[JOINT COMMITTEE PRINT]

SUMMARY

OF

TAX CUT PROVISIONS

OF

H.R. 5829

(As Ordered Reported by the Senate Finance Committee)

PREPARED BY THE

STAFF OF THE

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

This pamphlet provides a summary of the tax cut provisions of H.R. 5829, as ordered reported by the Senate Finance Committee on August 21, 1980. The pamphlet also includes the estimated revenue effects of the tax cut provisions. The tax cut provisions were added as an amendment to a House-passed bill, H.R. 5829 (a tariff bill providing for the duty-free entry of bronze bells for the Foundry United Methodist Church of Washington, D.C.)

This document is intended to be a brief summary of the decisions made by the Finance Committee. The Finance Committee report and reported bill will provide the official legislative history of the provisions.

I. SUMMARY OF TAX CUT PROVISIONS

A. Individual Income Tax Cuts

1. Reductions in tax rates

Under the committee bill, individual income tax rates in every tax bracket will be reduced by 1 to 3 percentage points, as shown for married couples in table 1. The rate in the lowest bracket will be reduced to 12 percent from the current 14 percent, and the rate in the highest bracket will be reduced to 67 percent from the current 70 percent. Some brackets will be narrowed in size.

2. Personal exemption

The present $1,000 personal exemption for each taxpayer and dependent and the extra exemptions for taxpayers who are age 65 and over and taxpayers who are blind will be increased to $1,100.

3. Zero bracket amount

The zero bracket amount, presently $3,400 for married couples and $2,300 for single persons and heads of households, will be increased to $3,600 and $2,400, respectively. The zero bracket amount (formerly the standard deduction) establishes both an amount of taxable income which is exempt from tax and an amount of taxable income which is subtracted from itemized deductions to determine the amount which actually may be deducted.

4. Earned income credit

The earned income credit, a refundable credit for families with children, will be increased from 10 percent of the first $5,000 of earnings to 11 percent of the same amount. Thus, the maximum credit will be increased to $550 from the present $500. The credit will be phased out as earned income increases from $7,000 to $11,000, rather than from $6,000 to $10,000 as under present law.

5. Deduction for two-earner couples

Under the committee bill, a new deduction will be allowed for couples in which both spouses have earned income. For 1981, the deduction will be 5 percent of the first $30,000 of earnings of the spouse with the lower earnings (maximum of $1,500). For 1982 and after, the rate of the deduction will be 10 percent (maximum of $3,000). This will partially offset the additional tax, commonly referred to as the "marriage penalty," which often results when two persons with earnings marry.

6. Effective date

The above individual income tax reduction provisions are effective for taxable years beginning after December 31, 1980. Reductions in income tax withholding to reflect the tax cuts (other than the second-earner deduction) will begin on January 1, 1981.

Table 1.—Tax Rates for Married Couples Filing Joint Returns: Comparison of Committee Bill and Present Law: [1]

Committee bill		Present law tax rate in equivalent bracket
If taxable income is:	*The tax is:*	
Not over $3,600	No tax.	
Over $3,600 but not over $5,600	0 plus 12.0% of excess over $3,600	14
Over $5,600 but not over $7,600	$240 plus 14.0% of excess over $5,600	16
Over $7,600 but not over $11,600	$520 plus 17.0% of excess over $7,600	18
Over $11,600 but not over $15,600	$1,200 plus 20.0% of excess over $11,600	21
Over $15,600 but not over $20,000	$2,000 plus 23.0% of excess over $15,600	24
Over $20,000 but not over $24,400	$3,012 plus 27.0% of excess over $20,000	28
Over $24,400 but not over $29,700	$4,200 plus 29.0% of excess over $24,400	32
Over $29,700 but not over $35,000	$5,737 plus 35.0% of excess over $29,700	37
Over $35,000 but not over $45,600	$7,592 plus 41.0% of excess over $35,000	43
Over $45,600 but not over $59,800	$11,938 plus 48.0% of excess over $45,600	49
Over $59,800 but not over $85,400	$18,754 plus 53.0% of excess over $59,800	54
Over $85,400 but not over $109,200	$32,322 plus 58.0% of excess over $85,400	59
Over $109,200 but not over $162,200	$46,126 plus 63.0% of excess over $109,200	64
Over $162,200	$79,516 plus 67.0% of excess over $162,200	68 or 70 [2]

[1] Comparable tax rate reductions and bracket changes also are made for single and head-of-household tax schedules.
[2] The bill collapses the present 68- and 70-percent tax brackets into a 67-percent bracket.

B. Capital Formation and Productivity Tax Reductions

1. Depreciation and investment credit revisions

a. Changes in the depreciation of personal property

Under the committee bill, a new method of depreciating most personal property will be substituted for the present law depreciation methods, including the Asset Depreciation Range (ADR) system. Public utility property will continue to use present law except that the ADR variance will be increased to 30 percent rather than 20 percent.

Under the committee's "2–4–7–10" system, the depreciable basis of tangible personal property will be placed in one of four open-ended recovery accounts.[1] The entire cost of the property is added to the account without reduction for the property's estimated salvage value. Thus, the new system will eliminate all disputes as to the salvage value of the property. Progress payments made toward the acquisition of assets which have a normal construction period of 2 years or more also will be added to the appropriate asset account rather than waiting until the asset actually is placed in service. The system utilizes a half-year convention[2] for all asset costs (including progress payments).

The four recovery accounts correspond to depreciation terms of 2, 4, 7 and 10 years. The bill requires that property be assigned to a recovery account which utilizes a life that is at least 40 percent shorter than its current midpoint useful life (under the present ADR system), except that no recovery period shall be reduced below 2 years. Assets will be assigned to recovery periods in accordance with the following schedule:

ADR midpoint life:	*Recovery period (years)*
6.5 years or less	2
7.0 years to 11.5 years	4
12.0 years to 16.5 years	7
More than 16.5 years	10

For example, assets used to manufacture clothing currently have a mid-point life of 9 years which, under this bill, would be reduced to 4 years. Equipment placed in the 7-year class would include the following assets which now have a mid-point life of 12 years; manufacturing of metal working machinery, electrical equipment, motor vehicles, ships and railroad cars. The Treasury Department would be required to publish simplified tables which incorporate these shortened lives and to establish lives for those types of tangible personal property not covered by the ADR system.

A declining balance method (200 percent, 150 percent or 100 percent) will be used to compute the year's deduction for all assets within

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[1] Under the system of open-ended accounts, the costs of all eligible property with the same recovery period are placed in the same open-ended account. This system applies in lieu of vintage accounts under the ADR system and item accounts under other depreciation systems. Under item accounts and vintage accounts, a taxpayer must keep separate accounts for property placed in service in different years.

[2] Under the half-year convention, one-half of the asset's cost is placed in the account in the year that the asset is placed in service. The other half of the asset's cost is added to the account in the next subsequent year.

a recovery account. (The taxpayer may make an annual election as to which of these rates is to apply to any account for the taxable year.) The amount of the depreciation for the year is then subtracted from the account to establish the balance of the account on which next year's deduction is computed. For example, assume the cost of assets in the 4-year recovery account equals $1,000. The taxpayer would choose one of the three fixed percentages for this account (50 percent, 37.5 percent, or 25 percent) and multiply this percentage by $1,000 in order to determine the amount of his deduction. If the taxpayer is elected to apply 50 percent (i.e., the percentage representing 200 percent of the straight-line rate for the 4-year recovery period), the depreciation deduction would be $500. The balance in the account used to determine the depreciation in the next year would be $500, increased or decreased by any additions or subtractions to the account.

Generally, no gains or losses will be recognized on the disposition of assets. Instead, the amount realized on the disposition will reduce the balance of the account which, in turn, will reduce the amount of depreciation deductions in subsequent years. If the amount realized from the disposition of assets reduces the balance of the account to a negative figure, the amount of the negative balance will be recaptured as ordinary income.

A taxpayer will be permitted to elect to "expense" (take an immediate deduction) up to $25,000 of expenditures each year for tangible personal property (new or used) during a year.
period of 20 years using the straight line method and composite depreciation is repealed.

b. Investment credit modifications

The investment tax credit for assets in the 7- or 10-year accounts will remain at 10 percent. Assets in the 4-year account will be eligible for a 6-percent investment tax credit. Assets in the 2-year account will be eligible for a 2.5-percent investment tax credit.

No investment tax credit will be allowed for those assets for which an immediate deduction is taken under the $25,000 "expensing" provision.

c. Optional approaches to depreciating real property

The committee bill provides several new elective approaches to depreciation of real property (without eliminating the present law methods). First, a taxpayer may elect to depreciate structures over a period of 20 years using the straingt line method and composite depreciation. (Under composite depreciation, the entire structure must be depreciated over a single life; by contract, under component depreciation, different parts of the structure are depreciated over different lives.) Second, a taxpayer may elect to depreciate low-income rental housing over 15 years using a straight line method and composite depreciation. Third, certain owner-occupied business structures can be depreciated over a period of 15 years using the 150-percent declining balance method. However, if this latter election is made, the recapture rules currently applicable to depreciable personal property will apply. Under these personal property recapture rules, the sale of depreciable property results in recapture (i.e., ordinary income treatment) for an amount equal to the lesser of the amount of gain recognized or the amount of depreciation deductions allowable. These lives will be audit-proof; i.e., if the taxpayer were to make one of these elections, the useful life could not be challenged by the Internal Revenue Service.

d. Rehabilitation tax credit changes

The present 10-percent rehabilitation tax credit for industrial and commercial structures will be increased to 25 percent for amounts paid or incurred after December 31, 1980. Under present law and under the bill, costs which qualify for the credit are depreciable rehabilitation costs incurred in connection with a building which has been in use for at least 20 years for the interior or exterior renovation, restoration or reconstruction of the building.

e. Effective dates

These provisions generally apply to assets placed in service after December 31, 1980. In addition, property placed in service prior to that time can become subject to the system, at the election of the taxpayer, in taxable years beginning after December 31, 1984. However, a taxpayer with a fiscal year which begins in 1980 may elect not to apply the 2–4–7–10 system to assets placed in service prior to his first fiscal year beginning in 1981.

2. Corporate income tax

Under the committee bill, the corporate income tax structure will be modified in 1981 and again in 1982. The effect of the modifications will be to reduce the rates and broaden the brackets generally for small businesses and to reduce the top rate over a 2-year period. Among the rate changes, the lowest rate will decrease from 17 percent to 15 percent, and the highest rate will decrease from 46 percent to 45 percent in 1981 and to 44 percent in 1982. The brackets are also revised, as set forth below.

Present law corporate tax brackets and rates are as follows:

Taxable income	*Tax rate (percent)*
$0 to $25,000	17
$25,000 to $50,000	20
$50,000 to $75,000	30
$75,000 to $100,000	40
Over $100,000	46

For 1981, the brackets and rates will be as follows:

Taxable income	*Tax rate (percent)*
$0 to $25,000	15
$25,000 to $50,000	20
$50,000 to $100,000	30
$100,000 to $150,000	40
Over $150,000	45

Beginning in 1982, the brackets and rates will be as follows:

Taxable income	*Tax rate (percent)*
$0 to $25,000	15
$25,000 to $50,000	20
$50,000 to $75,000	25
$75,000 to $100,000	30
$100,000 to $150,000	35
$150,000 to $200,000	40
Over $200,000	44

3. Other provisions affecting small business

In addition to the corporate rate cuts described above which apply to corporations generally, as well as small business, the committee bill includes other small business provisions outlined below.

a. Increase in minimum accumulated earnings credit

In addition to the regular corporate income tax, present law imposes an accumulated earnings tax of 27½ percent to 38½ percent on improperly accumulated corporate earnings where the accumulation occurs in an attempt to avoid the individual income tax. In computing the base on which this tax is imposed, there is excluded an amount equal to the earnings and profits of the taxable year which are retained for the reasonable needs of the business. This is known as the accumulated earnings credit. Present law provides a minimum credit of $150,000 of earnings which may be accumulated before any accumulated earnings are subject to this tax.

The committee bill increases the minimum accumulated earnings credit to $250,000. However, this increase will not apply to specified service corporations whose principal business consists of the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting.

b. Investment credit for used property

Present law provides a 10-percent regular investment credit. A taxpayer may claim this regular investment credit for the cost of up to $100,000 of used qualifying property acquired by purchase each taxable year.

The committee bill increases the annual cost ceiling on used property for purposes of the 10-percent regular investment credit from $100,000 to $150,000.

c. Time for furnishing Form W–2 to terminated employees

The Internal Revenue Code requires an employer to furnish to an employee who has terminated employment prior to the close of a calendar year a Form W–2 on the day the employee receives his or her last salary payment.

The Internal Revenue Service recently has published regulations which provide that the employer may furnish a Form W–2 to an employee whose employment terminates prior to the close of the calendar year at any time after the termination but no later than January 31 of the following year. However, if an employee who terminates employment prior to the close of the calendar year requests earlier receipt of a Form W–2, and if there is no reasonable expectation on the part of the employer and employee of further employment during the calendar year, then the employee must be given a Form W–2 on or before the later of the 30th day after the request or the 30th day after the last salary payment.

The committee bill codifies the general approach of these regulations.

d. Deferred application of Revenue Procedure 80–5 and Revenue Ruling 80–60 relating to inventory writedowns

In Revenue Procedure 80–5 and Revenue Ruling 80–60, the Internal Revenue Service provided rules which require taxpayers to conform their method of inventory accounting to that method of inventory accounting approved by the Supreme Court in *Thor Power Tool v. Commissioner*, 439 U.S. 522 (1979). For taxpayers with excess inventories (inventories in excess of foreseeable demand) that have been erroneously written down for tax purposes, these pronouncements require that the writedowns be taken into income.

These Internal Revenue Service pronouncements, which were issued on February 8, 1980, are applicable to 1979 taxable years.

The committee bill delays the implementation of Revenue Procedure 80–5 and Revenue Ruling 80–60 to taxable years beginning after 1979, in order to give taxpayers the opportunity to take mitigating action under the Treasury regulations.

e. Increase in maximum number of subchapter S shareholders

Under present law, one of the requirements that a corporation must meet in order to be eligible to elect to be treated as a subchapter S corporation is that it have no more than 15 shareholders.

The committee bill provides for an increase in the maximum number of shareholders in a subchapter S corporation from 15 to 25.

f. Refund of excise taxes for certain fuels used in intercity, local, and school buses

Present law imposes a manufacturers excise tax of 4 cents per gallon on gasoline and a retailers excise tax of 4 cents per gallon on diesel fuel and other special motor fuels used or sold for use in a highway motor vehicle. The Energy Tax Act of 1978 provided that a credit or refund of these taxes could be obtained if these fuels were used in a bus while engaged in (1) the furnishing (for compensation) of certain passenger land transportation available to the general public, or (2) the transportation of students or employees of schools. However, that Act did not permit the owners or operators of buses to purchase fuel tax-free even if the fuel was to be used in a qualifying activity, and the Code requires that refunds of these taxes can be obtained quarterly only if the amount attributable to the quarter is at least $1,000. If not, the credit or refund is available annually.

The committee bill allows the present law refund of the taxes on fuels used by these buses to be available on a quarterly basis (rather than on an annual basis) if the amount of the refund is at least $50.

g. Reserves for market-making activities

Under present law, a securities dealer must recognize any gain on the sale of equity securities, even if he is making a market for the securities. Generally, this gain will be treated as ordinary income.

The committee bill allows certain dealers in corporate securities to defer for 5 years the net gain (up to $1 million) from the sale of small business equity securities where the dealer is making a market in the securities.

Under the committee bill, a corporation which is engaged in market-making activities during the taxable year will be allowed to establish a deductible loss reserve equal to the net gains for that year from the sale of certain small business equity securities in which it makes a market. The deduction would be equal to the addition to the taxpayer's reserve. However, the reserve could not exceed $1 million. Moreover, the deduction could not exceed the taxpayer's taxable income for the year nor could it exceed 30 percent of the fair market value of the taxpayer's average monthly inventory positions in over-the-counter equity securities carried for market-making activities for the year.

This provision will apply to equity securities held by the taxpayer for sale in the ordinary course of its trade or business which are not traded on a registered security exchange and which are of corporations that had $25 million or less of debt and equity outstanding on the last day of the preceding taxable year.

Under the provision, the amount of an addition to the reserve for a taxable year would not be taken back into income until the earlier of (1) the fifth year following the year of the addition, or (2) the year the amount is withdrawn from the reserve. (A withdrawal is deemed to be from the earliest remaining addition to the reserve.)

h. Incentive stock options

Generally, under present law, an employee is taxed, at ordinary income rates on earned income, on a compensatory stock option at the time the option is received, or, if the option does not have a readily ascertainable fair market value, at the time it is exercised. The employer has a corresponding deduction as a business expense.

Under the committee bill, an incentive stock option which is granted to an employee will be taxed at capital gains rates when the employee sells the stock. The employer will receive no deduction.

For an option to qualify as an "incentive stock option": (1) the exercise price must be not less than fair market value of the stock at the time the option is granted (in the case of a variable option, determined as if the option had been exercised when granted); (2) the option must be exercised within 10 years of the date granted; (3) shareholder approval is required; (4) the individual may not be an employee owning more than 10 percent of the value or voting power of stock of the company (unless the option price is at least 110 percent of the stock's fair market value); (5) the optionee must be an employee continuously from grant of the option to 3 months prior to exercise; (6) the option may be transferred only at death; and (7) the stock must be held for at least 2 years after the date of the granting of the option and for at least one year after the option is exercised.

This provision will apply to options exercised after December 31, 1980.

i. Effective dates

These small business provisions generally apply to taxable years beginning after December 31, 1980.

4. Research and development tax credit

Under present law, a taxpayer may elect to deduct currently, or to amortize over 60 months or more, certain "research or experimental expenditures" incurred in the taxpayer's trade or business which otherwise would have to be capitalized.

Under the committee bill, a nonrefundable income tax credit also will be allowed for research expenditures to the extent they exceed the average of such expenditures in the base period. The rate of the new credit will be 25 percent of the incremental research expenditure amount. In the case of individuals, the amount of the present law deduction for research expenditures also eligible for the credit will be reduced by the amount of credit allowable for those expenditures.

For 1981, the credit will apply to incremental research expenditures in excess of those for 1980. For 1982, it will apply to the excess over the average of such expenditures for 1980 and 1981. For 1983 and later years, the credit will apply to the excess over the average of such expenditures for the three preceding taxable years.

The credit will be provided to the taxpayer which conducts or bears the cost of the research for use in its trade or business. The credit will not be available to a research and development business which conducts research for the taxpayer.

The provision redefines research expenditures for purposes of both the existing section 174 election and the new credit. The definition, which is intended to be substantially the same as the definition of "research and development" used for certain accounting purposes (Financial Accounting Standards Board, Statement No. 2), will cover all expenditures incurred incident to either:

(1) a planned search or critical investigation aimed at discovery of new knowledge with the intent that such knowledge will be useful in developing a new product or service, or a new process or technique, or in bringing about a significant improvement to an existing product or process, or

(2) a translation of research findings or other knowledge into a plan or design for a new product or process, or for a significant improvement to an existing product or process to the point that the product or process meets specific functional and economic requirements, and is ready for manufacture, sale, or use.

The amount of the credit for a particular taxable year will be limited to the taxpayer's income tax liability reduced by other tax credits (other than the investment tax credit, the credit for certain fuel uses, and the earned income credit). Any excess over this limit can be carried over to apply against tax liability for the three preceding and seven succeeding years. In the case of an individual taxpayer, the allowable deduction will be reduced by the amount of the credit.

The provision includes rules for determining whether there has been a true increase in qualifying research expenditures or merely a shifting of research expenditures among different persons. Thus, for credit computation purposes, research expenditures by the taxpayer will be aggregated with research expenditures of commonly controlled persons and of entities in which the taxpayer has an economic interest or the right to benefits of the research.

Effective date

The provision is effective for taxable years beginning after December 31, 1980.

5. Employee stock ownership plan tax credit

A tax credit employee stock ownership plan (generally called an ESOP) is an employer-maintained tax-exempt trust under which employees share in stock ownership of the employer.

Beginning with the Tax Reduction Act of 1975, employers making qualified investments were allowed an additional one-percent investment tax credit for contributions of stock to an ESOP meeting special requirements.

The additional investment tax credit for ESOP contributions was expanded by the Tax Reform Act of 1976. Under the 1976 Act, an employer was allowed an extra investment tax credit of up to one-half of one-percent for stock contributions to an ESOP if the contributions were matched by equal employee contributions. Thus, an employer could get a total additional investment tax credit of up to one and one-half percent after the 1976 Act.

The committee bill will permit an employer to claim a tax credit based on a percentage of payroll for contributions to an ESOP. A sponsoring corporation will have the option of claiming either the tax credit based on payroll of employees covered by the plan or the additional investment tax credit provided under existing law. The percentage of payroll eligible for this credit will be as follows:

1981	½ of 1 percent
1982	¾ of 1 percent
1983	1 percent

The wage-based credit, like the additional investment tax credit, will expire December 31, 1983.

Effective date

The provision is effective for periods beginning after December 31, 1980.

6. Deduction for individual retirement savings

Under present law an employee generally is entitled to deduct the amount contributed to an individual retirement account or individual retirement annuity or used to purchase retirement bonds (referred to collectively as "IRAs"). The limitation on the deduction for a taxable year is generally the lesser of 15 percent of compensation for the year or $1,500. The deduction limit for a spousal IRA is $1,750. No IRA deduction is allowed to an individual who is an active participant in a tax-qualified plan, a tax-sheltered annuity, or a governmental plan in a taxable year. Also, employee contributions to retirement plans are not deductible.

a. Limited employee retirement accounts (LERAs)

The committee bill provides that an active participant in a tax-qualified retirement plan or tax-sheltered annuity will be allowed a deduction for an amount contributed to the plan or to an IRA. The maximum deduction will be the lesser of 15 percent of compensation or $1,000. Where mandatory employee contributions to an employer sponsored retirement plan are made, only $100 of such contribution will be eligible for this deduction. No deduction will be allowed to an individual covered by a plan if the individual owns more than 10 percent of the employer maintaining the plan. Also, employees covered by governmental plans will generally not be eligible to make deductible contributions to LERAs.

b. Individual retirement accounts (IRAs)

In addition, for individuals who are not active participants in tax-qualified plans, etc., the contribution limit for an individual retirement account (IRA) will be increased from $1,500 to $1,750. The limit for spousal IRAs will be increased from $1,750 to $2,000.

Effective date

The LERA and IRA provisions are effective for taxable years beginning after December 31, 1980.

7. Capital gains tax cut

Under present law, noncorporate taxpayers may deduct from gross income 60 percent of the amount of any net capital gain for the taxable year. The remaining 40 percent of the net capital gain is included in gross income and taxed at the otherwise applicable regular income tax rates. As a result, the highest tax rate applicable to a taxpayer's entire net capital gain is 28 percent (70 percent top tax rate on the 40-percent includable capital gain). An alternative capital gains tax rate of 28 percent applies to a corporation's net capital gain (in lieu of any capital gains deduction) if that rate is lower than the corporation's regular tax rate. Otherwise, a corporation may pay a tax on the entire gain at its lower regular tax rate.

The committee bill increases the net capital gain deduction for noncorporate taxpayers from 60 to 70 percent, *i.e.*, 30 percent will be included in gross income and taxed at the otherwise applicable regular income tax rates. As a result, the highest tax rate applicable to a taxpayer's entire net capital gain will be 20.1 percent (67 percent top tax rate under the bill times the 30 percent of the net capital gain includable). The committee bill does not change the present law treatment of capital losses.

In the case of corporations, the alternative capital gain tax rate will be reduced from 28 to 20 percent.

Effective date

The lower rates will apply in the case of gains and losses properly attributable to periods after August 20, 1980. Special rules are provided to determine the period to which gains and losses are properly attributable in the case of pass-through entities.

8. Foreign earned income exclusion

Under present law, Americans working abroad generally are eligible for deductions intended to reflect the excess costs of living abroad if they were a bona fide resident of a foreign country for an entire taxable year or if they were physically present in a foreign country for 510 days (approximately 17 months) out of 18 consecutive months.[1] Taxpayers residing in hardship area camps may claim a $20,000 annual earned income exclusion in lieu of the excess living cost deductions.

The committee bill liberalizes the rules governing the taxation of income earned abroad. The liberalized rules apply to individuals working in developing countries (other than tax havens), regardless of the nature of the services they perform. In addition, the revised rules also apply to individuals working in other foreign countries if those individuals perform charitable, export-related, or natural resource-related services.

For those individuals described above, the committee bill will replace the present system of excess foreign living cost deductions with an

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[1] The excess foreign living cost deduction consists of separate excess housing, education, home leave, and general cost of living elements. An additional $5,000 hardship allowance is allowed to taxpayers working in hardship areas.

exclusion of foreign earned income of $50,000 a year, increasing to $65,000 for individuals residing abroad for more than 2 years. In addition, the exclusion will be increased by the excess of the individual's housing costs over 16 percent of the salary of a Government employee at step 1 of grade GS–14 (the 16-percent figure is currently $5,554). The eligibility requirement of present law will be modified to allow the exclusion for individuals overseas for 11 out of 12 months (or a shorter period where forced to leave because of civil unrest).

Income received for the performance abroad of export-related services, or compensation for employment abroad with an employer (including a branch) substantially all of whose income is derived from the export of U.S. goods or the performance of export-related services will qualify for the exclusion as export-related services. These services include:

(1) construction, architectural, engineering, or repair services performed in connection with agricultural, construction, or engineering projects located in a foreign country,

(2) services associated with the export of U.S. products (including marketing and market analysis, advertising and promotional activities, sales and distribution services, packaging and assembly, warehousing, documentation and customs clearing, and financing), and

(3) any other services performed overseas which are designated by the Secretary of Treasury (after consultation with the Special Trade Representative and the Secretary of Commerce) as contributing significantly to U.S. exports.

Income received for services performed abroad in the exploration for or extraction of petroleum or other natural resources, or compensation for employment abroad with an employer (including a branch) substantially all of whose income is derived from those activities, will qualify for the exclusion as natural resource-related services. Services performed abroad by an employee for an employer which meets the requirements of section 501(c)(3) will qualify for the exclusion as charitable services.

Effective date

The provisions are generally applicable beginning in 1980. (The provisions previously approved by the Committee dealing with individuals forced to leave because of civil unrest—S. 873—will be effective beginning in 1978; and the provisions with respect to charitable employees—S. 1703—will be effective beginning in 1979.

II. REVENUE EFFECTS

Estimated Revenue Effects of Tax Cut Decisions as Reported by Senate Finance Committee, Fiscal Years 1981–1985 and Calendar Year 1981 (Preliminary)

[Billions of dollars]

Item	Fiscal year—					Calendar year 1981
	1981	1982	1983	1984	1985	
A. Individual Tax Cut Provisions						
1. Increase in personal exemption	−1.7	−4.9	−5.1	−5.4	−5.6	−4.8
2. Increase in zero bracket amount	−1.0	−1.6	−1.6	−1.7	−1.8	−1.5
3. Increase in earned income credit [1]	−0.1	−0.6	−0.5	−0.5	−0.5	−0.6
4. Deduction for two-earner couples	−0.3	−3.4	−6.8	−8.3	−9.7	−2.7
5. Rate reductions	−7.9	−14.3	−17.2	−20.9	−25.0	−12.8
Total, individual tax cuts	**−11.0**	**−24.6**	**−31.3**	**−36.8**	**−42.6**	**−22.3**
B. Capital Formation and Productivity Tax Reductions						
1. Depreciation—investment credit revisions	−4.3	−13.3	−18.0	−18.7	−19.6	−9.9
2. Corporate rate reduction and small business provisions:						
a. Corporate rate reductions from 46 percent to 45 percent in 1981 and to 44 percent in later years	−0.7	−2.4	−3.7	−4.2	−4.8	−1.5
b. Corporate rate reductions on income below $150,000 in 1981 and below $200,000 in 1982 and later years	−0.3	−1.1	−1.8	−2.1	−2.3	−0.7
c. Increase in accumulated earnings credit	(2)	(2)	(2)	(2)	(2)	(2)

d. Increase in used equipment eligible for investment credit to $150,000	−0.1	−0.2	−0.2	−0.2	−0.2	−0.2
e. Elimination of certain W–2 filing requirements						
f. Deferral of application of revenue ruling on inventory writedowns	(3)	(3)	(3)	(3)	(3)	(3)
g. Increase in number of subchapter S shareholders to 25	(4)	(4)	(4)	(4)	(4)	(4)
h. Refund of excise tax on certain fuels used in intercity, local and school buses	(3)	(3)	(3)	(3)	(3)	
i. Reserves for market making activities	(5)	−0.1	−0.1	(5)	(5)	−0.1
j. Incentive stock options	(4)	(4)	(4)	(4)	(6)	(4)
Subtotal, small business (b. through j.)	−0.4	−1.4	−2.0	−2.3	−2.5	−0.9
3. Research and development tax credit	−0.2	−0.5	−0.6	−0.7	−0.8	−0.5
4. Savings incentives (LERAs & IRAs)	−0.3	−0.7	−0.9	−1.1	−1.2	−0.6
5. Payroll-based ESOP credit	−0.3	−1.0	−2.0	−1.6	−0.3	−0.6
6. Capital gains tax cut	−0.8	−2.7	−3.0	−3.2	−3.6	−2.7
7. Foreign earned income exclusion	−0.2	−0.4	−0.4	−0.4	−0.5	−0.3
Total, capital formation and productivity tax reductions	**−7.2**	**−22.3**	**−30.6**	**−32.3**	**−33.2**	**−17.0**
Grand Total	**−18.2**	**−46.9**	**−61.9**	**−69.1**	**−75.8**	**−39.4**

1 These figures include both the reduction in revenues and the increase in outlays from the changes in the earned income credit.

2 Indeterminate with respect to both amount and timing but could be substantial.

3 Negligible loss.

4 Loss of less than $5 million.

5 Loss of less than $50 million.

6 Gain of less than $50 million.

NOTE.—Detail may not add to total because of rounding.