

# SUMMARY OF THE PRESIDENT'S 1978 TAX REDUCTION AND REFORM PROPOSALS

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



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## INTRODUCTION

This pamphlet has been prepared by the staff of the Joint Committee on Taxation for the use of the Committee on Ways and Means in connection with hearings on the President's 1978 Tax Reduction and Reform Proposals.

The first part of the pamphlet provides a brief summary of the President's tax proposals. The second part outlines the present law, Administration proposal, and revenue effect for each change recommended by the President. Appendices to the pamphlet provide tables showing the revenue and income distribution effects of the proposals, and the estimated 1979 poverty levels and tax thresholds.

It should be noted that the revenue estimates provided in this pamphlet are those of the Treasury Department, Office of Tax Analysis.





## BRIEF SUMMARY OF ADMINISTRATION TAX PROPOSALS

### Tax Reduction Proposals

#### *Individual income tax reductions*

1. Tax rates would be reduced from the present range of 14 to 70 percent to a range of 12 to 68 percent. In each bracket, there would be a cut of up to 5 percentage points on joint returns, and up to 7 percentage points on returns of single people.

2. The existing \$750 personal exemption and the general tax credit (which equals the greater of \$35 per exemption or 2 percent of the first \$9,000 of taxable income) would be replaced by a \$240 tax credit for each personal exemption. The \$240 amount would be increased to take account of any revenues from the crude oil equalization tax which are to be returned to consumers.

3. These tax cuts would take effect on October 1, 1978. For calendar year 1978, there would be a tax cut approximately one-fourth the size of the full year cuts, which would be reflected in withholding rates in the last three months of the year.

#### *Business tax reductions*

1. The present corporate income tax rate schedule and the Administration's proposed rate schedule are as follows:

Taxable income	Present law rates (percent)	Proposed new rates (percent)
0 to \$25,000.....	20	18
\$25,000 to \$50,000.....	22	20
Above \$50,000.....	48	44

However, the rate on income in excess of \$50,000 would be reduced only to 45 percent in the period before January 1, 1980.

2. The 10-percent investment credit would be made permanent. (Under present law, the credit will go back to 7 percent after 1980.) The credit, which now applies only to equipment and certain special purpose structures, would be extended to all new industrial buildings and to investment made to rehabilitate existing buildings for construction costs incurred after 1977. Investment credits would be allowed to offset up to 90 percent of tax liability (instead of 100 percent of the first \$25,000 of tax liability and 50 percent of tax liability in excess of \$25,000 as under present law.) The full 10 percent investment credit (instead of 5 percent) would be extended to pollution control equipment qualifying for five-year amortization which is placed in service after 1977.

***Excise tax reductions***

1. The telephone excise tax, scheduled to be phased out between now and January 1, 1982, would be repealed as of October 1, 1978.
2. The Federal unemployment insurance tax, which applies to the first \$6,000 of earnings, would be reduced from 0.7 percent to 0.5 percent as of January 1, 1979. (The rate rose from 0.5 percent to 0.7 percent on January 1, 1977.)



## **Tax Reform Proposals**

### ***Itemized deductions***

1. The deduction for nonbusiness State and local sales taxes, gasoline taxes, personal property taxes, and State levies for disability insurance would be repealed.

2. The deduction for up to \$100 of political contributions (or \$200 on a joint return) would be repealed. The credit for 50 percent of the first \$50 of contributions (or \$100 on a joint return) would be retained.

3. Medical expenses and casualty losses would be deductible only to the extent that, combined, they exceed 10 percent of adjusted gross income. Medical insurance premiums would be treated in the same manner as other medical expenses. The rule limiting deductible casualty losses to the extent that each loss individually exceeds \$100 would be retained.

### ***Business deductions***

1. Deductions would be disallowed for entertainment facilities such as yachts, hunting lodges, and club dues, as well as for such entertainment activities as tickets to theater and sporting events.

2. Deductions would be disallowed for one-half of the cost of meals which otherwise would be deductible. However, meals consumed while traveling away from home overnight would continue to be deductible.

3. Expenses incurred to attend foreign conventions would be disallowed unless it is as reasonable for the meeting to be held outside as within the United States.

4. Deductions for first-class airfare would be disallowed to the extent they exceed coach fare for similar flights.

### ***Tax shelters***

1. The deduction under the minimum tax for one-half of an individual's regular income tax liability would be eliminated. Capital gains on the sale of a home would be exempt from the minimum tax.

2. The "at-risk" provision, which denies the deduction of a taxpayer's losses in an investment except to the extent the taxpayer is personally liable, would be extended to cover all activities other than real estate and to cover closely held corporations (controlled by 5 or fewer shareholders).

3. The current method of determining useful lives of buildings for depreciation, which is based on the facts and circumstances of the individual cases, would be replaced by a system of guideline lives based on the average lives now used by all taxpayers. The method of depreciation for buildings would generally be limited to straight-line depreciation, instead of the accelerated depreciation methods used under current law. However, new multi-family housing would be able to be depreciated using the 150 percent declining balance depreciation (instead of the present law 200 percent declining balance method)

through 1982. Also low income housing would continue to be depreciated using the 200 percent declining balance method of depreciation through 1982. After 1982, only new low-income housing would be eligible for accelerated depreciation methods, and the maximum allowable depreciation would be based upon the 150 percent declining balance method.

4. New limited partnerships with more than 15 limited partners would be taxed as corporations so that they could not pass through their losses to the partners. Residential real estate partnerships would be exempt through 1982 and low income housing would continue exempt as long as 150 percent declining balance depreciation was allowed.

5. The IRS would be authorized to conduct audits at the partnership level and apply any adjustments to returns of individual partners.

6. Taxes would be imposed currently on the earnings of most deferred annuities not purchased under qualified retirement plans.

7. All farming syndicates and all farm corporations, except nurseries, subchapter S corporations, and those with gross receipts of \$1 million or less would be required to use accrual accounting and to capitalize preproductive period expenses.

### ***Simplification of asset depreciation system (ADR)***

The proposal would give legislative authority to issue new ADR regulations to simplify and revise the present regulations for all electing businesses.

### ***Capital gains***

The 25-percent alternative tax on the first \$50,000 of an individual's capital gains would be repealed. Capital gains would continue to be taxed at one-half the regular tax rates.

### ***Fringe benefits***

1. The present employee tax exemption for premiums paid and benefits received under employer health, accident, disability, and group life insurance plans would be limited to those plans which do not discriminate in favor of shareholders, officers, and higher-paid employees.

2. The \$5,000 employee death benefit exclusion would be repealed.

3. There would be a limit on the extent to which qualified pension plans may be integrated with social security. Generally, there would have to be at least 1 percent in contributions or benefits on compensation below the social security wage base for every 1.8 percent in contributions or benefits provided on compensation above the wage base.

4. Employer contributions under a nondiscriminatory "cafeteria plan" would be taxable to participants only to the extent they are used to provide an otherwise taxable benefit.

### ***Transfer payments***

The current exclusion for unemployment compensation benefits would be phased out for incomes above \$20,000 for single persons and \$25,000 for married couples.

### ***Tax-exempt bonds***

1. State and local governments would have the option of issuing subsidized taxable bonds. The subsidy rate would be 35 percent of interest costs for bonds issued in 1979 and 1980 and 40 percent for bonds issued thereafter.

2. Interest on industrial development bonds for pollution control facilities, industrial parks and hospital construction would no longer be tax exempt unless, in the case of hospitals, there is a certification by the State that those new hospitals are needed.

3. The \$5,000,000 small issue exemption for industrial development bonds would be eliminated except for economically depressed areas, for which the limit would be increased to \$10,000,000.

4. Industrial development bonds still qualifying for the exemption would also be eligible for the option for the taxable bond subsidy.

### ***Financial institutions***

1. The excess additions to the bad debt reserves of commercial banks, now being phased out through 1987, would be disallowed as of 1979, at which time banks would compute their bad debt reserves based on actual experience.

2. The excess additions to the bad debt reserves of savings and loan associations and mutual savings banks would be phased down from 40 percent of taxable income to 30 percent of net income over a 5-year period.

3. The tax exemption for credit unions would be phased out over a 4-year period, and after 1982, they would be taxed on the same basis as savings and loan associations.

### ***Foreign income***

1. DISC would be phased out over a 3-year period.

2. The provisions of present law which permit the tax on income earned by U.S.-controlled foreign corporations to be deferred until the time the income is repatriated to the United States would be phased out over a 3-year period.

### ***Small business***

1. There would be an expansion and simplification of the subchapter S provisions, which generally allow electing small business corporations to be taxed in a manner similar to partnerships.

2. The provision in present law which allows losses from stock in a small business corporation as a deduction against ordinary income would be broadened by doubling (to \$1 million) the amount of stock which may qualify, increasing the aggregate amount of losses which may be so allowed to \$50,000 (\$100,000 on a joint return) and by eliminating some restrictions on the use of the provision.

3. Special ADR depreciation rules would be provided for businesses whose depreciable assets do not exceed \$500,000.





# EXPLANATION OF ADMINISTRATION'S TAX PROPOSALS

## I. TAX REDUCTION PROPOSALS

### A. Individual Income Tax Reductions

#### 1. *Substitution of \$240 exemption credit for the \$750 exemption deduction and the general credit*

##### *Present law*

Under present law, a taxpayer is allowed a \$750 deduction for each personal exemption, including those for age and blindness. The deduction is a deduction from adjusted gross income (AGI) in determining taxable income.

In addition, taxpayers are allowed a "general tax credit" equal to the greater of (1) \$35 per exemption or (2) for each return, 2 percent of taxable income up to \$9,000 (a maximum credit of \$180).

##### *Administration proposal*

The Administration proposal would replace the current \$750 exemption deduction and the general tax credit with a \$240 personal tax credit.<sup>1</sup> The credit would be a direct reduction in tax and would

<sup>1</sup> The Administration intends to recommend a further increase in the \$240 exemption credit if an energy bill with a crude oil equalization tax passes and provides a rebate to taxpayers only for 1978.

not be refundable. The effects of this proposal on the tax-free level of income are shown in Appendix B. The revenue effect by income class together with the 1979 rate reduction are shown in table 6 of Appendix A.

##### *Revenue effect*

Together with the rate reduction, this proposal would reduce budget receipts by \$22.5 billion in fiscal 1979 and by \$25.7 billion in fiscal 1980.

#### 2. *Individual tax rate reductions*

##### *Present law*

Under present law, marginal tax rates for individual taxpayers range from 14 to 70 percent.

##### *Administration proposal*

The Administration proposal would reduce the marginal tax rates from the present range of 14 to 70 percent to a range of 12 to 68 percent with a reduction of up to 5 percentage points in the taxable income range of \$15,200 to \$27,200 (including the new zero bracket amount) on joint returns. For returns of single persons the rate reductions would be somewhat larger, a maximum reduction of 7 percentage points.

The full reduction would take place in 1979. For 1978, a reduction of one-fourth the full reduction would apply. The proposed rate sched-

ules for 1979 are shown in Tables 7 and 8 of Appendix A along with the tax change by income class of the combined \$240 exemption credit and the new rates in table 6.

*Revenue effect*

Together with the \$240 credit, this proposal would reduce budget receipts by \$22.5 billion in fiscal 1979 and by \$25.7 billion in fiscal 1980.



## **B. Business Tax Reductions**

### **1. Corporate rate reductions**

#### *Present law*

For corporations, the normal tax rate is 20 percent on the first \$25,000 of taxable income and 22 percent on taxable income above \$25,000. In addition, there is a surtax of 26 percent on a corporation's taxable income greater than \$50,000. These rates apply to a taxable year that ends before January 1, 1979.

For taxable years that end after December 31, 1978, the normal tax will be 22 percent on all taxable income. The surtax of 26 percent will apply to taxable income greater than \$25,000, which will make the combined 48 percent rate applicable to taxable income above \$25,000.

#### *Administration proposal*

Effective October 1, 1978, under the Administration proposal, the normal tax would be reduced by 2 percentage points to 18 percent on the first \$25,000 of taxable income and to 20 percent on all taxable income greater than \$25,000. The surtax, reduced by 1 percentage point to 25 percent, would apply to all taxable income greater than \$50,000. As a result, the combined rate on taxable income above \$50,000 would be 45 percent. The surtax would be reduced by one additional point to 24 percent effective January 1, 1980, decreasing the combined rate of tax on taxable income above \$50,000 to 44 percent.

#### *Revenue effect*

The Administration has estimated that the lower corporation income tax rates would reduce calendar year tax liabilities by \$1.3 billion in 1978, \$6.0 billion in 1979, \$8.5 billion in 1980, \$9.2 billion in 1981, \$10.0 billion in 1982 and \$10.8 billion in 1983. The proposal would reduce budget receipts on a fiscal year basis by \$4.0 billion in 1979, \$7.1 billion in 1980, \$8.8 billion in 1981, \$9.6 billion in 1982 and \$10.3 billion in 1983.

### **2. Investment tax credit**

#### *Present law*

Present law provides a credit against income tax liability for a taxpayer's qualified investment in certain types of depreciable business or productive assets other than buildings. Generally, the investment credit rate is presently 10 percent of qualified investment. The rate was temporarily increased from 7 percent to 10 percent under the Tax Reduction Act of 1975 and is scheduled to return to 7 percent (4 percent for certain public utility property) in 1981. In the case of pollution control facilities for which special five-year amortization has been elected, the amount of the investment credit is generally one-half of the amount which would otherwise be available.

Eligible property consists of depreciable property having an estimated useful life for depreciation purposes of three years or more.

In addition, this property must be either tangible personal property or other tangible property (such as fixtures and heavy machinery) that is used as an integral part of a productive process. Buildings and their structural components do not generally qualify for the credit.

Under present law, investment credits for any year may be used, dollar-for-dollar, to completely offset the first \$25,000 of a taxpayer's income tax liability. Only 50 percent of tax liability in excess of \$25,000 may generally be offset by investment credits. However, utilities, railroads and airlines are allowed increased tax liability limitations under present law, which are scheduled to return gradually to the general 50-percent limitation. If the credits earned in the current year exceed the tax liability limitation, the excess may be carried back to the three preceding taxable years and carried forward to the seven following taxable years.

#### *Administration proposal*

The Administration proposal would make the following four changes to the investment credit rules:

*a. Permanent 10-percent rate.*—The present temporary 10-percent investment tax credit rate would be made permanent, eliminating the scheduled reduction to 7 percent (4 percent for utilities) in 1981.

*b. Full credit for pollution control equipment.*—The full 10-percent credit would be available for pollution control equipment which is amortized over a 5-year period. This increased credit would apply to qualified pollution control equipment for which the 5-year amortization election was made after December 31, 1977.

*c. Credit for industrial buildings and rehabilitation expenditures.*—The investment credit would be available for industrial buildings and structures placed in service after December 31, 1977. Rehabilitation expenditures for existing industrial buildings and structures would also receive the credit after December 31, 1977. These credits would be available only to the extent of basis attributable to construction after December 31, 1977.

*d. Limitation of 90 percent of tax liability.*—The tax liability limitation for applying investment credits by all taxpayers would be changed to 90 percent of liability, both for the first \$25,000 of tax liability and for tax liability in excess of \$25,000. These amendments would apply for taxable years beginning after December 31, 1978.<sup>1</sup>

#### *Revenue effect*

The estimated effects from the proposed changes on budget receipts are as follows:

[In billions of dollars]

	Fiscal year receipts				
	1979	1980	1981	1982	1983
Full credit for pollution control equipment.....	-0.2	-0.1	-.1	-.1	-.1
Extend 10-percent credit to industrial structures.....	-1.8	-1.6	-1.8	-2.0	-2.2
Increase limitation to 90 percent.....	-.4	-.7	-.4	-.2	-.2

<sup>1</sup> This change would also apply to WIN Credit.

## C. Other Tax Rate Reductions

### 1. Communication (telephone, etc.) taxes

#### *Present law*

Under present law, amounts paid for telephone services and teletypewriter exchange services are generally subject to the communications excise tax. For 1978, the rate is 4 percent. The tax is being phased out by reducing the rate one percentage point a year through 1981, after which the tax is scheduled to expire.

#### *Administration proposal*

The Administration proposal would repeal the communications excise tax as of October 1, 1978.

#### *Revenue effect*

The proposal would decrease budget receipts by \$1.0 billion in fiscal 1979 and by \$1.1 billion in fiscal 1980.

### 2. Unemployment tax rate reduction

#### *Present law*

The unemployment compensation program is a Federal-State insurance system designed to provide temporary compensation for the loss of wages by unemployed workers. Funds accumulated from payroll taxes paid by the employer on the first \$6,000 of earnings of each worker permit payment of benefits to unemployed insured workers.

The net Federal tax was increased to 0.7 percent beginning January 1, 1977. That rate is to continue until certain advances from the general fund to supplement the then depleted unemployment trust fund have been repaid. The tax rate is then to revert to 0.5 percent.

#### *Administration proposal*

Under the administration proposal, the Federal unemployment insurance tax would be reduced to 0.5 percent, effective January 1, 1979.

#### *Revenue effect*

The proposal would reduce budget receipts by \$0.6 billion in fiscal 1979 and by \$0.9 billion in fiscal 1980.



## II. TAX REFORM PROPOSALS

### A. Itemized Deductions

#### **1. Deductions for nonbusiness sales, gasoline, and personal property taxes**

##### *Present law*

Present law permits an itemized deduction for certain State and local taxes, even when the taxes are not related to any business or investment activity. Such deductible taxes include nonbusiness sales, gasoline, and personal property taxes.

The deductibility of State unemployment disability fund taxes which are withheld from employees' wages is uncertain in the case of taxes levied by States which require them only if employers do not provide private coverage. While the Internal Revenue Service maintains that these taxes are nondeductible personal insurance expenses, the Tax Court has held that they constitute deductible State income taxes.

Taxes paid by an individual in connection with a trade or business are generally deductible in the year paid or incurred even though they are part of the cost of a capital asset.

##### *Administration proposal*

The Administration proposal would repeal the deductions for State and local sales taxes, gasoline taxes, and personal property taxes which are not business related. Also, unemployment disability fund taxes would not be deductible by employees. State and local income taxes and real property taxes would continue to be generally deductible in the year paid or incurred.

In addition, taxes related to a business activity would be deductible under normal accounting principles. Thus, taxes related to the acquisition of a capital asset would have to be capitalized. In addition, construction period taxes would be capitalized.

These changes would apply to taxable years beginning after December 31, 1978.

##### *Revenue effect*

The proposal would increase budget receipts by \$2.7 billion in fiscal 1979 and by \$4.3 billion in fiscal 1980.

#### **2. Deductions for medical expenses and for casualty and theft losses**

##### *Present law*

Under present law, an individual may claim itemized deductions for the following medical care expenses: (1) the lesser of \$150 or one-half of amounts paid for medical insurance and (2) medical expenses in excess of 3 percent of the taxpayer's adjusted gross income. In calculating expenses subject to the 3-percent limitation, medical insur-

ance premiums are included to the extent that they are not separately deductible, and amounts paid for medicine and drugs are counted to the extent that they exceed one percent of adjusted gross income.

Present law also provides an itemized deduction for the total of the amounts by which an individual taxpayer's casualty and theft losses exceed \$100 for each casualty or theft.

#### *Administration proposal*

The Administration proposal would combine the medical expenses and the casualty and theft loss deductions into a single itemized deduction for hardship losses. The hardship loss deduction would be limited to the total of medical expenses and casualty and theft losses exceeding 10 percent of adjusted gross income. As under present law, casualty and theft losses could be taken into account only to the extent that they each exceed \$100. The separate deduction for medical insurance premiums and the one-percent floor on medicine and drugs would be repealed.

In addition, the definition of medical care expenses would be amended to cover only those facilities, services, and devices which are customarily used primarily for medical purposes and which are intended primarily for medical use by the taxpayer (or his dependents).

The changes would apply to taxable years beginning after December 31, 1978.

#### *Revenue effect*

The proposal would increase budget receipts by \$1.3 billion in fiscal 1979 and by \$2.1 billion in fiscal 1980.

### **3. Deduction for political contributions**

#### *Present law*

Under present law, an individual who itemizes deductions is allowed a deduction, not in excess of \$100 (\$200 in the case of a joint return), for political contributions and newsletter fund contributions made within the taxable year. Alternatively, the individual may elect to take an income tax credit equal to one-half of the political contributions and newsletter fund contributions made within the taxable year, but the credit may not exceed \$25 (\$50 in the case of a joint return).

#### *Administration proposal*

The Administration proposal would repeal the itemized deduction for political contributions, but would retain the present tax credit. The change would apply to taxable years beginning after December 31, 1978.

#### *Revenue effect*

The proposal would increase budget receipts by \$1 million in fiscal 1979 and by \$3 million in fiscal 1980.

## B. Business Deductions

### 1. *Entertainment and travel expenses*

#### *Present law*

Ordinary and necessary expenses paid or incurred during the taxable year generally are deductible if they bear a reasonable and proximate relation to the taxpayer's trade or business, or to nonbusiness activities engaged in for profit, and so long as the expenses are reasonable in amount. Ordinary and necessary business expenses which are deductible may include the cost of entertainment, meals, lodging, travel, and transportation.

*a. Entertainment expenses.*—The cost of entertainment is deductible only to the extent that it is reasonable in amount, is allocable to the taxpayer's business, and is not lavish or extravagant. Business entertainment may include expenses related to club memberships, meals, shows, sporting activities, conventions and trips, and various entertainment facilities. Generally, whether a particular entertainment expense is ordinary and necessary, and therefore deductible, depends upon the facts and circumstances involved.

No deduction is allowed for entertainment expenses unless the taxpayer can establish that they are directly related to (the "direct relationship" test), or associated with (the "associated with" test), the active conduct of the business, or that they are subject to any of a number of statutory exceptions.

Expenses with respect to entertainment facilities, such as clubs, lodges, pools, yachts, and airplanes, may be deductible if they are ordinary and necessary, and if the facility is used primarily (i.e., more than one-half of the time that it is used) for the furtherance of the taxpayer's business. Moreover, such expenses are allowable as deductions only in proportion to the activities which are directly related to the trade or business.

Generally, no deduction is allowed for entertainment expenses unless the taxpayer substantiates by adequate records, or by sufficiently corroborative evidence, (i) the amount of the expense, (ii) the time and place of its occurrence, (iii) its business purpose, and (iv) the business relationship to the taxpayer of the person(s) entertained by the taxpayer.

*b. Travel expenses.*—Domestic travel expenses, including first class airfare, may be deductible if they are paid or incurred away from home in connection with the taxpayer's trade or business, or in pursuit of an activity engaged in for profit. The deductibility of such expenses depends upon the primary purpose of the trip. If the trip is related primarily to the taxpayer's business, transportation expenses are deductible even though the taxpayer engages in some nonbusiness activities during the course of the trip. Conversely, if the trip is primarily nonbusiness in nature, then no amount of the transportation expenses



are deductible. However, other out-of-pocket business expenses incurred during the trip are deductible. (Special rules apply to foreign travel, and to foreign conventions.)

#### *Administration proposal*

The Administration proposal generally would disallow deductions for entertainment activities and facilities (except for 50 percent of the expense of entertainment meals) and for the excess of first class airfare over coach fare. One half of the dues or fees paid to a club or organization operated solely to provide meals under circumstances conducive to business discussions would remain deductible. Entertainment expenses incurred in connection with business travel also would be disallowed under the Administration's proposal. However, except as to the proposed limitation on the deductibility of first class airfare, and foreign convention expenses the Administration's proposals would not change the present tax treatment of business travel (including transportation, lodging and meals).

#### *Revenue effect*

The proposal would increase budget receipts by \$664 million in fiscal 1979 and by \$1.5 billion in fiscal 1980.

## **2. Foreign conventions**

#### *Present law*

Before the Tax Reform Act of 1976, a deduction was allowed for travel expenses paid or incurred to attend a foreign convention if the expenses were reasonable and necessary in the conduct of the taxpayer's business and directly attributable to the trade or business.

The 1976 Act limited the deductions allowable for the expenses of individuals attending foreign conventions. The term "foreign convention" means any convention, seminar, or similar meeting held outside the United States, its possessions, and the Trust Territory of the Pacific.

Generally, no deduction is allowed for expenses of attending more than two foreign conventions in any year. Attendance requirements, subsistence limitations and coach air fare limitations apply with respect to the expenses incurred in connection with the two foreign conventions for which expenses may be deducted.

#### *Administration proposal*

Under the Administration proposal, expenses of attending a foreign convention would be deductible only if it was as reasonable to hold the convention outside the United States and possessions as within. The factors to be considered in determining reasonableness of convention site are the purpose and activities of the convention, the purpose and activities of the sponsoring organization, the residence of active members of the sponsoring organization, and the places at which other meetings of the sponsoring organization have been held and the particular reason(s) why the convention is being held abroad rather than in the United States or possessions. For conventions satisfying this test, deductible subsistence expenses could not exceed 125 percent of the Federal per diem for the convention site. (Deductible air fare would be limited to coach fare under the generally applicable proposed rule described above.)

#### *Revenue effect*

The proposal would have a negligible revenue effect.

## C. Tax Shelters

### 1. Minimum tax for individuals

#### *Present law*

Under present law, individuals pay a minimum tax, in addition to the regular income tax, equal to 15 percent of their items of tax preference in excess of the greater of a \$10,000 exemption or one-half of the individual's regular income tax liability. The item of tax preference are: (1) the excluded one-half of capital gains; (2) the excess of percentage depletion over the basis of the property; (3) accelerated depreciation on real property; (4) the bargain element of stock options; (5) accelerated depreciation on personal property subject to a lease; (6) the excess of amortization of child care facilities over regular depreciation; (7) the excess of amortization of pollution control facilities over regular depreciation; (8) the excess of amortization of railroad rolling stock over regular depreciation; (9) adjusted itemized deductions in excess of 60 percent of adjusted gross income; and (10) intangible drilling costs in excess of the straight-line recovery of intangibles.

#### *Administration proposal*

The Administration proposal would repeal the offset of half of regular tax ability. All preferences in excess of the \$10,000 exemption would thus be subject to the minimum tax. Also, the Administration proposal would delete from the items of tax preference the amount of excluded capital gains from the disposition of the taxpayer's principal residence.

#### *Revenue effect*

The proposal would have no effect upon budget receipts in fiscal 1979. It will increase budget receipts by \$284 million in fiscal 1980.

### 2. At-risk limitation

#### *Present law*

Two separate "at risk" rules were enacted by the Tax Reform Act of 1976 to prevent certain tax shelter abuses. One rule ("the specific activity at risk rule") applies to all taxpayers (except corporations which are neither subchapter S corporations nor personal holding companies) who engage in any of four specified activities: producing and distributing motion pictures, farming, equipment leasing, and exploring for oil and gas. The other rule ("the partnership at risk rule") applies to all partnership activities other than real estate and those to which the specific activity at risk rule applies.

#### *Administration proposal*

The Administration proposal would revise the at risk rules by expanding the specific activity at risk rule to apply to all activities other than real estate. The partnership at risk rule would then be repealed as redundant. The revised at risk rule would apply to corporations in which 5 or fewer individuals own more than 50 percent of the stock, as well as to all subchapter S corporations and personal holding com-

panies. In the case of an affiliated group of corporations, the revised at risk rule would apply to all corporations in the group if it applied to the common parent. Finally, the revised at risk rule would require taxpayers to recapture deductions previously claimed if they reduce their amount at risk in the activity below zero.

#### *Revenue effect*

The proposal would increase budget receipts by \$2 million in fiscal 1979 and by \$14 million in fiscal 1980.

### **3. Real estate depreciation**

#### *Present law*

With respect to new residential rental property (the original use of which commences with the taxpayer), both the 200-percent declining balance method and the sum-of-the-years digits methods are allowed. (The sum-of-the-years digits is not allowed for any other class of real property.) Residential rental property which is used property can be depreciated at a 125-percent declining balance rate if it has a remaining life of 20 years when acquired. If used residential rental property has a remaining life of less than 20 years, then only straight-line depreciation is allowed. In the case of new non-residential property, depreciation under the declining balance method is limited to a rate which does not exceed 150-percent of the rate determined under the straight-line method. With respect to used non-residential real property, no accelerated method of depreciation is allowable. Additionally, the estimated useful lives of depreciable real property is based upon a facts and circumstances test.

#### *Administration proposal*

Under the Administration proposal, with exceptions for low-income housing and new multi-family housing, depreciation of all realty would be based on the straight-line method. With respect to low-income housing, a taxpayer could elect to compute depreciation using current methods through 1982; thereafter, only new low-income housing would be eligible for accelerated methods, and the maximum allowable depreciation would be based upon the 150-percent declining balance method. New multi-family housing could be depreciated through 1982 using the 150-percent declining method; after 1982, only the straight-line method would be allowable. The estimated useful lives of depreciable realty would be based upon surveys conducted by the Department of the Treasury of lives actually used by taxpayers. A limited facts and circumstances test would be provided. The proposals only apply to real estate constructed or acquired after the relevant effective dates.

#### *Revenue effect*

The proposal would increase budget receipts by \$27 million in fiscal year 1979 and by \$168 million in fiscal year 1980.

### **4. Classification of limited partnerships**

#### *Present law*

Under present law, the terms "partnership" and "corporation" are rather generally defined. The existing regulations provide that an organization formed as a partnership under local law will not be classified as a corporation for tax purposes unless it has more corporate characteristics than noncorporate ones. Under this "preponderance"



test, organizations formed as partnerships under the Uniform Limited Partnership Act are nearly always classified as partnerships for tax purposes.

Under present law, partnerships are not treated as taxable entities, and each partner is taxed on his share of the partnership income and allowed to deduct his share of any partnership losses. On the other hand, corporations (except for certain electing corporations with a limited number of shareholders—subchapter S corporations) are taxed as separate entities, with no pass-through of corporate income or losses to the shareholders.

#### *Administration proposal*

The Administration proposal would treat a limited partnership formed after the effective date as a corporation for tax purposes if the partnership has more than 15 limited partners.

Generally, the effective date would be the date of enactment. However, if substantially all of a partnership's assets consist of housing, the effective date would be January 1, 1983. However, the proposal would not apply to a partnership if substantially all (i.e., more than 90 percent) of its assets consists of subsidized low-income housing which is entitled to an accelerated depreciation method.

In two circumstances, the proposal would apply to a partnership formed before the effective date. First, it would apply if the number of limited partners increased after the effective date. Second, it would apply if a limited partner contributed money or property to the partnership after the effective date (unless the contribution was made pursuant to a binding agreement entered into on or before the effective date).

#### *Revenue effect*

The proposal would result in a negligible increase in budget receipts.

### **5. Audits of partnerships**

#### *Present law*

Partnerships are not taxable entities. Rather, each partner reports his share of the partnership income or loss and tax credits. Partnerships file annual information returns showing the gross income, deductions and credits of the partnership and the allocation of taxable income or loss and credits to the partners.

While the Internal Revenue Service may examine a partnership information return, it cannot, under present law, make adjustments to partnership taxable income at the partnership level which, ultimately, would be binding at the partner level. The Service must instead pursue the adjustment with each partner separately. Further, the statute of limitations on adjustments to tax liability of some partners may expire before the Service can finish its audit work with respect to each partner.

#### *Administration proposal*

The Administration proposal would establish procedural rules allowing the Internal Revenue Service to make an audit determination at the partnership level which, ultimately, would be binding upon the partners if it is either agreed to by a representative of the partnership or sustained in court in litigation between the Service and the

partnership. Under these rules, the Service would provide separate notices to each partner both as to the commencement of the audit of the partnership return and the result of the audit. Further, a special statute of limitations would be provided for adjustments of partnership income, loss or credits on the partner's return.

### *Revenue effect*

The proposal would result in a negligible increase in budget receipts.

## **6. Deferred annuities**

### *Present law*

An annuity contract may provide that annuity payments are to commence shortly after the consideration for the contract is paid (an immediate annuity) or the contract may provide that annuity payments are to commence after an extended period following the date on which the contract was initially purchased (a deferred annuity). Under present law, investment income earned on amounts invested in an annuity contract is not taxed to the policyholder until payments are made under the contract. Investment income earned on assets held in a life insurance company's reserve for an annuity contract is not taxed to the insurance company to the extent that income is required to be added to the reserve.

If the holder of an annuity contract withdraws a portion of the amount invested in the contract (withdrawals are permitted before annuity payments commence) the amounts withdrawn are not treated as income until all capital invested in the contract has been withdrawn. As annuity payments are made, each payment is allocated between income and capital on the basis of the capital investment in the contract at the time annuity payments began.

### *Administration proposal*

Under the Administration proposal, investment income on amounts invested in an annuity contract would generally be taxed currently to the policyholder during the accumulation period (i.e., the period beginning when an amount is first invested in the contract and ending when annuity payments commence). An exception would be provided for a single deferred annuity contract designated by the taxpayer (a designated contract) under which the amount invested each year (including reinvested policy dividends) is \$1,000 or less. Transition rules would be provided for existing contracts.

The Administration also proposes that amounts withdrawn from, and loans by the issuer to the holder of, an annuity contract during the accumulation period be considered income until all untaxed accumulations of income have been paid to the policyholder. The change in treatment of amounts withdrawn during the accumulation period would apply to all contracts (including preexisting and designated contracts).

No change would be made in the tax treatment of annuity contracts held under tax-qualified employees benefit plans or of tax deferred annuities for teachers or employees of certain types of tax-exempt organizations.

### *Revenue effect*

The proposal would have no effect upon fiscal 1979 budget receipts, but it will increase fiscal 1980 budget receipts by \$12 million, and by increasing amounts to \$57 million in fiscal 1983.

## 7. *Accrual accounting for certain farming operations*

### *Present law*

Under present law, most taxpayers engaged in farming can use the cash method of accounting and generally can deduct preproductive period expenses when paid. However, with certain exceptions, the Tax Reform Act of 1976 required corporations (and partnerships in which nonexcepted corporations are partners) engaged in farming to use the accrual method of accounting and to capitalize preproductive period expenses (sec. 447). The 1976 Act provided the following exceptions: (1) subchapter S corporations; (2) "family" corporations (in which one family owned at least 50 percent of the stock); (3) corporations with annual gross receipts of \$1 million or less; and (4) nurseries.

In addition, the 1976 Act modified traditional cash accounting for "farming syndicates" by (1) allowing a deduction for prepaid feed, seed or other farm supplies only when used or consumed, (2) requiring capitalization or inventorying of certain poultry expenses, and (3) requiring capitalization of certain preproductive period expenses paid or incurred to raise a grove, orchard or vineyard to maturity (sec. 464). For these purposes, a farming syndicate is a partnership or any other enterprise (other than a corporation which has not elected subchapter S) engaged in the trade or business of farming if either (1) participation interests are registered or required to be registered with a State or Federal securities agency, or (2) more than 35 percent of the enterprise's losses are allocable to limited partners or limited entrepreneurs (that is, with certain exceptions, persons not actively participating in the management of the farming enterprise).

### *Administration proposal*

Under the Administration proposal, family farming corporations (other than those which are excepted under another present law exemption) and all farming syndicates would be required to use an accrual method of accounting and to capitalize preproductive period expenses. The proposal would also expand the definition of preproductive period expenses to eliminate the specific exemption for taxes (other than income taxes and real property taxes).

The proposal would retain the present law exceptions to required accrual accounting and capitalization of preproductive period expenses for (1) subchapter S corporations (other than those classified as farming syndicates), (2) small corporations (those with \$1 million or less in annual gross receipts), and (3) nurseries.

### *Revenue effect*

The proposal would increase budget receipts by \$18 million in fiscal 1979 and by \$33 million in fiscal 1980.



## D. Simplification of the Asset Depreciation Range System

### *Present law*

Present law provides, in general, that the estimated useful life of a depreciable asset may be determined by the taxpayer on the basis of either a facts and circumstances test or, at the election of the taxpayer, the class life asset depreciation range system (ADR system). In general, the ADR system provides asset guideline classes and periods for eligible property. The asset depreciation range is the estimated useful life of eligible property which may vary between 80 percent and 120 percent of the asset guideline period. Under the ADR system, the half-year and modified half-year conventions are provided to take into account, for purposes of computing depreciation, the various times assets are placed in service during the taxpayer's taxable year. If a taxpayer makes the annual election to use the ADR system, certain annual reporting requirements are necessary.

### *Administration proposal*

The Administration proposal seeks legislative authority to issue new ADR regulations to simplify and reduce the length of the present regulations. Additionally, specific changes sought are as follows: (1) the straight-line and declining balance methods of depreciation, would be the only acceptable methods of depreciation; (2) salvage value would be disregarded for all purposes; (3) the half-year convention would be required for assets placed in service during the taxpayer's taxable year; and (4) the annual reporting requirement would be required to respond to specific survey requests.

### *Revenue effect*

The proposal would have a negligible revenue effect.

## E. Alternative Tax on Capital Gains

### *Present law*

Under present law, a noncorporate taxpayer who has a net capital gain for the taxable year (i.e., net gain from the sale or exchange of capital assets held by the taxpayer for more than one year in excess of net loss from the sale or exchange of capital assets held by the taxpayer for one year or less) may deduct 50 percent of the amount of the net capital gain from gross income.

In addition, a noncorporate taxpayer may be subject to an alternative tax in lieu of that which ordinarily would be imposed, but only if the amount of the alternative tax would be less than the amount of the tax which otherwise would be imposed on the gain. In general, under the alternative tax, the first \$50,000 of net long-term capital gain is taxed at a rate of 25 percent.

### *Administration proposal*

The Administration proposal would repeal the alternative tax for noncorporate taxpayers.

### *Revenue effect*

The proposal would have no effect on fiscal 1979 budget receipts. It would increase fiscal 1980 budget receipts by \$140 million.

## **F. Fringe Benefits**

### **1. Employer provided health, disability, and life insurance plans**

#### *Present law*

Under present law, employees can exclude from gross income the value of benefits provided under employer-sponsored health, disability, and (to a limited extent) group life insurance plans even though the plans may discriminate in favor of employees who are shareholders, officers, or highly compensated (the prohibited group). Employers are generally permitted a current tax deduction for the cost of providing these benefits even though the employees are not required to include them in income.

#### *Administration proposal*

The Administration proposal would permit employees to exclude the value of benefits under an employer-sponsored health, disability, or group life insurance plan from income only if the plan (1) satisfies certain nondiscriminatory participation standards similar to the standards which apply to a tax-qualified retirement plan, and (2) does not discriminate in favor of the "prohibited group" with regard to the benefits provided.

Also, under the Administration's proposal, additional limitations would apply to plans so that not more than 25 percent of employer contributions allocable to benefits for a plan year could be used to purchase benefits for a class of individuals each of whom owns (directly or indirectly) an ownership interest in excess of 10 percent.

#### *Revenue effect*

The proposal would increase budget receipts in fiscal year 1979 by \$14 million and by \$32 million in fiscal year 1980.

### **2. Employee death benefits**

#### *Present law*

Under present law, a special exclusion from gross income is provided in the case where amounts are paid by, or on behalf of, an employer to the estate of a deceased employee or to the beneficiaries of the deceased employee if the payments are made by reason of the death of the employee. This special exclusion may not exceed \$5,000.

#### *Administration proposal*

The Administration proposal would repeal the \$5,000 employee death benefit exclusion.

#### *Revenue effect*

The proposal would increase budget receipts in fiscal year 1979 by \$5 million and in fiscal year 1980 by \$34 million.

### **3. Integration of tax-qualified pension plans with social security**

#### *Present law*

Under present law, a tax-qualified pension, profit-sharing, or stock bonus plan must not discriminate in favor of higher-paid employees

by providing benefits or contributions that increase, as a percentage of pay, at higher pay levels. An integrated pension, etc., plan provides a lower rate of benefits or contributions for the part of an employee's pay taken into account under the social security system than for the part of the employee's pay in excess of the pay covered by social security. An integrated plan can meet the anti-discrimination rules of present law if the combination of employer-paid plan benefits or contributions and employer-paid social security benefits or contributions does not increase, as a percentage of pay, at higher pay levels. Under this standard, integrated plans can, in some cases, meet the anti-discrimination rules of present law even though they provide no employer-paid benefits or contributions for rank-and-file workers.

#### *Administration proposal*

The Administration proposal would replace the current standards governing social security integration with standards requiring that an integrated pension, profit-sharing, or stock bonus plan provide minimum benefits to all plan participants. For plans offsetting social security benefits against plan benefits, the extent of the offset would depend on the extent to which the plan replaces preretirement income. For other plans, there would have to be at least 1 percent in employer-paid contributions or benefits below the plan's integration level for every 1.8 percent above that level.

The proposal would apply to plan years beginning after December 31, 1979.

#### *Revenue effect*

The proposal would have no revenue effect in fiscal 1979.

### **4. "Cafeteria plans"**

#### *Present law*

Under present law, the taxation of benefits provided under a "cafeteria plan" (i.e., an arrangement under which a participant may designate how employer contributions on his behalf are to be allocated among taxable and nontaxable fringe benefits) depends upon whether the participants have the option to select a benefit which currently would be includible in income if offered separately (e.g., cash or group-term life insurance in excess of \$50,000) and whether the plan was in existence on June 27, 1974. An employer contribution to a cafeteria plan in existence on June 27, 1974, is taxable to a participant only to the extent that a taxable benefit is selected. However, if the plan was not in existence on June 27, 1974, the participant is taxable to the extent that the contribution could have been used to provide a taxable benefit. These rules apply to employer contributions made before January 1, 1978. Under present law, no specific guidance is provided for the tax treatment of contributions made on or after January 1, 1978.

#### *Administration proposal*

Under the Administration proposal, if a cafeteria plan does not discriminate in favor of employees who are officers, shareholders, or highly compensated (the prohibited group) in providing tax-free benefits, then an employer contribution would be taxable to a participant only to the extent that it is used to purchase taxable benefits. Health benefits provided under a cafeteria plan would be tested

separately under antidiscrimination rules corresponding to those that are proposed for separate health benefit plans.

Employer contributions to a discriminatory cafeteria plan would be included in the income of participating members of the prohibited group.

The new rules would apply to taxable years beginning after December 31, 1978.

*Revenue effect*

The proposal would result in a negligible increase in budget receipts.



## G. Transfer Payments

### *Unemployment compensation*

#### *Present law*

Under present law, by reason of administrative practice, unemployment compensation benefits paid under government programs generally are not includible in gross income. However, benefits paid under private plans (e.g., employer financed unemployment benefit plans and union sponsored plans) are includible in income when received.

#### *Administration proposal*

The Administration proposal would include unemployment compensation paid pursuant to government programs in the taxable income of taxpayers whose income from all sources (including unemployment compensation) exceeds either \$20,000, in the case of single taxpayers, or \$25,000, in the case of married taxpayers. These benefits would be includible in income at the rate of 50 cents of each dollar of unemployment compensation for each dollar of income from all sources (including unemployment compensation) in excess of the applicable \$20,000 or \$25,000 limit.

#### *Revenue effect*

The proposal would increase budget receipts by \$151 million in fiscal 1979 and by \$208 million in fiscal 1980.



## **H. Tax-Exempt Bonds**

### **1. Taxable bond option with Federal interest subsidy**

#### *Present law*

Under present law, interest on State and local government obligations is generally exempt from Federal income tax. The exemption applies to all State and local government bonds other than most industrial development bonds and arbitrage bonds.

#### *Administration proposal*

The Administration proposal would permit State and local governments, possessions of the United States, and the District of Columbia to elect to issue taxable obligations. Under the proposal, the Federal Government would provide an interest subsidy of 35 percent of the interest cost on taxable State and local obligations issued during 1979 and 1980, and 40 percent for obligations issued thereafter.

All obligations (including tax-exempt industrial development bonds) which may be issued as tax-exempt under the Internal Revenue Code or under the Housing Act of 1937 would be eligible for the taxable bond option. Obligations on which the United States guarantees all or part of the principal or interest would not be eligible for the subsidy. Obligations which the United States is committed to purchase as a means of providing financial assistance would not be eligible for the subsidy.

The Federal Government would make a payment of 35 or 40 percent (depending on the date on which the obligation was issued) of the interest liability of each obligation without any condition or requirement by the Secretary of the Treasury. The availability of funds necessary to finance the Federal interest subsidy would be assured by establishing an entitlement for State and local governments equal to the amount of the appropriations necessary to pay the full cost of the interest subsidy.

#### *Revenue effect*

This proposal would increase budget receipts by \$23 million in 1979, \$237 million in 1980, \$619 million in 1981, \$1,112 million in 1982 and \$1,525 million in 1983.

The interest subsidy would increase outlays (on a fiscal year basis) by \$99 million in 1979, \$495 million in 1980, \$977 million in 1981, \$1,599 million in 1982 and \$2,221 million in 1983.

### **2. Tax treatment of industrial development bonds**

#### *Present law*

Under present law, interest on State and local government obligations is generally exempt from Federal income tax. However, tax exemption is denied to State and local government issues of industrial development bonds with certain exceptions. A State or local government bond is an industrial development bond if (1) all or a major por-

tion of the proceeds of the issue are to be used in any trade or business not carried on by a government or tax-exempt organization, and (2) payment of principal or interest is secured by an interest in, or derived from payments with respect to, property used in a trade or business.

One exception to the general rule allows tax exemption to certain small issues of industrial development bonds; that is, issues in amounts of \$1 million or less, if the proceeds are used for the acquisition or construction of land or depreciable property. At the election of the issuer, the \$1 million limitation may be increased to \$5 million. If this election is made, the exemption is restricted to projects where the capital expenditures over a six-year period do not exceed \$5 million.

Tax exemption also is allowed for industrial development bonds issued to finance the following exempted facilities without any dollar limitation:

- (1) Residential real property for family units;
- (2) Sports facilities;
- (3) Convention or trade show facilities;
- (4) Airports, docks, wharves, mass commuting facilities, parking facilities, or storage or training facilities directly related to these facilities;
- (5) Facilities used to provide sewage treatment or solid waste disposal treatment and facilities designed for the local furnishing of electric energy or gas;
- (6) Air or water pollution control facilities;
- (7) Facilities for the furnishing of water, if available on reasonable demand to members of the general public, and
- (8) Industrial parks.

#### *Administration proposal*

*a. Increase in amount of small issues exemption.*—The Administration proposal would revise the industrial development bond small issue exemption by doubling the \$5 million small issue exemption to \$10 million. The proposal also would limit the small issue exemption to industrial development bonds issued to finance the acquisition or construction of land or depreciable property in economically-distressed areas. Economically-distressed areas would be defined by reference to such factors as (1) an average annual unemployment rate in excess of the national average rate and (2) an average annual growth rate in employment below the corresponding national rate.

*b. Repeal of tax exemption for IDB's issued for pollution control facilities and industrial parks.*—The Administration proposal would repeal the tax exemption for industrial development bonds issued to finance pollution control facilities and industrial parks.

*c. Denial of tax exemption on IDB's issued for hospitals without certificate of need.*—The Administration proposal would add to the definition of industrial development bonds for which an exemption is not available, obligations which are issued to finance private, non-profit hospitals unless need for the facilities had been established under the Public Health Services Act or the Social Security Act.

#### *Revenue effect*

This proposal would increase budget receipts by a negligible amount in fiscal year 1979, and by \$35 million in fiscal year 1980.

## **I. Financial Institutions**

### **1. Bad debt reserves of commercial banks**

#### *Present law*

Under present law, commercial banks may claim a bad debt deduction which need not be related directly to loan loss experience. Commercial banks are permitted to claim a bad debt deduction based on a fixed percentage of eligible loans. The present rate of 1.2 percent is scheduled to decrease to 0.6 percent in 1982, and reserves will have to be based on, actual loan loss experience in 1988 and thereafter. The excess of the amount of the allowable bad debt deduction for the taxable year, over the amount that would have been allowable had the institution maintained its bad debt reserve for all taxable years on the basis of actual experience, is an item of tax preference subject to the minimum tax.

#### *Administration proposal*

The proposal would require commercial banks to use their actual loan loss experience for computing their bad debt deductions beginning in 1979.

#### *Revenue effect*

The proposal would increase budget receipts by \$102 million in fiscal 1979 and by \$229 million in fiscal 1980.

### **2. Bad debt reserves of thrift institutions**

#### *Present law*

Under present law, thrift institutions (mutual savings banks, savings and loan associations, and cooperative banks) may claim a bad deduction based on a percentage of taxable income without regard to their actual loss experience on loans. This percentage is set at 41 percent for 1978 and at 40 percent for 1979 and thereafter. The excess of the amount of the allowable bad debt deduction for the taxable year, over the amount that would have been allowable had the institution maintained its bad debt reserve for all taxable years on the basis of actual experience, is an item of tax preference subject to the minimum tax.

#### *Administration proposal*

Under the proposal, thrift institutions would be required to reduce their bad debt deduction to 30 percent of taxable income over a 5-year period beginning in 1979. (As a result of these changes, thrift institutions would be entitled to the investment tax credit at an increased rate which would be 70 percent of the credit available to other entities.)

#### *Revenue effect*

The proposal would increase budget receipts by \$17 million in fiscal 1979 and by \$59 million in fiscal 1980.

### 3. *Taxation of credit unions*

#### *Present law*

Under present law, credit unions are tax-exempt.

#### *Administration proposal*

The proposal would repeal the tax exemption for credit unions. After a transition period, credit unions generally would be taxed on the same basis as savings and loan associations except that they would not be restricted as to their investments in order to get the special treatment. Credit unions would be entitled to the same bad debt deduction as savings and loans, although the amount of the deduction available under the percentage of taxable income method would be phased down ratably from, in effect, 100 percent to 30 percent over a period of five years. (As a result of these changes, credit unions would be entitled to the investment tax credit rate which would be 70 percent of the credit available to other entities.)

#### *Revenue effect*

The proposal would increase budget receipts by \$10 million in fiscal 1979 and by \$35 million in fiscal 1980.



## **J. Foreign Income**

### **1. Repeal of DISC**

#### *Present law*

Under present law, U.S. corporations may defer tax on a portion of their export-related income by channeling it through a Domestic International Sales Corporations (DISC's). Special pricing rules on transactions between the parent and its DISC permit a favorable allocation of profit to a DISC. Before 1976, one-half of a DISC's income was not subject to tax as long as these profits were invested in export-related assets. In the Tax Reform Act of 1976, DISC benefits were restricted by tying the amount of income eligible for deferral to increases in exports. (Deferral was allowed only to the extent that the DISC's exports of the current year exceeded 67 percent of its average exports during a four year moving base period.)

#### *Administration proposal*

The Administration proposal would repeal the DISC provisions over a 3-year period. DISC tax benefits would be reduced by one-third for DISC tax years ending in 1979, reduced two-thirds for DISC tax years ending in 1980, and eliminated entirely for 1981 and following years. Under the proposal, accumulated DISC income of prior years would remain tax deferred as long as it continued to be invested in export-related assets.

#### *Revenue effect*

This provision would increase budget receipts in fiscal 1979 by \$0.2 billion, and in fiscal 1980 by \$1.7 billion.

### **2. Termination of deferral**

#### *Present law*

As a general rule, income earned by a U.S.-controlled foreign corporation ("CFC") is not taxed to its U.S. shareholders until it is distributed in the form of dividends. This is referred to as "deferral" of the earnings of CFC's. There are, however, exceptions under which U.S. shareholders are currently taxed on certain undistributed tax haven income of CFC's and on the passive income of foreign personal holding companies. (Losses of CFC's may not be used to offset income of their U.S. shareholders.)

#### *Administration proposal*

The Administration proposal would phase out the "deferral" of earnings of CFC's over a 3-year period by treating an appropriate fraction—one-third in 1979, two-thirds in 1980, and the entire amount in 1981 and thereafter—of a CFC's gross income, deductions, and foreign taxes as having been earned or incurred directly by its U.S. shareholders. The earnings of a CFC would be taxed currently whether or not they are paid to the U.S. shareholders (usually parent companies) as dividends. Conversely, U.S. shareholders would be allowed to claim losses incurred by their CFC's.

The Administration's proposal also includes certain changes designed to mitigate the impact of the termination of deferral. The excess foreign tax credit rules would be liberalized to extend the carry-back period for excess foreign tax credits from the present two years to three years and the carryforward period from the present five years to seven years. U.S. shareholders would be allowed to take into account unrealized currency exchange gains or losses attributable to their foreign subsidiaries. The proposal also contemplates that the Treasury would consider the possibility of continuing deferral in certain circumstances in future tax treaties.

*Revenue effect*

This proposal would increase budget receipts in fiscal 1979 by \$40 million and in fiscal 1980 by \$0.9 billion.

## K. Small Business

### 1. *Small business corporations (subchapter S)*

Under present law, subchapter S of the Internal Revenue Code allows certain corporations engaged in an active trade or business to be treated for income tax purposes in a manner similar to that accorded partnerships.

#### *a. Eligibility for subchapter S election*

##### *i. Number of shareholders*

*Present law.*—Under present law, a corporation generally must have ten or fewer shareholders to qualify as a small business corporation. After a corporation has been an electing subchapter S corporation for 5 taxable years, it may increase its number of qualifying shareholders to fifteen.<sup>1</sup>

*Administration proposal.*—The Administration proposal would allow an electing subchapter S corporation to have fifteen or fewer shareholders from its initial election. This change would apply to taxable years beginning after December 31, 1977.

##### *ii. Certain trusts permitted as shareholders*

*Present law.*—Present law generally requires that the shareholders of a qualifying small business corporation be individuals. Exceptions allow grantor trusts and voting trusts to be shareholders and permit trusts established under the will of a deceased shareholder temporary ownership for no more than sixty days.

*Administration proposal.*—The Administration proposal would permit a testamentary trust to be an eligible shareholder for the term of a trust established under the will of a deceased shareholder. Similarly, an *inter vivos* grantor trust which now qualifies as a shareholder would continue to qualify after the grantor's death. A qualifying trust would be required to distribute all income currently to its beneficiaries in shares fixed by the governing instrument of the trust. For purposes of determining the number of shareholders in the electing small business corporation, each beneficiary having a present interest in the trust income would be treated as a shareholder.<sup>2</sup> These changes would apply to taxable years beginning after December 31, 1978.

##### *iii. Husband and wife as one shareholder*

*Present law.*—Under present law, a husband and wife are treated as one shareholder in an electing small business corporation if the stock

<sup>1</sup> Under special conditions, the number of shareholders may exceed ten (but not fifteen) during the initial five-year period.

<sup>2</sup> Because of the general increase to fifteen shareholders, special rules that permit the corporation to have more than 10 shareholders in certain limited circumstances (section 1371(e)) would be repealed.



is community property (or the income from the stock is community property), or if the stock is held by the husband and wife as joint tenants, tenants by the entirety, or tenants in common.

*Administration proposal.*—The Administration proposal would eliminate the requirement that the stock be community property, or be held by a married couple as joint tenants, tenants by the entirety, or tenants in common. The change would apply to taxable years beginning after December 31, 1978.

## ***b. Election to be taxed under subchapter S***

### *i. Time for election*

*Present law.*—Under present law, a small business corporation may elect to be taxed under subchapter S for a taxable year at any time during the first month of the year or at any time during the preceding month. For a new corporation, the first month of the taxable year does not begin until the corporation has shareholders, acquires assets, or begins doing business, whichever occurs first. Unless terminated, an election continues in effect and does not have to be renewed annually.

*Administration proposal.*—The Administration proposal would permit a corporation to make an election under subchapter S at any time before the beginning of the taxable year and for 60 days after the beginning of a taxable year. This change would apply to taxable years beginning after December 31, 1978.

### *ii. Termination of election*

*Present law.*—Under present law, the termination of an election is generally retroactive to the first day of the taxable year, even if it is caused by an event occurring at the end of the year.

*Administration proposal.*—Under the Administration proposal, the termination of an election would take effect on the date of the triggering event, i.e., the date when the corporation fails to qualify as a small business corporation or the date of revocation. However, a termination during the first year after an election still would take effect retroactively to the first day of the taxable year in order to prevent the creation of short taxable years for tax avoidance purposes. This change would apply to taxable years beginning after December 31, 1978.

### *iii. Election following termination*

*Present law.*—Under present law, a corporation whose election under subchapter S is terminated may not make a new election until the fifth taxable year after the termination (unless the Treasury consents earlier to a new election).

*Administration proposal.*—Under the Administration proposal, if an election under subchapter S is terminated because the corporation ceases to qualify as a small business corporation (e.g., because it has too many shareholders or owns 100 percent of another corporation's stock), but subsequently qualifies for a later year, filing a timely return as a subchapter S corporation for the later year would be treated as a binding request for consent to a new election. In determining whether to grant such a request, the Treasury would take into account the fact that termination was inadvertent. This change would apply to taxable years beginning after December 31, 1978.



*Revenue effect*

These proposals would have a negligible revenue loss.

*c. Net operating loss carryover*

*Present law.*—Under present law, a shareholder may deduct losses sustained by a subchapter S corporation only to the extent of his adjusted basis in the corporation's stock and loans to the corporation from him. Losses in excess of the taxpayer's adjusted basis may not be utilized for other taxable years.

*Administration proposal.*—Under the Administration proposal, shareholder whose net operating losses from a subchapter S corporation exceed his basis in the corporation's stock and debt would be allowed to deduct his losses to the extent of subsequent increases in his basis. Losses would not be transferable; they could be deducted only by the same shareholder in a subsequent year.

While the subchapter S election remains in effect, the carryover would be allowed as a deduction at the end of each subsequent taxable year of the corporation. However, the amount allowed as a deduction would be limited to the shareholder's basis in the corporation at the end of the year (taking into account all adjustments made during the year). Any unused portion of the carryover would be allowed as a deduction twelve calendar months after the subchapter S election is terminated. However, the amount allowed as a deduction would be limited to the shareholder's basis at the end of the twelfth month. Whenever the carryover is allowed as a deduction, a corresponding reduction in basis would be required. These changes would apply to taxable years beginning after December 31, 1977.

## 2. *Small business corporation stock*

### *Present law*

Under present law, a shareholder's loss on corporate stock is generally treated as a capital loss.<sup>1</sup> However, an exception is provided for stock in certain small business corporations which is called "Section 1244 stock." A loss sustained by an individual on section 1244 stock is treated as an ordinary loss, up to a maximum of \$25,000 in one year (\$50,000 in the case of a husband and wife filing a joint return).

The exception applies only if the stockholder is an individual. It covers only losses sustained by the original purchaser.

In order to qualify as section 1244 stock, stock must be common stock in a domestic corporation; it must be issued pursuant to a plan adopted by the issuing corporation; and it must be issued for money or other property (not including stock or securities). A corporation may not issue more than \$500,000 of section 1244 stock and the total stock offering plus the equity capital of the corporation may not exceed \$1,000,000. (Thus, a corporation whose equity capital exceeds \$1,000,000 cannot issue section 1244 stock.)

The special treatment accorded losses in section 1244 stock is limited to companies engaged in an active trade or business.

### *Administration proposal*

Generally, the Administration proposal would liberalize the rules relating to section 1244 stock.

A corporation would be permitted to issue up to \$1,000,000 of section 1244 stock and the \$1,000,000 ceiling on the corporation's equity capital would be eliminated.

The maximum amount treated as an ordinary loss would increase to \$50,000 (\$100,000 in the case of a joint return).

In addition, the requirement that the stock be issued pursuant to a plan would be repealed. All stock issued during the corporation's taxable year would be section 1244 stock if the aggregate worth of all stock ever issued by the corporation is \$1,000,000 or less. (For this purpose, the worth of stock would be the value of the consideration paid for the stock when issued.) If the aggregate worth of stock exceeds \$1,000,000 at the end of the taxable year, but was less than \$1,000,000 at the end of the taxable year, then an allocable portion of the stock issued during the year would be treated as section 1244 stock.

The changes would apply to stock sold after the date of enactment.

### *Revenue effect*

It is estimated that the small business stock changes would have no revenue effect.

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<sup>1</sup> Ordinary losses generally are fully deductible. Capital losses are subject to various limitations.

### **3. Depreciation relief for small businesses**

#### *Present law*

Under present law, a taxpayer may depreciate assets under either a facts and circumstances test or, at the election of the taxpayer, the asset depreciation range system. (See present law discussion under the previous part of this summary entitled "Simplification of the Asset Depreciation Range System".)

#### *Administration proposal*

Under the Administration proposal, special regulations would be issued governing depreciation by businesses whose depreciable assets (that are subject to the new rules) in the aggregate, initially did not exceed \$500,000. This \$1 million initial asset cost test would be applied at the entity level. A specially simplified schedule of class lives, similar to those under the ADR system, would be made available to electing businesses. Taxpayers would be allowed to vary a class life within a 40 percent range, as is allowed under ADR. In general, the qualified businesses that elect to use the special class lives could also ignore salvage value, would be permitted, but not required, to adopt the half-year convention, and generally would not be required to participate in statistical surveys required of those that elect under the ADR system, as it is proposed to be amended by the administration.

#### *Revenue effect*

The proposal would have no revenue effect.

## APPENDICES



## APPENDIX A: ESTIMATED REVENUE EFFECTS OF ADMINISTRATION TAX PROPOSALS

**Table 1.—Summary of Revenue Effects of the Administration's Income Tax Reductions, Tax Reforms and Telephone Excise and Unemployment Insurance Tax Reductions, Fiscal Years 1979-83**

[In billions of dollars]

	Fiscal years—				
	1979	1980	1981	1982	1983
<b><i>Individual income tax:</i></b>					
Tax reductions.....	-22.5	-25.7	-29.2	-33.4	-38.5
Tax reforms.....	4.2	7.4	8.9	10.6	12.3
Net change.....	-18.3	-18.2	-20.3	-22.8	-26.2
<b><i>Corporation income tax:</i></b>					
Tax reductions.....	-6.3	-9.4	-11.1	-11.8	-12.8
Tax reforms.....	1.1	3.0	4.3	5.0	5.2
Net change.....	-5.1	-6.5	-6.8	-6.8	-7.6
<b><i>Telephone excise and unemployment insurance tax reductions:</i></b>					
.....	-1.6	-2.0	-1.6	-1.2	-1.1
<b>Total.....</b>	<b>-25.0</b>	<b>-26.6</b>	<b>-28.6</b>	<b>-30.8</b>	<b>-34.9</b>

Source: Office of the Secretary of the Treasury, Office of Tax Analysis.

Table 2.—Fiscal Year Revenue Effect of the Administration's Tax Proposals <sup>1</sup>

[In millions of dollars]

Provisions	Full year 1976	Fiscal year				
		1979	1980	1981	1982	1983
\$240 credit and reduced tax rates-----	-17,305	-22,544	-25,669	-29,166	-33,394	-38,497
Itemized deduction changes:						
Repeal gasoline tax deductions-----	582	603	947	1,080	1,230	1,402
Repeal sales tax deductions-----	1,672	1,734	2,720	3,100	3,535	4,030
Repeal miscellaneous tax deductions-----	384	398	625	712	812	926
Deduction for medical and casualty ex- penses-----	1,396	1,336	2,056	2,282	2,533	2,812
Repeal political contributions deduction---	2	1	3	3	3	3
Repeal alternative capital gains tax-----	113	-----	140	151	162	174
Individual real estate tax shelters-----	320	9	93	228	361	448
Taxation of unemployment benefits-----	275	151	208	205	204	211
Tax interest element of annuity contracts-----	320	-----	12	26	40	57
Minimum tax change-----	229	-----	284	306	329	353
Taxable bond option (individual) <sup>2</sup> -----	255	30	301	783	1,381	1,873
Extend 10-percent investment tax credit to structures (individual)-----	-36	-55	-61	-72	-81	-82
Limit individual tax credits to 90 percent of tax before credits-----	38	7	58	64	71	74
Tax qualified retirement plans and employee death benefits-----	30	5	34	35	35	33
Corporate real estate shelters-----	180	18	75	152	226	296
Corporate family farm accounting-----	30	18	33	18	8	6
Bad debt reserves:						
Commercial banks-----	196	102	229	232	138	29
Mutual savings banks and savings and loans-----	82	17	59	112	179	264

Credit unions.....	82	10	35	65	101	145
Entertainment expenses.....	1, 125	664	1, 547	1, 695	1, 843	2, 011
Taxable bond option (corporations) <sup>2</sup> .....	-24	-7	-29	-61	-94	-130
Phase out DISC over 3 years.....	852	249	807	1, 551	1, 771	1, 675
Phase out deferral of tax on foreign source income.....	523	40	174	500	796	860
Corporate tax rate reduction.....	-5, 718	-3, 953	-7, 078	-8, 827	-9, 570	-10, 339
At risk limitation.....	10	2	14	10	8	5
Increase investment tax credit limit to 90 percent.....	-71	-397	-744	-368	-150	-199
Extend 10 percent investment tax credit to structures (corporations).....	-1, 055	-1, 725	-1, 506	-1, 748	-1, 961	-2, 161
Nondiscrimination rule for health and group term life plans.....	29	14	32	33	34	35
Full investment tax credit for pollution abatement facilities.....	-90	-184	-99	-116	-122	-128
Total individual.....	-11, 725	-18, 325	-18, 249	-20, 263	-22, 779	-26, 183
Total corporate.....	-3, 849	-5, 132	-6, 451	-6, 752	-6, 793	-7, 631
Subtotal, income tax proposals.....	-15, 574	-23, 457	-24, 700	-27, 015	-29, 572	-33, 814
Repeal telephone excise tax.....		-955	-1, 050	-700	-250	
Reduce unemployment payroll tax rate.....		-600	-900	-900	-1, 001	-1, 100
Total.....	-15, 574	-25, 012	-26, 650	-28, 615	-30, 822	-3, 9403

<sup>1</sup> There estimates assume the extension of all temporary provisions in present law (not shown), as proposed by the Administration, except the jobs tax credit.

<sup>2</sup> Fiscal year outlays associated with this proposal would be \$99 million in fiscal 1979 and rise to \$2.2 billion in 1983. For estimates of 1980, 1981, and 1982 outlays, see the summary of this proposal in section II.H.1, above, and the Budget of the U.S. Government for fiscal year 1979, table 15, p 474.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis.

Table 3.—Calendar Year Revenue Effect of the Administration's Tax Proposals <sup>1</sup>

[In millions of dollars]

	Full year 1976	Calendar year					
		1978	1979	1980	1981	1982	1983
\$240 credit and reduced tax rates---	-17,305	-6,067	-23,538	-26,583	-30,272	-34,732	-40,110
Itemized deduction changes:							
Repeal gasoline tax deductions---	582	-----	862	983	1,121	1,277	1,456
Repeal sales tax deductions---	1,672	-----	2,477	2,824	3,219	3,670	4,184
Repeal miscellaneous tax deductions-----	384	-----	569	649	739	843	961
Deduction for medical and casualty expenses-----	1,396	-----	1,909	2,119	2,352	2,611	2,898
Repeal political contributions deduction-----	2	-----	2	4	2	3	3
Repeal alternative capital gains tax---	113	-----	140	151	162	174	187
Individual real estate tax shelters---	320	-----	61	181	296	407	514
Taxation of unemployment benefits---	275	-----	212	207	204	204	214
Tax interest element of annuity contracts-----	320	-----	12	26	40	57	80
Minimum tax change-----	229	-----	284	306	329	353	380
Taxable bond option (individual) <sup>2</sup> ---	255	-----	197	592	1,080	1,666	2,218
Extend 10-percent investment tax credit to structures (individual)---	-36	-47	-54	-65	-73	-79	-86
Limit individual tax credits to 90 percent of tax before credits-----	38	-----	52	58	64	71	79



Tax qualified retirement plans and employee death benefits.....	30	-----	32	32	33	33	34
Corporate real estate shelters.....	180	-----	40	118	194	265	335
Corporate family farm accounting.....	30	-----	40	25	10	5	7
Bad debt reserves:							
Commercial banks.....	196	-----	227	232	232	23	6
Mutual savings banks and savings and loans.....	82	-----	37	85	145	221	316
Credit unions.....	82	-----	22	90	83	123	171
Entertainment expenses.....	1, 125	-----	1, 476	1, 633	1, 771	1, 932	2, 107
Taxable bond option (corporations) <sup>2</sup> .....	-24	-----	-15	-47	-79	-113	-150
Phase out DISC over 3 years.....	852	193	664	1, 228	1, 513	1, 613	1, 751
Phase out deferral of tax on foreign source income.....	523	-----	88	280	768	830	897
Corporate tax rate reduction.....	-5, 718	-1, 349	-5, 965	-8, 516	-9, 228	-10, 010	-10, 764
At risk limitation.....	10	-----	14	10	8	5	6
Increase investment tax credit limit to 90 percent.....	-71	-----	-882	-576	-114	-194	-205
Extend 10-percent investment tax credit to structures (corporations).....	-1, 055	-1, 100	-1, 389	-1, 649	-1, 869	-2, 074	-2, 268
Nondiscrimination rule for health and group term life plans.....	29	-----	32	33	34	35	36
Full investment tax credit for pollution abatement facilities.....	-90	-142	-93	-107	-127	-115	-144
Total individual.....	-11, 725	-6, 114	-16, 783	-18, 516	-20, 704	-23, 442	-26, 988
Total corporate.....	-3, 849	-2, 398	-5, 704	-7, 201	-6, 659	-7, 454	-7, 869
Subtotal, income tax proposal.....	-15, 574	-8, 512	-22, 487	-25, 717	-27, 363	-30, 896	-34, 857

**Table 3.—Calendar Year Revenue Effect of the Administration's Tax Proposals <sup>1</sup>—Continued**

[In millions of dollars]

	Full year 1976	Calendar year					
		1978	1979	1980	1981	1982	1983
Repeal telephone excise tax.....		—355	—1, 200	—900	—500	-----	-----
Reduce unemployment payroll tax rate.....		-----	—850	—900	—950	—1, 000	—1, 050
Total.....	—15, 574	—8, 867	—24, 537	—27, 517	—28, 813	—31, 896	—35, 907

<sup>1</sup> There estimates assume the extension of all temporary provisions in present law (not shown), as proposed by the Administration, except the jobs tax credit.

<sup>2</sup> Calendar year outlays associated with this proposal would be \$199 million in 1979, \$592 million in 1980, and \$2.4 billion in 1983. See footnote 2 to table 2.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis.

**Table 4.—Distribution of the Administration's 1979 Individual Tax Rate Cut, \$240 Credit, Itemized Deduction, Minimum Tax, and Alternative Tax Changes by Expanded Income Class <sup>1</sup>**

[1976 income level]

Expanded income class <sup>2</sup>	Returns with tax decrease (thousands)	Amount of tax decrease (millions)	Returns with tax increase (thousands)	Amount of tax increase (millions)	Net tax change (millions)	Percentage distribution of net tax decrease
0 to \$5,000-----	5, 097	\$-421	10	\$1	\$-420	3. 2
\$5,000 to \$10,000-----	16, 639	-1, 936	280	17	-1, 919	14. 8
\$10,000 to \$15,000-----	15, 056	-2, 851	712	53	-2, 798	21. 6
\$15,000 to \$20,000-----	11, 269	-3, 003	487	52	-2, 951	22. 8
\$20,000 to \$30,000-----	9, 449	-3, 515	400	48	-3, 467	26. 8
\$30,000 to \$50,000-----	3, 014	-1, 370	318	85	-1, 285	9. 9
\$50,000 to \$100,000-----	805	-465	177	128	-337	2. 6
\$100,000 and over-----	133	-110	112	357	247	-1. 9
<b>Total-----</b>	<b>61, 462</b>	<b>-13, 669</b>	<b>2, 495</b>	<b>741</b>	<b>-12, 928</b>	<b>100. 0</b>

<sup>1</sup> The Administration proposal makes 5.9 million returns nontaxable and causes 6.1 million to switch to the standard deduction.

<sup>2</sup> Expanded income equals adjusted gross income plus minimum tax preferences less investment interest expense to the extent of investment income.

Note: Details may not add to totals because of rounding.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis.

Table 5.—Federal Individual Income Tax and Social Security Tax Burden <sup>1</sup> Under the Administration's 1979 Individual Tax Rate Cut, \$240 Credit and Itemized Deduction Changes for a Single Person and Married Couples With No, 1, and 2 Dependents (Assuming a One Earner <sup>2</sup> Family With Deductible Personal Expenses of 23 Percent of Income Under Present Law and 20 Percent Under the Proposal)

Wage income	Tax liability																			
	Single person					Married couple with no dependents					Married couple with 1 dependent					Married couple with 2 dependents				
	Under present law	Under the proposal	Reduction	FICA tax increase	Net reduction	Under present law	Under the proposal	Reduction	FICA tax increase	Net reduction	Under present law	Under the proposal	Reduction	FICA tax increase	Net reduction	Under present law	Under the proposal	Reduction	FICA tax increase	Net reduction
3,000-----	0	0	0	8	-8	0	0	0	8	-8	-300	-300	0	8	-8	-300	-300	0	8	-8
5,000-----	279	179	100	14	86	0	0	0	14	-14	-300	-300	0	14	-14	-300	-300	0	14	-14
6,000-----	449	367	82	17	65	115	0	115	17	98	-200	-200	0	17	-17	-200	-200	0	17	-17
8,000-----	810	765	45	22	23	431	254	177	22	155	273	14	259	22	237	120	0	120	22	98
10,000-----	1,199	1,165	34	28	6	761	614	147	28	119	620	374	246	28	218	446	134	312	28	284
12,500-----	1,631	1,645	-13	35	-58	1,186	1,077	109	35	74	1,059	837	222	35	187	917	597	320	35	285
15,000-----	2,126	2,105	21	42	-21	1,651	1,552	99	42	57	1,486	1,312	174	42	132	1,330	1,072	258	42	216
17,500-----	2,660	2,605	55	49	6	2,075	1,990	85	49	36	1,910	1,750	160	49	111	1,745	1,510	235	49	186
20,000-----	3,232	3,105	127	120	7	2,555	2,390	165	120	45	2,368	2,150	218	120	98	2,180	1,910	270	120	160
25,000-----	4,610	4,265	245	298	-53	3,570	3,310	260	298	-38	3,360	3,070	290	298	-8	3,150	2,830	320	298	22
30,000-----	5,950	5,585	365	298	67	4,712	4,390	322	298	24	4,472	4,150	322	298	24	4,232	3,910	322	298	24
35,000-----	7,500	7,105	395	298	97	6,002	5,670	332	298	34	5,732	5,430	302	298	104	5,464	5,190	274	298	-24
40,000-----	9,233	8,745	488	298	190	7,427	7,110	317	298	19	7,135	6,870	265	298	-33	6,848	6,630	218	298	-80

<sup>1</sup> Computed without reference to the tax tables. FICA tax increases include the employee share only of 5.85 percent to \$18,900 under prior law and 6.13 percent to \$22,900 under present law.

<sup>2</sup> Two earner families are somewhat better off under the recently enacted FICA increase for incomes of \$17,500 to \$30,000 above. They are worse off at \$40,000 and above.

Note: Details may not add to totals because of rounding.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis.



**Table 6.—Distribution of Administration 1979 Individual Tax Rate Cut and \$240 Credit in lieu of the \$750 Exemption <sup>1</sup> By Expanded Income Class**

[1976 income level]

Expanded Income class <sup>3</sup>	Returns with tax decrease <sup>2</sup> (thousands)	Amount of tax decrease (millions)	Percentage distribution of tax decrease
0-\$5,000-----	5, 104	—\$423	2. 4
\$5,000 to \$10,000-----	16, 919	—2, 008	11. 6
\$10,000 to \$15,000-----	15, 764	—3, 150	18. 2
\$15,000 to \$20,000-----	11, 753	—3, 588	20. 7
\$20,000 to \$30,000-----	9, 845	—4, 688	27. 1
\$30,000 to \$50,000-----	3, 325	—2, 217	12. 8
\$50,000 to \$100,000-----	975	—881	5. 1
\$100,000 and over-----	242	—359	2. 1
<b>Total-----</b>	<b>63, 926</b>	<b>—17, 314</b>	<b>100. 0</b>

<sup>1</sup> 6.2 million returns are made nontaxable.

<sup>2</sup> Nearly 30 thousand returns have tax increases of about \$9 million.

<sup>3</sup> Expanded income equals adjusted gross income plus minimum tax preferences less investment interest expense to the extent of investment income.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis.

Table 7.—Administration's Proposed Individual Tax Rate Schedules for Joint Returns

Taxable income bracket	Present law		1979 Tax proposal	
	Tax at low end of bracket	Tax rate on income in bracket (percent)	Tax at low end of bracket	Tax rate on income in bracket (percent)
\$0 to \$3,200-----	0	0	0	0
\$3,200 to \$4,200-----	0	14	0	12
\$4,200 to \$5,200-----	140	15	120	14
\$5,200 to \$6,200-----	290	16	260	16
\$6,200 to \$7,200-----	450	17	420	17
\$7,200 to \$11,200-----	620	19	590	18
\$11,200 to \$15,200-----	1,380	22	1,310	19
\$15,200 to \$19,200-----	2,260	25	2,070	20
\$19,200 to \$23,200-----	3,260	28	2,870	23
\$23,200 to \$27,200-----	4,380	32	3,790	27
\$27,200 to \$31,200-----	5,660	36	4,870	32
\$31,200 to \$35,200-----	7,100	39	6,150	36
\$35,200 to \$39,200-----	8,660	42	7,590	39
\$39,200 to \$43,200-----	10,340	45	9,150	42

\$43,200 to \$47,200	12, 140	48	10, 830	44
\$47,200 to \$51,200	14, 060	50	12, 590	48
\$51,200 to \$55,200	16, 060	50	14, 510	48
\$55,200 to \$57,200	18, 060	53	16, 430	51
\$57,200 to \$65,200	19, 120	53	17, 450	51
\$65,200 to \$67,200	23, 360	53	21, 530	51
\$67,200 to \$79,200	24, 420	55	22, 550	54
\$79,200 to \$91,200	31, 020	58	29, 030	57
\$91,200 to \$93,200	37, 980	60	35, 870	57
\$93,200 to \$103,200	39, 180	60	37, 010	60
\$103,200 to \$113,200	45, 180	62	43, 010	60
\$113,200 to \$123,200	51, 380	62	49, 010	62
\$123,200 to \$133,200	57, 580	64	55, 210	62
\$133,200 to \$143,200	63, 980	64	61, 410	64
\$143,200 to \$153,200	70, 380	66	67, 810	64
\$153,200 to \$163,200	76, 980	66	74, 210	65
\$163,200 to \$178,200	83, 580	68	80, 710	65
\$178,200 to \$183,200	98, 780	68	90, 460	66
\$183,200 to \$203,200	97, 180	69	93, 760	66
\$203,200 and over	110, 980	70	106, 960	68

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Source: Office of the Secretary of the Treasury, Office of Tax Analysis.

Table 8.—Administration's Proposed Individual Tax Rate Schedules for Single Returns

Taxable income bracket	Present law		1979 tax proposal	
	Tax at low end of bracket	Tax rate on income in bracket	Tax at low end of bracket	Tax rate on income in bracket
\$0 to \$2,200-----	0	0	0	0
\$2,200 to \$2,700-----	0	14	0	12
\$2,700 to \$3,200-----	70	15	60	13
\$3,200 to \$3,700-----	145	16	125	15
\$3,700 to \$4,200-----	225	17	200	15
\$4,200 to \$5,200-----	310	19	275	18
\$5,200 to \$6,200-----	500	19	455	19
\$6,200 to \$8,200-----	690	21	645	20
\$8,200 to \$10,200-----	1, 110	24	1, 045	20
\$10,200 to \$12,200-----	1, 590	25	1, 445	22
\$12,200 to \$14,200-----	2, 090	27	1, 885	23
\$14,200 to \$16,200-----	2, 630	29	2, 345	25
\$16,200 to \$18,200-----	3, 210	31	2, 845	25
\$18,200 to \$20,200-----	3, 830	34	3, 345	29
\$20,200 to \$22,200-----	4, 510	36	3, 924	29
\$22,200 to \$24,200-----	5, 230	38	4, 505	33



\$24,200 to \$26,200 -----	5, 990	40	5, 165	33
\$26,200 to \$28,200 -----	6, 790	40	5, 825	38
\$28,200 to \$30,200 -----	7, 590	45	6, 585	38
\$30,200 to \$34,200 -----	8, 490	45	7, 345	41
\$34,200 to \$38,200 -----	10, 290	50	8, 985	46
\$38,200 to \$40,200 -----	12, 290	50	10, 825	50
\$40,200 to \$42,200 -----	13, 290	55	11, 825	50
\$42,200 to \$46,200 -----	14, 390	55	12, 825	51
\$46,200 to \$50,200 -----	16, 590	60	14, 865	57
\$50,200 to \$52,200 -----	18, 990	60	17, 145	58
\$52,200 to \$54,200 -----	20, 190	62	18, 305	58
\$54,200 to \$56,200 -----	21, 430	62	19, 465	60
\$56,200 to \$62,200 -----	22, 670	62	20, 665	60
\$62,200 to \$64,200 -----	26, 390	64	24, 265	60
\$64,200 to \$66,200 -----	27, 670	64	25, 465	63
\$66,200 to \$72,200 -----	28, 950	64	26, 725	63
\$72,200 to \$78,200 -----	32, 790	66	30, 505	63
\$78,200 to \$82,200 -----	36, 750	66	34, 285	66
\$82,200 to \$90,200 -----	39, 390	68	36, 925	66
\$90,200 to \$92,200 -----	44, 830	68	42, 205	66
\$92,200 to \$102,200 -----	46, 190	69	43, 525	67
\$102,200 and over -----	53, 090	70	50, 225	68

Source: Office of the Secretary of the Treasury, Office of Tax Analysis.

**Table 9.—Distribution of the Administration's Proposed Itemized Deduction Changes (Repeal of the State Gasoline, Sales, and Personal Property Tax Deductions and a 10-percent Floor on Medical and Casualty), By Expanded Income Class <sup>1</sup>**

[1976 income level]

Expanded income <sup>2</sup>	Returns with tax increase (thou- sands)	Amount of tax increase (millions)	Percentage distribution of tax increase
0 to \$5,000.....	82	\$2	( <sup>3</sup> )
\$5,000 to \$10,000.....	1,038	89	2.2
\$10,000 to \$15,000.....	3,160	352	8.7
\$15,000 to \$20,000.....	4,536	636	15.8
\$20,000 to \$30,000.....	6,252	1,220	30.2
\$30,000 to \$50,000.....	2,727	930	23.0
\$50,000 to \$100,000.....	882	524	13.0
\$100,000 and over.....	232	281	7.0
<b>Total.....</b>	<b>18,909</b>	<b>4,035</b>	<b>100.0</b>

<sup>1</sup> These provisions would cause an estimated 6.1 million returns to switch to the standard deduction.

<sup>2</sup> Expanded income equals adjusted gross income plus minimum tax preferences less investment interest expense to the extent of investment income.

<sup>3</sup> Less than half of 1 percent.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis.

# Appendix B: Tax-Free Income Levels Under Present Law and the Administration Proposal Compared to Projected Property Levels

	Tax-free levels		Projected 1979 poverty levels <sup>1</sup>
	Present law	Adminis- tration proposal, 1979	
Single person.....	\$3, 200	\$3, 967	\$3, 449
Couple without children.....	5, 200	6, 553	4, 438
Family of 4.....	7, 200	9, 256	6, 959

<sup>1</sup> Applicable to nonfarm families. Assumes Consumer Price Index of 203.9 in 1979.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis.

