[COMMITTEE PRINT]

DESCRIPTION OF H.R. 13511, AS PASSED BY THE HOUSE

"THE REVENUE ACT OF 1978"

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

This pamphlet provides a general description of the provisions of H.R. 13511 (The Revenue Act of 1978), as passed by the House of Representatives on August 10, 1978.

The first part of the pamphlet gives a brief summary of the provisions of the bill by title. The second part is a description of the provisions of the bill by title, including present law treatment, an explanation of the provision, and its effective date. A more detailed explanation of each provision is contained in the Ways and Means Committee Report on the bill (House Report No. 95-1445; August 4, 1978).

The third part of the pamphlet includes tables on the estimated revenue effects of the bill, both for calendar years 1979-1983 and for fiscal years 1979-1983. It also includes revenue distribution tables for certain of the bill's provisions.

I. SUMMARY OF H.R. 13511

Title I—Individual Income Taxes

A. Tax reductions and extensions

The individual tax brackets would be widened by 6 percent of taxable income in excess of the zero bracket amount. Also, there would be rate cuts in certain brackets.

In addition, the zero bracket amount ($2,200 for single persons and $3,200 for married couples) would be increased to $2,300 for single persons and $3,400 for married couples. This has essentially the same effect as a comparable increase in the standard deduction would have had under prior law.

B. Personal exemption and general tax credit

The present $750 personal exemption for each taxpayer and dependent would be increased to $1,000. The general tax credit, which equals the greater of (1) $35 for each personal exemption or (2) 2 percent of the first $9,000 of taxable income in excess of the zero bracket amount, would be allowed to expire at the end of 1978.

C. Earned income credit

The earned income credit which is due to expire on December 31, 1978, would be made permanent. In addition, the earned income credit would be modified in several respects to make it easier for taxpayers to compute the credit and to enable the Internal Revenue Service to allow the credit to taxpayers who qualify but neglect to claim the credit on their tax return.

D. Itemized deductions

1. *State-local nonbusiness gasoline taxes.*—The provision of present law which permits itemized deductions for State and local taxes on gasoline, diesel, and other motor fuels not used in business or investment activities would be repealed.

2. *Political contributions.*—The provision of present law which permits itemized deductions for certain political contributions up to $100 per year ($200 in the case of a joint return) would be repealed. The provision of present law which permits an income tax credit equal to one-half of such political contributions, but not more than $25 ($50 in the case of a joint return), would be retained.

3. *Medical expenses.*—The provision of present law which permits itemized deductions for one-half the cost of medical and hospitalization insurance premiums (up to $150), without regard to the general limitation that medical expenses are deductible only to the extent exceeding three percent of adjusted gross income, would be repealed. In addition, the special limitation in present law which permits deduction of medicine and drug costs only to the extent the costs exceed one percent of adjusted gross income would be repealed. Also, under this revision only insulin and prescription medicine and drugs would be eligible for the medical expense deduction.

As a result of these modifications, the full amount of medical and hospitalization insurance premiums, the costs of prescription medicine and drugs (and nonprescription insulin), and other qualifying medical expenses would be deductible to the extent that they exceed three percent of adjusted gross income.

E. Unemployment compensation

The current exclusion from taxable income for unemployment compensation paid pursuant to government programs would be phased out at higher levels of income. The amount of unemployment compensation excluded would be reduced by one-half of the excess of gross income (including unemployment compensation) over $20,000 for single taxpayers, and generally over $25,000 for married taxpayers.

F. Deferred compensation

Employees and independent contractors performing services for a State or local government or a tax-exempt rural electric cooperative would be able to defer annually an amount equal to the lesser of $7,500 or 33⅓ percent of their currently includible compensation. In cases where amounts less than these limitations are deferred, a limited catch-up would be available during the three-year period preceding retirement. In addition, compensation deferred under unfunded deferred compensation plans maintained by taxable employers would be subject to the principles of law in effect on February 1, 1978. Finally, the rules for the deductibility of employees' deferred compensation would be extended to deferred payments for services performed by independent contractors.

G. Cafeteria plans

Participants in nondiscriminatory "cafeteria" plans (welfare benefit plans which permit participants to choose which fringe benefits they want purchased with employer contributions) would not have taxable income to the extent that they elect to have employer contributions applied to purchase nontaxable benefits (e.g., accident and health benefits or group-term life insurance in an amount less than $50,000). Participants would have taxable income to the extent that they elect to have employer contributions applied to purchase taxable benefits or they elect to receive cash or other property in lieu of fringe benefits. A special rule is provided to insure that health benefits are provided on a nondiscriminatory basis.

H. Cash or deferred profit-sharing plans

Amounts that a participant in a qualified, nondiscriminatory "cash or deferred" profit-sharing plan (a plan which permits participants to elect to defer part, or all, of the profit-sharing contribution to be made by the employer for the year) elects to defer under the plan would not be taxable to the participant in the year of deferral. In determining the qualified status of a plan, relevant revenue rulings relating to nondiscrimination and treatment of these plans as qualified profit-sharing plans, which had been issued prior to January 1, 1972, would apply.

TITLE II—TAX SHELTER PROVISIONS

A. Changes in at-risk rules

The at-risk loss restriction provision of present law, which now applies to four specified activities (farming, oil and gas, motion pictures, and equipment leasing), would be extended to apply to all activities except real estate. In light of the broadened application of this provision, the partnership at-risk loss restriction would be repealed.

This provision (now applicable to individuals, trusts, estates, subchapter S corporations, and personal holding companies) would also be made applicable to any closely held corporation in which five or fewer individuals own more than 50 percent of the stock.

In addition, the provision would be modified to provide for recapture of previously allowed deductions where there were withdrawals of amounts originally placed at risk.

B. Partnership provisions

A civil penalty would be imposed on a partnership for failure to file (or late filing of) a partnership return. Also, the general three-year period of limitations under present law (in which a person may be assessed additional income tax for a particular year) would be extended to four years after the date the partnership return is filed with respect to income, deduction and credit items which have been passed through from certain partnerships to that person. This provision would only apply to partnerships subject to registration or reporting requirements of the Securities and Exchange Commission.

TITLE III—BUSINESS TAX REDUCTIONS

A. Corporate rate reductions

The corporate tax rate applicable to the first bracket of taxable income $(0–$25,000) would be reduced from 20 percent to 17 percent. The rate applicable to the second bracket ($25,000–$50,000) would be reduced from 22 percent to 20 percent.

In addition, two additional brackets would be created. The corporate tax rate applicable to the third bracket ($50,000–$75,000) would be 30 percent and the rate applicable to the fourth bracket ($75,000–$100,000 would be 40 percent. Finally, taxable income in excess of $100,000 would be taxed at 46 percent (rather than 48 percent as under present law).

B. Investment credit modifications

The present 10-percent investment credit and the $100,000 used property limitation scheduled to expire at the end of 1980, would be made permanent. In addition, the 50-percent limitation on the amount of investment credit that can be used to reduce tax liability in excess of $25,000 for any taxable year would be increased to 90 percent, phased in at an additional 10 percent per year. Finally, eligible property for purposes of the investment tax credit would be expanded to include rehabilitation expenditures with respect to industrial and commercial buildings (including retail structures and warehouses). It would not apply to residential property.

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C. Investment credit for pollution control facilities

The full investment credit would be allowed for pollution control facilities which are eligible for an election to use 5-year amortization, except to the extent the facility has been financed with tax-exempt industrial development bonds. Under present law, the investment credit on pollution control facilities for which the taxpayer elects 5-year amortization is limited to one-half of the credit that otherwise would be available.

D. Targeted jobs credit

A permanent tax credit of 50 percent of the first $6,000 of wages per employee for the first year of employment and 16⅔ percent of such wages for the second year of employment would be provided for hiring: (1) AFDC recipients who register for the WIN program, (2) recipients of Supplemental Security Income (SSI), (3) handicapped individuals, (4) individuals of ages 18 through 24 who are members of households receiving food stamps, (5) Vietnam veterans who are members of households receiving food stamps, (6) recipients of general assistance for 30 or more days, and (7) individuals of ages 16 through 18 who are participants in a high school or vocational school sponsored or cooperative education program. Wages eligible for the credit would be limited to 30 percent of the total FUTA wages paid by an employer.

The current general jobs tax credit would be allowed to expire at the end of 1978.

The Secretaries of Treasury and Labor would be required to submit a report to Congress by June 30, 1981, on the effectiveness of the general jobs credit in stimulating employment in 1977 and 1978 and of the targeted jobs credit, as provided in the bill, in improving the employment situation of the targeted groups.

E. Increase limit on small issues of industrial development bonds

The small issues limitation on industrial development bonds would be increased from $5 million to $10 million for capital expenditures made over a 6-year period for a project.

F. Small business provisions

1. *Subchapter S provisions.*—Three modifications would be made with respect to subchapter S corporations: (1) fifteen or fewer shareholders would be allowed for its initial election; (2) husbands and wives owning subchapter S corporation stock, regardless of how the stock is held, would be treated as one shareholder for purposes of determining whether the subchapter S shareholder limitation has been complied with; and (3) a subchapter S election would be allowed to be made at any time during the first 75 days of the current taxable year or at any time during the preceding taxable year.

2. *Small business corporation stock.*—A corporation would be permitted to issue up to $1,000,000 of section 1244 stock (as opposed to the $500,000 limitation of present law). Section 1244 stock is stock in new, small businesses, and present law provides that this stock is potentially subject to ordinary loss treatment. The maximum amount treated as an ordinary loss from the sale or exchange of section 1244 stock for a taxable year would be increased to $50,000 ($100,000 in the case of a joint return). In addition, the requirement that the section 1244 stock be issued pursuant to a plan would be repealed.

3. *Special depreciation rules for small business.*—The additional first year depreciation allowance (sec. 179) would be modified in three respects. First, the percentage allowable would be increased from 20 percent to 25 percent. Second, the base amount for the cost of eligible depreciable tangible property would be increased from $10,000 to $20,000 (in the case of a joint return, the amount would be increased from $20,000 to $40,000). As a result of these two changes, the amount deductible would be increased from $2,000 (20% of $10,000) to $5,000 (25% of $20,000). In the case of a joint return, the amount deductible would be increased from $4,000 (20% of $20,000) to $10,000 (25% of $40,000). Third, the provision would be made applicable only to a taxpayer whose adjusted basis in depreciable assets as of the beginning of the taxable year did not exceed $1 million.

G. Accrual accounting for farming corporations

An additional exception to the rules which require that certain farming corporations use an accrual method of accounting and capitalize preproductive period expenses would be provided to cover certain corporations that are controlled by two or three families.

In addition, farmers, florists, and nurseries on an accural method would not be required to take inventories of growing crops into account in computing taxable income unless these taxpayers are required by statute to capitalize preproductive period expenses. Further, farmers, florists, and nurseries who are currently using an accrual method of accounting, but who are not required by statute to use such a method of accounting, would be allowed until 1981 to change to the cash method of accounting.

H. Five-year amortization for low-income rental housing

A 3-year extension of the special 5-year amortization rule for certain expenditures to rehabilitate low income rental housing would be provided (i.e., until January 1, 1982). Under the special amortization rules for certain low-income rental property, taxpayers may elect to amortize up to $20,000 of certain rehabilitation expenditures, on a per dwelling units basis, over a period of 60 months if the additions or improvements have a useful life of 5 years or more.

TITLE IV—CAPITAL GAINS PROVISIONS

A. Alternative capital gains tax

The election for individuals to have the first $50,000 of long-term capital gains taxed at an alternative rate of 25 percent would be repealed, effective for taxable years beginning after December 31, 1978.

B. Minimum and maximum tax

Capital gains would be removed from the list of tax preferences under both the minimum and maximum taxes, effective for taxable years beginning after December 31, 1978.

C. Alternative minimum tax on capital gains

An alternative minimum tax would be provided at the rate of 10 percent on the excluded one-half of an individual's long-term capital gains, reduced by a $10,000 exemption. This alternative minimum tax would be imposed only to the extent it exceeds the individual's regular tax liability. The alternative minimum tax base excludes any capital gain realized on the sale or exchange of an individual's principal residence.

D. Inflation adjustment for capital assets

Taxpayers would be allowed to adjust the basis of certain capital assets upward by the rate of inflation. For eligible assets sold after December 31, 1979, the basis adjustment would reflect the rate of inflation indicated by the consumer price index for the holding period of the asset. However, the adjustment would be made only with respect to increases in the consumer price index occurring after December 31, 1979. In general, assets eligible for the basis adjustment would be corporate stock, real estate, and tangible personal property.

E. Exclusion of gain on sale of residences

An individual, regardless of age, could elect (on a one-time basis) to exclude from gross income $100,000 of any gain realized on the sale or exchange of his or her principal residence. The exclusion would apply only if the present nonrecognition treatment for rollovers is not elected, and would be available only with respect to gain realized on the sale or exchange of a principal residence which the taxpayer has owned and occupied as his or her principal residence for the two-year period which immediately precedes the sale. The exclusion would apply to sales or exchanges after July 26, 1978.

The provision of present law relating to gain realized on the sale of a principal residence by a taxpayer 65 and over would be repealed.

F. Nonrecognition of gain on certain residential sales

An individual could elect not to recognize gain on the sale of more than one principal residence within an 18-month period (rather than the present law limit of one "rollover" during the 18-month period), if a replacement principal residence is purchased and occupied within that period, and if each sale and purchase is attributed to the individual's relocation for the convenience of his or her employer. Gain not recognized on any sale would reduce the individual's tax basis for each of his or her new residences.

G. Capital gains tax study

The Treasury Department would be required to prepare, and submit to Congress, by September 30, 1981, a report on the effectiveness of the reductions of both the individual and the corporate capital gains tax rates in stimulating investment and increasing the rate of economic growth, including a study of the effects of these reductions on the growth of employment and on income tax revenues.

II. DESCRIPTION OF H.R. 13511, AS PASSED THE HOUSE

Title I—Individual Income Taxes

A. Widening of tax brackets, rate cuts in certain brackets and increase in zero bracket amount (sec. 101(a) of the bill and secs. 1, 21, and 63 of the Code)

Present law

Under present law, individual income tax rates begin at 14 percent on taxable income in excess of $3,200 on a joint return and $2,200 on a single return. There is no tax on the first tax bracket, referred to as the "zero bracket amount." There is also a floor under itemized deductions equal to the zero bracket amount, so that itemizers can only deduct expenses in excess of that amount. This floor results from the conversion of the old standard deduction into a zero rate bracket and a floor under itemized deductions made by the Tax Reduction and Simplification Act of 1977 (P.L. 95-30).

Individual tax rates range up to 70 percent on taxable income in excess of $203,200 for joint returns and $102,200 for single returns. Present law also provides different rate schedules for heads-of-households, married couples filing separately, and estates and trusts.

Explanation of provisions

The bill provides new tax rate schedules in place of each of the tax rate schedules of present law. The present law rate schedule and the new one provided by the bill for married couples filing joint returns are shown in the table below.

Tax Rate Schedule Under Present Law and H.R. 13511 for Married Couples FilingJointly[1]

Present Law

If the taxable income is:	The tax is:
Not over $3,200	No tax.
Over $3,200 but not over $4,200	14% of the excess over $3,200.
Over $4,200 but not over $5,200	$140, plus 15% of excess over $4,200.
Over $5,200 but not over $6,200	$290, plus 16% of excess over $5,200.
Over $6,200 but not over $7,200	$450, plus 17% of excess over $6,200.
Over $7,200 but not over $11,200	$620, plus 19% of excess over $7,200.
Over $11,200 but not over $15,200	$1,380, plus 22% of excess over $11,200.
Over $15,200 but not over $19,200	$2,260, plus 25% of excess over $15,200.
Over $19,200 but not over $23,200	$3,260, plus 28% of excess over $19,200.
Over $23,200 but not over $27,200	$4,380, plus 32% of excess over $23,200.
Over $27,200 but not over $31,200	$5,660, plus 36% of excess over $27,200.
Over $31,200 but not over $35,200	$7,100, plus 39% of excess over $31,200.
Over $35,200 but not over $39,200	$8,660, plus 42% of excess over $35,200.
Over $39,200 but not over $43,200	$10,340, plus 45% of excess over $39,200.
Over $43,200 but not over $47,200	$12,140, plus 48% of excess over $43,200.
Over $47,200 but not over $55,200	$14,060, plus 50% of excess over $47,200.
Over $55,200 but not over $67,200	$18,060, plus 53% of excess over $55,200.
Over $67,200 but not over $79,200	$24,420, plus 55% of excess over $67,200.
Over $79,200 but not over $91,200	$31,020, plus 58% of excess over $79,200.
Over $91,200 but not over $103,200	$37,980, plus 60% of excess over $91,200.
Over $103,200 but not over $123,200	$45,180, plus 62% of excess over $103,200.
Over $123,200 but not over $143,200	$57,580, plus 64% of excess over $123,000.
Over $143,200 but not over $163,200	$70,380, plus 66% of excess over $143,200.
Over $163,200 but not over $183,200	$83,580, plus 68% of excess over $163,200.
Over $183,200 but not over $203,200	$97,180, plus 69% of excess over $183,200.
Over $203,200	$110,980, plus 70% of excess over $203,200.

See footnotes at end of table.

If the taxable income is:	The tax is:
Not over $3,400	No tax.
Over $3,400 but not over $4,460	14% of the excess over $3,400.
Over $4,460 but not over $5,520	$148.40, plus 15% of excess over $4,460.
Over $5,520 but not over $6,580	$307.40, plus 16% of excess over $5,520.
Over $6,580 but not over $7,640	$477, plus 17% of excess over $6,580.
Over $7,640 but not over $11,880	$657.20, plus 18% of excess over $7,640.[2]
Over $11,880 but not over $16,120	$1,420.40, plus 21% of excess over $11,880.[2]
Over $16,120 but not over $20,360	$2,310.80 ,plus 24% of excess over $16,120.[2]
Over $20,360 but not over $24,600	$3,328.40, plus 28% of excess over $20,360.
Over $24,600 but not over $28,840	$4,515.60, plus 32% of excess over $24,600.
Over $28,840 but not over $33,080	$5,872.40, plus 36% of excess over $28,840.
Over $33,080 but not over $37,320	$7,398.80, plus 39% of excess over $33,080.
Over $37,320 but not over $41,560	$9,052.40, plus 42% of excess over $37,320.
Over $41,560 but not over $45,800	$10,833.20, plus 45% of excess over $41,560.
Over $45,800 but not over $50,040	$12,741.20, plus 48% of excess over $45,800.
Over $50,040 but not over $58,520	$14,766.40, plus 50% of excess over $50,040.
Over $58,520 but not over $71,240	$19,016.40, plus 53% of excess over $58,520.
Over $71,240 but not over $83,960	$25,758, plus 55% of excess over $71,240.
Over $83,960 but not over $96,680	$32,754, plus 58% of excess over $83,960.
Over $96,680 but not over $109,400	$40,131.60, plus 60% of excess over $96,680.
Over $109,400 but not over $130,600	$47,763.60, plus 62% of excess over $109,400.
Over $130,600 but not over $151,800	$60,907.60, plus 64% of excess over $130,600.
Over $151,800 but not over $173,000	$74,475.60, plus 66% of excess over $151,800.
Over $173,000 but not over $194,200	$88,467.60, plus 68% of excess over $173,000.
Over $194,200 but not over $215,400	$102,883.60, plus 69% of excess over $194,200.
Over $215,400	$117,511.60, plus 70% of excess over $215,400.

[1] And surviving spouses.
[2] Rate reduction from present law.

Increase in zero bracket amount

The first change from present law is the increase in the zero bracket amount from $3,200 to $3,400 for joint returns and from $2,200 to $2,300 for single persons. For heads-of-households the increase is also $100 to $2,300. For married persons filing separate returns, the increase is from $1,600 to $1,700.

The bill also increases the present floor under itemized deductions by $200 for joint returns and $100 for single, head-of-household and separate returns, since the zero bracket amount builds the old standard deduction into the tax rate schedule.

Widening of tax rate brackets

The second rate schedule change is that the size of the tax brackets (in excess of the zero bracket) are increased by 6 percent. For example, under present law the zero bracket amount is $3,200 and the first tax bracket is from $3,200 to $4,200, or $1,000 wide. Under the bill, the zero bracket amount is $3,400 and the bracket width is increased by 6 percent of $1,000 (or $60) to $1,060, so that the first income bracket range is from $3,400 to $4,460. The same principle applies throughout the rate schedule.

Reduction in certain tax rates

Third, the bill reduces three of the lower tax rates. The present 19, 22, and 25 percent rates are each reduced one point to 18, 21, and 24 percent, respectively.

Effective date

The change in the tax rate schedule, including the higher zero bracket amount, is effective for taxable years beginning after December 31,1978.

The bill specifically applies the rules for rate changes of fiscal year taxpayers to allow these taxpayers the benefits of the rate cuts and increase in the zero bracket amount (as well as the personal exemption increase) for that part of their fiscal year which falls in 1979.

B. Increase in the personal exemption (sec. 102 of the bill and secs. 21, 151, and 6013(b)(3) of the Code)

Present law

Under present law, the amount of the personal exemption is $750 for the taxpayer, his or her spouse, and each dependent whose gross income is less than $750 (unless the dependent is a child of the taxpayer who is either under age 19 or a student). An additional exemption is provided for a taxpayer who is blind or age 65 or over. Present law also provides a general tax credit, which is the larger of $35 per exemption or 2 percent of the first $9,000 of taxable income (in excess of the zero bracket amount), with a maximum credit of $180. The credit is scheduled to expire at the end of 1978.

Explanation of provision

The bill provides a permanent increase in the personal exemption from $750 to $1,000, and also raises the gross income limit for a dependent from $750 to $1,000. The general tax credit it allowed to expire at the end of 1978, as under existing law.

Effective date

The increase in the personal exemption is effective for taxable years beginning after December 31, 1978. The general tax credit will no longer apply for taxable years ending after December 31, 1978.

The bill applies the rules for rate changes of fiscal year taxpayers to allow these taxpayers the benefits of the personal exemption (as well as the rate cuts and increase in the zero bracket amount) for that part of their fiscal year which falls in 1979.

C. Changes in filing requirements and withholding changes (secs. 101 and 102 of the bill and secs. 6012(a) and 3402 of the Code)

Present law

Under present law, a tax return must be filed by a single person if his or her income is $2,950 or more a year and by a married couple, both under age 65, filing a joint return if their income is $4,700 or more.

Explanation of provision

The income levels at which a tax return must be filed are increased to reflect the increase in the zero bracket amount from $2,200 to $2,300 for single persons and from $3,200 to $3,400 for joint returns and the increase in the personal exemption from $750 to $1,000. Consequently, the new filing level under the bill is $3,300 for a single person, $5,400 for a married couple both under age 65, $6,400 if only one spouse is age 65 or over, and $7,400 if both spouses are age 65 or over.

The withholding rates and tables are to be changed by the Secretary of the Treasury to reflect the increase in the zero bracket amount, the wider taxable income brackets, the rate reduction, and the higher personal exemption.

Effective date

The change in the filing requirement is effective for taxable years beginning after December 31, 1978, and the withholding changes apply to remuneration paid after December 31, 1978.

D. Extension and simplification of the earned income credit (secs. 103 and 104 of the bill and sec. 43 of the Code)

Present law

Under present law, an eligible individual is allowed a credit against tax equal to 10 percent of the first $4,000 of earned income (for a maximum credit of $400). The amount of the credit is phased out as the adjusted gross income (or earned income, if greater) of an individual increases from $4,000 to $8,000. Under this phase-out, one dollar of credit is lost for each ten dollars of income in excess of $4,000, regardless of whether the individual has at least $4,000 of earned income. Because the credit is refundable, it may exceed an individual's income tax liability for the year. An individual is eligible for the earned income tax credit only if that individual maintains a household in the United States for himself or herself and for one or more children who are under the age of 19, are students, or are disabled dependents.

Earned income eligible for the credit includes all wages, salaries, tips, and other employee compensation, plus the amount of the taxpayer's net earnings from self-employment. Earned income is eligible for the credit, however, only if it is includible in the gross income of the taxpayer during the taxable year in which the credit is claimed.

Presently, the credit is scheduled to expire at the end of 1978.

Explanation of provision

The bill makes the earned income credit permanent, and makes certain simplifying revisions in the provision.

The bill replaces the current phaseout of the credit by providing that the allowable credit for any taxable year will not exceed the excess of (a) $400 over (b) 10 percent of the excess of adjusted gross income (or, if greater, earned income) over $4,000. The purpose of this change is to allow the credit to be determined directly from tables.

The bill repeals the provision that earned income eligible for the credit does not include any items which are excluded from adjusted gross income The bill also changes eligibility requirements for the credit so that individuals who are eligible for the credit can be identified from entries on the individual income tax return (Form 1040) after a slight modification to identify heads of household who maintain a household for a child. Any individual who is considered to be married and who is entitled to a dependency exemption under section 151 for a child living with the individual and surviving spouse, and any head of a household who maintains a household for a child generally will be eligible for the earned income credit.

These changes would eliminate certain computations for the taxpayer and also allow the Service to give the credit to taxpayers who are eligible for the credit but who neglect to claim it.

Effective date

The amendments made by this provision are effective for taxable years beginning after December 31, 1978.

E. Itemized deductions

1. Repeal of deduction for State-local nonbusiness gasoline and other motor fuel taxes (sec. 111 of the bill and sec. 164(a)(5) of the Code)

Present law

Under present law, an individual who itemizes deductions can deduct State and local taxes imposed on gasoline, diesel, and other motor fuels not used in business or investment activities (sec. 164(a)(5)). For example, taxes on gasoline consumed in personal use of a family car are deductible by an itemizer.

A taxpayer who purchases and uses gasoline for nonbusiness purposes may obtain the deductible amount of State gasoline taxes from tables printed in the instructions for the return (IRS Form 1040). If an itemizer does not want to use the gasoline tax tables, or has purchased and used other motor fuels for nonbusiness purposes, he or she must obtain and keep receipts showing the exact amounts of State and local taxes paid.

Explanation of provision

The bill repeals the itemized deduction for State and local taxes on gasoline, diesel, and other motor fuels not used by the taxpayer in business or investment activities.

Effective date

The repeal of the deduction is effective for taxable years beginning after December 31, 1978.

2. Revision of deduction for medical, dental, etc., expenses (sec. 112 of the bill and sec. 213 of the Code)

Present law

Under present law, an individual who itemizes deductions generally can deduct unreimbursed medical and dental expenses paid for the medical care of the individual, and his or her spouse and dependents, to the extent that the total of such expenses exceeds 3 percent of adjusted gross income. Amounts paid for medicine and drugs may be counted toward the deductible amount only to the extent they exceed one percent of adjusted gross income.

In addition, one-half the amount of medical insurance premiums (up to $150) can be deducted by itemizers without regard to the 3-percent limitation. The balance of medical insurance premiums is added to other medical expenses and is subject to the 3-percent limitation.

Explanation of provision

The bill repeals the provision of present law which allows an itemized deduction for one-half of the cost of medical insurance premiums (up to $150) without regard to the general limitation that medical expenses are deductible only to the extent they exceed 3 percent of adjusted gross income.

In addition, the bill repeals the special limitation in present law which permits deduction of prescription and nonprescription medicine and drug costs only to the extent they exceed one percent of adjusted gross income. The bill provides that only "prescribed drugs" and insulin would be eligible for the medical expense deduction.

As a result of the modifications made by the bill, the full amount of medical insurance premiums, the costs of prescription drugs (and insulin), and other qualifying medical expenses would be deductible to the extent that, in the aggregate, they exceed 3 percent of adjusted gross income.

Effective date

The modifications in the itemized deduction for medical expenses are effective for taxable years beginning after December 31, 1978.

3. Repeal of deduction for political contributions (sec. 113 of the bill and sec. 218 of the Code)

Present law

Under present law, an individual who itemizes deductions can deduct political or newsletter fund contributions of up to $100 per year ($200 in the case of a joint return). Contributions eligible for the deduction may be made to (1) candidates for nomination or election to Federal, State, or local office in general, primary, or special elections; (2) committees sponsoring such candidates; (3) national, State, or local committees of a national political party; and (4) newsletter funds of an official or candidate.

Alternatively, a taxpayer can elect an income tax credit equal to one-half of such political and newsletter fund contributions, but not more than $25 ($50 in the case of a joint return).

Explanation of provision

The bill repeals the itemized deduction for political or newsletter fund contributions. The income tax credit for such contributions, however, will remain available to taxpayers as under present law.

Effective date

The repeal of the deduction is effective for taxable years beginning after December 31, 1978.

F. Treatment of unemployment compensation (sec. 114 of the bill and sec. 85 of the Code)

Present law

Present law does not expressly exclude from gross income amounts received under unemployment compensation programs. However, unemployment compensation paid under most government programs is exempt from taxation under a series of Internal Revenue Service rulings beginning in the 1930's. (Railroad unemployment insurance benefits specifically are exempted from taxation under the Railroad Unemployment Insurance Act itself.)

In contrast to its rulings on unemployment compensation benefits paid under government programs, however, the Internal Revenue Service consistently has held that unemployment compensation benefits paid under private plans are taxable to the extent that they exceed the recipient's prior contributions.

Explanation of provision

In general, a portion of benefits in the nature of unemployment compensation paid pursuant to government programs will be included in the recipient's adjusted gross income. The amount of unemployment compensation included in income will be limited to one-half of the excess of (1) the sum of the taxpayer's adjusted gross income, all unemployment compensation paid pursuant to government programs and all disability income of the type eligible for exclusion from income under section 105(d) over (2) the taxpayer's "base amount."

The base amount is $25,000 in the case of a married individual filing a joint return; zero in the case of a married individual filing a separate return, unless he or she lived apart from his or her spouse for the entire taxable year; and $20,000 in the case of all other individuals. The base amount is zero for married individuals filing separate returns.

For purposes of this provision, "unemployment compensation" means any amount received under a law of the United States or of a State which is in the nature of unemployment compensation. Unemployment compensation programs are those designed to provide cash benefits on a regular basis to normally employed workers during limited periods of unemployment.

Effective date

The provision applies to unemployment compensation paid after December 31, 1978, in taxable years ending after that date.

G. Deferred compensation plans

1. State and local government deferred compensation plans (sec. 121 of the bill and sec. 457 of the Code)

Present law

Under present law, a taxpayer using the cash receipts and disbursements method (cash method) of accounting is generally not required to include compensation in gross income until it is actually or constructively received. However, a taxpayer ordinarily will be taxed on income if he or she has a right to receive that income and the exercise of that right is not subject to substantial restrictions.

In addition, under certain conditions, a taxpayer is required to treat the receipt of noncash benefits as income. Under the cash method, a taxpayer is required to report any item of income that is received in cash or in the form of a "cash equivalent."

In 1960, the Internal Revenue Service published a revenue ruling which set forth a number of general principles regarding the constructive receipt and cash equivalent doctrines and then provided examples of their application to deferred compensation arrangements. These examples made it clear that the constructive receipt and cash equivalent doctrines would not be applied to certain deferred compensation arrangements between an employee and an employer even though the employee might have obtained an agreement from the employer to make an immediate cash payment following the performance of services.

In 1972, the Internal Revenue Service issued the first favorable private letter ruling with respect to an unfunded deferred compensation arrangement where a State or local government unit was the employer. Subsequently, many States and local governments have obtained private rulings with respect to their deferred compensation plans which provide that participating employees who use the cash method will include in income benefits payable under the deferred compensation plan only in the taxable year in which such benefits are received or otherwise made available.

In 1977, the Internal Revenue Service stopped issuing private rulings dealing with the income tax treatment of individuals under the type of unfunded deferred compensation plans typically established by State and local governments, pending a review of the area. After its review the Internal Revenue Service proposed regutations on February 3, 1978 which provided generally that, if payment of an amount of a taxpayer's fixed basic or regular compensation is deferred at the taxpayer's individual election to a taxable year later than that in which the amount would have been payable but for the election, the deferred amount would be treated as received in the earlier taxable year. These proposed regulations would apply to plans maintained by States and local governments and tax-exempt organizations as well as plans maintained by taxable employers.

Explanation of provision

The bill adds a new provision to the Code to provide certainty with respect to unfunded deferred compensation plans maintained by States and local governments and tax-exempt rural electric cooperatives and their tax-exempt affiliates. Thus, under this provision, employees and independent contractors who provide services for an entity that maintains an eligible State deferred compensation plan will be able to defer compensation as long as such deferral does not exceed the prescribed annual limitations.

In general

Amounts of compensation deferred by a participant in an eligible State deferred compensation plan, plus any income attributable to the investment of such deferred amounts, will be includible in the income of the participant or his beneficiary only when it is paid or otherwise made available. For this purpose, the fair market value of any property distributed to the participant from the plan will be includible in income.

Plan requirements

To qualify as an eligible State deferred compensation plan, the plan must be maintained by (1) a State, a political subdivision of a State, an agency or instrumentality of a State or one of its political subdivisions, or (2) a tax-exempt rural electric cooperative, and any affiliates which are tax-exempt under section 501(c)(6) of the Code. In addition, the plan by its terms must not allow the deferral of more than $7,500, or 33⅓ percent of the participant's includible compensation for the taxable year, whichever is less.

An eligible State deferred compensation plan may provide a limited "catch-up" provision under which a participant may defer all, or a portion of any deferral limitations not utilized for prior taxable years.

An eligible State deferred compensation plan cannot make benefits available to participants before the earlier of (1) separation from service with the sponsoring entity, (2) retirement in accordance with the terms of any retirement plan maintained by the sponsoring entity, (3) death, or (4) the occurrence of an unforeseeable emergency (as defined in regulations).

Finally, for the deferred compensation plan to be eligible under the bill, all amounts of compensation deferred under the plan, all property or rights to property purchased with the amounts deferred, and any income earned on property purchased with amounts deferred must remain assets of the plan sponsor subject to the claims of its general creditors.

Effective date

All plans to which this provision applies will have until January 1, 1982, to satisfy the plan requirements for classification as an eligible State deferred compensation plan. However, the limitations on amounts that can be deferred under such a plan will apply for all taxable years beginning after December 31, 1978. In addition, the catch-up provisions will apply prior to 1982 only if all State deferred compensation plans in which a participant is participating, or has participated in during taxable years for which there is an underutilized deferral limitation, are "eligible" State deferred compensation plans.

2. *Private nonqualified plans (sec. 122 of the bill)*

Present law

Under present law, amounts deferred under unfunded deferred compensation plans maintained by taxable entities are treated basically in the same manner as amounts deferred under unfunded deferred compensation plans maintained by States or local governments. However, unfunded deferred compensation plans maintained by taxable entities do differ from public plans in that, under Title I of the Employee Retirement Income Security Act of 1974, they are limited to providing benefits in excess of those permitted under tax-qualified plans, or their coverage must be limited primarily to highly compensated and managerial employees.

The proposed regulations issued by the Internal Revenue Service on February 3, 1978, would have applied to nonqualified deferred compensation plans maintained by taxable entities as well as to those maintained by nontaxable entities.

Explanation of provision

The bill provides that the taxable year for including compensation deferred under a deferred compensation plan maintained by a taxable entity is to be determined in accordance with the principles set forth in regulations, rulings, and judicial decisions relating to deferred compensation which were in effect on February 1, 1978.

Effective date

This section is effective for taxable years ending on or after February 1, 1978.

3. *Payments to independent contractors (sec. 123 of the bill and secs. 404(b) and 404(d) of the Code)*

Present law

Under present law, an employer generally is permitted a deduction for deferred compensation provided under a nonqualified plan in the year that such compensation is includible in the employee's gross income, even though the employer is on the accrual basis and normally would be entitled to a current deduction. This rule applies to any method of contributions or compensation having the effect of a plan deferring the receipt of compensation.

Under present law, the rule permitting a deduction for deferred compensation only when there is a corresponding income inclusion by a plan participant applies only where there is an employer-employee relationship. Thus, an accrual basis taxpayer generally is able to establish an unfunded deferred compensation plan for a cash basis independent contractor and obtain a deduction for such liability in accordance with the usual accrual accounting rules.

Explanation of provision

The bill adds a new provision which denies a deduction for deferred compensation provided under a nonqualified plan to non-employee participants until that compensation is includible in the gross income of the participants.

The bill also clarifies current law by providing that a method of compensation or employer contributions having the effect of a plan deferring the receipt of compensation does not have to be similar to a stock bonus, pension, profit-sharing, or annuity plan to be subject to the deferred compensation deduction-timing rules.

Effective date

The amendments made by this section will apply to deductions for taxable years beginning after December 31, 1978.

4. Tax treatment of cafeteria plans (sec. 124 of the bill and sec. 124 of the Code)

Present law

Under a "cafeteria plan" or "flexible benefit plan" an employee may choose from a package of employer-provided fringe benefits, some of which may be taxable and some of which may be nontaxable. Under a provision of the Employee Retirement Income Security Act of 1974 (ERISA), an employer contribution made before January 1, 1977, to a cafeteria plan in existence on June 27, 1974, is required to be included in an employee's gross income only to the extent that the employee actually elects taxable benefits. In the case of a plan not in existence on June 27, 1974, the employer contribution is required to be included in income to the extent the employee could have elected taxable benefits. Under the Tax Reform Act of 1976, these rules apply with respect to employer contributions made before January 1, 1978.

Explanation of provision

Under the bill, generally, employer contributions under a cafeteria plan which permits employees to elect between taxable and nontaxable benefits are excluded from the gross income of an employee to the extent that nontaxable benefits are elected. However, in the case of a highly compensated employee, amounts contributed under a cafeteria plan will be included in gross income for the taxable year in which the plan year ends, to the extent the individual could have elected taxable benefits unless the plan meets specified antidiscrimination standards with respect to coverage and eligibility and with respect to contributions or benefits.

Coverage and eligibility.—A cafeteria plan will be considered to meet the coverage standards of the bill if it benefits a classification of employees found by the Secretary of the Treasury not to discriminate in favor of highly compensated employees. The plan will meet the eligibility standards of the bill if it (1) does not require an employee to complete more than three years of employment in order to become eligible to participate, and (2) allows an employee who is otherwise eligible to participate to enter the plan as a participant not later than the first day of the first plan year beginning after the date the employee completes three years of employment.

Contributions or benefits.—A plan will not be discriminatory if total benefits and nontaxable benefits attributable to highly compensated employees, measured as a percentage of compensation, are not significantly greater than total benefits and nontaxable benefits attributable to other employees (measured on the same basis), provided the plan is not otherwise discriminatory under the standards of the bill.

In the case of a cafeteria plan which provides health benefits, the plan will not be treated as discriminatory if: (1) contributions on behalf of each participant include an amount which equals either 100 percent of the cost of health benefit coverage under the plan of the majority of highly compensated participants who are similarly situated (e.g., same family size), or 75 percent of the cost of the most plan participant, and (2) the other contributions or benefits provided by the plan bear a uniform relationship to the compensation of plan participants.

Effective date

The amendment is effective for taxable years beginning after the December 31, 1978.

5. Tax treatment of cash or deferred profit-sharing plans (sec. 125 of the bill)

Present law

Under present law, the benefits or contributions under a tax-qualified plan must not discriminate in favor of employees who are officers, shareholders, or highly compensated, and the plan must meet standards designed to assure that the classification of employees covered by the plan is not discriminatory. In the case of a tax-qualified cash or deferred profit-sharing plan, the employer gives an employee the choice of (1) being paid a specified amount in cash as current compensation, or (2) having that amount contributed to the plan. A 1956 revenue ruling upheld the tax-qualified status of a cash or deferred profit-sharing plan by providing that the plan did not discriminate where over one-half of the employees who elected profit-sharing contributions (deferral), rather than current compensation, were among the lowest paid two-thirds of the employees who had met the plan's 3-year eligibility requirement.

On December 6, 1972, the Internal Revenue Service issued proposed regulations which called into question the tax treatment of employees covered by cash or deferred profit-sharing plans. Under the rules in effect at the time of the proposal, an employee was not taxed currently on amounts he chose to have contributed to a tax-qualified cash or deferred profit-sharing plan.

In order to allow time for Congressional study of this area, section 2006 of the Employee Retirement Income Security Act of 1974 (ERISA) provided for a temporary freeze of the status quo. Under ERISA, the tax treatment of contributions to cash or deferred profit-sharing plans in existence on June 27, 1974, is governed under the law as it was applied prior to January 1, 1972, and this treatment was to continue at least through December 31, 1976, or (if later) until regulations are issued in final form in this area.

In the case of plans not in existence on June 27, 1974, contributions to a cash and deferred profit-sharing plan are treated as employee contributions (until January 1, 1977, or until new regulations are prescribed in this area). This was intended to prevent a situation where a new plan might begin in reliance on pre-1972 law before Congress has determined what the law should be in the future.

The Tax Reform Act of 1976 extended the temporary freeze on the status quo until January 1, 1978, in order to allow additional time for Congressional study of this area.

Explanation of provision

The bill will change present law with respect to new cash or deferred profit-sharing plans by permitting those plans to be tax-qualified, provided the plans satisfy the law with respect to cash or deferred profit-sharing plans as it was administered before January 1, 1972.

Effective date

The amendment is effective for taxable years beginning after De-

TITLE II—TAX SHELTER PROVISIONS

A. Provisions related to at risk rules (secs. 201–204 of the bill and secs. 465 and 704(d) of the Code)

Present law

Among the provisions of the Tax Reform Act of 1976 which deal with tax shelters are two "at risk" rules. These rules are designed to prevent a taxpayer from deducting losses in excess of his actual economic investment in the activity involved.

The first of these at risk rules—"the specific at risk rule"—applies to four specified activities: (1) farming; (2) exploring for, or exploiting, oil and natural gas resources; (3) holding, producing, or distributing motion picture films or video tapes; and (4) leasing of personal property. This specific at risk rule applies to all types of taxpayers other than regular corporations (that is, corporations which are not subchapter S corporations or personal holding companies).

Under the specific at risk rule, a taxpayer's loss for any taxable year from specified activities is limited to the amount the taxpayer has placed at risk and could actually lose from this activity. The taxpayer is not generally to be considered at risk with respect to the proceeds (or his share of the proceeds) of a nonrecourse loan used directly or indirectly to finance his participation in the activity.

Losses which may not be deducted for any taxable year because of the specific at risk rule are deferred and may be deducted in any subsequent year in which this at risk limitation does not prevent the deduction.

The other at risk rule—"the partnership at risk rule"—applies generally to activities engaged in through partnerships. This rule provides that, for purposes of the limitation on allowance of partnership losses, the adjusted basis of a partner's interest does not include any portion of any partnership liability with respect to which the partner has no personal liability. However, there are two exceptions to this rule. First, the rule does not apply to any activity to the extent that the specific at risk rule applies. Second, the rule does not apply to any partnership the principal activity of which is investing in real property (other than mineral property).

Explanation of provisions

Extending the at risk rule to all activities other than real estate

In general.—The bill extends the specific at risk rule to all activities except real estate. For the newly covered activities, the specific at risk rule covers activities which are a part of a trade or business or are engaged in for the production of income.

Aggregation of activities.—Separate rules for aggregation and separation of activities are provided for the activities to which the at risk rule is extended by this bill. In general, it is provided that, with respect to these newly covered activities, those activities which constitute a trade or business shall be treated as one activity if either (1) the taxpayer actively participates in the management of the trade or business, or (2) the trade or business is carried on by a partnership or electing subchapter S corporation and 65 percent or more of the losses from the taxable year is allocable to persons who actively participate in the management of the trade or business. Furthermore, the Internal Revenue Service is given specific authority to prescribe regulations under which the activities which are made subject to the risk limitation by this bill shall be aggregated or treated as separate activities.

Exclusion for real property.—In the case of activities to which the bill extends application of the at risk rule, the holding of real property (other than mineral property) shall be treated as a separate activity, and the at risk rule shall not apply to losses from such activity. For purposes of this exclusion, personal property and services which are incidental to making real property available as living accommodations shall be treated as part of the activity of holding such real property.

In situations where a trade or business involves both the holding of real property (other than mineral property) and the providing of personal property and services which are not incidental to making real property available as living accommodations, the holding of the real property will be treated as a separate activity which is not subject to the at risk rule. The remainder of the trade or business will be treated as a separate activity (or activities) to which the at risk rule would apply.

Loans from related and interested parties.—The Tax Reform Act of 1976 specifically requires that a taxpayer not be considered at risk with respect to amounts borrowed for use in an activity (or which are contributed to the activity) if the amounts are borrowed from any person who has an interest in the activity (other than that as a creditor) or who is related to the taxpayer. Although this rule will continue to apply without change to the four specified activities, the bill provides that, in the case of the activities which are newly made subject to the at risk provision by the bill, this automatic nonrecourse provision shall apply only to the extent provided in regulations prescribed by the Treasury.

Repeal of partnership at risk rules.—Since all the activities currently covered by the partnership at risk rules would now be covered by the new expanded version of the specific at risk rules under section 465, section 704(d) is repealed by the bill, effective for taxable years beginning after December 31, 1978. The bill provides that, to the extent losses have been disallowed for a taxable year pursuant to the partnership at risk rules of section 704(d) prior to its amendment by this bill, these losses will be treated as if they had been disallowed by the specific at risk rule of section 465 and, as a consequence, will be treated as a deduction in the first taxable year beginning after December 31, 1978.

Extension of at risk rules to closely held corporations

Under present law, the only corporations to which the specific at risk rule (sec. 465) applies are subchapter S. corporations and personal holding companies. The bill extends the application of this rule to all corporations in which five or fewer individuals own more than 50 percent of the stock. The stock ownership rule is determined by reference to the stock ownership rule for personal holding companies (sec. 542(a)(2)). If a corporation meets these ownership requirements, it will be subject to the at risk rules even if it does not meet other definitional requirements of a personal holding company or because it is excepted from personal holding company status.

Recapture of losses where amount at risk is less than zero

In order to be consistent with the original intent of the at risk rule, the bill requires the recapture of previously allowed losses when the amount at risk is reduced below zero.

Mechanically, this rule works by providing that, if the amount at risk is reduced below zero (by distributions to the taxpayer, by changes in the status of indebtedness from recourse to nonrecourse, by the commencement of a guarantee or other similar arrangement which affects the taxpayer's risk of loss, or otherwise), the taxpayer will recognize income to the extent that his at risk basis is reduced below zero. However, the amount recaptured is limited to the excess of the losses previously allowed in that activity over any amounts previously recaptured. A suspended deduction in the amount equal to the amount of recaptured income would be provided to the taxpayer. This suspended deduction would be allowed in a subsequent year if and to the extent the taxpayer's at risk basis is increased.

Effective date

The amendments made to the at risk rule generally apply to taxable years beginning after December 31, 1978. Thus, activities and transactions entered into prior to such taxable years may be subject to the expanded at risk rule even though they were not subject to section 465 as in effect prior to taxable years beginning after December 31, 1978.

B. Partnership provisions (secs. 211 and 212 of the bill and secs. 6501, 6511 and 6698 of the Code)

Present law

For income tax purposes, partnerships are not taxable entities. Instead, a partnership is a conduit, in which the items of partnership income, deduction and credit are allocated among the partners for inclusion in their respective income tax returns.

Partnerships are required to file an annual information return setting forth the partnership income, deductions and credits, names and addresses of the partners, each partner's distributive share of partnership income, deduction and credit, and certain other information required by the regulations. Neither the partnership nor any partner is subject to a civil penalty for failure to file, or for late filing of, a partnership information return.

The Code provides a period of limitations during which the Service can assess a tax or a taxpayer may file a claim for refund. Generally, the period is 3 years from the date the tax return is filed. In the case of a partnership, the income tax return of each of the partners begins that the period is 3 years from the date the tax return is filed (if filed before the due date, the due date is treated as the date filed). In the case of a partnership, the income tax return of each of the partners begins that individual partner's period of limitations. The date of filing of the partnership return does not affect the period of limitations. In order to extend the period of limitations with respect to partnership items, the Service must obtain a consent for extension of the statute of limitations from each of the partners—not the partnership. Generally, an agreement to extend the period of limitations relates to all items on the returns of the partner who consents to the extension.

Explanation of provisions

Penalty for failure to file partnership return

The bill enacts a new provision that imposes a civil penalty on the partnership for failure to timely file a complete partnership information return as required by existing Code sections.

The penalty is assessed for each month, or fraction of a month (but not to exceed 5 months), that the partnership return is late or incomplete. The amount of penalty for each month, or fraction of a month, is $50 multiplied by the total number of partners in the partnership during the partnership's taxable year for which the return is due. The penalty will not be imposed if the partnership can show that failure to file a complete or timely return is due to reasonable cause.

Extension of statute of limitations

The bill extends the period of time in which assessments of deficiencies and claims for refund of tax attributable to "partnership items" may be made. These special periods of limitation apply only to partnership items which are attributable to "federally registered partnerships".

With respect to deficiencies, the bill provides generally that the Service may assess a deficiency attributable to partnership items within 4 years after the partnership return for the partnership taxable year in which the item arose is filed. If the partnership return does not properly show the name and address of the person to be assessed the deficiency, the period of assessment will not expire until 1 year after that information is provided to the Service in the manner prescribed by regulations.

With respect to credits and refunds, the bill provides generally that the taxpayer may file a claim for credit or refund of tax attributable to partnership items within 4 years after the due date (including extensions) of the partnership return for the partnership taxable year in which the item arose. If the taxpayer has entered into an agreement with the Service to extend the period of time for assessing a deficiency attributable to partnership items, a claim for credit or refund of tax attributable to partnership items may be filed within 6 months after the expiration of the extension of time for assessment.

Federally registered partnership

The special period of limitations applies only to partnership items flowing from "federally registered partnerships." A federally registered partnership means any partnership the interests in which have been offered for sale prior to the close of the taxable year in an offering required to be registered with the Securities and Exchange Commission, or any partnership which is or has been subject to the annual reporting requirements of the Securities and Exchange Commission. If a partnership is excused from registration or reporting by either a statutory or a regulatory exemption of the SEC, it is not to be treated as a federally registered partnership.

Extension by agreement

Any general partner of the partnership in which the partnership item arose, or any other person authorized by the partnership in writing, may consent to extend the 4-year period of limitation for all partners. The partnership may restrict the authority of any (or all) general partner(s) to execute such a consent by notifying the Secretary of the Treasury in writing in the manner prescribed by regulations.

Effective date

The penalty provision of this bill is effective for returns for taxable years beginning after December 31, 1978.

The statute of limitation provision of this bill is effective for items arising in partnership taxable years beginning after December 31, 1978.

Title III—Business Tax Reductions and Extensions

A. Corporate rate reductions (sec. 301 of the bill and sec. 11 of the Code)

Present law

Under present law, corporate income is subject to a normal tax of 20 percent on the first $25,000 of taxable income and 22 percent on taxable income in excess of $25,000. In addition, a surtax of 26 percent is imposed on corporate taxable income in excess of $50,000. This rate structure was enacted temporarily in the Tax Reduction Act of 1975 and has been extended through the end of 1978 in subsequent legislation.

For taxable years ending after December 31, 1978, the normal tax will be 22 percent on all corporate taxable income. In addition, the 26 percent surtax will be imposed on all taxable income in excess of $25,000. Thus, for taxable years ending after December 31, 1978, corporations will pay corporate income tax of 22 percent on the first $25,000 of taxable income and 48 percent on taxable income in excess of $25,000.

Explanation of provision

The committee bill repeals the present normal tax and surtax and in their place imposes a five-step tax rate structure on corporate taxable income. Under the committee bill, the following tax rate structure will be applicable after December 31, 1978:

[In percent]

Taxable income	Tax rate under H.R. 13511	Tax rate under present law
0 to $25,000	17	20
$25,000 to $50,000	20	22
$50,000 to $75,000	30	48
$75,000 to $100,000	40	48
Over $100,000	46	48

The bill continues the special rules for the tax treatment of mutual savings banks conducting a life insurance business, insurance companies, mutual funds (regulated investment companies), and real estate investment trusts.

Effective date

The provisions are effective for taxable years beginning after December 31, 1978.

The bill specifically applies the rules for rate changes of fiscal year corporate taxpayers to allow these corporations the benefits of the new corporate rates for that part of their 1978–1979 fiscal year which falls in 1979.

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B. Permanent increase and revisions in investment tax credit

1. Permanent extension of 10-percent credit and $100,000 limitation on used property (sec. 311 of the bill, secs. 46(a)(2) and 48(c) of the Code)

Present law

Present law provides a credit against income tax liability for a taxpayer's investment in certain types of depreciable business assets. The investment credit rate is presently 10 percent of qualified investment. This rate was temporarily increased from 7 percent to 10 percent under the Tax Reduction Act of 1975 and is presently scheduled to return to 7 percent (4 percent for certain public utility property) in 1981.

Present law also limits the availability of the credit for investment in qualified used property to $100,000 per year for any taxpayer. This limitation was temporarily increased from $50,000 to $100,000 under the Tax Reduction Act of 1975 and is scheduled to return to $50,000 in 1981.

Explanation of provision

Under the bill, the temporary investment credit rate of 10 percent for all taxpayers is made permanent. The present temporary $100,000 annual limitation on used property eligible for the credit, which is scheduled to return to $50,000 in 1981, is also made permanent. The bill does not extend the provisions for an additional investment credit when employers contribute to employee stock ownership plans (ESOP's).

Effective date

These amendments will become effective on January 1, 1981, when the temporary extensions are scheduled to expire.

2. Increase in limitation to 90 percent of tax liability (sec. 312 of the bill and sec. 46(a) of the Code)

Present law

Generally, the amount of the investment credit a taxpayer may apply against his tax liability in any one year cannot exceed the first $25,000 of tax liability plus 50 percent of the tax liability in excess of $25,000. Special limitations have been provided for public utility property, under which the 50 percent limit was increased to 100 percent for 1975 and 1976, was 90 percent for 1977, and declines by 10 percentage points in each succeeding year until it returns to the generally applicable 50-percent limit in 1981. Similar increases in the tax liability limitation are available (under the Tax Reform Act of 1976) to railroads and airlines for their investment in transportation property, each of which are allowed to apply their investment credits against 100 percent of tax liability for 1977 and 1978, and the limitation is reduced by 10 percentage points in each subsequent year until it returns to 50 percent in 1983.

Generally investment credits which are not, because of the tax liability limitation, used in the year earned may be carried back to the preceding three taxable years and carried over to the seven following taxable years. Credits which are not used during these carryback and carryover periods expire, and the taxpayer no longer obtains tax benefits from the credits.

Explanation of provision

The bill increases the present 50-percent tax liability limitation to 90 percent, to be phased in at an additional 10 percentage points per year beginning with taxable years which end in 1979. As a result, the limitation will be 60 percent for taxable years ending in 1979, 70 percent for 1980, 80 percent for 1981, and 90 percent for 1982 and subsequent years.

Special rules are also provided for railroads, airlines, and certain utilities so that the phase-in of this increased limitation does not reduce the amounts of investment credits these taxpayers may use under the special increased limitations made available to them by present law.

Effective date

These amendments are effective for taxable years ending after December 31, 1978.

3. Increased credit for pollution control facilities (sec. 313 of the bill and sec. 46(c) of the Code)

Present law

In the case of pollution control facilities for which five-year amortization has been elected, the investment credit is allowed for only one-half of the investment which is eligible for this special amortization.

Explanation of provision

The bill relaxes the restriction in present law limiting the amount of investment credit available for pollution control facilities which a taxpayer has elected to amortize over a five-year period. Under the bill, the full investment credit will generally be allowed on pollution-control facilities which are amortized over 5 years and which have actual useful lives of at least 5 years. (Pollution control facilities which have useful lives of 3 or 4 years will continue to be subject to the present law rule which, in effect, limits the credit to one-third of the full credit.)

A limitation is provided where five-year amortization is elected and the pollution control facility has also been financed in whole or in part by tax-exempt industrial development bonds. In this case, the bill limits the amount of credit to, in effect, one-half of the full credit to the extent the property has been financed by industrial development bonds.

Effective date

This amendment applies to pollution control facilities acquired or constructed after December 31, 1978.

4. Extenson of credit to rehabilitation expenditures for certain existing structures (sec. 314 of the bill and sec. 48 of the Code)

Present law

Eligible property for purposes of the investment tax credit includes tangible personal property (such as machinery and equipment) which is used in a trade or business or for the production of income. The investment credit is also allowed for other tangible property which is used in manufacturing, production, extraction, or as integral part of furnishing transportation, communications, or electrical, gas, or other utility services, even though such tangible property may otherwise be considered real (and not personal) property under local law. Buildings and their structural components are not eligible for the credit nor are expenditures for the purpose of rehabilitating or renovating existing buildings or structures.

Explanation of provision

The bill extends the investment credit to rehabilitation expenditures incurred in connection with existing buildings used in all types of business or productive activities except buildings, such as apartments, which are used for residential purposes. Eligible buildings would include factories, warehouses, office buildings, hotels,[1] and retail and wholesale stores. The type of building would be determined on the basis of its use when placed in service after rehabilitation, e.g., an apartment building rehabilitated for use as an office building would be treated as an eligible office building.

In order to qualify as a rehabilitation expenditure, the expenditure must be incurred after July 26, 1978, in connection with the rehabilitation or reconstruction of a building which has been in use for a period of at least 5 years before the commencement of the rehabilitation. In addition, the expenditure must be for property with a useful life of 5 years or more.

For purposes of this provision, the rehabilitation of a building will include the renovation, restoration, and reconstruction of an existing building. Thus, interior or exterior renovation restoration to materially extend the useful life of the building, to signifiantly upgrade its usefulness, or to preserve it will normally qualify. Capital expenditures for the replacement of plumbing, electrical wiring, flooring, permanent interior partitions and walls, and the heating or air conditioning systems (including temperature control systems) could qualify as qualified rehabilitation expenditures when incurred in connection with a rehabilitation.

Effective date

These amendments will be effective for taxable years ending after July 26, 1978, with respect to qualifying rehabilitation expenditures incurred after that date. The amendment relating to certified historic structures applies to property placed in service after July 26, 1978.

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[1] Buildings used for lodging will not generally be eligible (sec. 48(a) (3)). However, the exception for lodging facilities would not apply to hotels and motels where the predominant portion of the accommodations is used by transients.

C. Targeted jobs tax credit (sec. 314 of the bill and secs. 51, 52, and 53 of the Code)

Present law

The Tax Reduction and Simplification Act of 1977 provided a new jobs tax credit for 1977 and 1978. The credit is 50 percent of the increase in each employer's wage base under the Federal Unemployment Tax Act (FUTA) above 102 percent of that wage base in the previous year. The FUTA base for 1977 consisted of wages paid of up to $4,200 per employee.[1] The employer's deduction for wages is reduced by the amount of the credit. Therefore, although the maximum gross credit for each new employee is $2,100, the effective per employee credit ranges from $1,806 (for a taxpayer in the 14-percent tax bracket) to $630 (for taxpayer in the 70 percent bracket).

The total amount of the credit has four limitations: (1) the credit cannot be more than 50 percent of the increase in total wages paid by the employer for the year above 105 percent of total wages paid bv the employer in the previous year, (2) the credit must be no more than 25 percent of the current year's FUTA wages, (3) the credit for a year cannot exceed $100,000, and (4) the credit cannot exceed the taxpayer's tax liability. Credits which exceed tax liability for a year may be carried back for 3 years and carried forward for 7 years.

Present law (adopted in the 1977 Act) also provides an additional nonincremental credit equal to 10 percent of the first $4,200 of FUTA wages paid to handicapped individuals (including handicapped veterans) who receive vocational rehabilitation. The credit for handicapped workers cannot be greater than one-fifth of the regular 50-percent new jobs credit which would have been allowable without regard to the $100,000 limitation. However, the special 10-percent credit is not itself subject to any specific dollar limitation.

Separate provisions included in present law are the work incentive (WIN) credit and the associated welfare recipient tax credit. Under these provisions, employers can receive a tax credit equal to 20 percent of the wages paid during the first 12 months of employment to individuals who have received AFDC for at least 90 days or who are placed in employment under the WIN program. The amount of the credit available to any employer is limited to $50,000 of tax liability plus one-half of tax liability in excess of $50,000. Under both credits, wages and benefits must be no less than wages and benefits paid to other employees of the employer for similar jobs, the employee for whose wages the credit is taken must not displace any individual from employment, and the employee must not be a close relative, dependent or major stockholder of the employer. The welfare recipient credit expires January 1, 1980.

[1] For 1978, the FUTA wage base went up to $6,000. In order to make the 1978 wage base comparable with 1977 for purposes of the jobs credit, present law requires that only the first $4,200 of the FUTA wage base for each employee be included in the computation.

Explanation of provision

General rules

The bill amends the provisions of the new jobs credit so that a credit is allowed only for hiring members of seven target groups. The credit allowed in any taxable year is equal to 50 percent of wages attributable to the first year of trade or business employment, and 16⅔ percent of wages attributable to the second year of trade or business employment.

No more than $6,000 of wages during either the first or second year of employment may be taken into account with respect to any individual. Thus, the maximum credit per individual is $3,000 in the first year of employment and $1,000 in the second year of employment. However, because the deduction for wages is reduced by the amount of the credit, hiring a member of a target group who earns $6,000 causes a reduction in the employer's taxes which ranges from $900 (for an employer in the 70-percent bracket) to $2,580 (for an employer in the 14-percent bracket).

Target groups

Under the bill, the seven target groups are as follows:

(*1*) *WIN registrants.*—WIN registrants are those who have been placed in employment under a work incentive program established under section 432(b)(1) of the Social Security Act. This is the same group of individuals covered by the current WIN credit, which the bill terminates for taxable years ending after December 31, 1978. The bill also terminates the welfare recipient credit. AFDC recipients will be eligible employees only if they are placed in employment under the WIN program.

(*2*) *Vocational rehabilitation referrals.*—Vocational rehabilitation referrals are those individuals who have a physical or mental disability which constitutes a substantial handicap to employment and who have been referred to the employer while receiving, or after completing, vocational rehabilitation services under an individualized, written rehabilitation plan under a state plan approved under the Rehabilitation Act of 1973, or under a rehabilitation plan for veterans carried out under chapter 31 of title 38, U.S. Code.

(*3*) *Food Stamp Youths.*—Food stamp youths are individuals who are at least 18 (or if a high school or vocational school graduate, at least 16) but not age 25, on the date they are hired by the employer, and who are members of a household receiving food stamps within the 60-day period ending on the hiring date.

(*4*) *Food stamp Vietnam veteran.*—The fourth target group consists of Vietnam veterans who are members of households receiving food stamps within the 60-day period ending on the date the individual is hired by the employer. For purposes of the bill, a Vietnam veteran is an individual who has served on active duty in the Armed Forces (other than for training) more than 180 consecutive days, or has been discharged or released from active duty (whether for training or otherwise) in the Armed Forces for a service-connected disability, but in either case the active duty must have taken place after August 4, 1964, and before May 8, 1975.

(*5*) *SSI recipients.*—SSI recipients are those receiving either Supplemental Security Income under Title XVI of the Social Security Act or State supplements described in section 1616 of that Act or section 212 of P.L. 93-66. To be an eligible employee, the individual must have received SSI payments during a month ending during the 60-day period which ends on the date the individual is hired by the employer.

(6) *General assistance recipients.*—General assistance recipients are individuals who receive general assistance for a period of not less than 30 days if this period ends within the 60-day period ending on the date the individual is hired by the employer. A recipient will be an eligible employee only after the program has been designated by the Secretary of the Treasury, after consultation with the Secretary of Health, Education, and Welfare, as a general assistance program which provides cash payments to needy individuals.

(7) *Cooperative education students.*—The seventh target group consists of youth who actively participate in qualified cooperative education programs, who have attained age 16 but who have not attained age 19, and who have not graduated from high school or vocational school.

In the case of individuals in this group, wages paid or incurred by the employer are taken into account only if the school certifies that the wages are attributable to services performed while the individual is enrolled in and actively pursuing the qualified cooperative education program and while the individual is age 16 through 18 and not a vocational or high school graduate.

Limitation on amount of qualified wages

To prevent the hiring of targeted employees from displacing a substantial number of non-targeted employees, the bill provides that qualified first-year wages during a taxable year cannot exceed 30 percent of aggregate FUTA wages for all employees during the calendar year ending in that taxable year. FUTA wages are the first $6,000 of wages per employee per calendar year.

Special rules are provided for certain agricultural and railroad employers not covered by FUTA. These rules are similar to those currently in effect for the new jobs credit and allow these employers to use their records under the social security tax (FICA) and the Railroad Unemployment Insurance Act (RUIA), respectively.

Application of new jobs credit rules

The bill retains several provisions of the current new jobs credit which are relevant to the targeted jobs credit. Thus, all employees of all companies that are members of a group of companies under common control are to be treated as if they were employees of the same employer for purposes of determining the years of employment, of employee wages for any employee up to $6,000, and the 30 percent FUTA cap.

The targeted jobs credit is nonrefundable; that is, the amount of the credit may not exceed the taxpayer's income tax liability. If, after applying all other nonrefundable credits, a person's remaining tax liability for a year is less than the targeted jobs credit, the excess credit can be carried back 3 years and carried forward 7 years, beginning with the earliest year.

Effective date

The provision is effective for taxable years beginning after December 31, 1978.

D. Small issues exception to industrial development bond tax treatment (sec. 321 of the bill and sec. 103(b) of the code)

Present law

Under present law, interest on State and local government obligations generally is exempt from Federal income taxation. However, interest on State and local government issues of industrial development bonds is taxable, with certain exceptions. A State or local government obligation is an industrial development bond if (1) all or a major portion of the proceeds of the issue are to be used in a trade or business (unless carried on by a governmental unit or by certain tax-exempt organizations) and (2) payment of principal or interest is secured by an interest in, or derived from payments with respect to, property used in such trade or business.

An exception to the general rule of taxability of interest on industrial development bonds is provided for certain small issues. This exception applies to issues in amounts of $1 million or less, if the proceeds are used for the acquisition, construction, or improvement of land or depreciable property. At the election of the issuer, the $1 million limitation can be increased to $5 million. If this election is made, the exception is restricted to projects where the capital expenditures and the total of a series of small issues over a six-year period do not exceed $5 million.

Explanation of provision

The bill increases from $5 million to $10 million the amount of the limitation on the size of the small issue election for tax-exempt industrial development bonds. The bill does not increase the size of the regular $1 million limitation nor does the bill change the existing capital expenditures and serial issues limitations of the small issues election.

Effective date

The provision is effective for bonds issued after December 31, 1978, in taxable years ending after that date.

E. Five-year amortization for low-income rental housing (sec. 322 of the bill and sec. 167(k) of the Code)

Present law

Under the Code, special depreciation rules are provided for expenditures to rehabilitate low-income rental housing. Low-income rental housing includes buildings or other structures that are used to provide living accommodations for families and individuals of low or moderate income. Occupants of a dwelling unit are considered families and individuals of low or moderate income only if their income does not exceed certain limits, as determined by the Secretary of Treasury in a manner consistent with the limits established for the Leased Housing Program under section 8 of the United States Housing Act of 1937, as amended.

Under the special depreciation rules for low-income rental property, taxpayers can elect to compute depreciation on certain rehabilitation expenditures under a straight-line method over a period of 60 months, if the additions or improvements have a useful life of 5 years or more. Under present law, only the aggregate rehabilitation expenditures for any housing which do not exceed $20,000 per dwelling unit qualify for the 60-month depreciation. In addition, for the 60-month depreciation to be available, the sum of the rehabilitation expenditures for 2 consecutive taxable years—including the taxable year—must exceed $3,000 per dwelling unit.

Explanation of provision

The bill provides a three-year extension of the special 5-year depreciation rule for expenditures to rehabiliate low-income rental housing.

Effective date

The three-year extension applies to expenditures paid or incurred with respect to low- and moderate-income rental housing after December 31, 1978, and before January 1, 1982 (including expenditures made pursuant to a binding contract entered into before January 1, 1982).

F. Small business tax revisions

1. Small business corporations (subchapter S)

a. Subchapter S corporation allowed 15 shareholders (sec. 331 of the bill and sec. 1371 of the Code)

Present law

The subchapter S rules allow corporations engaged in active trades or businesses to elect to be treated for income tax purposes in a manner similar to that accorded partnerships. Where an eligible corporation elects under the subchapter S provisions, the income or loss (except for certain capital gains) is not taxed to the corporation, but each shareholder reports a share of the corporation's income or loss each year in proportion to his share of the corporation's total stock. Once made, the election continues in effect for the taxable year and subsequent years until it is terminated.

In order to be eligible for a subchapter S election, the corporation generally must have 10 or fewer shareholders. After a corporation has been an electing subchapter S corporation for 5 consecutive taxable years, it may increase its number of qualifying shareholders to 15. In addition, the number of shareholders may exceed 10 (but not 15) where the additional shareholders acquire their stock through inheritance.

Explanation of provision

Under the bill, the number of shareholders permitted in order for a corporation to qualify for and maintain subchapter S status is increased from 10 to 15.

Effective date

The provision applies to taxable years beginning after December 31, 1978.

b. Permitted shareholders of subchapter S corporation (sec. 332 of the bill and sec. 1371 of the Code)

Present law

For purposes of determining the maximum number of shareholders a corporation may have in order to be eligible for a subchapter S election, present law provides that stock which is community property of a husband and wife (or the income from which is community property income) under the law of a community property State will be treated as owned by one shareholder. Similarly, a husband and wife are treated as one shareholder where they own the stock as joint tenants, tenants in common, or tenants by the entirely.

Also, a surviving spouse and the estate of a deceased spouse (or the estates of both deceased spouses) are treated as one shareholder where the husband and wife were treated as one shareholder at the time of the death of the deceased spouse.

Explanation of provision

Under the provision, a husband and wife (and the estates of the husband and the wife) are to be treated as one shareholder for purposes of determining the number of shareholders in a corporation in order to determine if it is eligible to qualify as an electing small business corporation.

Effective date

The provision applies to taxable years beginning after December 31, 1978.

c. Extension of period for making subchapter S elections (sec. 333 of the bill and sec. 1372(c) of the Code)

Present law

Present law requires that in order for a subchapter S election to be effective for a taxable year, it must be filed during a 2-month period which begins 1 month before the start of the taxable year. (For example, if a calendar year corporation wishes to elect subchapter S effective for 1978, the election must be filed during December of 1977 or January of 1978.) An election is not valid for either the intended year or any future year if it is not filed within this period. Extensions of time for filing the election are not granted. If an election is found to be untimely upon audit several years later, the corporation is taxed as a regular corporation for all the intervening years.

Explanation of provision

Under the bill, the period of time to make the subchapter S election is expanded to include the entire preceding taxable year of the corporation. In addition, the bill will permit all corporations to make the election during the first 75 days of the taxable year for which the election is effective.

Effective date

This amendment is effective for subchapter S elections made for taxable years beginning after December 31, 1978.

2. Small business corporation stock (sec. 335 of the bill and sec. 1244 of the Code)

Present law

Under present law, individuals may deduct capital losses against up to $3,000 of ordinary income each year, and long-term capital losses must be reduced by 50 percent when they are deducted against ordinary income. Ordinary losses may be deducted in full against ordinary income. Ordinary loss treatment, rather than capital loss treatment, is provided in certain cases for small business corporation stock which is disposed of at a loss. This special treatment is accorded only to individual shareholders (not trusts or estates) to whom the stock was originally issued.

The maximum amount of ordinary loss from the disposition of section 1244 stock that may be claimed in any taxable year is limited to $25,000, except for married taxpayers filing joint returns, in which case ordinary loss treatment is limited to $50,000. Any loss in excess of the applicable annual limitation is treated as a capital loss.

For stock to qualify as section 1244 stock, eight requirements must be met: (1) the stock must be common stock; (2) the corporation issuing the stock must adopt a written plan under which the stock will be issued, and the stock may be offered for sale only during the two-year period beginning with the date of plan adoption; (3) the corporation issuing the stock must be a domestic corporation; (4) the amount of section 1244 stock issued by the corporation may not exceed $500,000, and the total stock issued plus the equity capital of the corporation may not exceed $1,000,000; (5) no prior offering of stock of the corporation or any portion of a prior offering of stock may be unissued; (6) the stock must be issued for money or other property, subject to certain exceptions; (7) more than 50 percent of the gross receipts of the corporation must be derived from the active conduct of a trade or business during the corporation's existence or for its five most recent taxable years prior to the taxable year during which the loss is incurred, whichever period is less; and (8) no subsequent offering of stock, simultaneous with or subsequent to the adoption of a plan to issue section 1244 stock may be made.

Explanation of provision

In general, the bill would increase the amount of section 1244 stock that a qualified small business corporation could issue, repeal the equity capital limitation, increase the amount of loss that certain shareholders may treat as an ordinary loss rather than as a capital loss, and repeal the requirement of a written plan to issue the stock.

The bill increases the amount of section 1244 stock that a qualified small business corporation may issue from $500,000 to $1,000,000.

Under present law, a domestic corporation is not treated as a small business corporation for purposes of section 1244 if the aggregate dollar amount to be paid for its stock plus the equity capital less the amount of indebtedness to persons other than shareholders exceeds $1,000,000. The bill repeals the equity capital limitation. Thus, after the date of enactment of this bill, a corporation, assuming other requirements are met, may issue additional common stock under the provisions of section 1244 without regard to the amount of its equity capital.

The bill increases the maximum amount an individual may treat as an ordinary loss on section 1244 stock for any taxable year. Under the provisions of the bill, the maximum amount that may be treated as an ordinary loss is increased to $50,000 ($100,000 for a joint return).

The bill repeals the present law requirement that a written plan to issue section 1244 stock must be adopted by the issuing corporation. Additionally, the present law requirement that provides that no prior offering of stock of the corporation or any portion of a prior offering of stock may be unissued at the time a written plan is adopted is also repealed. The bill provides that a corporation may issue common stock under the provisions of section 1244 without adopting a written plan but that only the first $1,000,000 worth of common stock may qualify as section 1244 stock.

Effective date

This provision is to apply to common stock issued after the date of enactment of this Act.

3. Depreciation for small business (sec. 336 of the bill and sec. 179 of the Code)

Present law

Under present law, a deduction is allowed for additional first-year depreciation of assets used in a trade or business in an amount not exceeding 20 percent of the cost of eligible property. In general, depreciable property placed in service during a taxable year is eligible under the provision if it is tangible personal property with a useful life of 6 years or more. The cost of the property which may be taken into account may not exceed $10,000 ($20,000 for individuals who file a joint return). Thus, the maximum additional first-year depreciation deduction is limited to $2,000 ($4,000 for individuals filing a joint return).

Explanation of provision

The bill increases the allowable additional first-year depreciation percentage from 20 percent to 25 percent and increases the dollar limitation on eligible property from $10,000 ($20,000 for individuals filing joint returns) to $20,000 ($40,000 for individuals filing joint returns). These changes have the effect of increasing the maximum deduction for additional first-year depreciation from $2,000 ($4,000 in the case of individuals filing joint returns) to $5,000 ($10,000 in the case of individuals filing joint returns).

The bill limits the benefits to small businesses by providing that additional first-year depreciation is to be available only for taxpayers with depreciable assets whose adjusted basis as of the beginning of the taxable year is less than $1 million. For purposes of this $1 million limitation, a controlled group of corporations is treated as one taxpayer.

Effective date

This provision applies to taxable years beginning after December 31, 1978.

4. Accrual accounting for farming corporations (sec. 341 of the bill and sec. 447 of the Code)

Present law

In general

Under present law, most taxpayers who are in the business of selling nonfarm products are required to report gross income using an accrual method of accounting and to accumulate their production costs in inventory until the products are sold. However, taxpayers engaged in farming have been allowed to report income and expenses from farm operations on the cash method of accounting, which does not require the accumulation of inventory costs. In addition, farmers have been permitted to deduct currently many of the costs of raising farm assets (such as costs related to breeding animals, orchards, and vineyards) which are used in the trade or business of farming. (In nonfarming businesses, such as manufacturing, similar costs generally are treated as capital expenditures and are depreciated over the useful lives of the assets acquired.) These special farming tax rules are still generally applicable to most farmers, although some restrictions were imposed on certain farming corporations and farming syndicates by the Tax Reform Act of 1976.

Tax Reform Act of 1976

With certain exceptions, the Tax Reform Act of 1976 required corporations (and partnerships in which non-excepted corporations are partners) engaged in farming to use an accrual method of accounting and to capitalize preproductive period expenses. However, subchapter S corporations, family corporations (in which one family owns at least 50 percent of the stock), corporations with annual gross receipts of $1 million or less, and nurseries are not required to use the accrual method of accounting or to capitalize preproductive period expenses.

The 1976 Act provisions generally are effective for taxable years beginning after December 31, 1976. However the Tax Reduction and Simplification Act of 1977 postponed the effective date of the required accural accounting provision until taxable years beginning after December 31, 1977, for any farm corporation if, as of October 4, 1976 (the date of enactment of the 1976 Act), either (a) two families owned at least 65 percent of the stock; or (b) three families owned at least 50 percent of the stock and substantially all of the rest of the stock was owned by employees, their families, or exempt pension, etc., trusts for the benefit of the employees.

Explanation of provision

The bill provides exceptions to the required accrual accounting and capitalization of preproductive period expenses rules for certain corporations which are controlled by two or three families. Under these exceptions, the provisions requiring accrual accounting and the capitalization of preproductive period expenses will not apply to any farm corporation if, as of October 4, 1976, and at all times thereafter, either (1) two families own (directly or through attribution) at least 65 percent of the total combined voting power of all classes of stock of the corporation entitled to vote and at least 65 percent of the total number of shares of all other classes of stock of the corporation, or (2) (a) members of three families own (directly or through attribution) at least 50 percent of the total combined voting power of all classes of stock entitled to vote and at least 50 percent of the total number of shares of all other classes of stock and (b) substantially all of the remaining stock is owned by the corporation employees or by their family members) or by a tax-exempt employees' trust for the benefit of the corporation's employees.

The bill also provides that, with respect to corporations described in the preceding paragraph, stock acquired after October 4, 1976, by the corporation's employees, their families, or a tax-exempt trust for their benefit will be treated as owned by one of the two or three families whose combined stock ownership was used to establish the initial qualification for this provision (as of October 4, 1976). The provision requires that corporations must have been engaged in the trade or business of farming on October 4, 1976, and at all times thereafter, to qualify for this exception.

Effective date

The provision applies to taxable years beginning after December 31, 1977.

5. Accounting for costs of growing crops (sec. 342 of the bill)

Present law

In general, prior to 1976, farmers, nurserymen, and florists were not required to inventory growing crops regardless of the method of accounting they used for income tax purposes. However, in 1976 the Internal Revenue Service reversed its long standing positions and ruled that an accrual method taxpayer engaged in farming is required to inventory growing crops. This ruling also provided that nurserymen using an accrual method of accounting must inventory growing trees and that florists using an accrual method of accounting must inventory growing plants. In each case an exception was provided for taxpayers who use the crop method of accounting. The changes made by this ruling are to be applied only to taxable years beginning on or after January 1, 1978.

On July 18, 1978, the Service announced that farmers, nurserymen and florists who have been using an accrual method of accounting without inventorying growing crops and who relied on the Service's former position would be allowed to change their method of accounting to the cash receipts and disbursements method of accounting, which does not require the accumulation of costs in inventory.

With certain exceptions, the Tax Reform Act of 1976 required corporations and partnerships (in which non-excepted corporations are partners) engaged in farming to use the accrual method of accounting and to capitalize preproductive period expenses. However, subchapter S corporations, family corporations (in which one family owns at least 50 percent of the stock), corporations with annual gross receipts of $1 million or less, and nurseries are not required to use the accrual method of accounting or to capitalize preproductive period expenses. In general, the requirement that preproductive period expenses be capitalized would have the effect of requiring taxpayers to inventory (or capitalize) the costs of growing crops.

The 1976 Act provisions generally are effective for taxable years beginning after December 31, 1976.

Explanation of provision

This provision permits a farmer, nurseryman, or florist who is on an accrual method of accounting and is not required by section 447 of the Code to capitalize preproductive period expenses to be exempt from the requirement of Rev. Rul. 76-242 that growing crops be inventoried. This is intended to allow taxpayers who have been using an accrual method of accounting without inventorying crops under the prior Service position to continue to do so.

This provision also allows those farmers, nurserymen, or florists who are eligible to use an accrual method of accounting without inventorying growing crops to elect, without the prior approval of the Internal Revenue Service, to change to the cash receipts and disbursements method of accounting with respect to any trade or business in which the principal activity is growing crops.

Effective date

This provision generally applies to taxable years beginning after December 31, 1977. However, the rules permitting a taxpayer to change to the cash method of accounting apply only with respect to taxable years beginning after December 31, 1977, and before January 1, 1981.

Title IV—Capital Gains Provisions

A. Reduction in maximum capital gains tax rate (secs. 401 and 402 of the bill and secs. 57, 1201, and 1348 of the Code)

Present law

Noncorporate taxpayers

Under present law, a noncorporate taxpayer generally deducts from gross income 50 percent of the amount of any net capital gain for the taxable year. The remaining 50 percent of the net capital gain is includible in gross income and taxed at the regular tax rates. This can lead to a capital gains tax rate of up to 35 percent, *i.e.*, one-half the maximum individual tax rate of 70 percent.

In lieu of taxing 50 percent of long-term capital gains at regular tax rates, an alternative tax applies if it results in a lower tax rate than that produced by the normal method. The alternative tax consists of a 25-percent tax on the first $50,000 of net long-term capital gain. The alternative tax is beneficial only to those noncorporate taxpayers whose income is subject to marginal tax rates exceeding 50 percent. Taxpayers who elect the alternative tax are not eligible for income averaging.

Regardless of the manner in which the tax on capital gains is computed, present law treats one-half of a noncorporate taxpayer's net capital gain as an item of tax preference subject to the 15-percent minimum tax. The minimum tax for individuals equals 15 percent of a taxpayer's tax preferences, reduced by either $10,000 or one-half of regular tax liability, whichever is greater. Also, as an item of tax preference, one-half the net capital gain reduces the amount of personal service income eligible for the 50-percent maximum tax.

Generally, the effect of classifying one-half of a noncorporate taxpayer's capital gains as an item of tax preference is to increase the maximum rate of tax on capital gains to 39.875 percent. This is the sum of the highest applicable rate of regular tax (35 percent), and a 4.875-percent minimum tax (the effective rate of the minimum tax after giving effect to the deduction for one-half of regular taxes).[1] In some isolated cases in which the taxpayer uses the $10,000 exemption instead of the deduction for one-half of regular taxes, the combined minimum and regular tax rates may equal 42.5 percent. If the impact of the 50-percent maximum tax on earned income, under which preferences reduce the amount of income eligible for maximum tax, is taken into account, the highest potential tax rate on capital gains generally is 49.125 percent. This is the sum of a 35-percent regular tax, a tax increase on earned income equal to 10 percent of the capital gain (a tax increase from 50 percent to 70 percent on an amount of earned income equal to one-half the gain), and a 4.125-percent mini-

[1] On a $1 gain, the minimum tax is 15 percent of half the gain (50 cents), reduced by one-half the regular tax on the gain (17½ cents), or 4.875 cents.

mum tax.[2] In certain very unusual circumstances, the rate of tax on a capital gain can be as high as 52.5 percent, *i.e.*, where due to various tax credits the minimum tax exemption is not increased by the regular income tax on the capital gains because the taxpayer uses the $10,000 exemption instead of the deduction for one-half of regular taxes.

Corporate taxpayers

Under present law, the alternative tax on corporate net capital gains is 30 percent. No special deduction for 50 percent of a long-term capital gain is available for corporations as is the case with noncorporate taxpayers. Use of the corporate alternative tax will not be advantageous to a corporation if its gain is subject only to the normal corporate rate under present law (which is less than 30 percent), rather than the combined normal and surtax rate of 48 percent.

Under present law, 18/48ths of a corporation's net long-term capital gain is treated as an item of tax preference subject to the 15-percent minimum tax. For corporations, the minimum tax exemption equals the greater of $10,000 or all of regular tax liability (instead of half as with noncorporate taxpayers). Also, a series of special rules apply to capital gains from timber and reduce the minimum tax on that item of preference.

For corporations the maximum capital gains tax rate is 31.125 percent, consisting of a 30-percent regular tax and a 1.125 percent minimum tax.[3]

Explanation of provisions

Noncorporate taxpayers

The bill eliminates capital gains as an item of tax preference subject to the existing 15-percent minimum tax. As a result, capital gains will no longer reduce the amount of personal service income eligible for the 50-percent maximum tax. The bill, however, does not change the present treatment of other items of tax preference for purposes of either the minimum tax or the maximum tax on personal service income.

In addition, the bill repeals the 25-percent alternative tax on the first $50,000 of a noncorporate taxpayer's net long-term capital gain. As a result of these changes, the maximum capital gains tax rate applicable in the case of noncorporate taxpayers will be 35 percent, *i.e.*, one-half the highest individual tax rate of 70 percent.

Corporate taxpayers

The bill removes a corporation's net long-term capital gain from the classification as an item of tax preference subject to the 15-percent minimum tax.

The present alternative tax for corporate capital gains is not changed by the bill.

Effective date

These provisions are effective for taxable years beginning after December 31, 1978.

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[2] On a $1 gain, the minimum tax is 15 percent of half the gain (50 cents) reduced by one-half the regular tax liability (one-half of 45 cents, or 22½ cents), or 4.125 cents.

[3] The minimum tax on a $1 corporate capital gain is 15 percent of 18/48ths of the gain (37.5 cents) reduced by the regular tax on the gain (30 cents), or 1.125 cents.

B. Alternative minimum tax on capital gains (sec. 403 of the bill and secs. 56–58 of the Code)

Present law

Present law treats one-half of a noncorporate taxpayer's net capital gain as an item of tax preference subject to the 15-percent minimum tax. The minimum tax for individuals equals 15 percent of a taxpayer's tax preferences, reduced by either $10,000 or one-half of regular tax liability, whichever is greater. As an item of tax preference, it reduces the amount of personal service income eligible for the 50-percent maximum tax.

Explanation of provision

The bill removes capital gains as an item of tax preference subject to the existing 15-percent minimum tax. However, the bill provides for the imposition of an alternative minimum tax at a rate of 10 percent on one-half of a noncorporate taxpayer's net capital gains, reduced by a $10,000 exemption, if this amount exceeds the taxpayer's regular tax liability as computed after the application of tax credits. The tax applies to individuals, estates and trusts.

The alternative minimum tax base excludes any capital gains realized on the sale or exchange of an individual's principal residence, regardless of whether the gain is excluded from gross income. However, the property must have been owned and used by the taxpayer as his or her principal residence for periods aggregating 2 years or more during the 3-year period ending on the date of the sale or exchange.

Under the bill, noncorporate taxpayers who realize capital gains would compute their regular tax liability, and compare this amount with that calculated under the alternative minimum tax. These amounts would be compared prior to being increased by the amount, if any, of the existing 15-percent minimum tax. For this purpose, regular tax liability is computed before subtraction of the credit for withheld tax (sec. 31), the credit for refunds of taxes on gasoline, etc. (sec. 39), and the earned income credit (sec. 43), but after the subtraction of other credits.

Where the alternative minimum tax exceeds the regular tax, no credits generally will be allowable against the alternative minimum tax liability. This rule is designed to assure that each taxpayer, in fact, pays some minimum amount of tax with respect to capital gains. However, certain refundable credits will be allowed against the alternative minimum tax (*i.e.*, the credit for withheld taxes, the credit for refunds of gasoline and other fuel taxes, and the earned income credit), because the amounts involved would be available as refunds to the taxpayer in any event.

In addition, for alternative minimum tax purposes, there is no prerequisite that capital gains actually produce a tax benefit for the taxpayer. Thus, unlike the situation with respect to the present minimum tax, there is to be no adjustment of net capital gains subject to the alternative minimum tax where the tax treatment accorded to the gains does not result in a reduction of the taxpayer's tax. Similarly, there is to be no deferral of alternative minimum tax liability in the case of net operating losses, as there is with respect to the present 15 percent minimum tax.

Effective date

This provision is effective for taxable years beginning after December 31, 1978.

C. Indexing of basis of certain capital assets (sec. 404 of the bill and new sec. 1024 of the Code)

Present law

The amount taken into account under present law in computing gain from the sale of exchange of any asset is the sales price of the asset reduced by the taxpayer's basis in that asset. The taxpayer's basis reflects his actual cost in the asset adjusted for depreciation, depletion, and other amounts. However, no adjustment is allowed for inflationary increases in the value of the asset.

Explanation of provisions

In general

The bill provides for an inflation adjustment (or indexing) to the basis of certain assets for purposes of determining gain or loss upon sale in a taxable transaction. The inflation adjustment is based on the increase in the consumer price index in the month the asset is sold over the level of the index of the month of purchase. Assets generally eligible for the indexing adjustment are common stock, tangible personal property and real property where these assets are capital assets or assets used in a trade or business and are held for more than one year. The inflation adjustment applies only to increases in the consumer price index occurring after 1979, regardless of whether the asset was acquired prior to that time.

Assets eligible for the adjustment

The provision applies to a limited category of assets (called "indexed assets"). First, it applies to common stock or stock possessing most of the attributes of common stocks in a corporation. The term common stock does not include options, warrants and other contract rights with respect to stock (and since these contracts constitute intangible property, they are not otherwise eligible for the inflation adjustment).

The second type of indexed property is tangible personal property. The determination of what assets are considered to be tangible personal property for purposes of this provision is to conform with the definition of tangible personal property for purposes of the investment credit.

The third type of indexed property is real property. For this purpose the term "real property" includes land, structures and various mineral interests in real property, but does not include any contract rights with respect to real property which do not themselves constitute real property.

Each of these types of assets is considered to be an indexed asset only where it is held for one year and at the time of sale is a capital asset or property used in a trade or business (under sec. 1231(b)). Thus, ordinary income assets, such as inventory, will not be indexed assets. Similarly, stock held by dealers in securities will not be indexed assets, except where any stock meets the requirements of a security held for investment (under sec. 1236). However, timber, coal and iron ore, plus certain livestock, and unharvested crops, will be indexed assets to the extent they are treated as property used in the trade or business (under sec. 1231).

The bill includes a number of exceptions to these general rules. Stock in subchapter S corporations, foreign corporations, personal holding companies, and collapsible corporations is excluded from eligibility for indexing. In addition, interests in mutual funds (Regulated Investment Companies) and real estate investment trusts are excluded. Also under the bill stock is not treated as an indexed asset for any period during which the owner or his spouse has sold short that stock or substantially similar stock.

Determination of adjusted basis

Under the provision, adjusted basis generally is the taxpayer's basis in an asset immediately prior to the sale as determined under present law. Thus, deductions allowable for depreciation and depletion reduce the amount of basis eligible for the inflation adjustment.

Also, any substantial increases in investments (including substantial improvements) in an indexed asset are treated as separate assets with their own holding periods and basis adjustments. Substantial withdrawals of capital from a corporation which are not treated as a partial sale of the asset are to be treated in a similar manner to substantial improvements.

Determination of inflation ratio

The inflation adjustment is to be computed by multiplying the taxpayer's adjusted basis in the indexed asset by the applicable inflation ratio, determined by the ratio of the level of the Consumer Price Index for All Urban Consumers for the month of sale to the index level for the month of purchase. The amount of basis as adjusted will equal this inflation ratio multiplied by adjusted basis. There will, however, be no downward basis adjustment where the ratio does not exceed one. It is contemplated that the Internal Revenue Service will print in its instructions a table of monthly CPI index numbers beginning with December 1979. Taxpayers can thus look up the CPI for the month of purchase and the month of sale of an indexed asset, divide to determine the applicable inflation ratio, and multiply that result by the adjusted basis of the assets sold.

Effective date

The provision applies to sales and other dispositions taking place after December 31, 1979 in taxable years ending after that date.

D. Exclusion of gain on sale of residences (secs. 405 of the bill and secs. 57, 121, and 1034 of the Code)

Present law

In general

Under present law, the entire amount of gain or loss realized on the sale or exchange of property generally is recognized. However, under a "rollover" provision of the Code, gain is not recognized on the sale or exchange of a taxpayer's principal residence if a new principal residence, at least equal in cost to the adjusted sales price of the old residence, is purchased and used by the taxpayer as his or her principal residence within a period beginning 18 months before, and ending 18 months after, the date of the sale of the old resident. The basis of the new residence then is reduced by the amount of the gain not recognized on the sale of the old residence. When the purchase price of the new residence is less than the adjusted sales price of the old residence, gain is recognized only to the extent that the adjusted sales price of the old residence exceeds the taxpayer's cost of purchasing the new residence.

If, however, an individual realizes gain on the sale or exchange of a residence and fails to satisfy the rollover requirements, then the gain generally is taxable pursuant to the usual rules of the Code to the extent the exclusion for sales of residences by elderly taxpayers does not apply.

Individuals age 65 and over

Under present law, an individual who has attained the age of 65 may elect to exclude from gross income, on a one-time basis, the entire gain realized on the sale of his or her principal residence if the adjusted sales price is $35,000 or less. If the adjusted sales price exceeds $35,000, the amount excludible is that portion of the gain which is determined by multiplying the total gain by a fraction, the numerator of which is $35,000, and the denominator of which is the adjusted sales price of the residence. The exclusion is not available unless the property was owned and used by the taxpayer as his or her principal residence for 5 years or more during the 8-year period preceding the sale.

Explanation of provision

The bill repeals the provision of present law relating to gain realized on the sale of a principal residence by a taxpayer 65 and over. It provides that an individual, regardless of age, may elect to exclude from gross income up to $100,000 ($50,000 in the case of married individuals who file separate returns) of any gain realized on the sale or exchange of his or her principal residence. The exclusion applies only once in a taxpayer's lifetime, and the provisions relating to rollover of gain on the sale of a principal residence would not apply to any sale or exchange of the principal residence with respect to which this election is made. The exclusion applies only with respect to gain realized on the sale or exchange of a residence which the taxpayer has owned and occupied as his or her principal residence for periods aggregating two years out of the three-year period which immediately precedes the sale. The definition of a taxpayer's principal residence is that presently used for the rollover provision.

There is to be only one lifetime election with respect to married taxpayers, i.e., the election does not apply separately to each spouse. If, however, each of two parties have made elections independently prior to becoming married, there is to be no recapture of the taxes attributable to the gain excluded with respect to the sale of one of the residences. If spouses make an election during marriage, and subsequently become divorced, no further elections are available to either of them or to their spouses should they marry.

Effective date

This provision is effective for sales of personal residences after July 26, 1978.

E. Rollover of gain on sale of residence (sec. 406 of the bill and secs. 1034, 1038(e)(1), 1250(d)(7), 6212(c)(2) and 6504 of the Code)

Present law

Under present law, gain realized from the sale of property used by the taxpayer as his or her principal residence ("old residence") generally is not recognized where the taxpayer purchases and uses property as his or her principal residence ("new residence"), within a period beginning 18 months before, and ending 18 months after, the sale. In determining a taxpayer's new residence, where he or she purchases more than one property which is used as a principal residence during the 36-month replacement period, only the last principal resirence used by the taxpayer constitutes a "new residence."

This nonrecognition treatment is available, however, only once during any 18-month period. Thus, where the nonrecognition treatment applied to the sale of a taxpayer's residence, it would not apply again for a period ending 18 months from the date of the sale of the old residence.

Explanation of provision

The bill generally provides for the rollover of gain realized on the sale of more than one principal residence where an individual relocates for employment purposes more than once within a period beginning 18 months from the time that his or her first principal residence is sold. Taxpayers generally will be allowed the benefits of this multiple rollover provision where there was a reasonable expectation at the time of the relocation that the taxpayer would be employed, or remain, at the new location for a substantial period of time.

Thus, where the taxpayer is entitled to deduct moving expenses with respect to a relocation falling within the 18-month period, the multiple rollover provision would be available so as to allow the nonrecognition of gain on the sale of a principal residence occupied by the taxpayer of, in fact, the taxpayer subsequently relocated within the 18-month period for employment purposes and acquired a new principal residence. However, in order to qualify for such treatment, a sale must be in connection with the commencement of work by the taxpayer as an employee or as a self-employed individual at a new principal place of work and the taxpayer must satisfy both the geographic and length of employment requirements for deductibility of moving expenses.

Effective date

This provision is effective for sales and exchanges of personal residences after July 26, 1978.

F. Capital gains study (sec. 407 of the bill)

Present law

Present law generally does not require the Treasury Department to submit reports to the Congress on the effectiveness of specific tax provisions in accomplishing the purposes for which they were enacted. However, the Congress occasionally has required such reports to be submitted by the Treasury Department.

Explanation of provision

The bill requires the Treasury Department to prepare, and submit to Congress a report on the effectiveness of the reductions of both the individual and the corporate capital gains tax rates in stimulating investment and increasing the rate of economic growth. The report also is to include a study of the effects of these reductions on the growth of employment, and on income tax revenues. The report is to be made by September 30, 1981.

III. REVENUE EFFECTS OF THE BILL[1]

Table 1 summarizes the calendar years 1979 through 1983 revenue effect of H.R. 13511, as passed by the House of Representatives. It shows the net tax reduction for individuals, businesses, and for taxpayers with capital gains. The bill provides a net tax reduction in calendar 1979 of $16,332 million, $19,631 million in 1980, and $32,193 million in 1983.

Table 2 summarizes the net revenue effect of the bill on a fiscal year basis. The net tax cuts in the bill will reduce fiscal year 1979 receipts by $9,387 million, fiscal 1980 receipts by $17,864 million, and fiscal 1983 receipts by $29,811 million.

Table 3 shows the revenue effect of H.R. 13511 by provision for calendar years 1979 through 1983.

Table 4 shows the revenue effect of the bill by provision for fiscal years 1979 through 1983.

Table 5 shows the revenue effect by expanded income class (at 1978 income level) of the provisions of H.R. 13511 which affect individuals with the exception of deferred compensation and unemployment compensation provisions as well as the basis adjustment for capital gains and the exclusion of capital gains on the sale of principal residences. This table also shows the distribution of the individual tax reductions as a percent of the total reduction and also as a percent of the present law tax. A total of 64.4 million returns would receive a reduction averaging $161 and 2.6 million returns would experience a tax increase averaging $38. The increases result from a combination of the repeal of certain itemized deductions and of the 2-percent taxable income credit.

Table 5A gives the distribution by expanded income class (at 1978 income level) of the individual tax reductions from widening the tax rate brackets, the tax rate cuts and the increased zero bracket amount. Table 5B shows the distribution of the combination of these same individual tax reductions plus the substitution of a $1,000 personal exemption for the general tax credit.

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[1] The revenue estimates in Tables 1–4 are the tax reductions from levels which would have prevailed had the existing temporary tax cuts been extended. Thus, where the bill merely extends an expiring tax cut, the tables do not show any revenue effect; and where the bill replaces an expiring tax cut with a new provision (such as substituting an increased personal exemption for the expiring general tax credit), the revenue loss from the new provision is only the excess of its gross revenue loss over what the revenue loss would have been had the expiring provision been extended. A revenue gain is shown for failing to extend the general jobs tax credit. Table 6 shows the revenue losses which would have occurred had certain existing temporary tax provisions been extended through 1983, both the provisions actually extended in the bill and the provisions replaced by other provisions.

All estimates assume that current trends in tax data continue unchanged into the future. No "feedback," or change in taxpayer behavior as a result of changes in tax incentives, is included.

Table 6 shows the effect on fiscal year budget receipts of extension of the temporary tax reduction provisions due to expire at the end of 1978 or 1980 under present law. These extensions total $8.2 billion in fiscal year 1979. This does not include the existing general jobs tax credit also scheduled to expire at the end of 1978, the extension of which would reduce receipts by $0.7 billion. Thus, the tax changes in the bill (new tax cuts plus extensions) would reduce receipts in fiscal year 1979 by $18.2 billion ($10.0 billion of new tax cuts plus $8.2 billion of extensions).

Table 7 shows the revenue effect of removing capital gains from the list of minimum tax preferences, repealing the alternative capital gains tax, and establishing an alternative minimum tax on capital gains by expanded income class (at 1978 income levels).

Table 8 shows the tax reduction from excluding capital gains from the sale of principal residences at 1978 income level by expanded income class.

Table 9 shows the long-run tax reduction for individuals at 1978 increase levels from indexing the basis of certain capital assets. This provision is shown in Tables 3 and 4 at amounts which are much smaller than the long-run effect. The long-run revenue effect is calculated assuming that all assets have been purchased after December 31, 1979, and thus receive an inflation adjustment over the entire holding period of the asset. This occurs after approximately 20 years, or about year 2000.

Table 10 shows the individual income tax burden by family size at various assumed levels of income and deductions under present law and under the bill. This table includes only the changes in the personal exemption, zero bracket amount, rate schedules, and repeal of the general tax credit.

Table 1.—Summary of Revenue Effect of H.R. 13511, as Passed by the House, Calendar Years 1979–83 [1]

[In millions of dollars]

Major Category	Calendar year— 1979	1980	1981	1982	1983
Individual Reduction	**−10, 437**	**−11, 980**	**−13, 778**	**−15, 850**	**−18, 255**
Business Reduction	**−4, 033**	**−5, 063**	**−6, 201**	**−6, 560**	**−7, 169**
Capital Gains Reduction	**−1, 862**	**−2, 588**	**−4, 079**	**−5, 344**	**−6, 769**
Individual Reduction	−1, 767	−2, 355	−3, 539	−4, 444	−5, 407
Business Reduction	−95	−233	−540	−900	−1, 362
Total Reduction	**−16, 332**	**−19, 631**	**−24, 058**	**−27, 754**	**−32, 193**

[1] The revenue estimates in Tables 1–4 are the tax reductions from levels which would have prevailed had the existing temporary tax cuts been extended. Thus, where the bill merely extends an expiring tax cut, the tables do not show any revenue effect; and where the bill replaces an expiring tax cut with a new provision (such as substituting an increased personal exemption for the expiring general tax credit), the revenue loss from the new provision is only the excess of its gross revenue loss over what the revenue loss would have been had the expiring provision been extended. A revenue gain is shown for failing to extend the general jobs tax credit. Table 6 shows the revenue losses which would have occurred had certain existing temporary tax provisions been extended through 1983, both the provisions actually extended in the bill and the provisions replaced by other provisions.

All estimates assume that current trends in tax data continue unchanged into the future. No "feedback," or change in taxpayer behavior as a result of changes in tax incentives, is included.

Table 2.—Summary of Revenue Effect of H.R. 13511, as Passed by the House, Fiscal Years 1979–83[1]

[In millions of dollars]

Major Category	Fiscal year— 1979	1980	1981	1982	1983
Individual Reduction	**−6, 959**	**−11, 450**	**−13, 153**	**−15, 136**	**−17, 425**
Business Reduction	**−2, 146**	**−4, 494**	**−5, 587**	**−6, 390**	**−6, 840**
Capital Gains Reduction	**−282**	**−1, 920**	**−2, 722**	**−4, 236**	**−5, 546**
Individual Reduction	−282	−1, 767	−2, 355	−3, 539	−4, 444
Corporate Reduction		−153	−367	−697	−1, 102
Total Reduction	**−9, 387**	**−17, 864**	**−21, 462**	**−25, 762**	**−29, 811**

[1] The estimates take into account a hypothetical revenue gain from failing to extend the general jobs tax credit. For example, in fiscal year 1979, this gain is $689 million. Without this assumed revenue gain, the revenue loss from the nex tax cuts in the bill would be $10,076 million. To determine the overall revenue effect of the bill in fiscal year 1979, this must be added to the revenue loss from extending expiring tax cuts (see table 6) of $8,206 million, for a total of $18,282 million.

Table 3.—Revenue Effect of H.R. 13511 by Provision, Calendar Years 1979–83

[In millions of dollars]

Provision	Calendar 1979	1980	1981	1982	1983
Individual tax reductions and revisions:					
1. 6-percent bracket widening, rate cuts and increased zero bracket amount	−10,584	−12,240	−14,180	−16,453	−19,121
2. Repeal general tax credit	10,397	10,985	11,618	12,302	13,039
$1,000 personal exemption	−11,681	−12,382	−13,125	−13,913	−14,747
3. *Itemized deductions:*					
a. Repeal gasoline tax deduction	1,151	1,358	1,602	1,890	2,231
b. Revise medical expense deduction	40	47	56	66	78
c. Repeal political contributions deduction	6	7	8	10	11
4. Simplification of the earned income credit	−17	−16	−16	−15	−14
5. Tax certain unemployment benefits	251	261	259	263	268
Total, Individual	**−10,437**	**−11,980**	**−13,778**	**−15,850**	**−18,255**
Business tax reductions and revisions:					
1. Cut rate on income over $100,000 from 48 to 46 percent, and Tax income below $100,000 as follows: 0 to $25,000 at 17 percent; $25,000 to $50,000 at 20 percent; $50,000 to $75,000 at 30 percent; and $75,000 to $100,000 at 40 percent	−5,069	−5,551	−6,078	−6,655	−7,288
2. Increase investment credit limitation to 90 percent					

(phase in over 4 years)	−287	−629	−1, 169	−826	−728
10-percent credit for pollution control facilities	−8	−25	−53	−91	−112
10-percent credit for rehabilitation expenditures	−237	−276	−300	−328	−355
3. Repeal general jobs credit	2, 458	2, 458	2, 458	2, 458	2, 458
Targeted jobs credit	−523	−718	−772	−855	−900
4. $10,000,000 limitation on capital expenditure for industrial development bonds	−2	−10	−18	−26	−34
5. Small business provisions	−379	−322	−277	−242	−216
6. Tax shelter provisions	14	10	8	5	6
Total, Business	**−4, 033**	**−5, 063**	**−6, 201**	**−6, 560**	**−7, 169**
Capital gains tax provisions:					
Individual:					
1. Repeal alternative tax	133	143	154	166	178
2. Remove capital gains from preferences	−1, 327	−1, 459	−1, 605	−1, 766	−1, 942
3. Exclude capital gains from sale of a principal residence	−745	−820	−901	−992	−1, 091
4. Alternative minimum tax on capital gains	172	190	209	230	253
5. Index basis of certain capital asset		−409	−1, 396	−2, 082	−2, 805
Corporate:					
6. Remove capital gains from preferences	−95	−104	−114	−125	−137
7. Index basis of certain capital assets		−129	−426	−775	−1, 225
Total, Capital gains	**−1, 862**	**−2, 588**	**−4, 079**	**−5, 344**	**−6, 769**
Grand Total	**−16, 332**	**−19, 631**	**−24, 058**	**−27, 754**	**−32, 193**

NOTE.—Details may not add to totals due to rounding.

Table 4.—Revenue Effect of H.R. 13511 by Provision, Fiscal Years 1979–83

[In millions of dollars]

Provision	Fiscal 1979	1980	1981	1982	1983
Individual tax reductions and revisions:					
1. 6-percent bracket widening, rate cuts and increased zero bracket amount	−6, 549	−11, 608	−13, 440	−15, 587	−18, 104
2. Repeal general tax credit	7, 278	10, 809	11, 428	12, 097	12, 818
$1,000 personal exemption	−8, 177	−12, 171	−12, 902	−13, 677	−14, 497
3. *Itemized deductions:*					
a. Repeal gasoline tax deduction	471	1, 237	1, 458	1, 720	2, 029
b. Revise medical expense deduction	16	43	51	60	71
c. Repeal political contributions deduction	2	6	7	8	10
4. Simplification of the earned income credit		−17	−16	−16	−15
5. Tax certain unemployment benefits		251	261	259	263
Total, Individual	**−6, 959**	**−11, 450**	**−13, 153**	**−15, 136**	**−17, 425**
Business tax reductions and revisions:					
1. Cut rate on income over $100,000 from 48 to 46 percent, and Tax income below $100,000 as follows: 0 to $25,000 at 17 percent; $25,000 to $50,000 at 20 percent; $50,000 to $75,000 at 30 percent; $75,000 to $100,000 at 40 percent	−2, 281	−5, 286	−5, 788	−6, 338	−6, 940

2. Increase investment credit limitation to 90 percent (phase in over 4 years)	−129	−441	−872	−1, 015	−782
10-percent credit for pollution control facilities	−6	−18	−42	−76	−104
10-percent credit for rehabilitation expenditures	−84	−259	−292	−318	−340
3. Repeal general jobs credit	689	2, 458	2, 458	2, 458	2, 458
Target jobs credit	−189	−602	−745	−824	−875
4. $10,000,000 limitation on capital expenditure for industrial development bonds	([1])	−3	−11	−22	−30
5. Small business provisions	−148	−357	−305	−263	−232
6. Tax shelter provisions	2	14	10	8	5
Total, Business	**−2, 146**	**−4, 494**	**−5, 587**	**−6, 390**	**−6, 840**
Capital gains tax revisions:					
Individual:					
1. Repeal alternative tax	([1])	133	143	154	166
2. Remove capital gains from preferences	([1])	−1, 327	−1, 459	−1, 605	−1, 766
3. Exclude capital gains from sale of a principal residence	−282	−745	−820	−901	−992
4. Alternative minimum tax on capital gains	([1])	172	190	209	230
5. Index the basis of certain capital assets		([1])	−409	−1, 396	−2, 082
Corporate:					
1. Remove capital gains from preferences		−95	−104	−114	−125
2. Index basis of certain capital assets		−58	−263	−583	−977
Total Capital gains	**−282**	**−1, 920**	**−2, 722**	**−4, 236**	**−5, 546**
Grand Total	**−9, 387**	**−17, 864**	**−21, 462**	**−25, 762**	**−29, 811**

[1] Less than $500,000.

NOTE.—Details may not add to totals due to rounding.

Table 5.—Distribution by Income Class of Individual Income Tax Changes Under H.R. 13511 [1]

[1978 income level]

Expanded income class[2] (thousands)	Returns with tax reduction (thousands)	Tax reduction (millions)	Returns with tax increase (thousands)	Tax increase (millions)	Net tax reduction (millions)	Percentage distribution of tax reduction	Tax cut as percent of present law tax
0 to $5	4, 607	$83	83	$34	$49	0. 5	------------
$5 to $10	15, 385	440	947	13	427	4. 2	5. 2
$10 to $15	12, 760	846	1, 058	26	820	8. 0	4. 8
$15 to $20	11, 099	1, 309	475	10	1, 299	12. 6	5. 4
$20 to $30	12, 890	2, 821	43	2	2, 819	27. 4	6. 3
$30 to $50	5, 826	2, 383	7	2	2, 381	23. 2	6. 1
$50 to $100	1, 426	1, 324	2	1	1, 324	12. 9	5. 5
$100 to $200	291	488	8	6	482	4. 7	3. 7
$200 and over	74	676	4	7	669	6. 5	4. 9
Total	**64, 357**	**10, 370**	**2, 627**	**99**	**10, 271**	**100. 0**	**5. 6**

[1] The table includes the combined revenue effects of the individual income tax reduction provisions (rate bracket widening, rate cuts increased zero bracket amount and substitution of a $1,000 personal exemption for the general tax credit), the changes in itemized deductions, and the capital gains changes (except for the effects of the basis adjustment for capital assets and the exclusion for gains on the sale of principal residences). It does not include the individual provisions relating to deferred compensation or unemployment compensation.

[2] Expanded income equals adjusted gross income plus minimum tax preferences less investment interest to the exent of investment income.

NOTE.—Details may not add to totals because of rounding.

Table 5A.—Individual Reductions From Widening Tax Brackets, Rate Cuts, and Increased Zero Bracket Amount, 1978 Income Levels

Expanded income class [1]	Tax decrease: Amount (millions)	Percent of tax	Percentage distribution
0 to $5,000	$68	49.6	0.7
$5,000 to $10,000	634	7.7	6.9
$10,000 to $15,000	1,300	7.6	14.2
$15,000 to $20,000	1,528	6.4	16.7
$20,000 to $30,000	2,559	5.7	27.9
$30,000 to $50,000	1,868	4.8	20.4
$50,000 to $100,000	858	3.6	9.4
$100,000 and over	351	1.3	3.8
Total	9,167	5.0	100.0

[1] Expanded income equals adjusted gross income plus minimum tax preferences less investment interest to the extent of investment income.

Table 5B.—Individual Tax Reduction From Widening Tax Brackets, Rate Cuts, Increased Zero Bracket Amount and Substitution of a $1,000 Personal Exemption for the General Tax Credit, 1978 Income Levels

Expanded income class [1]	Tax decrease: Amount (millions) liability	Percent of tax liability	Percentage distribution
0 to $5,000	$83	60.6	0.8
$5,000 to $10,000	450	5.4	4.3
$10,000 to $15,000	906	5.3	8.7
$15,000 to $20,000	1,434	6.0	13.8
$20,000 to $30,000	3,130	7.0	30.2
$30,000 to $50,000	2,633	6.7	25.4
$50,000 to $100,000	1,240	5.2	12.0
$100,000 and over	479	1.8	4.6
Total	10,356	5.6	100.0

[1] Expanded income equals adjusted gross income plus minimum tax preferences less investment interest to the extent of investment income.

Table 6.—Estimated Revenue Effect of Extending or Making Permanent Existing Temporary Income Tax Reduction Provisions, Fiscal Years 1979–1983 [1]

[In millions of dollars]

Provisions	Fiscal year— 1979	1980	1981	1982	1983
Individual income taxes:					
Per capita credit*	−4, 514	−6, 583	−6, 780	−6, 984	−7, 194
Optional taxable income credit*	−2, 764	−4, 226	−4, 648	−5, 113	−5, 624
Earned income credit		−1, 061	−1, 019	−978	−938
Investment tax credit at 10-percent rate			−271	−741	−794
Amortization for low-income housing	(2)	−2	−6	−11	−14
Total, individual income taxes	**−7, 278**	**−11, 871**	**−12, 724**	**−13, 827**	**−14, 564**
Corporation income taxes:					
Rate reductions	−927	−2, 148	−2, 352	−2, 575	−2, 819
Investment tax credit at 10-percent rate			−1, 800	−4, 460	−5, 489
Amortization for low-income housing	(2)	−2	−5	−8	−10
Total, corporation income taxes	−928	−2, 150	−4, 157	−7, 043	−8, 318
Grand total, individuals and corporations	**−8, 206**	**−14, 021**	**−16, 881**	**−20, 870**	**−22, 882**

[1] Those items indicated by an asterisk (*) are not extended by H.R. 13511, but are allowed to expire after 1978 and are replaced by an increase in the personal exemption from $750 to $1,000. The expiring general jobs tax credit is not included here, but it is shown in tables 3 and 4.

[2] Less than $500,000.

NOTE.—Details may not add to totals due to rounding.

Table 7.—Revenue Effect of Removing Capital Gains From Preferences, Repealing the Alternative Tax, and Establishing an Alternative Minimum Tax for Capital Gains

[1978 income level]

Expanded income class	Returns with tax decrease (thousands)	Tax decrease (millions)	Returns with tax increase (thousands)	Tax increase (millions)	Net tax decrease (millions)	Percentage of total
Below $5	1	—1	9	33	31	—3
$5 to $10			(1)	(1)	(1)	(1)
$10 to $15		(1)	7	3	3	(1)
$15 to $20	11	—2	(1)	(1)	—2	(1)
$20 to $30	29	—9	(1)	(1)	—9	1
$30 to $50	99	—58	4	1	—56	6
$50 to $100	124	—203	78	10	—193	20
$100 to $200	43	—181	54	28	—153	16
$200 and over	22	—592	14	18	—574	60
Total	327	—1, 047	167	94	—953	100

[1] Less than $500,000, 500 returns, or 0.05 percent.

Table 8.—Tax Reduction From the $100,000 Exclusion of Capital Gains From the Sale of a Principal Residence

[1978 income level]

Expanded income class (thousands)	Returns (thousands)	Tax reduction (millions)	Percentage of total
Below $5	30	$2	0. 3
$5 to $10	46	6	0. 9
$10 to $15	84	32	4. 7
$15 to $20	75	46	6. 8
$20 to $50	286	477	70. 5
$50 to $100	18	64	9. 4
$100 to $200	4	30	4. 4
$200 and over	1	20	3. 0
Total	**544**	**677**	**100. 0**

Table 9.—Long-Run[1] Tax Reduction for Individuals From the Indexing of Basis for Certain Capital Assets (Assuming the Other Capital Gain Changes in the Bill)

[1978 Income Level]

Expanded income class (thousand)	Tax reduction (million)	Percentage of total
Below $10	$38	1.2
$10 to $20	158	4.8
$20 to $50	740	2.5
$50 to $100	784	23.8
$100 to $200	525	16.0
$200 and over	1,042	31.7
Total	3,228	100.0

[1] The long-run effect is achieved once all eligible assets sold have been purchased after December 31, 1979. This would be nearly complete after approximately 20 years, in the year 2000. The estimate assumes no change in economic activity in response to the tax change.

Table 10.—Federal Individual Income Tax Burden[1] for Hypothetical Taxpayers Under Certain Provisions[2] of H.R. 13511

[Single person and married couple with no, 1, 2, and 4 dependents (assuming deductible personal expenses of 23 percent of income]

Income	Tax liability														
	Single person			Married couple with no dependents			Married couple with 1 dependent			Married couple with 2 dependents			Married couple with 4 dependents		
	Under present law	Under the bill	Reduction	Under present law	Under the bill	Reduction	Under present law	Under the bill	Reduction	Under present law	Under the bill	Reduction	Under present law	Under the bill	Reduction
3,000	0	0	0	0	0	0	−300	−300	0	−300	−300	0	−300	−300	0
5,000	279	257	21	0	0	0	−300	−300	0	−300	−300	0	−300	−300	0
6,000	449	433	16	115	84	31	−200	−200	0	−200	−200	0	−200	−200	0
8,000	810	798	12	431	384	47	273	229	44	120	84	36	0	0	0
10,000	1, 199	1, 184	15	761	722	39	620	548	71	446	384	62	128	84	44
12,500	1, 631	1, 593	38	1, 186	1, 172	14	1, 059	992	67	917	812	105	562	464	88
15,000	2, 126	2, 055	71	1, 651	1, 645	6	1, 436	1, 435	51	1, 330	1, 253	77	990	893	97
17,500	2, 660	2, 573	87	2, 075	2, 049	25	1, 910	1, 839	70	1, 745	1, 629	115	1, 385	1, 240	145
20,000	3, 232	3, 127	105	2, 555	2, 474	81	2, 368	2, 244	124	2, 180	2, 034	146	1, 808	1, 614	194
25,000	4, 510	4, 350	160	3, 570	3, 410	160	3, 360	3, 158	202	3, 150	2, 918	232	2, 738	2, 438	300
30,000	5, 950	5, 737	213	4, 712	4, 488	224	4, 472	4, 208	264	4, 232	3, 928	304	3, 778	3, 368	410
35,000	7, 600	7, 253	247	6, 002	5, 716	286	5, 732	5, 396	336	5, 464	5, 076	388	4, 954	4, 446	508
40,000	9, 233	8, 905	328	7, 427	7, 082	345	7, 135	6, 722	413	6, 848	6, 362	486	6, 278	5, 668	610

[1] Computed without reference to the tax tables.

[2] Includes only the repeal of general tax credit, increase in personal exemption, increase in zero bracket amount, rate reduction and widening of the tax brackets.

[3] Wage or salary and/or self-employment income.

NOTE.—Negative tax liability results from the refundable earned income credit.