pertinent provisions of the bill for tax reform, phase one involves tax credits for individual savings and investments, exclusions from income of amounts received by individuals as dividends, limited exclusions for individuals of certain capital gains, adjustments in corporate normal taxes, increases in investment credit, increases in corporate surtax exemption, annual price level adjustments, increases in class life variances for purposes of depreciation and amortization of pollution control facilities.

G. Net Operating Losses

Messrs. Burke and Ketchum.—The proposal would allow taxpayers who have net operating losses to elect to substitute for the present carryforward period (generally 5 years) an extended carryback period (in addition to the general 3 years). This would allow taxpayers to elect an 8-year carryback (with no carryforward). Taxpayers receiving refunds of more than $10 million would be required to share them with their employees by contributing shares of their stock to an employee stock ownership plan ("ESOP"). Any taxpayer having outstanding loans guaranteed under the Emergeny Loan Guarantee Act would be required to reduce the guaranteed loan balance by the amount of any refund received under the carryback election (less any amount paid to an ESOP). The effective date of the proposal is for taxable years beginning after January 1, 1970. The proposal also deals with the trafficking of loss carryovers of unprofitable corporations to profitable corporations by limiting a net operating loss carryover to that portion of the post-sale income clearly attributable to the business that suffered the losses (H.R. 8737 and H.R. 8799).

Mr. Archer.—The proposal would susbtitute a 10-year carryback-carryforward for the general rule of present law. A taxpayer would be allowed, subject to certain limitations, to select the 10-year period to which a loss occurred in a taxable year provided that such period consists of 10 consecutive years. The proposal would be applicable for losses incurred in taxable years beginning on or after January 1, 1970.

Mr. Vander Jagt.—The proposal would provide an elective 10-year carryback provided the taxpayer gives up its carryforward of losses. This would apply to corporations as well as unincorporated businesses. The first loss year affected would be 1970, and the loss for such a year could not be carried back to a year before 1962. For years up through 1974, a recapture rule would apply to taxpayers that revoke their election, and an ESOP–SUB provision would apply to these years.

H. Personal Savings

Administration.—The individual retirement account (IRA) provisions adopted in 1974 would be expanded to cover persons who participate in a regular retirement plan at a level below the IRA limits (this was also suggested by Mr. Steiger), and the present $1,500 limit on contributions to an IRA would be increased to $2,000 with an automatic cost of living adjustment. In addition, provision would be made for tax deductible contributions to an individual savings account (ISA) that represent extra savings of a long-term nature.

Mr. Archer.—The proposal would allow an exclusion from gross income of up to $1,000 ($2,000 for those filing joint returns) for qualified savings and investments made during the taxable year.

I. Other

Mr. Corman.—The proposal would not allow depreciation deductions for a taxable year for an amount in excess of the depreciation taken into account in reporting earnings for the year to shareholders. The proposal would also provide that an interest-free loan or a rent-free use of corporation property by a one-percent shareholder would be treated as a cash distribution to the shareholder for tax purposes.

Mr. Stark and Mrs. Keys.—The proposal would repeal the Asset Depreciation Range system.

IX. CAPITAL GAINS AND LOSSES

A. Increase in Amount of Ordinary Income Against Which Capital Losses May Be Offset

1974 committee bill.—The committee last year agreed to increase the amount of ordinary income against which net capital losses can be deducted from $1,000 to $3,000. This would have applied both to capital losses incurred in 1974 and in future years and to existing carryovers from prior years. The carryforward of losses from pre-1969 years would have been treated in the same manner as those from later years.

B. Individuals May Elect 3-Year Carryback of Capital Losses

1974 committee bill. The committee decided last year to give individuals with losses in excess of $30,000 (including losses incurred in a year and carry forwards into the year) the option of electing a three-year carryback of capital losses against capital gains (but not against ordinary income). Individuals who use the carryback option would have to recompute their tax for the prior years to which the losses are carried back.

C. Increase in Wash Sale Period

1974 committee bill.—In connection with carryback option the committee decided last year to extend to 60 days the period in which purchases and sales of the same asset would be considered wash sales.

D. Increase in Holding Period for Capital Gain or Loss

1974 committee bill.—The committee decided last year to increase the holding period that defines short-term capital gains from six months to one year. The increase would be phased in over a three-year period starting January 1, 1975, so that the holding period would be eight months in 1975, ten months in 1976, and one year thereafter.

Mr. Rostenkowski.—If the committee decides to increase the holding period, he suggests that consideration be given to the effect that the increase would have on agricultural commodities futures contracts.

E. Increase in Capital Gain Deduction for Assets Held for Long Periods

1974 committee bill.—The committee decided last year to provide, in addition to the present 50-percent exclusion for long-term capital gains, a second exclusion equal to one percent of the taxpayer's gain for each asset for each year the asset is held in excess of five years. The additional deduction would be limited to 20 percent of the gain on each asset (after twenty-five years) and to not more than 75 percent of the taxpayer's overall net capital gain. The additional exclusion would apply only in the case of sales or exchanges of securities, businesses and real estate.

Messrs. Waggonner and Conable.—The proposal would tax capital gains at a reduced rate which decreases over the length of time the asset is held.

Mr. Crane.—The proposal would adjust the basis for calculating capital gains at the rate of inflation.

F. Repeal of Alternative Tax for Individuals

1974 committee bill.—The committee last year decided to eliminate the 25 percent alternative tax rate for the first $50,000 of capital gains.

G. Section 1245 Property Excluded From Section 1231

1974 committee bill.—The committee decided last year to require that gains on depreciable personal property which are currently treated as long-term capital gains under section 1231 (not including gains referred to in section 1231(b) (2) and (3)), and to which the recapture rules of section 1245 apply, be treated as ordinary income.

H. Exclusion of Gain From Sale of Residence

1974 committee bill.—Under existing law, an individual over 65 who sells a property that he had used as his principal residence for five or more years out of the past eight years can exclude his whole capital gain if the sales price is less than $20,000. When the sales price exceeds $20,000, he can exclude a fraction of the gain equal to the ratio of $20,000 to the sales price. The Committee decided last year to extend this exclusion to all individuals regardless of age and to increase the $20,000 figure to $35,000. Under the decision, when the sales price of a principal residence exceeds $35,000, the seller could exclude a fraction of the gain equal to $35,000 divided by the sales price. This exclusion would be available only if the rollover provision under section 1034 is not elected.

Messrs. Karth and Steiger.—The proposal would provide an exclusion from gross income of the gain from the sale of a residence. Mr. Karth agrees with the provision contained in the 1974 committee bill.

I. Other

Mr. Archer.—The proposal would provide an exclusion of up to $1,000 of capital gains on securities.

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