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REPORT
No. 95–66

TAX REDUCTION AND SIMPLIFICATION ACT OF 1977

REPORT

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

ON

H.R. 3477

together with

ADDITIONAL, MINORITY AND SUPPLEMENTAL VIEWS

MARCH 28 (legislative day, FEBRUARY 21), 1977.—Ordered to be printed

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MARCH 28 (legislative day, FEBRUARY 21), 1977.—Ordered to be printed

Mr. LONG, from the Committee on Finance, submitted the following

REPORT

together with

ADDITIONAL, MINORITY AND SUPPLEMENTAL VIEWS

[To accompany H.R. 3477]

The Committee on Finance, to which was referred the bill (H.R. 3477) to provide for a refund of 1976 individual income taxes, to make certain payments to individuals, to reduce individual and business income taxes, to provide tax simplification, and to revise certain other tax provisions, and for other purposes, having considered same, reports favorably with amendments and recommends that the bill as amended do pass.

I. SUMMARY

The Tax Reduction and Simplification Act of 1977 (H.R. 3477) is designed to provide economic stimulus to increase consumer spending, expand production of goods and services and reduce unemployment. Also, the bill will considerably simplify income tax returns and the tax computation for almost all individual taxpayers.

The bill, as amended by the Finance Committee, contains the following principal provisions:

- A refund of 1976 individual income taxes equal to $50 for each taxpayer and dependent, phased out between $25,000 and $30,000 of adjusted gross income.
- $50 payments to many beneficiaries of several income maintenance programs, including social security, supplemental security income (SSI), railroad retirement, aid to families with dependent children (AFDC), Veterans Administration pensions and compensation, and black lung benefits.
- A permanent change to set the standard deduction at $2,200 for single returns and $3,200 for joint returns and heads of households.
- Creation for 96 percent of all taxpayers of a new simplified method of computing tax through revised tax tables, into which will be built what is now the standard deduction, the personal exemption, and the general tax credit.
- Elimination of the legal concept of the standard deduction and replacement of it with a new concept of a floor under itemized deductions equal to what is now the standard deduction, with this new floor being built into the tax tables and tax rate schedules.
- A new business tax credit under which businesses may elect either a 25-percent new jobs tax credit or an additional 2-percent investment credit for 1977 and 1978. After 1978, the 12-percent investment credit will remain in effect for all businesses for 1979 and 1980.
- Extension of the 1977 individual and corporate tax reductions through 1978, including the general tax credit, the earned income credit and the corporate rate reductions.
- Elimination of retroactive tax increases resulting from the Tax Reform Act of 1976 for people eligible for the sick pay exclusion or the exclusion for income earned abroad.
- Extension of 5-year amortization for child care facilities.
- Allowance of a limited deduction for business use of the home for the care of children, handicapped individuals, and elderly persons.
- An increase in the authorization for the Work Incentive (WIN) program.

The committee bill will reduce budget receipts and increase outlays by $13.7 billion in fiscal year 1977, $18.4 billion in fiscal year 1978 and $5.4 billion in fiscal year 1979. Of this, the extension of the 1977 tax reductions, individual and corporate, accounts for $7.9 billion in fiscal year 1978 and $6.5 billion in fiscal year 1979. The rest—$13.7

billion in fiscal year 1977, $10.5 billion in fiscal year 1978 and $8.9 billion in fiscal year 1979—represents new economic stimulus.

Refund of 1976 individual income taxes and related payments

The bill contains a refund of 1976 individual income taxes and related payments to individuals equal in most cases to $50 per person. The income tax refund is phased out proportionately as adjusted gross income (AGI) rises from $25,000 to $30,000. Payments of $50 will also go to many beneficiaries of social security, SSI, railroad retirement, AFDC, Veterans Administration pensions and compensation, and black lung benefits. Where it is administratively feasible, these payments will also be phased out as AGI rises from $25,000 to $30,000. Except for the individuals subject to the income phaseout, the committee has attempted to structure the refunds and payments so that as many Americans as possible receive them, while eliminating most cases of double payments under these programs. The number of double payments under the committee's bill will be significantly lower than under the House bill.

The tax refund and related payments will increase individuals' disposable income by $10.4 billon, largely in May and June of this year. Much of this additional income will be spent during the rest of 1977, which will increase employment as businesses produce more goods and services to satisfy the additional consumer demand.

Individual income tax simplification

The committee bill changes what is now the standard deduction to $2,200 for single individuals and $3,200 for heads of households and married couples who file joint returns. Under the committee's bill, heads of households are given the same standard deduction as joint returns, rather than being grouped with single returns, as under current law. By increasing individuals' after-tax income by almost $6 billion annually, this change will also stimulate spending, production, and employment. This tax cut will be reflected in reduced withholding as of May 1, 1977.

The committee's bill will significantly reduce the "marriage penalty" relative to the House bill. Under the House bill, two single persons would have received a standard deduction $1,800 greater than that allowed to a married couple. Under the committee bill, this marriage penalty will be $1,200. This may be compared to a marriage penalty under present law with respect to the standard deduction between $1,300 and $2,000.

Relative to present law, the Finance Committee bill provides tax reductions for 46.9 million tax returns and increases for 1.7 million returns. The reduction in budget receipts will be $2.0 billion in fiscal year 1977, $7.6 billion in 1978 and $6.0 billion in 1979.

The bill considerably simplifies the filling out of individual income tax returns. It provides for a new set of tax tables, in which 96 percent of taxpayers will be able to look up their tax. The personal exemption, general tax credit, and what is now the standard deduction will be built into these tax tables, so that only about 4 percent of all taxpayers will have to make these calculations and compute their taxes under the tax rate schedules.

In connection with the new tax tables, the concept of the standard deduction is eliminated from the tax law and tax forms, and amounts equal to what would otherwise be the standard deduction ($2,200 for single persons and $3,200 for heads of households and married couples) are built into the tax tables and tax rate schedules as a "zero rate bracket." This means that the 14-percent tax bracket would begin at a redefined "taxable income" of $2,201 for single persons and $3,201 for heads of households and married couples, instead of $1 as under existing law. Since the standard deduction is being built into the tax rate schedules, the bill places a floor under itemized deductions equal to what would otherwise be the standard deduction. Thus, itemizers will be able to deduct only amounts in excess of $2,200 for single persons and $3,200 for married couples and heads of households; however, since these floor amounts will be built into tax rates, itemizers will not experience any change in their tax liability as a result of this feature of the bill. Their tax computation, however, will be simplified because they will be able to use the new tax tables.

The increase in what is now the standard deduction (and what is being converted into a floor under itemized deductions and a zero rate bracket) will make it worthwhile for additional taxpayers who file approximately 7 million tax returns not to itemize their deductions, which itself is an important simplification. These revisions of the standard deduction concept, tax tables and taxable income are permanent changes, in contrast to the other major features of the bill which are temporary.

Business tax credit

The committee amendment makes a major revision in the business tax credit in the House bill. The committee's business tax credit permits businesses to elect either a 25-percent jobs tax credit or an additional 2-percent investment credit for 1977 and 1978. The 12-percent investment credit will then remain in effect for all businesses for 1979 and 1980. The jobs tax credit will benefit most labor-intensive businesses, and the increased investment credit will benefit most capital-intensive businesses.

The jobs tax credit is based on the Federal unemployment tax records which virtually all employers must keep under existing law. Specifically, the credit will equal 25 percent of the increase in each employer's wage base under the Federal Unemployment Tax Act (FUTA) above 103 percent of that wage base in the previous year. (The 3-percent adjustment is intended to take account of the normal growth in employment.) To prevent abuses that could have arisen under the House bill, the committee amendment denies businesses a deduction for an amount of wages equal to the credit. The committee's jobs tax credit will also be available with respect to many more employees than the credit in the House bill because it does not contain the House bill's $40,000 ceiling on the credit allowable to any one employer.

The business tax credit will reduce budget receipts by $0.9 billion in fiscal year 1977, $2.4 billion in 1978 and $2.4 billion in 1979.

Extension of 1977 tax cuts

The bill also extends through 1978 the individual and corporate tax cuts enacted in 1975 and 1976 which would otherwise expire at the end of 1977. The committee believes that the economic situation warrants such an extension. These tax cuts include the general tax credit and the earned income credit for individuals, as well as the increase in the surtax exemption and the reduction in corporate tax rates for small businesses.

Individual tax cuts.—The general tax credit equals the greater of $35 per capita or 2 percent of the first $9,000 of taxable income. In addition to extending this temporary credit through 1978, the bill extends the $35 alternative credit to the additional exemptions for age and blindness, and eliminates the 2-percent alternative credit for married people who file separate returns. Both these changes are needed to build the general tax credit into the new tax tables and are part of the tax simplification program in the bill. The reduction in budget receipts from extending the credit through 1978 is estimated to be $6.8 billion in fiscal year 1978 and $3.9 billion in fiscal year 1979.

The earned income credit equals 10 percent of the first $4,000 of earned income. It is phased out as earned income or adjusted gross income rises from $4,000 to $8,000 and is available only to families who maintain a household for a child who is under 19, a student, or a disabled dependent. It is a "refundable" tax credit; that is, it can exceed tax liability. Extending the credit through 1978 will reduce budget receipts by $1.3 billion in fiscal year 1979.

The committee amendment deletes from the House bill a provision making the earned income credit generally available to families on AFDC who have earned income.

Corporate tax reductions.—The corporate tax reductions for small business reduce the tax rate on the initial $25,000 of corporate taxable income from 22 percent to 20 percent and raise the corporate surtax exemption from $25,000 to $50,000. Thus, the corporate rate structure will continue to be 20 percent on the first $25,000 of corporate taxable income, 22 percent on the next $25,000, and 48 percent on taxable income above $50,000. Extending these tax cuts through 1978 will reduce receipts by $1.0 billion in fiscal year 1978 and $1.3 billion in fiscal year 1979.

Other provisions

The committee bill contains several other provisions relating to problems on which the committee felt prompt legislative action was needed but which were not dealt with in the House bill.

The committee bill changes the effective date for two provisions in the Tax Reform Act of 1976 which imposed tax increases on middle-income people for 1976. These were the provisions in that Act limiting the sick pay exclusion and the exclusion for income earned abroad. The committee bill makes these changes apply to 1977 and subsequent years. The reduction in budget receipts will be $0.4 billion in fiscal year 1977.

Also, the committee bill eliminates interest and penalties that would result for 1976 from changes in the law made by the Tax Reform Act of 1976. In addition, the committee bill applies to 1976 the rules that had been applied to 1975 regarding business expense deductions of State legislators.

The committee bill modifies the limitation on deductions for business use of the home in the case of day care centers, for which the limitations enacted in the Tax Reform Act of 1976 were unduly restrictive.

In addition, the committee extended through 1981 the special provision allowing 5-year amortization for expenditures relating to child care facilities primarily for children of the taxpayer's employees. The provision was enacted in 1971 for a 5-year period and had expired at the end of 1976.

The committee bill also increases the authorization for the Work Incentive (WIN) program by $435 million for each of fiscal years 1978 and 1979. There will be no non-Federal matching requirement for these funds.

Further, the committee added a provision to require studies and reports to the Congress, on the economic and employment effects of the $50 refund and special payments and the business tax credit provisions of the bill. The studies are to be made by the Treasury Department, the Council of Economic Advisors, the Federal Reserve Board, and the Congressional Budget Office.

II. REASONS FOR THE BILL

The Tax Reduction and Simplification Act of 1977, as amended by the Finance Committee, is designed to serve two primary purposes. First, and most important, the bill will stimulate consumer demand, the production of goods and services and investment and employment to insure that economic growth proceeds more strongly in 1977 and 1978. The economic stimulus is achieved by: (1) a program of tax refunds and payments designed to reach virtually all low and middle-income Americans, (2) a permanent increase in the amount of the standard deduction and, therefore, a reduction in individual taxes, which will increase consumer spending, (3) a program of business tax reductions designed to encourage business to invest in additional equipment and to hire additional new employees, and (4) an extension through 1978 of certain individual and corporate tax reductions scheduled to expire at the end of 1977.

Second, the bill will provide simplification of the individual income tax and materially ease the burden of taxpayers in filling out their tax returns. Simplification is achieved by including in the tax tables and rate schedules the revised "standard deduction," the personal exemption, and the general tax credit so that fewer computations will have to be made by taxpayers as compared to those required under current law.

In addition, the committee bill deals with certain other matters on which prompt legislative action is needed. These include provisions which alleviate hardships created by the Tax Reform Act of 1976 and an increase in the authorization for the WIN program.

A. The Economic Situation

The need for economic stimulus

The committee is concerned about the unsatisfactory performance of the U.S. economy. While the unemployment rate averaged 4.7 percent in the period 1948–69, it has averaged 6.2 percent in the 1970's and reached 9 percent in May 1975. The pace of economic growth has also been disappointing. Over the period 1948–69, economic growth averaged 3.9 percent per year, but in the 1970's it has averaged only 2.4 percent per year. Furthermore, the rate of inflation has been higher in the 1970's than over the period 1948–69: 2.3 percent per year between 1948 and 1969 and 6.5 percent per year in the 1970's.

The economic recovery in 1976 began strongly; however, there has been a distinct slowdown in the growth rate of real GNP (which measures the production of goods and services adjusted for inflation). In the nine months ending in March 1976, real GNP grew at an annual rate of 8 percent. In the second quarter of 1976, however, the economy grew at a 4.5 percent annual rate; in the third quarter of

1976, the rate of growth fell to 3.9 percent; and in the fourth quarter of 1976. the rate of growth fell still further to 2.6 percent.[1]

Of particular concern to the committee is the continued high level of unemployment in 1977. The unemployment rate averaged more than 7 percent in 1976, and actually rose in the second half of the year. While the unemployment rate did fall from 7.8 percent in December to 7.3 percent in January 1977, this primarily reflected not a sharp rise in employment but rather a reduction of 440,000 in the number of persons looking for work, probably as a result of the cold weather. In February, the unemployment rate rose to 7.5 percent, reflecting the effect on employment of the cold weather and natural gas shortages. There is a possibility, however, that the rate of unemployment may rise further, as persons who left the labor force because of poor job prospects return to the labor market in search of employment.

Spending for new plant and equipment continues to be sluggish. In 1973, gross fixed investment (expenditures for new housing, plant and equipment), measured in 1972 dollars, was $190.7 billion. In 1974, gross fixed investment fell to $173.5 billion, a 9-percent decline, and in 1975 it fell to $149.8 billion, a 21-percent decline from 1973 and a 14-percent decline from 1974. Fixed investment rose to $162.8 billion in 1976, an 8.7-percent increase over 1975; however, to date it is still below the 1974 level. In the last quarter of 1976, investment in equipment actually declined.

The weakness in new plant and equipment expenditures is highlighted by noting that at this point in previous recoveries such investment has averaged 5.3 percent above the previous peak. In this recovery, investment remains 11.8 percent below the previous peak.

Despite the sluggish growth of output in the economy and a decline in the rate of inflation, the committee is very concerned about the possibility of renewed inflation and has taken it into account in designing the stimulus provisions of this bill. The committee concluded that the stimulus provided by this bill creates no significant inflationary pressures.

The rate at which wholesale prices (the prices of basic commodities and raw materials) increase has declined steadily since 1974. Wholesale prices increased 15.4 percent in 1973 and 20.9 percent in 1974; but the rate of increase fell to 4.2 percent in 1975 and was 4.7 percent in 1976. The rate of increase of consumer prices has also declined since 1974. Consumer prices rose by 8.8 percent in 1973 and 12.2 percent in 1974; in 1975 they rose by 7 percent, and in 1976 they rose by 4.8 percent. However, there is some concern about whether these favorable trends in wholesale and retail prices are sustainable throughout 1977 and 1978. The slowdown in consumer prices has been due in part to unusually favorable food prices. In 1976, food prices rose by only 0.6 percent. It is unlikely, in view of water shortages in the West, gas shortages in the South and East, and the severe damage by cold weather to winter crops throughout the country, that food prices in 1977 (and, therefore, in part consumer prices) will continue to rise slowly. Re-

[1] The preliminary fourth quarter growth rate was 3 percent; however, the February revision, which took into account the colder than expected weather in the fourth quarter, lowered the rate to 2.6 percent.

duced supplies of these products, together with no changes in demand for them, will tend to raise prices, apart from the enactment of this bill.

On balance, the committee concluded that there was an immediate need for an economic stimulus to ensure that steady growth in 1977 and 1978 would proceed and reduce the unacceptably high levels of unemployment. The Administration's overall 1977 tax and spending package of $15.7 billion seems to balance the competing objectives of a reduced level of unemployment and a continued moderation in rates of inflation. Stimulus much in excess of $16 billion this fiscal year would, in the committee's judgment, run the risk of creating additional inflationary pressures. Total stimulus materially below $16 billion, on the other hand, would be inadequate in ensuring that economic growth in 1977 and 1978 would proceed rapidly enough to reduce unemployment.

Also, the committee concluded that the tax stimulus should consist primarily of measures designed to increase consumer spending, along with an additional tax incentive to directly encourage increased employment and investment.

B. Economic Stimulus Provisions

1. One-time refund of 1976 income taxes and payments to certain beneficiaries of income maintenance programs

In designing a program of economic stimulus, the committee believed it essential to provide prompt additional spending in the economy. In addition, it is essential to direct tax refunds and payments to those groups which would spend rather than save their additional income, since inadequate aggregate consumer demand appears to be the major factor in the recent slowdown in the economy's growth rate.

The purpose of the refund is to provide a prompt, readily understood payment which will result in an increase in consumer spending. The basic tax refund amounts to $50 per taxpayer and dependent. For the vast majority of taxpayers, the refund is simply $50 times the number of the taxpayer's personal exemptions. Thus, the average family of four will receive $200. The refund is proportionately phased out between $25,000 and $30,000 or adjusted gross income (AGI). Thus, a family of four with an AGI of $27,500 will receive a refund of $100. It is estimated that these one-time refunds amount to $8.6 billion in fiscal year 1977.

The second temporary part of the committee's economic stimulus program is a one-time payment of $50 to many people participating in certain income maintenance programs. The committee was concerned that a $50 payment be made to as many persons as possible without making significant numbers of double payments. The committee realized that under the bill's tax refund provision, many persons who have little or no taxable income—such as the aged, the disabled, and AFDC recipients—will have no income tax liability and therefore would not receive a $50 refund payment. Accordingly, the committee bill includes one-time $50 payments to many beneficiaries of social security, SSI, railroad retirement, AFDC, black lung benefits, and certain Veterans Administration pensions and compensation programs.[2] Not only does the committee believe that greater equity in the payment program will be achieved by allowing those with the greatest need to participate in the program, but also, because it is likely that such individuals will spend their entire payment, the committee believes that the overall stimulus of the program will be significantly enhanced.

Without special provisions, however, substantial numbers of double payments would be made to those eligible for payments under more than one of the programs mentioned above or those qualifying for both a tax refund and a special payment. To reduce the problem of double payments to the greatest extent possible without unduly delaying the payment of the $50 refunds and without imposing an undue administrative burden on the agencies administering the various programs, the committee has included special provisions to limit the number of $50 payments to an individual to one such payment. Also, the committee bill proportionately phases out the payment to social security, black lung and railroad retirement recipients with adjusted gross income between $25,000 and $30,000. Because of significant administrative problems, the $50 payment will not be denied to AFDC recipients who also receive a $50 tax refund or are beneficiaries of railroad retirement, black lung or Veterans' Administration programs. The committee believes that the administrative costs and delay involved in eliminating these double payments would be substantial. The provisions to eliminate double payments in the committee bill will be more effective and more easily administered that the comparable provisions in the House bill.

It is estimated that these payments will amount to $1.8 billion in fiscal year 1977.

2. *Change in standard deduction*

The second ingredient in the stimulus package is the increase in what is now the standard deduction. While the refund and special payments are designed to provide a temporary stimulus in 1977, the committee thought it necessary to provide for a permanent tax reduction that will also encourage consumer spending in 1977 and future years. By providing for a tax reduction in future years as well, the committee is ensuring that there will be a continuing stimulus to the economy which should help promote self-sustaining economic growth.

Under current law the standard deduction (which is 16 percent of adjusted gross income with a minimum and maximum amount) varies between $1,700 and $2,400 for single persons and between $2,100 and $2,800 for married couples filing joint returns. Thus, there is a "marriage penalty," a reduced standard deduction as a result of getting married, which ranges from $1,300 to $2,000. The House bill replaced the current minimum and maximum amounts with a flat $2,400 for single persons and $3,000 for married couples filing jointly. The marriage penalty under the House bill was thus $1,800 for everyone, as compared to the range of $1,300 to $2,000 under current law.

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[2]The committee bill also provides that the one-time payment be disregarded in the consideration of eligibility or benefit levels under various Federal assistance programs.

The committee was concerned that the marriage penalty under the House bill would be very substantial, and larger than under current law for a large number of people. Accordingly, the committee revised the standard deduction amount for single persons to $2,200 and revised the standard deduction for married couples filing jointly to $3,200. Thus, under the committee bill, the marriage penalty will be only $1,200, rather than $1,800 as under the House bill. Also, the committee bill provides the $3,200 standard deduction amount to heads of households. Under current law, heads of households (for example, a divorced mother with a dependent child) must use the single person's standard deduction.

This change to a flat standard deduction amount includes a major restructuring of the standard deduction concept, which is discussed in greater detail below (under section D. "Simplification of Income Tax Returns for Individuals.") The change in the standard deduction provides a tax cut of $2.0 billion in fiscal year 1977, $7.6 billion in fiscal year 1978 and $6.0 billion in fiscal year 1979. Of these amounts, the provision permitting heads of households to use the joint return standard deduction reduces receipts by $67 million in fiscal year 1977, $665 million in fiscal year 1978 and $624 million in fiscal year 1979.

3. *Tax reduction for business—elective increase in investment credit or new jobs credit*

The third item in the tax reduction program is an elective program of an additional investment tax credit or a new jobs tax credit. The first two parts of the stimulus program are designed by the committee to increase consumer spending and stimulate economic growth. An important result will be improvements in the labor market. The committee believes it is also important to provide a direct incentive for capital-intensive firms to invest in additional equipment and for labor-intensive firms to increase their employment.

The committee reviewed several business tax reduction proposals. Under current law, investments in qualified property are eligible for a 10-percent investment tax credit. While the new jobs tax credit in the House bill would provide an incentive for additional employment, the committee was concerned that the overall $40,000 limitation would provide little benefit to larger businesses. Also, the committee was concerned that capital-intensive firms would not benefit from the House provision. In view of the low level of investment in the economy, it was thought essential to provide an additional incentive to business to invest in new equipment as well as to hire additional employees.

Accordingly, the committee bill provides a business tax reduction which for 1977 and 1978 will be on an elective basis, either an additional 2 percentage points of the investment tax credit (from 10 percent to 12 percent) or a 25-percent new jobs tax credit. After 1978, the additional 2 percentage point investment tax credit will be available to all businesses for 1979 and 1980.

The committee bill modifies the House new jobs tax credit in a number of ways which will enhance its effectiveness and limit possible abuses. The new jobs credit under the House bill was limited to $40,000 per employer per year, for a credit equivalent to hiring 24 new employees. The committee bill eliminates this ceiling to make the

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credit available with respect to a larger portion of the work force. Under the House bill, the new jobs tax credit equalled 40 percent of the first $4,200 of wages paid subject the Federal Unemployment Tax Act (FUTA) in excess of 103 percent of such wages paid in the prior year. In order to keep the overall revenue impact of the credit within the total size of the package, the rate of credit was reduced to 25 percent.

The committee amendment also modifies the House jobs tax credit to limit possible abuses. First, the committee amendment requires that firms reduce by the amount of the credit their ordinary deduction for wages. This will prevent individuals in high brackets from receiving tax reductions under the new jobs credit that exceed 100 percent of the wages paid to new employees. Second, in order to prevent inordinately large tax reductions to new and rapidly expanding firms, the committee amendment limits the wages on which the credit is computed to no more than 50 percent of FUTA wages paid for the year. The committee amendment also deleted the additional credit for the handicapped in the House bill.

It is estimated that these business tax reduction provisions will reduce revenues by $0.9 billion in fiscal year 1977, $2.4 billion in fiscal year 1978, and $2.4 billion in fiscal year 1979. Of this revenue reduction, the new jobs credit is estimated to involve $0.4 billion for fiscal 1977, $1.2 billion for fiscal 1978, and $0.8 billion for fiscal 1979. It is estimated that the additional investment tax credit will reduce revenues by $0.5 billion for fiscal year 1977, $1.2 billion in fiscal year 1978, and $1.6 billion in fiscal year 1979. In addition the investment credit increase will involve a revenue reduction of $2.0 billion in fiscal year 1980 and $1.3 billion for fiscal year 1981.

4. One-year extension of 1977 tax reductions for individuals and corporations

The fourth part of the economic stimulus program is the extension of the general tax credit and the earned income credit for individuals and the corporate rate reductions for small businesses through 1978. The extension adds to the stimulus of the refund program by preventing tax increases that would occur after the end of 1977 without further action, increases which would adversely affect the course of the recovery. Also, enacting the extension at this time will add to business and consumer certainty and confidence. Overall, the one-year extension of the individual and corporate tax cuts amounts to $7.8 billion in fiscal year 1978 and $6.5 billion in fiscal year 1979.

C. Economic Impact of Committee Action

In the absence of the economic stimulus provided by this legislation and by pending proposals before other committees [3] it is generally expected that the sluggish performance of the economy would persist in 1977 and 1978. The major forecasts of the economy examined by the committee suggest that the growth in real output would, without

[3] In addition to the tax package, the Administration proposed a variety of temporary spending programs which total $2.1 billion in outlays in fiscal year 1977. The Third Concurrent Resolution provides for $3.4 billion in additional outlays in fiscal 1977.

the economic stimulus, average no better than 5.9 percent in 1977 and no more than 5.6 percent in 1978 and could be well below those rates. Moreover, the unemployment rate is expected to be well in excess of 7 percent in 1977 and average 7.4 percent as late as the third quarter 1978. At the same time, inflation is expected to persist in the 5 to 6 percent range.

With the stimulus provided by the tax package and the expenditure proposals before other committees, it is likely that the pace of economic growth will be higher in 1977 and 1978. The package should reduce the rate of unemployment by about $5/10$ of a percentage point by the end of 1977, or by 500,000 workers, so that it will then be about 7-percent. By the third quarter of 1978, it is expected that, as a result of the stimulus package, the unemployment rate will be below 7 percent. Because there is substantial slack in the economy, it is not likely that the additional stimulus will add to the inflation rate.

D. Simplification of Income Tax Returns for Individuals

Need for simplification

The second major purpose of the committee bill is to simplify the tax system so that individual taxpayers will have fewer computations to make in filling out their tax returns. There is general agreement that the present individual tax forms have become too long and are a source of complexity and taxpayer error. The Internal Revenue Service has reported that significant numbers of the short-form 1040A tax returns filed in the early weeks of this year contained errors. The major sources of errors involved computing the standard deduction and computing the general $35 tax credit.

Revision of tax tables and conversion of standard deduction to a "floor" under itemized deductions

The committee agreed to the House revision of the standard deduction in this bill not only because it would provide additional stimulus to the economy in 1978 but also because it would simplify the individual income tax returns. The revision of the standard deduction represents a substantial restructuring of the individual income tax, and, when combined with the new tax tables, should make filing of income tax returns much simpler for both itemizers and nonitemizers.

Tax forms and tax tables

Under present law, there are two ways in which a taxpayer determines the amount of tax owed. A taxpayer either determines his tax from the tax tables in which he looks up the dollar amount of tax or from the tax bracket rate schedule. The tax tables are considerably easier for the typical taxpayer to use than the rate schedules.

The bill provides a considerable simplification of the filing out of tax returns for the individual income tax. It provides for a new set of tax tables, from which 96 percent of taxpayers will be able to look up their tax. The personal exemption, general tax credit and what is now the standard deduction will be built into these tax tables, so that only about 4 percent of taxpayers will have to make these computations.

Under the bill, the $750 personal exemptions and the general tax credit also will be built into the tax tables. (The general tax credit is the greater of either $35 per capita or 2 percent of the initial $9,000 of taxable income.) This will allow taxpayers whose income and number of exemptions are covered by the tax table to determine tax liability from the tax tables without making separate calculations for exemptions or the general tax credit.

Conversion of standard deduction into zero bracket and floor under itemized deductions

In connection with the new tax tables, the concept of the standard deduction, under both the House and committee bill, is eliminated from the tax law and tax forms, and amounts equal to what would otherwise be the standard deduction ($2,200 for single people and $3,200 for married couples and heads of households) are built into the tax tables and tax rate schedules as a "zero rate bracket." This means that the 14-percent tax bracket would begin at a redefined "taxable income" of $2,201 for single people and $3,201 for married couples and heads of households, instead of $1 as under existing law. Since the standard deduction is being built into tax rate schedules, the bill places a floor under itemized deductions equal to what would otherwise be the standard deduction. Thus, itemizers will only be able to deduct amounts in excess of $2,200 for single people and $3,200 for married couples and heads of households; however, since these amounts will be built into tax rates, itemizers will not experience any change in their tax liability as a result of this bill. Their tax computation, however, will be simplified. Also, for individuals (but not for corporations) "taxable income" is redefined to equal the amount of taxable income under present law plus the amount of the zero rate bracket (that is, the amount which is now the standard deduction).

The increase in what is now the standard deduction (and what is being converted into a floor under itemized deductions and a zero rate bracket) will make it worthwhile for many taxpayers (involving about 7 million tax returns) not to itemize their deductions, which itself is an important simplification.

E. Postponement of Certain Provisions of the Tax Reform Act of 1976

It has come to the committee's attention that several revenue raising provisions of the Tax Reform Act of 1976 were imposed retroactively and would cause substantial hardship. This is particularly true of the changes in the exclusions of sick pay and income earned abroad for individuals. In view of the fact that the provisions were enacted on October 4, 1976 and applied to calendar year 1976, the committee concluded that substantial inequities would result from the retroactive application of these provisions, and that individuals could suffer substantially from them. Acordingly, the effective date of the changes in the sick pay and income earned abroad provisions were generally changed from January 1, 1976 to January 1, 1977. In addition, the committee bill removes any penalties and interest relating to underpayments of estimated tax for 1976 due to any of the retroactive features of the 1976 Act.

It is estimated that the change in effective date for the sick pay provision will reduce revenues by $327 million in fiscal year 1977; the change in effective date for the modifications in the exclusion of income earned abroad will reduce revenues by $38 million in fiscal year 1977; and the removal of penalties and interest will reduce revenues by $15 million in fiscal year 1977.

F. Other Provisions Added by the Committee

The committee added three other tax provisions to the bill, relating to business use of the home for day care, travel expenses away from home for State legislators, and 5-year amortization for child care facilities. Further, the committee added a provision to increase the authorizations for WIN program for fiscal years 1978 and 1979.

1. Business use of the home for day care

The committee amendment provides that deductions related to the business use of private homes for day care for children, the handicapped or the elderly be exempted from certain rules enacted in the Tax Reform Act of 1976. Under the 1976 Act, to be deductible, any portion of the home used for business purposes must be used exclusively and regularly for the particular trade or business in order to claim expenses as a business deduction. The rule contained in the committee bill recognizes the special character of day care provided in the home, and the infeasibility of requiring that certain rooms (e.g., a kitchen or bathroom) be used exclusively for day care in order to be deductible. This is to be effective as of December 31, 1975, the effective date of the 1976 Tax Reform Act provision.

It is estimated that the provision relating to business use of the home for day care facilities will reduce revenues by $20 million in fiscal year 1977, $17 million in fiscal year 1978, and $17 million in fiscal year 1979.

2. Travel expenses away from home for State legislators

Another amendment added by the committee extends through 1976 the provision adopted by the Tax Reform Act of 1976 relating to the deduction of travel expenses away from home for State legislators for one year, that is through 1976, in order to give the committee additional time to consider a permanent solution to this problem.

3. Extension of 5-year amortization for child care facilities

In addition, the committee extended the provision for rapid amortization for certain child care facilities which expired at the end of 1976. The committee believes that employer provision of child care facilities is an important way to make it easier for mothers to go to work. Thus, the committee extended the 5-year amortization provision beginning January 1, 1977, for five years, or through 1981.

4. Increased authorizations for WIN program

Further, the committee added a provision to increase the authorizations for the WIN program by $435 million for each of fiscal years 1978 and 1979. No non-Federal matching funds are required for these additional authorizations for the WIN program.

G. Study of Economic nd Employment Effect of Tax Reductions

The committee believes that there should be a greater effort to examine the economic and employment effects of tax changes after they have been enacted. Such an examination will assist Congress in making future decisions on tax policy. In addition, it will provide a systematic review of the economic forecasts that are made by Federal Government agencies and are used in making economic policy.

The committee bill, therefore, provides for a series of studies and reports to the Congress on the economic and employment impact of the principal tax change in the bill—the refund of 1976 individual income taxes and related payments, the new jobs tax credit and the investment credit—by the Department of the Treasury, the Council of Economic Advisers, the Congressional Budget Office and the Board of Governors of the Federal Reserve System.

III. BUDGET EFFECTS OF THE BILL

Table 1 gives a summary of the budget effects of H.R. 3477, as amended (the Tax Reduction and Simplification Act of 1977). Overall, it shows that the committee bill makes financial resources available to the economy in an amount estimated at $13.7 billion in fiscal year 1977, $18.4 billion in 1978 and $15.4 billion in 1979. The table breaks these totals down into seven categories: (1) refunds of 1976 individual income taxes of $8.6 billion in fiscal year 1977; (2) payments to certain program beneficiaries of $1.8 billion in fiscal year 1977; (3) liberalization and modification of the standard deduction amounting to $2.0 billion in fiscal year 1977, $7.6 billion in 1978, and $6.0 billion in fiscal year 1979 (plus $6.2 billion in fiscal year 1980 and $6.4 billion in fiscal year 1981, which are not shown in the table); (4) an elective new jobs tax credit or an increased investment credit involving a revenue loss of $0.9 billion in fiscal year 1977, $2.4 billion in 1978, and $2.4 billion in 1979 (plus $2.0 billion in fiscal year 1980 and $1.3 billion in fiscal year 1981 for the increased investment credit, which are not shown in the table); (5) a one-year extension of the 1977 individual and corporate tax cuts, totaling $7.9 billion in fiscal year 1978 and $6.5 billion in 1979; (6) modification of certain provisions of the Tax Reform Act of 1976 and a renewal of 5-year amortization for certain child care facilities, with decreased receipts of over $400 million in fiscal year 1977, and less than $50 million each in fiscal year 1978 and in fiscal year 1979; and (7) increased authorizations for the WIN program of $435 million in each of fiscal years 1978 and 1979.

Table 2 shows the budget effects of the bill in greater detail by bill title and section.

Table 3 sets forth the distribution of the $8.6 billion of refunds of 1976 tax by adjusted gross income class. It shows that almost 61 percent of the $8.6 billion will go to tax returns with $15,000 or less of adjusted gross income.

Table 4 presents the effect (based upon 1976 income levels) of the committee's conversion of the present law standard deduction into a liberalized flat deduction incorporated into the tax rate schedules. About 47 million tax returns will have tax decreases—of which 3.7 million are made nontaxable. In addition, it is expected that 7.3 million returns would shift from itemizing deductions to direct use of the tax tables into which a "zero tax rate bracket" has been incorporated in lieu of the standard deduction. These returns enjoy an aggregate tax reduction of $5.7 billion. About 1.7 million returns of single persons will have tax increases totaling $93 million. As Table 4 indicates, over 81 percent of the net tax decrease resulting from this provision will go to tax returns with $15,000 or less of adjusted gross income.

Tables 5 and 6 illustrate the tax burden under present law in 1977 and under the modification of the standard deduction. The tax savings are shown for single persons and for married couples with no, two, and four dependents and for heads of households with one, two, and four dependents, with various levels of adusted gross income.

Table 1.—Summary of Budget Effect of the Tax Reduction and Simplification Act of 1977, Fiscal Years 1977–79

[In billions of dollars]

Category	Fiscal year 1977	1978	1979
1. Refund of 1976 individual income taxes	−8.6		
2. Payments to beneficiaries of various programs	−1.8		
Subtotal—refunds and payments	−10.4		
3. Increase and revision of the standard deduction	−2.0	−7.6	−6.0
4. Elective business tax credits:			
Investment credit	−0.5	−1.2	−1.6
New jobs credit	−0.4	−1.2	−0.8
Subtotal—business tax credits	−0.9	−2.4	−2.4
5. 1-year extension of tax cuts:			
Individual [1]		−6.8	−5.2
Corporate		−1.0	−1.3
Subtotal—tax cut extensions		−7.9	−6.5
6. Other tax provisions: Amortization of child care facilities and modification or postponement of certain provisions of the Tax Reform Act of 1976	−0.4	−(2)	−(2)
7. Authorizations for WIN program		−0.4	−0.4
Total	**−13.7**	**−18.4**	**−15.4**

[1] Consists of the general tax credit and earned income credit (the earned income credit extension has no budget effect, however, until fiscal 1979).
[2] Less than $50,000,000.

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

Table 2.—Estimated Budget Effect of H.R. 3477, the Tax Reduction and Simplification Act of 1977, by Title and Section, Fiscal Years 1977–79

[In billions of dollars]

Title and section	Fiscal year 1977	1978	1979
Title I—Refund of 1976 individual income taxes; payments to recipients of certain benefits:			
Sec. 101—A refund of $50 per person of 1976 taxes: [1]			
Refunds against 1976 tax liability	−7.3		
Refunds in excess of 1976 tax liability	−1.3		
Total, sec. 101	−8.6		
Sec. 103—Authorization of grants to American Samoa, Guam, and the Virgin Islands [2]		−(3)	
Secs. 111–114—			
Payments to social security, supplemental security income, and railroad retirement beneficiaries and payments to recipients of "black lung" benefits	−1.2		
Payments to beneficiaries of veterans' compensation and pensions	−0.1		
Payments to beneficiaries of aid to families with dependent children	−0.6		
Total, secs. 111–114	−1.8		
Total, title I	**−10.4**	−(3)	

[1] The tax refund is generally limited to 1976 liability but is refundable with respect to returns entitled to the earned income credit and returns with earned income and dependent children. It is phased out between $25,000 and $30,000 of adjusted gross income.

[2] These possessions use the U.S. tax laws for their own income tax purposes. The authorization for these grants is intended to cover the income tax reductions for these possessions as a result of the refunds and the standard deduction changes which reduce their revenues for 1977.

[3] Less than $50,000,000.

Table 2 (Continued).—Estimated Budget Effect of H.R. 3477, the Tax Reduction and Simplification Act of 1977, by Title and Section, Fiscal Years 1977–79

Title II—Revision of standard deduction and reduction of individual income taxes:			
Secs. 201 and 202—Revision of the standard deduction to a flat $2,200 for single persons and $3,200 for joint returns and heads of households	−2.0	−7.6	−6.0
Sec. 203—Extension of individual income tax reductions:			
Extension through 1978 of the general tax credit [4]		−6.8	−3.9
Extension through 1978 of the refundable earned income credit			−1.3
Total, sec. 203		−6.8	−5.2
Total, title II	**−2.0**	**−14.4**	**−11.3**
Title III—Reduction in business taxes:			
Sec. 301—Extension of corporate income tax reductions through 1978		−1.0	−1.3
Sec. 302—Elective business tax credits:			
Investment credit	−0.5	−1.2	−1.6
New jobs credit	−0.4	−1.2	−0.8
Subtotal, business tax credits	−0.9	−2.4	−2.4
Total, title III	**−0.9**	**−3.5**	**−3.7**

[4] This provision is amended for 1977 and 1978 to limit the tax credit to $35 per exemption in the case of separate returns and to extend the $35 credit to the additional exemption for age and blindness.

Table 2 (Continued).—Estimated Budget Effect of H.R. 3477, the Tax Reduction and Simplification Act of 1977, by Title and Section, Fiscal Years 1977–79

[In billions of dollars]

Title and Section	Fiscal year 1977	1978	1979
Title IV—Postponement or modification of certain provisions in the Tax Reform Act of 1976:			
Sec. 401—Changing the effective date of the sick pay exclusion provision to taxable years beginning after December 31, 1976 (sec. 505 of Tax Reform Act)	−0.3		
Sec. 402—Changing the effective date of the income earned abroad provision to taxable years beginning after December 31, 1976 (sec. 1011 of Tax Reform Act)	−(3)		
Sec. 403–405—Elimination of interest and penalties on underpayment of estimated tax arising out of the Tax Reform Act of 1976	−(3)		
Sec. 406(b)—Elimination of the exclusive use test in business use of homes for the provision of day care services (sec. 504 of Tax Reform Act)	−(3)	−(3)	−(3)
Sec. 407—State legislators' travel expenses away from home (sec. 604 of Tax Reform Act)	−(3)		
Total, title IV	**−0.4**	**−(3)**	**−(3)**
Title V—Economic impact studies			
Title VI—Other provisions:			
Sec. 601—Authorizations for WIN program		−0.1	−0.4
Sec. 602—Amortization for child care facilities	−(3)	−(3)	−(3)
Total, title VI	**−(3)**	**−0.4**	**−0.4**
Grand total, titles I, II, III, IV, V, and VI	**−13.7**	**−18.4**	**−15.4**

[3] Less than $50,000,000.

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

Table 3.—Estimated Effect of the Committee's Tax Refund Program by Income Class

[Calendar year 1976 income levels]

Adjusted gross income class	Number of returns affected (thousands)	Tax refund: Amount (millions)	Tax refund: Percent of total refund
Under $5,000	10,713	$981	11.4
$5,000 to $10,000	19,500	2,004	23.4
$10,000 to $15,000	16,080	2,230	26.0
$15,000 to $20,000	11,782	1,907	22.2
$20,000 to $30,000	9,910	1,454	17.0
Total	**67,984**	**8,577**	**100.0**

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

Table 4.—Effect of the Committee's Change in the Standard Deduction by Income Class

[Calendar year 1976 income levels]

Adjusted gross income class	Returns with tax decrease: Total number with tax decrease (thousands)	Returns with tax decrease: Number made nontaxable (thousands)	Returns with tax decrease: Number shifting to the standard deduction (thousands)	Returns with tax decrease: Decrease in tax liability (millions)	Returns with tax increase: Total number with tax increase (thousands)	Returns with tax increase: Number shifting to itemizing deductions (thousands)	Returns with tax increase: Increase in tax liability (millions)	Net decrease in tax liability: Amount (millions)	Net decrease in tax liability: Percent of net decrease
Under $5,000	7, 200	2, 196	268	$517				$517	9. 2
$5,000 to $10,000	17, 166	1, 377	1, 918	2, 191	([1])		([1])	2, 191	39. 2
$10,000 to $15,000	12, 295	80	2, 924	1, 852	474	6	$12	1, 840	32. 9
$15,000 to $20,000	6, 365	5	1, 332	698	938	2	56	642	11. 5
$20,000 to $30,000	3, 313	1	730	339	247		18	321	5. 7
$30,000 to $50,000	504	([1])	103	72	57		5	67	1. 2
$50,000 to $100,000	66		8	14	8		1	13	. 2
$100,000 and over	5		1	1	1		([1])	1	([1])
Total	**46, 914**	**3, 658**	**7, 282**	**5, 684**	**1, 725**	**8**	**93**	**5, 591** [2]	**100. 0**

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

[2] This distributional table reflects, for the revised standard deduction, the net decrease in tax liability ($5.6 billion) for calendar year 1976, the latest year for which distributional data are available. The fiscal year data (in Table 2) for fiscal years 1977 ($2.0 billion) and 1978 ($7.6 billion) reflect the late start on changed withholding in fiscal year 1977 and the consequent bunching up of decreased receipts in fiscal year 1978. Thereafter, the calendar year liability figures and the fiscal year receipts figures approximate each other: the calendar year 1979 decrease in liability is $6.1 billion, fiscal year 1979 decrease in receipts is $6.0 billion; calendar year 1980 decrease in liability is $6.3 billion, fiscal year 1980 decrease in receipts is $6.2 billion; etc.

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

Table 5.—Federal Individual Income Tax Burden[1] in Calendar Year 1977 Under Present Law and Under the Committee's Modification of the Standard Deduction—Single Person and Married Couple With No, 2 and 4 Dependents (Assuming Deductible Personal Expenses of 17 Percent of Income)

	Tax liability					
	Single person			Married couple with no dependents		
Adjusted gross income [2]	Under present law	Under committee bill	Tax reduction	Under present law	Under committee bill	Tax reduction
$3,000	$43	0	$43	0	0	0
$5,000	364	$279	85	$130	0	$130
$6,000	534	449	85	284	$115	169
$8,000	905	810	95	608	431	177
$10,000	1, 331	1, 221	110	948	761	187
$12,500	1, 816	1, 798	19	1, 395	1, 186	209
$15,000	2, 369	2, 369	0	1, 849	1, 706	143
$17,500	2, 965	2, 965	0	2, 336	2, 280	56
$20,000	3, 604	3, 604	0	2, 855	2, 855	0
$25,000	5, 050	5, 050	0	3, 990	3, 990	0
$30,000	6, 670	6, 670	0	5, 288	5, 288	0
$35,000	8, 445	8, 445	0	6, 758	6, 758	0
$40,000	10, 335	10, 335	0	8, 363	8, 363	0

[1] Computed without reference to the tax tables.
[2] Wage or salary and/or self-employment income.

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

Table 5 (Continued).

Adjusted gross income [2]	Tax liability [3]					
	Married couple with 2 dependents			Married couple with 4 dependents		
	Under present law	Under committee bill	Tax reduction	Under present law	Under committee bill	Tax reduction
$3,000	−$300	−$300	0	−$300	−$300	0
$5,000	−300	−300	0	−300	−300	0
$6,000	−200	−200	0	−200	−200	0
$8,000	294	120	$174	0	0	0
$10,000	651	446	205	308	128	$180
$12,500	1,114	917	197	766	562	204
$15,000	1,519	1,380	139	1,161	1,037	124
$17,500	1,976	1,926	50	1,616	1,566	50
$20,000	2,480	2,480	0	2,075	2,075	0
$25,000	3,570	3,570	0	3,120	3,120	0
$30,000	4,808	4,808	0	4,298	4,298	0
$35,000	6,218	6,218	0	5,648	5,648	0
$40,000	7,778	7,778	0	7,163	7,163	0

[1] Computed without reference to the tax tables.

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

[3] Negative figures are due to the refundable earned income credit.

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

Table 6.—Federal Individual Income Tax Burden[1] in Calendar Year 1977 Under Present Law and Under the Committee's Modification of the Standard Deduction—Single Person and Head of Household With 1, 2 and 4 Dependents (Assuming Deductible Personal Expenses of 17 Percent of Income)

	Tax liability[3]					
	Single person			Head of household with 1 dependent		
Adjusted gross income[2]	Under present law	Under committee bill	Tax reduction	Under present law	Under committee bill	Tax reduction
$3,000	$43	0	$43	−$300	−$300	0
$5,000	364	$279	85	−$102	−300	$198
$6,000	534	449	85	−174	−82	256
$8,000	905	810	95	716	464	252
$10,000	1, 331	1, 221	110	1, 080	801	279
$12,500	1, 816	1, 798	19	1, 504	1, 280	224
$15,000	2, 369	2, 369	0	1, 998	1, 835	163
$17,500	2, 965	2, 965	0	2, 537	2, 476	61
$20,000	3, 604	3, 604	0	3, 108	3, 108	0
$25,000	5, 050	5, 050	0	4, 380	4, 380	0
$30,000	6, 670	6, 670	0	5, 824	5, 824	0
$35,000	8, 445	8, 445	0	7, 436	7, 436	0
$40,000	10, 335	10, 335	0	9, 174	9, 174	0

[1] Computed without reference to the tax tables.
[2] Wage or salary and/or self-employment income.
[3] Negative figures are due to the refundable earned income credit.
Note: Details may not add to totals because of rounding.

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Table 6 (Continued).

Adjusted gross income [2]	Tax liability [3]					
	Head of household with 2 dependents			Head of household with 4 dependents		
	Under present law	Under committee bill	Tax reduction	Under present law	Under committee bill	Tax reduction
$3,000	−$300	−$300	0	−$300	−$300	0
$5,000	−257	−300	$43	−300	−300	0
$6,000	4	−200	204	−200	−200	0
$8,000	565	294	271	224	0	$224
$10,000	930	660	271	590	314	276
$12,500	1, 346	1, 130	216	1, 003	780	223
$15,000	1, 810	1, 657	154	1, 466	1, 317	150
$17,500	2, 334	2, 274	61	1, 954	1, 898	56
$20,000	2, 898	2, 898	0	2, 490	2, 490	0
$25,000	4, 140	4, 140	0	3, 670	3, 670	0
$30,000	5, 554	5, 554	0	5, 023	5, 023	0
$35,000	7, 128	7, 128	0	6, 534	6, 534	0
$40,000	8, 859	8, 859	0	8, 229	8, 329	0

[1] Computed without reference to the tax tables.
[2] Wage or salary and/or self-employment income.
[3] Negative figures are due to the refundable earned income credit.

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

IV. GENERAL EXPLANATION

A. 1976 TAX REFUND AND RELATED PROVISIONS

1. Refund of 1976 Individual Income Taxes (sec. 101 of the bill and secs. 6428 and 6611(e) of the Code)

Present law

Under present law, individual taxpayers generally are required to file their 1976 tax returns by April 15, 1977. (This deadline applies to calendar year taxpayers, who account for the great bulk of all individual taxpayers.)

The Tax Reduction Act of 1975 (P.L. 94–12), which included a refund of 1974 individual income taxes, was enacted on March 29, 1975. Most of the refund checks were mailed in May and early June of that year. The 1975 refund equaled 10 percent of 1974 tax liability, with a maximum refund of $200 for any tax return and a minimum refund of $100. However, the refund of 1974 taxes could not exceed the taxpayer's tax liability.[1]

The refund of 1974 taxes was phased down proportionately from $200 to $100 at adjusted gross income levels from $20,000 to $30,000. For example, a taxpayer whose adjusted gross income was $25,000 and who was otherwise entitled to a refund of $200 by reason of his tax liability, received a refund of $150 under the 1975 Act.

The 1974 refund applied only to taxpayers who were individuals, and was not available to estates and trusts, nor was it available to nonresident aliens. In the case of married individuals who filed separate returns for 1974, the minimum and maximum refunds and the adjusted gross income limitation were cut in half for each spouse.

Reasons for change

The committee is concerned about the decline in the rate of economic growth in 1976 and the persistence of high rates of unemployment. Gross national product in constant prices (that is, the production of goods and services in the economy, adjusted for inflation) grew at an annual rate of 8 percent from mid-1975 to the first quarter of 1976. However, the growth rate fell to 4.5 percent in the second quarter of 1976, 3.9 percent in the third quarter, and only 2.6 percent in the fourth quarter. The committee believes this growth rate is unacceptably low. A one-time refund of 1976 individual income taxes and the related payments to beneficiaries of certain income maintenance programs will provide an immediate boost to consumer spending, which in turn will lead to increased production and employment. Thus, the refund and

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[1] Sec. 6428, effective for the taxpayer's first taxable year beginning in 1974, is still effective with respect to the refund of 1974 tax liability, since the period of limitations is still open.

related payments are an essential part of a coordinated program of economic stimulus for 1977 and 1978. They will provide stimulus in 1977, after which stimulus will be provided by other tax cuts, jobs, and public works programs.

After analyzing the available data, the committee agrees with the conclusion that much of the refund and related payments will be spent by consumers in 1977. The committee has structured the refund and related payments to attempt to ensure this result by phasing out the tax refund at upper income levels, where people are likely to save most of their tax refunds, and by providing $50 payments to many low-income people, who will be very likely to spend any additional funds.

The tax refund and related payments provide immediate economic stimulus without eroding the Federal Government's revenue base in the future, as would permanent tax reductions of this magnitude. The committee hopes to be able to consider permanent tax reduction in connection with a comprehensive reform of the individual and corporate income taxes, but to enact such reduction in this bill would be inappropriate because it would prejudge the issue of how a tax reform bill should be structured. Furthermore, the amount of permanent tax reduction that will be appropriate will depend on the spending programs enacted in the next several years, the magnitude of which is unknown at this time.

For this reason, the bill concentrates the bulk of the 1977 economic stimulus in the refund of 1976 individual taxes and the related payments to individuals.

Explanation of provisions

Under the House bill, and as agreed to by the committee, individual taxpayers (other than most nonresident aliens [2]) are to receive refunds of 1976 taxes. The refund will equal $50 times the number of personal exemptions claimed by the taxpayer for himself, his spouse and his dependents. The refund will generally be limited to the amount of the taxpayer's tax liability for 1976. In addition, the refund will be phased out proportionately as a taxpayer's adjusted gross income rises from $25,000 to $30,000.

Eligible personal exemptions

In general, the exemptions from which the refund is computed are the regular personal exemptions for the taxpayer, a spouse, and each dependent for whom the taxpayer is entitled to claim an exemption. There is no refund for the additional personal exemptions which are allowed a taxpayer for old age or blindness.

The total number of exemptions on which the refund will be based is that reflected on line 6d of the individual income tax return forms 1040 and 1040A for 1976.

Limitation based on tax liability

For most taxpayers, the refund is not to exceed tax liability for 1976. The tax liability for purposes of this limitation is reduced by the total of the so-called "nonrefundable" income tax credits to which the taxpayer may be entitled. On form 1040, the tax liability after credits

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[2] A nonresident alien who files a joint return with a resident is eligible for the refund.

will be equal to the amount on line 22, less the amounts on line 58 (self employment tax), line 61 (excess contribution tax from form 5329—"IRA") and the amount, if any, written in by the taxpayer below line 61 for "Tax On Undistributed Individual Retirement Accounts and Annuities." The tax liability will also be computed with certain other adjustments relating to tip income, which are necessary in order to assure speedy and efficient processing of the refunds through the Internal Revenue Service's computer facilities.

In order to provide refunds for certain taxpayers with low amounts of income, exceptions to the tax liability limitation are provided in two situations. Under the first exception, taxpayers who claim the earned income credit could receive a refund in excess of tax liability. (The earned income credit is described below in section E.)

The second category of people for whom the refund could exceed tax liability under the bill is provided to prevent a "notch" in the refundable feature of the proposal. If the refund were allowed to exceed tax liability only for recipients of the earned income credit, there would be a "notch" at the income level at which the earned income credit phases out. For example, a 6-person family with adjusted gross income of $7,999 could be entitled to a 10¢ earned income credit under present law, which would make it eligible for a $300 refund, as described above. (A 6-person family does not pay income tax on the first $8,067 of income under existing law because of the personal exemption, the minimum standard deduction and the general tax credit.) However, if the refund could exceed tax liability only for recipients of the earned income credit, a $1 increase in income to $8,000 would eliminate the family's earned income credit and thereby reduce its refund from $300 to zero.

In general, this second category for whom the refund may exceed tax liability consists of people who would have been eligible for the earned income credit were it not for the income phaseout of that credit. Specifically, these are people with some earned income and a dependent child living with them. Earned income is to be determined from information provided on lines 9 and 58 of form 1040 or line 9 of form 1040A. The Internal Revenue Service can determine that a taxpayer lives with a dependent child from information provided on line 6b of forms 1040 and 1040A. There would still be a small number of cases in which the "notch" described above remains (persons ineligible for the earned income credit solely because of the income phaseout who do not claim their child as a dependent or who have earned income that does not result in entries on lines 9 or 58 of the form 1040), but it is difficult administratively to eliminate the notch entirely and still provide the full $50 refund to recipients of the earned income credit.

Phaseout of refund

The primary objective for this refund provision is to increase consumer spending to stimulate greater production and employment. In order to achieve this objective, the committee agreed to the provisions of the House bill which make the refund available only to those taxpayers with low levels of income who, it may be reasonably assumed, will tend to spend, rather than save, most of any additional funds. Accordingly, the bill provides for a phaseout of the refund as adjusted gross income rises from $25,000 to $30,000.

To illustrate this phaseout provision, consider a taxpayer who filed a joint return for 1976 on which he validly claimed regular personal exemptions for himself and his spouse plus exemptions for his two dependent children and his dependent mother. He would be entitled in this case to a potential refund of $250 (equal to his 5 exemptions times $50).[3] Assume further that the taxpayer's tax liability for 1976 is $4,000 so that the tax liability limitation would not apply because tax liability exceeds the $250 potential refund. However, the taxpayer reported adjusted gross income (AGI) of $27,000, which causes application of the phaseout provision. Because the refund is phased out to the extent a taxpayer's AGI is more than $25,000, and is phased out entirely at an AGI level of $30,000, the taxpayer's potential $250 refund in this example is reduced in the ratio of the amount by which his AGI exceeds $25,000 (or $2,000) bears to the $5,000 phaseout range ($30,000 minus $25,000), or in a ratio of ⅖ths. As a result the taxpayer's refund in this example is reduced by ⅖ths of $250, or $100, and he would receive a refund of $150.

Eligibility for refunds

The refund applies only to taxpayers who are individuals. Where married taxpayers file a joint return for 1976, the amount of the refund is determined by reference to the total exemptions and the limitations are based on the joint income tax liability and adjusted gross income figures as combined for purposes of the joint return. In the case of married taxpayers who file separate returns for 1976, the adjusted gross income limitation amount is cut in half with respect to each spouse so that the phaseout will begin to apply where each spouse's income exceeds $12,500, and the refund will be entirely phased out of AGI of $15,000. Similarly, the number of exemptions and the tax liability limitation for each spouse will be based upon information reported on his or her separate return. In the case of a separate return where one spouse claims the other as a dependent, the phaseout will be between $25,000 and $30,000.

Refunds are not to be available in the case of nonresident aliens (other than those filing joint returns under Sec. 6013(g)) and trusts and estates. The refund is available in a situation where a decedent's executor or other representative files a final return of the decedent for 1976. In such a case, the refund is available for the decedent's final return, but not for the estate's return for the remainder of that year.

Taxable year affected

The refund provisions of the bill generally apply to the taxable year of a taxpayer which began during the 1976 calendar year. Thus, individuals who use the calendar year 1976 for tax reporting purposes, as well as those who report on a fiscal year which began in 1976 and ends during 1977, generally are entitled to refunds to the extent provided in the bill. However, if an individual has two taxable years which began during 1976 (when one taxable year was a short year), the refund provisions of the bill apply only to the first of the two taxable years. If the first taxable year beginning in 1976 is a short taxable year, the AGI is to be annualized for purposes of applying the phaseout rule discussed above.

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[3] As noted earlier, additional personal exemptions for age over 65 or blindness are not taken into consideration for this purpose.

Procedures for making refunds

Under the bill, a taxpayer computes his tax liability for 1976 without regard to the refund. After the taxpayer's return has been filed, the Internal Revenue Service will compute and pay the refund based on the taxpayer's exemptions, tax liability, and adjusted gross income for the year.

In order to carry out this procedure, the bill provides that the taxpayer is to be treated as if he made an additional payment to the Treasury against his 1976 income tax liability. This constructive payment is to be treated as if made on the due date of the taxpayer's 1976 return (without taking into account any extension of time to file the return) or, if later, on the date on which he actually files his 1976 return.

Other aspects of the refund

Although under present law (secs. 6601(e)(1), 6659(a), and 6671 (a)), interest, additions to tax, and penalties which a taxpayer owes on an underpayment of his tax liability are treated as part of his liability for "tax," the committee intends that interest, additions to tax, and penalties not be treated as part of the tax liability for purposes of determining the refunds to be made under this bill.

In determining marital status for purposes of the refund provisions of the bill, the provisions of section 143 of present law are to be utilized. As a result a married person living apart from his or her spouse will, under certain conditions, be treated as a single person, and have his or her 1976 refund determined accordingly.

The amount of the refund which a taxpayer may receive and retain is to be determined by reference to his exemptions, adjusted gross income and tax liability as finally determined for Federal income tax purposes. Consequently, the refund is not finally determined by the amount of tax liability shown on the return as filed by the taxpayer, but (like refunds generally) may be subsequently increased or decreased depending on adjustments which may be made in the taxpayer's final tax liability for 1976.

Because a refund under this bill does not result technically from a reduction in tax liability for 1976 (but instead results from a constructive payment against a taxpayer's liability for tax), the bill does not affect the definition of a "deficiency" in tax under present law (sec. 6211), nor the computation of the negligence or civil fraud additions to tax (imposed by sec. 6653 of present law), which are based on the amount of the deficiency.

Interest on refunds

Under present law, the Internal Revenue Service is not required to pay interest on an overpayment of income tax if it makes a refund within 45 days after the last date prescribed for filing the return (without regard to extensions) or, if the return is filed late, within 45 days after the date on which the return is actually filed (sec. 6611 (e)). In order, however, to facilitate speedy processing of the special 1976 refund by the Internal Revenue Service, the bill includes a provision designed to give the Service up to 60 days to make 1976 refunds to individuals without incurring an obligation to pay interest on the refunds. In the interest of administrative feasibility, the bill extends the 45-day interest-free period both for the special one-time refund under the committee's bill and for refunds of 1976 tax generally under present law. This special extension of the 45-day period under present law applies to refunds of any tax under subtitle A of the Code (secs. 1–1564) which are made to an individual for a taxable year which began during the calendar year 1976. As under present law, the 60-day period for which no interest is required will run from the later of the due date of the return (disregarding extensions) or the date on which the return is actually filed.

If the Service takes more than 60 days to make the refund, it must pay interest on the refund (as occurs under present law after 45 days for refunds generally).

This 60-day provision does not extend to refunds made to an estate or trust, to a nonresident alien individual or to a corporation. As to these taxpayers, who are not covered under the refund provisions, the 45-day period of present law continues to apply. The 45-day period is also the governing rule for all other taxable years, i.e., those beginning before and after 1976 (other than 1974, when a similar refund provision applied).

Effective date

The refund is effective for taxable years beginning in 1976.

Revenue effect

The refund of 1976 individual income taxes involves a revenue loss of $8.6 billion in fiscal year 1977. Of this, $7.3 billion offsets tax liability and $1.3 billion represents refunds in excess of tax liability.

2. *Disregard of Refunds With Respect to Federal and Federally Assisted Benefit Programs (sec. 102 of the bill)*

In some instances individuals who receive refunds of 1976 income tax payments under the bill will also be receiving benefits or assistance under one or more Federal or Federally assisted programs based on individually determined needs. Such programs include those which provide supplemental security income benefits, aid to families with dependent children, medicaid, food stamps, educational and housing benefits, and veterans' pensions. In those instances where the recipient receives a refund under the bill, if the refund were treated as income or resources, it could reduce the amount of benefits or assistance which the individual is entitled to receive under the assistance program.

For example, an individual who is a member of a family receiving a payment under the supplemental security income program might receive, during some month in 1977, a tax refund for 1976 under the bill which, if considered to be income or resources of the recipient during that month, might make him ineligible to continue receiving aid for that month. In some States the refund might also disqualify persons for medicaid or from eligibility to purchase food stamps, or, if treated as income, the refund might make the individual ineligible for a loan, or for a reduced rental, etc. under other aid programs.

The committee agrees with the House that these refunds of 1976 tax should not change an individual's eligibility for these assistance programs. In addition, the cost of identifying and making the adjustments might well exceed any savings in assistance funds were the refunds to be taken into account for these purposes.

Accordingly, the bill includes the provision of the House bill which provides that 1976 income tax refunds under the bill are not to be considered income or (in 1977 and 1978) as resources for purposes of determining who is eligible to receive aid or assistance, or the amount or extent of aid or assistance, under any Federal or Federally assisted aid or assistance program. For this purpose the concept of aid or assistance is intended to include all assistance benefits, including those made in a form other than cash, such as a reduced rental and eligibility for a loan. It is also intended that a refund which an individual receives pursuant to the bill should not be considered part of his resources or assets in 1977 or 1978 for purposes of any resources test under the applicable social program. This requirement is to be treated as a condition for Federal financial participation in any such State or local aid or assistance program for the first calendar quarter of 1978.

3. Payments To The Governments Of American Samoa, Guam, and the Virgin Islands (sec. 103 of the bill)

The Organic Acts and other laws which pertain to the internal governmental operations of American Samoa, Guam and the Virgin Islands authorize the governments of these U.S. possessions to impose income taxes. The governments of the three possessions use the same income tax laws that are applied in the United States, giving them what is called a "mirror image" of the U.S. income tax laws.

As a result of using the "mirror image," whenever U.S. income tax law is amended, the tax laws of American Samoa, Guam and the Virgin Islands are also changed automatically. The passage of the Tax Reduction Act of 1975, for example, caused an identical change in the "mirror image" laws of these three possessions. Thus, the refunds and other income tax reductions under the 1975 Act reduced the tax collections in these three possessions, which, in interaction with restrictions placed upon their governments to issue indebtedness, caused a financial hardship for the three possessions.

In the case of the Virgin Islands, the burden caused by the Tax Reduction Act of 1975 was reduced by passage in late 1976 of legislation (P.L. 94–392) which authorized an $8.5 million appropriation for the government of the Virgin Islands to reimburse it for at least part of the tax revenues it lost under the 1975 Act.

The committee agrees with the House that the United States Government should compensate for the reduction in individual income tax revenues for the governments of American Samoa, Guam, and the Virgin Islands resulting from this bill.

Accordingly, the bill authorizes an appropriation for these governments to compensate them for refunds of 1976 taxes they will make and also for reductions in revenues they will have because of the change in the standard deduction for 1977 tax years. The amounts of the payments under this provision are to be determined by the Secretary of the Treasury upon certification by the governments of the three possessions. The amounts for American Samoa and Guam are to be certified by the U.S. Government Comptroller for Guam and the amount for the Virgin Islands is to be certified by the U.S. Government Comptroller for the Virgin Islands. It is estimated that payments will be $15 million in fiscal year 1978.

Receipt of this payment by a possession is made contingent on its furnishing certain information to the Secretary of the Treasury that may be needed to prevent double payments of a tax refund and a special payment to beneficiaries of certain income maintenance programs, as described below.

4. Payments Not to be Considered Income or a Reduction in Federal Income Taxes Under State Law (sec. 104 of the bill)

The general rules of the Federal income tax law provide that a refund of Federal income tax is not to be considered income to the recipient for purposes of the Federal income tax. The laws of several of the States which impose individual income taxes allow their taxpayers a deduction for Federal income taxes similar to the deduction for State income taxes which is allowed under the Federal income tax law. Treatment of this payment as income subject to Federal or State income tax or as a reduction in a deductible item for State tax purposes would dilute the intended stimulative effect to the economy.

In order to address these problems, the Committee's bill provides, as does the House bill, that the deemed $50 overpayment (refund) pertaining to an individual's 1976 income taxes will not be considered income for purposes of the Federal income tax law. In addition, in order to maintain its stimulative effect and clarify questions pertaining to State tax treatment, which arose under the Tax Reduction Act of 1975, it is specifically required that the payment is not to be considered as income or as a reduction in the Federal income tax for purposes of the laws of any State or the District of Columbia relating to income taxation.

B. PAYMENTS TO RECIPIENTS UNDER CERTAIN BENEFIT PROGRAMS

1. Special Payments to Recipients of Benefits Under Certain Programs (secs. 111, 113, and 114 of the bill)

Present law

In order to provide for many people who would not get a tax refund, Congress in 1975 also authorized a special one-time payment to the beneficiaries of certain Federal income maintenance programs. This payment of $50 was made to those eligible individuals who for March 1975 were entitled to receive monthly insurance benefits under title II of the Social Security Act, to monthly pension or annuity benefits under the Railroad Retirement Acts, or to supplemental security income (SSI) benefits. In order to be eligible for the payments under the 1975 Act, an individual must have been a resident of the United States who actually received a benefit for March 1975 before September 1 of that year.

Under the 1975 Act, an individual who was eligible under more than one of these programs was entitled to only one $50 payment. Identification of such individuals caused no delay in making the $50 payments, because the records of the two agencies involved were fully coordinated and information regarding entitlement of an individual under more than one of the programs was readily available. In addition, it was provided that these special payments were not to affect a recipient's eligibility or level of assistance under any other Federal, State or local program.

Reasons for change

During the course of its consideration of this bill, the committee noted that, as in 1975, low-income Americans who would be most likely to spend any refund or payment would also be generally foreclosed from receiving a tax refund because many of them do not have any tax liability. As a complement to the provisions which authorize the refund of $50 per exemption to taxpaying members of the population, this section of the bill provides $50 payments to recipients of benefits or aid under five Federally-funded or assisted programs. (In addition, sec. 112, described below, authorizes Federal payments to States for the purpose of making $50 payments to AFDC beneficiaries.) These provisions are for the most part similar to the special payments made under the 1975 Tax Reduction Act. However, to assure that the $50 payments are made to as many of the non-tax-paying population as possible, the categories of individuals who would be eligible for the payment have been expanded. As a result, many more people would qualify for double payments than in 1975 because they receive benefits under more than one income maintenance program or would get both a special payment and a tax refund. Both the House and the committee believed that the payment of more than one $50 payment per individual should not generally be permitted and have included special provisions in the bill to eliminate double payments where possible. The committee bill will eliminate a larger number of potential double payments than the House bill.

Explanation of provision

Eligible beneficiaries

Under the House bill, payments of $50 would be made to individuals who are entitled (1) to monthly benefits payable under Title II of the Social Security Act,[1] (2) to a monthly annuity or pension under the Railroad Retirement Acts of 1935, 1937, or 1974; (3) to a benefit as an eligible individual or an eligible spouse under the supplemental security income (SSI) benefits program established by Title XVI of the Social Security Act, or to a payment made by a State under either State or Federally-administered programs to supplement SSI benefits; (4) to a "Black Lung" disease benefit paid by either the Department of Health, Education, and Welfare or the Department of Labor under Title IV of the Federal Coal Mine Health and Safety Act of 1969; and (5) to veterans' compensation, dependency and indemnity compensation, or a pension (but *not* educational or mortgage benefits) under programs administered by the Veterans Administration for military veterans. their spouses, parents and their dependents.

Under these provisions, an individual would be eligible for a special $50 payment if he received either Federal SSI benefits, a State supplement, or both. The committee noted that most beneficiaries who receive only State supplements would receive a $50 tax refund or payment under another program and that it would be difficult to administer the double payment rules (discussed below) in cases where the States administer their supplements to SSI. As a result, the committee amendment removes recipients of State supplements to SSI from eligibility for this payment unless they also receive Federal SSI.

The House bill provides that, in order to be eligible for this special one-time $50 payment, a beneficiary of one of these programs must have been paid a benefit under the relevant program for March 1977 in a check issued before January 1, 1978. The committee amendment changes the date of eligibility for the payment to SSI recipients from March to April 1977, but retains the March date for the other programs.

A cut-off date is desirable to prevent an unnecessary prolongation of this special 1977 program in those few cases where payment of benefits under one of the above five programs occurs after April 1977. Checks for these payments are issued after April only where those who subsequently become eligible receive retroactive benefit payments at a later time. The committee was informed that delaying the benefit payment cut-off until January 1, 1978, would cause significant problems in administering the program for the few beneficiaries who receive benefit payments during the later months of 1977. In addition, it is likely that most beneficiaries who would receive retroactive payments are new social security beneficiaries who would also receive a $50 tax

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[1] Recipients of the special monthly benefits under sec. 228 of the Social Security Act (for persons who were 72 years of age before 1968 and who had no Social Security) are eligible for this payment.

refund in any case. Accordingly, the committee amendment moves the cut-off date from December 31 in the House bill to April 30.

In addition, under both the House bill and the committee amendment, the special $50 payments are only to be made to any individual whose address of record for purposes of receiving the benefit which creates the qualification for this payment is within the United States. For purposes of these payments, the United States is defined to include the 50 States, the District of Columbia, Puerto Rico, Guam, American Samoa, and the Virgin Islands.

Income phaseout

Under the House bill there was no phase-out of payments based upon an individual's level of income. The committee amendment phases out the payments to social security, SSI black lung and railroad retirement beneficiaries as a beneficiary's adjusted gross income for tax purposes rises from $25,000 to $30,000 ($12,500 to $15,000 for married people who file separate returns), the same income levels used to phase-out the tax refund. This phaseout does not apply, however, to recipients of veterans' benefits. In the case of child beneficiaries, the income phaseout will be based on the adjusted gross income of the child's parent, not the child's AGI.

Because this phaseout is based upon adjusted gross income (AGI) reported for tax purposes, the committee is aware that subsequent changes in AGI (resulting from an IRS audit, for example) may change the proper amount of the payment under this provision. Such changes would tend to be difficult to administer. As a result, it is the committee's intent that AGI originally reported on the tax return be used for purposes of the income phaseout and that subsequent changes to AGI be ignored.

Prevention of double payments

Under the House bill, an individual's eligibility to receive the special $50 payment under these provisions is to be coordinated with the individual's receiving a tax refund under the other provisions of this bill (or causing another individual to receive a refund) in order to prevent, to the greatest extent possible, double payments under which funds are paid out to or for the same individual through both the tax refund and these special payment programs. These rules to prevent double payments apply to income tax refunds paid out by Guam, the Virgin Islands, and American Samoa, as well as income tax refunds paid by the U.S. Government.

The committee made changes to the House bill in order to achieve more closely the goal of eliminating double payments where this is administratively possible.

Under the committee amendment, a child beneficiary of social security will not receive the $50 special payment when there is no adult beneficiary in the family unit. These are typically cases where the child beneficiary is being claimed as an exemption on someone else's tax return, so that making a $50 special payment to these people would result in double payments which would not be eliminated under the House bill.

The committee intends that the elimination of double payments for recipients of social security, railroad retirement, SSI and black lung benefits be made as follows: The Social Security Administration will prepare a computer tape consisting of the names of beneficiaries of social security, railroad retirement and black lung benefits for March 1977 and of supplemental security income for April 1977. The Social Security Administration will process this tape to ensure that beneficiaries of more than one of these programs are listed only once. To the extent possible, the Social Security Administration will also include on the tape the social security numbers of the beneficiaries. Child beneficiaries will be grouped under the social security numbers of their parents or guardians.

The Social Security Administration will then send this tape by June 15, 1977, to the Internal Revenue Service which will administer the actual screening for double payments of the $50 special payment and the tax refund (as well as the income phaseout of the special payment). The IRS will attempt to match each potential recipient of a special payment with a taxpayer. In the case of child beneficiaries, the IRS will attempt to match them with the tax return of their parent rather than with any tax return they may have filed themselves. In those cases in which beneficiaries can be matched with tax returns, special $50 payments will not be made to beneficiaries who have received a tax refund equal to $50, whose parents received a $50 tax refund, or who were denied part or all of their tax refund because of the income phaseout. When the tax refund was less than $50 because of the tax liability limitation, the special payment will be the difference between the actual tax refund and $50. However, when the tax refund was less than $50 because of the income phaseout, there will be no special payment because the income phaseout would apply here as well.

Special rules for Veterans Administration benefits

The $50 payment to certain VA beneficiaries will have different rules than the payment to other beneficiaries under this section of the bill. For purposes of the $50 payment to recipients of VA benefits, beneficiaries will be defined as follows: In the case of disability pensions and compensation, the beneficiaries are the veterans themselves, not their dependents. In the case of death benefits and dependency and indemnity compensation, the beneficiaries are each widow and each child of the deceased veteran. In the case of parent's benefits, each parent is considered a beneficiary.

The committee noted that there were a number of problems with eliminating double payments in the case of recipients of V.A. benefits under the House bill. As a result, the committee amendment significantly revises the special payment provisions in the House bill as they apply to Veterans Administration beneficiaries. Under these changes, the $50 special payment will not be paid to those V.A. recipients who are (1) beneficiaries of income-tested programs (pension and parents' dependency and indemnity compensation programs) who receive social security, SSI or railroad retirement benefits, (2) beneficiaries of income-tested programs whose income (as defined under the test applicable to the program) exceeds $1,200 for single individuals and $1,800 for married couples and people with a child, (3) beneficiaries of disability compensation programs whose disability is 40 percent or less,

(4) child beneficiaries if their parents do not receive benefits and (5) foreign residents. However, the payment will go to all other V.A. beneficiaries without further checks for double payments. The effect of these amendments is to eliminate only those V.A. beneficiaries who would probably receive either a tax refund or the special payment as a beneficiary under another of the eligible programs, in a fairer and administratively simpler manner than the House bill provides.

The VA will be able to determine by itself the identity of beneficiaries eligible for the $50 payment, except for identifying the VA beneficiaries who also receive SSI. The committee intends that the Social Security Administration prepare a computer tape consisting of the names and VA claim numbers of SSI beneficiaries who receive VA pension or compensation in April 1977. The VA will then match these SSI beneficiaries with their tape of VA beneficiaries and deny the $50 VA payment to these people.

Other issues

The Secretary of the Treasury is to be primarily responsible for eliminating double payments under these rules. The Secretary of Health, Education and Welfare, the Railroad Retirement Board, the Secretary of Labor, the Administrator of Veterans' Affairs, and the appropriate State agencies are required to provide to the Secretary of the Treasury whatever information and data is deemed by him to be necessary in order to make the determinations (such as eligibility for, and amounts of, payments) required under these provisions. They are also to process these data as directed by the Secretary of the Treasury.

Solely for purposes of these rules, a waiver of the otherwise applicable Federal disclosure laws is provided to enable the Secretary of the Treasury to collect, analyze and distribute information and data necessary for him to execute the requirements of this provision. The Secretary of the Treasury is also required to establish safeguards to prevent use and disclosure of this information for any purpose other than provided by this bill.

The committee intends that the rules designed to prevent payments not cause significant delays because of the unavailability of necessary information in useful form. The bill consequently provides that the Secretary of the Treasury may waive some of these rules to prevent double payments and the income phaseout of the special payments where he concludes that waiting for the necessary information to be available in a usable format would cause significant delay. When he makes such a waiver, the Secretary is to report to Congress the reasons for the waiver and the circumstances surrounding it.

It is foreseeable that these rules will cause some individuals to receive both a payment under this provision and a tax refund which total more than the individual would otherwise be entitled to receive. The bill provides that a recipient will not be liable to repay any erroneous or excessive payments resulting from incorrect application of the rules against double payments or the income phaseout unless these payments have resulted from fraud or gross negligence. Similarly, the Federal, State and local officers responsible for such double or excessive payments are relieved from liability in the absence of fraud or gross negligence.

The committee intends that payments under this provision should not change an individual's eligibility for Federal or federally assisted aid programs. The cost of identifying and making the adjustments might well exceed any savings in assistance funds were the payments to be taken into account for these purposes. As is provided in the case of tax refunds under section 101 of this bill (see sec. 102), the committee has included a provision under which payments under this section of the bill are not to be considered income or (in 1977 and 1978) as resources for purposes of determining who is eligible to receive aid or assistance, or the amount or extent of aid or assistance, under any Federal or federally assisted program. For this purpose the concept of aid or assistance is intended to include all assistance benefits including those made in a form other than cash, such as a reduced rental and eligibility for a loan. It is also intended that a payment which an individual receives pursuant to the bill should not be considered part of his resources or assets in 1977 or 1978 for purposes of any resources test under the applicable program. This requirement is to be treated as a condition for federal financial participation in any such state or local aid or assistance program for the first calendar quarter of 1978.

Payments received under this provision are not to be considered income to the recipient for purposes of the Federal income tax laws.

Budgetary effect

These payments will amount to $1.3 billion in fiscal year 1977.

2. *Special Payment To Recipients of Aid To Families With Dependent Children Under Approved State Plans (secs. 112 and 114 of the bill)*

Under the House bill, States are required to make a special $50 payment to individuals who, for the month of March 1977, received aid to families with dependent children (AFDC). In making the special payments States must meet the following requirements: (1) they may make the payments only to those individuals with respect to whom a check for March 1977 AFDC benefits was issued prior to January 1, 1978, and (2) they may not make payments to individuals who are entitled to payments on the basis of their eligibility for social security, railroad retirement, supplementary security income (SSI), black lung, or veteran's benefits as provided under section 111 (except as may be allowed by waiver of the Secretary of Treasury under section 114). However, AFDC recipients may receive both a full tax refund and a full $50 benefit payment under this provision. Coordinating the AFDC payment with the tax refund would be administratively difficult.

The committee's amendment makes several changes to these provisions of the House bill. The committee amendment provides that the March 1977 date in the House bill, for which an individual must be on a State's AFDC rolls, is moved forward one month, to April 1977, in order to make eligibility under this provision consistent with eligibility under the special payment provisions for social security and other beneficiaries under section 111 of the bill. Similarly, the committee amendment requires that an AFDC beneficiary must be paid his April 1977 benefit before May 1, 1977 (instead of before January 1, 1978, as in the House bill) in order to be eligible for this special $50 payment. The committee amendment also eliminates for AFDC recipients the prohibition on double payments for recipients of railroad retirement, Veterans Administration, and black lung benefits. (The prohibition on double payments is retained, however, for social security beneficiaries.) The committee was informed that only a few individuals received benefits under both AFDC and one of these programs, and that there would be significant administrative problems in trying to eliminate double payments in these situations. It is estimated that only about 10 percent of the eligible AFDC recipients will get either a tax refund or a special payment under one of the other programs.

The Federal Government will pay each State, either in advance or retroactively, the full amount of the $50 payments required under this section plus an amount to cover administrative expenses equal to 75 cents for each AFDC recipient. It is intended that each State will, as soon as possible, provide the Secretary of the Treasury with an estimate of the cost of paying its March 1977 AFDC recipients the $50 payment. When the Secretary of the Treasury has reviewed this estimate and found it satisfactory (using any information or assistance which he may require of the Secretary of Health, Education, and Welfare), a letter of credit is to be issued to the account of the State providing funds for the State to draw against in making the special $50 payment and to compensate the States for costs of administering the payment.

To the extent necessary and possible, existing administrative rules and procedures pertaining to the AFDC program are to be followed in making the special $50 payment required by this section. This includes existing audit and reconciliation procedures and the rules, functions and obligations pertaining to the rights of individuals. However, the committee emphasizes that administrative delays should be reduced as much as possible in order to produce prompt receipt of the $50 payments by qualified beneficiaries and further the overall stimulative goal of this bill. Thus, the administrative authorities are not expected to follow, for example, the specific quality control procedures and sanctions described in title 45, section 205.40 of existing Federal regulations.

The Secretary of the Treasury, the Secretary of Health, Education, and Welfare, the Railroad Retirement Board, the Secretary of Labor, and the Administrator of Veterans' Affairs are required to provide to the appropriate State agencies and to process whatever information is deemed by the Secretary of the Treasury to be necessary in order for the State agencies to make the determination of eligibility for an AFDC recipient to receive a payment under this provision. In addition, the State agencies and the Secretary of Health, Education, and Welfare are required to provide the Secretary of the Treasury with information considered necessary by him to determine the amount of the reimbursement for the payments and for each State's compensation of administrative costs it incurs in making these payments.

Solely for purposes of these rules, a waiver of the otherwise applicable Federal disclosure laws is provided to enable the Secretary of the Treasury to collect, analyze and distribute information and data necessary for him to execute the requirements of this provision. The Secretary of the Treasury is also required to establish safeguards to prevent use and disclosure of the information he receives for any purpose other than provided by this bill.

The AFDC payment provision contains a "disregard" rule similar to that applying to special payments under sec. 111 of the bill. Also, there is a provision allowing the Secretary of the Treasury to waive the prohibition against double payments, as with the special payments under sec. 111. Payments received under this provision are not to be considered income to the recipient for purposes of the Federal income tax laws.

These payments will cost approximately $0.6 billion in fiscal year 1977.

3. Cut-off for Special Payments to Social Security and Other Income Maintenance Beneficiaries under the Tax Reduction Act of 1975 (sec. 115 of the bill)

The Tax Reduction Act of 1975 authorized a special one-time payment to the beneficiaries of certain Federal income maintenance programs. This payment of $50 was made to those eligible individuals who for March 1975 were entitled to receive monthly insurance benefits under title II of the Social Security Act, to monthly pension or annuity benefits under the Railroad Retirement Acts, or to supplemental security income (SSI) benefits. In order to be eligible for the payments under the 1975 Act, an individual must have been a resident of the United States who actually received a benefit for March 1975 before September 1 of that year.

During its consideration of the House bill, the committee noted that special payments under the Tax Reduction Act of 1975 are still being made in certain cases. These cases have usually arisen where the beneficiary was a foreign resident at the time he or she received the March 1975 benefit payment (before September of that year), but subsequently moved back to the United States and applied for the special payment. Since the two tests of U.S. residency and receipt of the March 1975 benefit were mutually exclusive, the opportunity to receive the 1975 special payment at some later time was technically not foreclosed under the 1975 Act. The committee amendment prevents this subsequent payment problem under the 1977 stimulus program by requiring that a recipient's address of record for purposes of receiving the April 1977 benefit must be within the United States in order to be eligible for the 1977 special payment.

The committee did not believe that it was the intent of Congress in the Tax Reduction Act of 1975 to have these special payments made at a future date when beneficiaries who were foreign residents at the time of the 1975 payment returned to the United States. In view of this, the committee added an amendment to terminate any further special payments under the 1975 Act to federal income maintenance beneficiaries.

This committee amendment will be effective on the date of enactment.

It is estimated that the budget effect will be negligible.

C. REVISION OF THE STANDARD DEDUCTION, TAX TABLES, TAX RATE SCHEDULES, WITHHOLDING, AND FILING REQUIREMENTS

(Secs. 201, 202, 204, 205, and 206 of the bill and secs. 1, 3, 36, 43, 63, 141, 142, 144, 145, 3402, and 6012 of the Code)

Present law

Under present law, the standard deduction is 16 percent of adjusted gross income (AGI), but not less than a minimum standard deduction of $1,700 for single persons and $2,100 for joint returns, nor more than maximums of $2,400 or $2,800 for single and joint returns, respectively. Heads of households are entitled to the standard deduction for single persons. For married couples who file separate returns, the minimum and maximum standard deductions are one-half the amounts for joint returns. These levels were made permanent by the Tax Reform Act of 1976.

Under present law, there are two ways in which a taxpayer determines the amount of tax owed. A taxpayer either determines tax liability either by looking up the tax in tax tables or by using the rate schedule. The tax tables are considerably easier for the taxpayer than the rate schedules.

The tax tables where a taxpayer looks up, rather than computes, tax liability are based on filing status (joint return, single return, etc.) and taxable income. These taxable income tables were provided by the Tax Reform Act of 1976. They replaced the prior tables based on adjusted gross income and the number of exemptions, in which standard deductors with AGI below $15,000 looked up their tax. (Prior to 1976, itemizers and standard deductors with AGI over $15,000 were required to use rate schedules.)

A taxpayer must now compute the standard deduction (or itemized deductions) and subtract the appropriate amount from adjusted gross income. Then the taxpayer must multiply $750 by the number of personal exemptions claimed and subtract the resulting amount to obtain taxable income. Most taxpayers now look up the amount of tax before credits in a tax table based on taxable income. (This table covers taxable income up to $20,000 and is used by approximately 93 percent of all taxpayers.) The taxpayer must then compute the general tax credit, which is the greater of $35 per person or 2 percent of taxable income up to $9,000. The taxpayer must then subtract this credit from the tax determined under the tables to obtain the tax after credits. (See the illustration of a computation under present law in table 2, below.) If there are additional credits (such as the credit for the elderly or child care credit), they too must be subtracted.

Reasons for change

The committee agrees with the House that the present individual income tax forms 1040 and 1040A need to be simplified. The forms have become too long and complex; their many computations, elections and instructions are a source of taxpayer confusion and error. For example, the presentation of the standard deduction on the forms requires printing five numbers just for single and joint returns (two minimums, a percentage of income and two maximums).

The way in which a taxpayer determines his tax also needs to be simplified. Under the present system, both standard deductors and itemizers are required to make too many computations to obtain their tax. (See illustration of computations in table 2, below.) Complexity and the number of computations could be substantially reduced by having taxpayers look up their tax in the pre-1976 type of tax tables based on adjusted gross income and the number of exemptions. Under such a system, taxpayers would not have to compute their taxable income and their general tax credit.

For returns using the standard deduction this change to tax tables would only require building the existing standard deduction, the personal exemption and the general tax credit into the tax tables. This approach alone would enable about 73 percent of tax returns to be based on the tables. The remaining returns would still have more complex computations than is desirable. If itemizers could also use the tax tables, an additional 23 percent of returns would be relieved of complex computations, bringing the total of returns based on the simpler tables to 96 percent.

Because the House bill builds the standard deduction into the tax tables, it is necessary to use the amount of the standard deduction as a floor under itemized deductions to enable itemizers to use the tax tables. Itemizers will be able to deduct only those amounts in excess of the floor and will subtract the excess itemized deductions from AGI to yield an amount of income consistent with the scale on which the tax tables are based. Such an income concept is called "tax table income."

Itemizers generally will be required to compute tax table income (with the floor under itemized deductions) in order to decide if their tax is to be determined on the tax tables. To prevent itemizers whose tax table income is above the table ceiling levels from being required to subtract the floor on itemized deductions from their income, the bill builds the floor into the rate schedules, as well as the tax tables, as a zero rate bracket. Taxpayers not using the tax tables will subtract their personal exemptions from tax table income in order to determine taxable income, against which the rate schedules are to be applied. As a result of this change, the present law concept of taxable income is redefined to reflect the floor under itemized deductions.

The committee agrees with the House's analysis and with the simplification provisions in the House bill.

In the past, the Congress has used the minimum standard deduction (which under the bill will in effect become the same standard deduction for everyone) to establish, in conjunction with other provisions, the tax-free income level approximating the poverty level. This policy started with the Revenue Act of 1964. The House determined, and the committee agrees, that a higher floor is now needed to increase the income level at which people begin to pay income tax (the tax threshold) to offset its erosion by inflation. However, the committee amendment changes the levels set by the House bill in order to reduce the higher tax burden of married couples where both spouses have income compared to two single persons with the same income.

In considering the standard deduction revisions, the committee was concerned about the difference in the tax liabilities which single and married individuals must pay. Under present law, two single individuals with relatively equal incomes filing single returns pay less tax as single persons than they would pay if they married each other. This larger liability, often called the "marriage penalty," is partly attributable to the loss of one standard deduction. Under the House bill, the part of the marriage penalty related to the loss of a standard deduction is larger than the current penalty for many taxpayers.

The present law marriage penalty with respect to the standard deduction ranges from $1,300 to $2,000, because of the differences in the minimum, maximum, and percentage standard deduction. This marriage penalty under the House bill is $1,800. The committee amended the standard deduction levels in the House bill in order to decrease this marriage penalty to $1,200. The committee amendment thereby decreases the standard deduction aspects of the marriage penalty below the penalty under present law for all taxpayers.

In addition, the committee believed that the present law does not adequately recognize the economic status of heads of households, who are generally low- or middle-income widows or divorced mothers with young children. To provide relief to heads of households, the committee decided to allow them to claim the same standard deduction as married persons instead of that for single persons.

The extent to which the standard deduction (which becomes a zero rate bracket in this bill) determines a tax-free income level and how the tax-free level compares to projected poverty levels is shown in table 1, below, for various taxpayers. For example, under present law, the tax-free income level for a single person is $2,700. With the House's proposed "flat standard deduction" of $2,400, the tax-free income level for a single individual would be $3,400 in 1977. (The $3,400 is the sum of the $2,400 "standard deduction," the $750 personal exemption, and $250 of income, the tax on which is offset by the $35 per capita tax credit.) This compares with the projected poverty levels of approximately $3,100 in 1977 and $3,400 in 1979. The committee amendment provides "standard deductions" of $2,200 for single returns and $3,200 for head of household and joint returns. These amounts would create tax-free income levels of $3,200 for single individuals and $5,200 for married couples filing jointly with no dependents and for heads of households with one dependent (see table 1).

Table 1.—Tax-Free Income Levels Under Present Law and Committee Bill Compared to Projected Poverty Levels

	Tax-free levels		Projected poverty levels [1]	
	1976 law	H.R. 3477 for 1977 and thereafter [2]	1977	1979
Single person	$2, 700	$3, 200	$3, 107	$3, 439
Head of household with one dependent	3, 700	5, 200	3, 900	4, 315
Couple without dependents	4, 100	5, 200	4, 018	4, 448
Family of 4	6, 100	7, 200	6, 110	6, 763

[1] Applicable to nonfarm families. Projections assume consumer price indexes of 179.11 in 1977 and 198.26 in 1979.
[2] Reflects committee amendments and assumes extension of the $35 per capita tax credit.

Explanation of provisions

1. Revision of the standard deduction

The House bill eliminates the present minimum, percentage and maximum standard deductions and replaces them with what is, in effect, a flat standard deduction of $2,400 for single persons, $3,000 for married individuals filing joint returns, and $1,500 for married individuals filing separate returns. Heads of households are entitled to the same standard deduction as single persons.

The committee bill provides a standard deduction of $2,200 for single persons, $3,200 for married individuals filing joint returns and for heads of households, and $1,600 for married individuals filing separate returns. Under both versions, these new flat levels are converted into a new "zero bracket amount" (explained in detail below). These increases in the "standard deduction" will reduce revenue by approximately $5.6 billion on a full-year basis under the committee bill. Of this reduction, about 81 percent will go to taxpayers with incomes under $15,000, and about 92 percent to taxpayers with incomes under $20,000. As a result of the $200 decrease from the present law maximum standard deduction of $2,400 for single persons to $2,200 under the committee amendment, approximately 1.7 million taxpayers will have tax increases which average about $50 per return. The new levels of the "standard deduction" will equal or exceed itemized deductions on approximately 7.3 million more returns and it will no longer be worthwhile to itemize deductions on these returns. Thus, the percentage of taxpayers who itemize will fall from 31 percent to 23 percent. About 3.7 million returns will become nontaxable.

2. Tax tables

The House bill eliminates the present tax tables based on taxable income and replaces them with tax tables based on the number of exemptions and "tax table income" (explained below) for both itemizers and nonitemizers. The committee agrees with this simplification provision in the House bill. For taxpayers who do not itemize, tax table income equals adjusted gross income; they will simply total their adjusted gross income and look up their tax liability in the tables. Itemizers will subtract an amount equal to their "standard deduction" (the new zero bracket amount) from their itemized deductions and then subtract the remaining "excess itemized deductions" from adjusted gross income to obtain "tax table income." Approximately 96 percent of all taxpayers will be able to look up their tax liability in these new tax tables.

Tax tables are to be provided at least for all individuals in each filing status with tax table income of $20,000 or less. The House intended and the committee concurs that the tax tables cover as many exemptions and as high a tax table income level as practicable. The Internal Revenue Service has the authority to determine the ceiling amount for income levels and the number of exemptions below which taxpayers would be able to use the tax tables. It is intended that the Service publish tax tables in the ranges of approximately $20,000 and 3 or fewer exemptions for single persons and $40,000 and 9 or fewer exemptions for joint returns.

The bill also permits some taxpayers, such as certain dependents claimed by other taxpayers, who are entitled to no standard deduction or less than a full standard deduction under present law and who could not use the pre-1976 AGI tax tables, to use the new tax tables. These taxpayers would be required to make on additional but simple computation (involving an unused zero bracket amount, explained below) in order to determine their tax table income. Only a small number of taxpayers would not be able to use the new tax tables and would have to use the rate schedules.

Taxpayers ineligible for the tax tables include those with tax table income above the table limits or with too many exemptions, as well as those who compute their tax using income averaging, the alternative capital gains tax, the maximum tax, or the section 911 foreign income exclusion; those who file a short period return under section 443(a)(1) on account of a change in annual accounting period, and estates and trusts. A separate rate schedule is provided for estates and trusts, which do not get a standard deduction under present law.

3. Conversion of standard deduction into zero bracket amount and floor under itemized deductions

By incorporating the flat standard deduction in a zero rate bracket in the tax tables and rate schedules, the House bill eliminates the need for the separate concept of the standard deduction in the Code and the subtraction of the standard deduction in computing tax liability. This change facilitates additional simplifying modifications in the tax law and in the tax forms. The committee agrees with these changes.

From a technical viewpoint, the most significant change in the bill is the redefinition of taxable income. Although this change alters a basic concept, it will affect few taxpayers because conforming changes are made to insure that there is no (or only minimal) effect on taxpayers' liabilities and because the tax forms do not require reference to Internal Revenue Code definitions. Both the House and the committee believe that this redefinition of taxable income greatly facilitates simplification in the forms for the vast majority of taxpayers.

Under present law, taxable income for individuals means adjusted gross income reduced by the standard deduction (or itemized deductions) and by personal exemptions. The bill redefines taxable income as adjusted gross income reduced by "excess itemized deductions" and by personal exemptions, and, in a few cases, increased by the "unused zero bracket amount," if any. Only a few taxpayers would actually have to compute taxable income under this bill.

Under the bill's simplified approach, the taxpayer will look up "tax table income" in the new tax tables to determine tax liability. Only taxpayers with tax table income or exemptions in excess of the levels incorporated in the tax tables will need to compute taxable income and use the rate schedules.[1] The schedules will also incorporate the "standard deduction" as a zero rate bracket.

The bill defines tax table income as adjusted gross income (AGI) reduced by the excess itemized deductions and in certain cases, increased by the unused zero bracket amount if any. Taxpayers who must add their unused zero bracket amount are married individuals filing separate returns where either spouse itemizes deductions, nonresident alien individuals, U.S. citizens entitled to the benefits of section 931, and individuals, such as students, with little earned income but with passive or investment income who are claimed as dependents by other taxpayers.

The zero bracket amount, which is effectively equivalent to the present law standard deduction, but is incorporated in the tax tables and not generally used independently, is set by the committee bill at $3,200 for joint returns, heads of households, and surviving spouses; $2,200 for single individuals; $1,600 for married individuals filing separately; and zero in any other case. This amount creates a floor under itemized deductions, which under the bill may be separately subtracted from adjusted gross income only to the extent they exceed this floor. The creation of the zero bracket means that for a joint return the 14-percent bracket would start at taxable income of $3,201, instead of taxable income of $1, as under present law.

Itemizers will still receive the full benefit of their itemized deductions, because the amount of the zero rate bracket, that is the floor under itemized deductions, will be built into the tax tables. However, most itemizers will not have to compute and subtract their personal exemptions nor calculate and subtract the general tax credit. All of these computations will be built into the tax tables, just as they will be for those who do not itemize.

The term "excess itemized deductions" means the excess (if any) of a taxpayer's itemized deductions over the zero bracket amount, the new floor under itemized deductions. Itemized deductions are defined to include all allowable deductions except deductions allowable in

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[1] As stated above, the small number of taxpayers who compute their tax using income averaging, the alternative capital gains tax, the maximum tax, or the section 911 foreign income exclusion; those who file a short period return under section 443(a)(1) on account of a change in annual accounting period, and estates and trusts also could not use the tax tables.

arriving at adjusted gross income and the deductions for personal exemptions under section 151.[2] As under present law, all itemized deductions provided in the Internal Revenue Code remain "allowable," that is, they may all be claimed by an eligible taxpayer. Even though an itemizer only subtracts the amount of his "excess itemized deductions" in determining tax table or taxable income, all of his properly claimed itemized deductions are "allowed" under this bill. Itemized deductions are also "allowed" to taxpayers who are required to include an unused zero bracket amount in computing their taxable income (to the extent that their itemized deductions reduce their zero bracket amount). Of course, itemized deductions are not "allowed" in any case where the taxpayer has not elected (or is not deemed to have elected) to itemize his other deductions.

In general, only individuals who have itemized deductions in excess of the zero bracket amount may elect to itemize their deductions. However, taxpayers who are not entitled to a standard deduction under present law and whose itemized deductions are less than the zero bracket amount are deemed to have elected to itemize. Those taxpayers who are claimed as dependents by other taxpayers and whose earned income is less than the zero bracket amount are also deemed to have elected to itemize and their earned income in excess of their itemized deductions is treated as an itemized deduction.

If a married individual files a separate return, the individual may elect to itemize deductions only if one of the spouses qualifies to make the election to itemize by having itemized deductions in excess of the zero bracket amount and makes the election. In such cases, the other spouse must also itemize. If the other spouse has itemized deductions less than the zero bracket amount, that spouse is treated as having elected to itemize and thus, his or her itemized deductions are allowed. Taxpayers have until the statute of limitations runs with respect to their returns to change their election (by filing an amended return). The Secretary of the Treasury is to prescribe regulations for changing an election to itemize after a return has been filed. The rules for changes of election by married individuals filing separately will require that both spouses change consistently, as is required under present law. No changes of election will be allowed after the tax liability for a taxable year has been compromised under section 7122.

The unused zero bracket amount is generally an amount equal to the excess (if any) of the zero bracket amount over itemized deductions. The unused zero bracket amount is applicable to taxpayers, listed above, who under present law are entitled to no standard deduction or less than a full standard deduction. However, if an individual, who is claimed as a dependent by another taxpayer, has earned income in excess of itemized deductions, he is to determine his unused zero bracket amount by subtracting his earned income (instead of itemized deductions) from the zero bracket amount.

A comparison of the computations required of taxpayers using the tax tables under the bill with the computations required under present law is outlined in Table 2 below.

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[2] In the case of nonresident aliens, excess itemized deductions are the excess of the itemized deductions allowed under section 873 over the zero bracket amount. In the case of individuals entitled to the benefits of section 931, excess itemized deductions are the excess of the itemized deductions allowed under section 931(d) over the zero bracket amount.

Table 2.—Examples of Tax Computations Under Present Law and the Bill

Case 1.—Standard deduction; family of 4, with $15,000 AGI

Present law

1. Adjusted gross income	$15,000
2. Determine standard deduction (16 percent of income but not less than $2,100 nor more than $2,800) and subtract from income	2,400
3. Difference, line 1 less line 2	12,600
4. Multiply number of exemptions by $750	3,000
5. Subtract line 4 from line 3	9,600
6. Look up tax in tax table	1,727
7. Compute general tax credit (greater of $35 times number of exemptions; or 2 percent of line 5 but not more than $180)	180
8. Subtract line 7 from line 6 to get tax after credit	$1,547

Bill

1. Adjusted gross income	$15,000
2. Look up tax in new tax table (The lower tax under the bill reflects the increase in the standard deduction.)	$1,375

Case 2.—Itemized deductions for those using tax tables; family of 4, with $15,000 AGI and $4,000 itemized deductions

Present law

1. Adjusted gross income	$15,000
2. Total itemized deductions	4,000
3. Difference, line 1 less line 2	11,000
4. Multiply number of exemptions by $750	3,000
5. Subtract line 4 from line 3	8,000
6. Look up tax in tax table	1,375
7. Compute general tax credit (greater of $35 times number of exemptions; or 2 percent of line 5 but not more than $180)	160
8. Subtract line 7 from line 6 to get tax after credit	$1,215

Bill

1. Adjusted gross income	$15,000
2. Itemized deductions	4,000
3. Floor on itemized deductions	3,200
4. Excess itemized deductions, line 2 less line 3	800
5. Tax table income, line 1 less line 4	14,200
6. Look up tax in new tax table	$1,215

4. Technical and conforming changes resulting from new concepts

The bill makes several conforming and technical amendments to the Code to reflect the elimination of the standard deduction and the adoption of the new definition of taxable income, as well as the use of the new related terms, "zero bracket amount" and "excess itemized deductions."

In cases where the effect of the new definition of taxable income would result in a substantive or economic change from the effect of the present law definition, the bill includes amendments which, in general, preserve the effect of present law but which incorporate the new terms created in this bill.

Changes in rate of tax.—A technical amendment provides that the bill's simplification changes, involving the standard deduction and its incorporation in the tax tables and rates schedules as a zero bracket amount, the new definition of taxable income and the related new terms, shall not be treated as changes in a rate of tax for purposes of section 21 of the Code (which prescribes rules for determining tax liability when rate changes do occur).

Net operating loss.—A net operating loss (NOL), which is defined as the excess of deductions over gross income, is not itself affected by the new provisions. However, because the standard deduction was among the deductions allowed individual taxpayers in determining their net operating losses in cases where the taxpayer had some nonbusiness income, the elimination of the standard deduction provision, without a compensating amendment, would increase the amount of nonbusiness income (of those without excess itemized deductions) against which any business loss would be applied in determining the amount of any NOL. Therefore, the modification to section 172 allows individual taxpayers who do not itemize to treat an amount equal to their "zero bracket amount" as a deduction attributable to nonbusiness income. In addition, a deduction equal to the zero bracket amount is provided for all individual taxpayers for purposes of determining the amount of taxable income in any year against which an NOL carryback or carryforward can be used.

Taxpayers who have itemized deductions less the new zero bracket amount and who are treated as if they have elected to itemize deductions, may also subtract such deductions in determining their net operating losses. Taxpayers with earned income less than the zero bracket amount who are claimed as dependents by other taxpayers (and thus have an unused zero bracket amount) are also to treat their earned income in excess of their itemized deductions as an itemized deduction for purposes of the NOL computations.

Lump-sum distributions.—Present law (sec. 402(e)) provides a 10-year averaging rule for taxation of lump sum distributions from tax-qualified pension, etc., plans. Under this rule, the tax on a lump sum distribution is ten times the tax on one-tenth of the distribution. (The 10-year averaging tax is computed under section 1(c), the tax rates for single individuals, regardless of the filing status of the taxpayer.) The bill changes this to ten times the tax on $2,200 plus one-tenth of the distribution. The bill takes into account the zero bracket amount in such a way as to preserve the effect of present law.

Change in accounting period.—The rules relating to a change in accounting period resulting in a short period for a taxpayer electing a 52–53 week year under section 441(f)(2)(B) also require a technical amendment to insure that annualizing the short period income produces the same tax liability as determined under present law (under which no standard deduction is allowed). The bill requires the taxpayer first to subtract his deductions for the short period and the proportionate amount of any personal exemptions for the short period from his gross income. The result of this subtraction is then multiplied by 365. The product of the multiplication is divided by the number of days in the short period. Then the taxpayer's zero bracket amount is added to the total, which in effect allows a deduction only for itemized deductions, even if the itemized deductions are less than the zero bracket amount. The tax on this amount is determined according to the tax rate schedules, and the liability bears the same relation to the annual tax as the number of days in the short period bears to 365.

Short taxable year.—Similarly, the bill amends the general provision for annualizing taxable income in order to conform it to the new definition of taxable income, while preserving the same tax result which would be achieved under present law. The general rule of the annualizing provisions (sec. 443) operates on a 12-month taxable year with a disallowance of the standard deduction. The short period gross income, reduced by short period deductions and a proportionate share of personal exemptions is, under the bill, multiplied by 12 and increased by the taxpayer's zero bracket amount. The tax liability for the short period will bear the same relation to the liability on the annualized taxable income as the number of months in the short period bears to twelve months; e.g., in the case of a 2-month short period, the tax liability would be one-sixth of the tax liability on the annualized taxable income.

Limitation on percentage depletion based on taxable income.—A technical amendment is made to the rules (in sec. 613A(d)) which limit a taxpayer's percentage depletion deduction for oil and gas to 65 percent of taxable income (computed without regard to depletion). Since under the bill taxable income is increased by eliminating the standard deduction and limiting itemized deductions to the excess over the zero bracket amount, the amendment requires that the depletion deduction be limited to 65 percent of the difference between taxable income and the zero bracket amount. Thus, the change in the definition of taxable income will not result in any change in the amount of depletion which a taxpayer would otherwise be allowed.

Trust distributions.—A technical amendment is also made to the provision relating to the tax on an amount deemed distributed by a trust in preceding years, when such years are loss years. Under present law, the tax rates applying to a distribution of previously accumulated trust income are determined by the beneficiary's taxable income for 3 of the 5 years preceding the distribution. The beneficiary's taxable income for these purposes may not be less than zero in any year. The committee's technical amendment insures that such distributions will conform to the new definition of taxable income and the new tax tables and rate schedules by placing a floor equal to the zero bracket amount under the beneficiary's taxable income. This floor places the income from the trust distribution in a tax bracket higher than the new zero bracket, that is, above the level where the tax rates changes from zero to the minimum rate. This achieves the same tax results as are achieved under present law.

Income from sources within or without the United States.—The bill makes technical amendments to the definitions of taxable income from sources within the United States and taxable income from sources without the United States (under secs. 861 and 862). These amendments apply to individual taxpayers who do not itemize deductions and are designed to adjust the computation of taxable income from sources within the United States and from sources without the United States so that their dollar amount is the same as under present law.[2] In computing taxable income from the United States and foreign sources under present law (as a result of changes in the computation of the foreign tax credit made by the Tax Reform Act of 1976), the standard deduction is allocated between the United States and foreign sources. Under the provision in the bill, in the case of individuals who do not itemize, an amount equal to the zero bracket amount is treated as a deduction which cannot definitely be allocated to some item or class of gross income. Thus, the amount of taxable income from sources within and from sources without the United States is reduced by the portion of the zero bracket amount allocable to each. No adjustment is necessary for taxpayers who itemize deductions because taxable income from sources within and from sources without the United States is the excess of gross income from each source over the full amount of the itemized deductions properly allocable or apportioned thereto.

A technical amendment is also made to the definition of "entire taxable income" for purposes of the limitation on foreign tax credits of section 904(a). This amendment is necessary so that the denominator of the limiting fraction, (i.e., entire taxable income) conforms with the numerator, taxable income from foreign sources. This is accomplished by providing that in the case of individuals (those who do itemize as well as those who do not) "entire taxable income" is the excess of taxable income over the zero bracket amount. Thus, the dollar amount of a taxpayer's entire taxable income will remain the same as under present law.

Earned income from sources outside the United States.—The bill makes a technical amendment to section 911 (relating to the exclusion for earned income of private citizens working abroad) designed to maintain the benefit of the exclusion at the same level as under present law.[3] The earned income exclusion of up to $15,000 (in some cases $20,000) annually is taken, in effect, from the taxpayer's lowest rate

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[2] This adjustment is necessary, for example, to determine foreign source taxable income for purposes of section 904(a) and also to determine income subject to recapture under section 904(f). This adjustment is not made in the case of nonresident aliens or individuals entitled to the benefits of section 931, because all nonresident aliens and individuals entitled to the benefits of section 931, even those whose itemized deductions do not exceed the zero bracket amount, are considered to be individuals who have elected to itemize deductions.

[3] The technical amendment to section 911 amends that provision as modified by the Tax Reform Act of 1976. A separate provision of this bill changes the effective date of these modifications to taxable years begininng after December 31, 1976.

brackets; that is, income in excess of the excluded amount is subject to tax at the rates which would apply if no exclusion were allowed. The amount of tax of a taxpayer entitled to the earned income exclusion is computed under present law by reducing the tax which otherwise would be imposed by an amount equal to a tax on "net excluded earned income" (the excess of the excluded earned income over the itemized deductions allocable thereto). Since the bill establishes a zero rate bracket in the tax rate schedule, it is necessary to increase "net excluded earned income" by the zero bracket amount so that none of the taxpayer's excluded income is subject to tax in the zero rate bracket. The U.S. tax which will be imposed under the bill on that revised amount (the sum of the taxpayer's net excluded earned income and his or her zero bracket amount) will thus be the same as the amount of tax imposed under present law.

Capital losses.—The amount of capital losses which a taxpayer other than a corporation is allowed in any taxable year is limited to the taxpayer's capital gains for the same taxable year plus the smallest of three different amounts. It is necessary to amend the provision for one of the three amounts (i.e., the taxpayer's taxable income) which may be added to capital gains to determine the capital loss limitation, in order to maintain the same level of limitation which is placed on such losses under present law. A technical amendment produces this result by reducing taxable income (as newly defined) by the taxpayer's zero bracket amount, but not below zero.

Income averaging.—The bill's change in the definition of taxable income also requires technical adjustments in the Code provisions for income averaging. In order to leave taxpayers in a position similar to that which they would occupy if the definition of taxable income were not changed by the bill, their taxable income must be adjusted for years prior to those beginning in 1977, when the change in the definition of taxable income becomes effective. The simplest method for giving taxpayers essentially the same access to and the same advantages from income averaging as they enjoy under present law is to increase their pre-1977 base period taxable income, that is, their taxable income for taxable years beginning in 1973, 1974, 1975, and 1976, by their zero bracket amount. Although the zero bracket amount added to the pre-1977 taxable income generally exceeds a taxpayer's standard deduction for each of those years, the use of a single flat amount is simpler than determining four separate standard deductions. Furthermore, any lost tax savings to a taxpayer because of adding in the zero bracket amount instead of a standard deduction results in only a slightly higher taxable income, and after averaging, will involve only a *de minimis* amount, probably well under $20. By making the adjustments backwards to prior years, the need for these adjustments will eventually disappear as present law taxable income years (that is, taxable years before 1977) drop from the four base years. In addition, this adjustment will prevent an undesirable one-time surge in the number of taxpayers eligible for income averaging in 1977. If no adjustment were made for pre-1977 years, not only would the taxpayer using averaging in 1977 have a higher averageable income, but more taxpayers would be artificially eligible because they would be comparing new taxable income from which no reduction for a standard deduction has been made, with the present law taxable income for four prior years when taxable income was reduced by a standard deduction.

Underpayment of estimated tax.—Section 6654(d)(2) of the Code, which imposes additions to tax for underpayment of an installment of estimated tax, contains a "safe haven" rule involving the annualization of taxable income. To conform the annualizing rule to the new definition of taxable income, the bill authorizes the Secretary to prescribe new regulations. These regulations should, in effect, annualize taxpayers' adjusted gross income and itemized deductions, then determine taxpayers' excess itemized deductions (if any), add any unused zero bracket amount and deduct personal exemptions to determine annualized taxable income. Of course, other Treasury regulations must be revised where necessary in order to conform to the changes made in this bill.

Miscellaneous.—Because of the elimination of the standard deduction as a separate concept and operation, the deductions for individuals and corporations allowed by section 161 are always to be used in determining taxable income for those who itemize their deductions. Therefore, the cross reference to the definition of taxable income is modified to refer to section 63 generally, not just a subsection of that section. Similarly, the cross reference to taxable income in section 211 which allows additional itemized deductions for individuals also is amended to refer to section 63 and not just one of its subsections. The minimum tax preference item called "excess itemized deductions" under present law is renamed "adjusted itemized deductions" to avoid confusion with the changes made by the bill. The reference to section 63(a) in section 1034 (relating to the sale or exchange of residence) is also amended to refer to section 63 generally. None of these amendments constitutes a substantive change.

5. Change in general tax credit

To make it possible to use tax tables which incorporate the general tax credit, the House bill also provides the $35 per capita credit option in the general tax credit for purposes of the extra exemptions for the aged and blind. The committee concurs in the House bill provision with regard to the general tax credit. This change will reduce receipts by $76 million in fiscal year 1978.

To further simplify the tax form and tax computation, another change is made in the general tax credit for married individuals filing separate returns. Because of the optional feature of the general tax credit (2 percent of taxable income with a maximum of $90 for separate returns or the $35 per capita tax credit), the tax tables for married individuals filing separately would require two columns, one for each type of credit. This would be necessary because both spouses are required to elect the same alternative. Two columns and a consistent election are not only confusing but compliance would be difficult for many taxpayers filing separate returns because they often do not know the election which the other spouse has made.

The House bill deals with this problem by limiting married couples filing separate returns to the $35 per capita tax credit and eliminating the 2 percent of taxable income credit for such returns. The committee agrees with this change. Since most married couples who file separate returns are in fact separated, one spouse frequently is unable to claim any exemption for dependents and therefore selects the 2 percent of taxable income credit. The maximum tax increase that could result from the elimination of the 2-percent credit is $55 (the difference between the $90 maximum on the 2-percent credit and the $35 per capita credit). This change increases tax liability by an estimated $40 million a year.

6. Withholding changes

The increase in the "standard deduction" will be reflected in reduced withholding beginning May 1, 1977. The withholding changes will be at the proper annual rate rather than an accelerated rate to reflect the entire year's liability change in only eight months of withholding. The reduction in withholding will apply to both "standard deductors" and itemizers, for whom the reduction in withholding will generally represent smaller refunds but in some cases will require larger final payments.

The higher standard deduction provided by the committee for heads of households requires a special withholding adjustment because heads of households are withheld under present law according to the rate schedule for single persons. In order to avoid overwithholding, heads of households will be permitted to claim an additional personal exemption only for withholding purposes. Since the difference between the standard deduction for single persons and married persons is $1,000 ($3,200 for joint returns and $2,200 for single persons), the additional personal exemption will reflect $750 of this $1,000 difference. This has the effect of reflecting $2,950 for withholding instead of the full head of household standard deduction amount of $3,200. If head of household withholding were based on the joint return rate schedule, there would be substantial underwithholding because the joint tax rates are lower than the head of household rates. Heads of households may elect to have the $2,950 reflected in their withholding by filing a new form W-4 (Employee's Withholding Allowance Certificate) on which they claim the extra personal exemption with their employer. The Internal Revenue Service will be required to modify this form to enable heads of households to claim an additional personal exemption for withholding purposes.

For wages paid after December 31, 1978, the withholding tables are to be the same as those in effect on January 1, 1975, except that they will be modified to reflect the higher "standard deduction" (the new zero bracket amount) provided by this bill. This 1979 change in withholding is made because the general tax credit is scheduled to expire at the end of 1978.

7. Filing requirements

Under present law, the income level at which a tax return must be filed is $2,450 for a single person and for a head of household, and $3,600 for a joint return. These levels reflect the minimum standard deduction of $1,700 for single individuals and heads of households and $2,100 for joint returns, and one $750 personal exemption for single and head of household returns and two $750 exemptions for joint returns. Because of the increase in the "standard deduction" amount in the House bill, these levels increase to $3,150 for single and head of household returns and $4,500 for joint returns. Under the committee bill, these levels are $2.950 for single returns, $3,950 for head of household returns, and $4,700 for joint returns.

Effective date

The changes in the standard deduction, tax tables and tax rate schedules and filing requirements are effective for taxable years beginning after December 31, 1976. The withholding changes apply to wages paid after April 30, 1977, and before January 1, 1979.

Revenue effect

It is estimated that the changes in the standard deduction will reduce receipts by $2.0 billion in fiscal year 1977, $7.6 billion in fiscal year 1978, and $6.0 billion in fiscal year 1979. The large revenue loss in fiscal year 1979. The large revenue loss in fiscal year 1978 is due to the substantial refunds resulting from the late start of reduced withholding in 1977. In addition, extensions of the $35 credit to the aged and blind will reduce receipts by $77 million in fiscal year 1978, and the restriction of the general tax credit in the case of married individuals filing separate returns will increase receipts by about $40 million in fiscal year 1978. (The latter two amounts are included in the estimate for the extension through 1978 of the $35 general credit, discussed later under "Extension of Individual Tax Reductions.")

D. INCREASED INVESTMENT CREDIT OR NEW JOBS CREDIT

Present law

Investment tax credit

The investment tax credit now is 10 percent of the cost of qualified equipment. The Tax Reduction Act of 1975 and the Tax Reform Act of 1976 increased the rate of the investment credit from 7 percent to 10 percent (from 4 percent for public utilities) through 1980. The credit is allowed when the taxpayer places in service qualified equipment with a useful life of at least 3 years. Equipment with a useful life of 3 or 4 years receives one-third the credit, and equipment with a useful life of 5 or 6 years receives two-thirds the credit. Used property qualifies for the credit, but the amount of qualifying property is limited to $100,000 (increased from $50,000 by the 1975 tax reductions). Generally, equipment becomes eligible for the credit when it is placed in service. For equipment with a normal construction period of 2 years or more, however, the credit is available as progress payments are made; this provision is being phased in between 1975 and 1979 and was enacted as part of the Tax Reduction Act of 1975.

In any taxable year, the credit is generally limited to $25,000 plus one-half of tax liability above that amount. Utilities, however, in the Tax Reduction Act of 1975, were allowed a 100-percent limitation for 1975 and 1976 with a phasedown by 10 percentage points a year to 50 percent in 1981. Railroads and airlines, in the Tax Reform Act of 1976, were allowed the 100-percent limitation for 1977 and 1978 followed by a phasedown of 10 percentage points a year to 50 percent in 1983. For all businesses, unused credits may be carried back 3 years and carried forward 7 years, subject to the limitations applicable in those years. Unused credits from prior years are to be used before credits earned in later years.

An additional one percentage point of credit is allowed if that amount is placed in an employee stock ownership plan (ESOP), under a provision enacted in the Tax Reduction Act of 1975, and extended through 1980 in the Tax Reform Act of 1976. In the 1976 Act, an additional one-half percentage point of investment credit was provided if both the employer and employee put that amount into an ESOP.

WIN tax credit

The only tax provision in present law specifically designed to stimulate increased employment is the work incentive credit (WIN) and the associated welfare recipient tax credit. Under the WIN credit rules, employers can receive a tax credit equal to 20 percent of the wages paid during the first 12 months of employment to AFDC recipients or to those certified 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. The WIN credit is generally not available if the employment is terminated without cause within a certain period (generally six months) after the employment starts.

Three changes, designed to encourage employers to participate in the WIN program, were made by the Tax Reform Act of 1976. First, the limitation based on tax liability was increased from the previous $25,000 of tax plus one-half the excess. Second, the period an employee must be retained for the credit to be available was reduced from 2 years to 180 days. Third, an exception to this retention rule was provided if dismissal results from a substantial reduction in business.

Reasons for change

The committee believes that a temporary business tax cut can provide an important economic stimulus. By allowing firms to choose between a new jobs tax credit and an additional investment tax credit, both labor-intensive and capital-intensive firms will be given an incentive to increase their productive resources; by removing the House bill's $40,000 limitation on the total jobs credit allowable to any one firm, the committee has extended the effect of this provision to large employers, who provide a significant portion of the nation's jobs.

Although the House bill did not include an investment credit, the committee concluded that the poor outlook for investment necessitated an additional incentive for capital expenditures. In addition to providing more stimulus to the economy, an increase in the amount of investment is desirable for other reasons. The investment not only creates jobs both directly and through the multiplier effect, but it also increases productivity. This is anti-inflationary because it increases the ability to make output available to meet future consumer demands and because it results in lower production costs so that wage increases will exert less upward pressure on product prices. Increased productivity also has favorable implications for our balance of payments and the exchange rate of the dollar. Finally, unless the stock of capital is increased significantly in the future, there will be serious problems in providing enough jobs for those entering the labor force. In view of these considerations, the committee concluded that it would be appropriate to add an additional two percentage points to the investment credit. The investment credit is available for 4 years so that firms have sufficient time to respond to this stimulus.

The committee also believes that one of the most distressing features of our current economic situation is the high unemployment rate. The new jobs tax credit is included in this bill because it addresses this problem directly. By limiting the credit to increases in employment, the committee believes it has provided a substantial incentive to hire new workers for a relatively modest revenue cost.

The clearly temporary nature of this provision is designed to make the employer's response an immediate one. Firms can take the opportunity to hire additional workers who can be employed to build up the inventories they desire to meet the increased sales induced by other parts of this bill. Firms with order backlogs, firms which may have deferred general maintenance activities because of the recession, and firms which may wish to increase the quality of their goods or services will have an incentive to add workers to their payrolls immediately.

The new jobs tax credit reflects the considerable interest in Congress in establishing a tax incentive oriented toward new jobs, and it results in a program which can be easily administered by employers and the government. For the vast majority of businesses, this provision will require no additional recordkeeping, tracing of employees, or extensive searching through old records; they will use records already maintained in order to file required Federal Unemployment Tax Act (FUTA) returns. Thus, employers can easily understand their status with respect to this credit. In the interest of simplicity, no records of employee hours, no distinctions between part-time and full-time employees, and no tabulations of new employees are necessary.

The committee made several changes in the new jobs tax credit provision of the House bill. First, the committee believes that the incentive provided in the new jobs tax credit should be made available to large employers, who could provide a substantial share of any new jobs created by this provision. Thus, the committee removed from the House bill the $40,000 limitation on the amount of credit which could be received by any one employer. Second, the House bill offered the potential for some taxpayers in high rate brackets to receive a tax reduction greater than a new employee's wages. The committee eliminated this problem by providing that the deduction for wages and salaries be reduced by the amount of the credit. Third, the committee wanted to maintain the same total revenue loss as the business tax section of the House bill. Because the optional investment credit and the removal of the $40,000 limitation increased the revenue loss by more than is gained by the reduction of wage deductions, the committee lowered the credit percentage from 40 to 25.

Fourth, the credit is limited to the excess of total wages over 105 percent of the previous year's total wages. This provides more protection (than the 103-percent limitation in the House bill) against employers' benefitting from the conversion of existing full-year, full-time jobs into part-year, part-time jobs. Fifth, the House bill provides a credit for all the employees of a new business. The committee believes that this would provide new businesses with too great a competitive advantage relative to existing businesses, and thus it added a provision limiting the wage amount from which the credit is computed to 50 percent of the current year's unemployment insurance wages. Finally, the committee eliminated the House bill's provision for an extra credit for the handicapped.

The committee amendment requires that firms choose either the additional investment credit or the new jobs tax credit for 1977 and 1978. This allows the credit rates to be higher, while maintaining the same revenue loss as the House bill, than would be the case if all firms were given the benefit of both provisions. The jobs credit is initially available for only two years because it is a new, experimental program.

Firms must choose the same option in both 1977 and 1978 so that they do not have an incentive to distort the timing of their investments and their employment increases. Without this feature, for example, a firm with a large investment project in 1977 might choose the investment credit in 1977 and then might be tempted to delay new hiring until 1978 so that it could benefit from switching to the new jobs tax credit in that year.

After 1977, the additional 2 percentage point increase in the investment tax credit will be available to all businesses for 1979 and 1980.

1. *Explanation of provision—Investment credit increase*

Taxpayers may make an election with respect to the new jobs tax credit or an additional two percentage points in the investment credit. Generally, the choice of the investment credit will increase it from 10 percent to 12 percent (or from 11 or 11½ percent to 13 or 13½ percent, respectively, where the election for an ESOP also has been made).

The two additional percentage points of the investment credit will be available for the portion of the basis of property completed by the taxpayer after December 31, 1976, that is attributable to construction, reconstruction or erection after December 31, 1976, and before January 1, 1979. Property that is acquired by the taxpayer after December 31, 1976, and is placed in service between that date and January 1, 1979, also is eligible for the two additional points. In addition, the election for the increase in the investment credit applies to qualified progress expenditures made between December 31, 1976, and January 1, 1979, for property that is eligible for the investment credit. Regardless of whether they elect the new jobs credit for 1977 and 1978, all taxpayers will receive the additional investment credit for similar activities undertaken after December 31, 1978, and before January 1, 1981.

The committee intends that the additional investment credit be available to public utilities with respect to flow-through of the investment credit under the elections made after enactment of the Tax Reduction Act of 1975. Under present law, the credit is not allowed to a public utility where it is required to flow through the credit immediately through a reduction in the cost of service or the rate base. The credit is allowed where the credit is flowed through ratably over the useful life of the asset, where the rate base reduction is restored over the useful life of the asset, or where the utility has elected (sec. 46(f)(3)) immediate flow-through.

Corporations that are members of a controlled group of corporations, as well as other corporations, partnerships and individual taxpayers which are under common control and thus are treated as a single employer for purposes of the new jobs tax credit (see discussion below), will be treated as having claimed the investment credit unless all such taxpayers elect the new jobs tax credit. Thus, the decision to take the investment credit by any one taxpayer treated as a single employer with other taxpayers determines the decision for the other taxpayers.

2. *Explanation of provision—New jobs tax credit*

General rules

The committee amendment provides the same general rules for a new jobs tax credit as were in the House bill except that under the amendment the new jobs tax credit (1) equals 25 percent of unemployment insurance wage increases (rather than 40 percent as under the House bill), (2) no maximum total credit is provided (the House bill limited the credit to $40,000 per employer or taxpayer), (3) a credit is allowed for a year only if total wages for the year are more than 5 percent above total wages for the previous year (the House bill required a 3-percent increase in total wages), (4) any deduction for wages and salaries is to be reduced by the amount of the credit, and (5) a limitation is provided for new or rapidly expanding businesses.

The committee amendment provides employers with an income tax credit of 25 percent of additions to the first $4,200 of wages paid to additional employees in 1977 and 1978. Generally, the maximum credit allowed for adding one new employee is $1,050 (25 percent of $4,200). There is no maximum total credit for any employer or taxpayer.

For 1977, the amendment provides that the credit is to be equal to 25 percent of the increase in the employer's 1977 unemployment insurance wages over 103 percent of 1976 unemployment insurance wages. For most employers, "unemployment insurance wages" for 1976 and 1977 are the wages reported by the employer for Federal unemployment insurance purposes. For 1978, the credit equals 25 percent of the increase in 1978 unemployment insurance wages (up to $4,200 per employee) over 103 percent of 1977 unemployment insurance wages.

Most employers are covered by the Federal Unemployment Tax Act (FUTA) system, and therefore they will be able to claim the new jobs tax credit on the basis of existing records and without making complex computations.[1] FUTA wages and total wages for 1976 already have been reported on FUTA forms so that, for most employers, the information needed for the 1977 credit can be taken directly from the 1976 and 1977 FUTA returns.

For 1978, most employers will use their 1977 and 1978 FUTA records as the basis for claiming the credit, but they are to use a $4,200 wage limit for credit purposes instead of the $6,000 wage limit for 1978 FUTA purposes.[2]

Both the amendment and the House bill require a 3 percent increase over the prior year's unemployment insurance wages for an employer to obtain any credit. The 3 percent rule is designed to allow the credit only where an employer's employment growth exceeds normal increases in employment for the economy as a whole.

To insure that the new jobs tax credit is based on actual increases in employment rather than artificial increases in unemployment insurance wages (for example, an employer could increase unemployment insurance wages by dividing full-time jobs into part-time or part-year jobs), the credit is not to exceed 25 percent of the increase in total wages (unemployment insurance wages without any dollar limit) for

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[1] For 1976 and 1977, FUTA wages are limited to the first $4,200 of wages paid to an employee; in 1978, the limit increases to $6,000.

[2] The committee intends that the Internal Revenue Service's 1978 FUTA forms include a line for excess wages over $4,200, as well as wages over $6,000. An employer therefore will be able to make the computation at the same time the employer completes the FUTA forms. The Service's instructions should make clear that this line is solely for the new jobs tax credit and that the computation need not be made by employers who are not electing the credit.

the year over 105 percent of total wages for the preceding year.[3] The committee provided the 5 percent increment rather than 3 percent as provided in the House bill, because it believed this higher requirement would better insure against increases in total wages due to pay raises; the 5 percent increment is closer to projected increases in total salaries and normal employment growth than was the 3 percent amount.

The committee did not include in its amendment the provision of the House bill which denied twice the credit for the firing of an employee solely to earn a new jobs tax credit. The committee believes this provision would have been administratively difficult to enforce.

Limitation on FUTA increases

The committee amendment provides a limitation on the amount of the credit available to new and rapidly expanding businesses. The amendment limits the increase in unemployment insurance wages (taken into account under the credit) to 50 percent of the current year's unemployment insurance wages. Specifically, an employer whose 1976 FUTA wages, increased by 3 percent, are less than half the employer's 1977 FUTA wages uses 50 percent of its 1977 FUTA wages in lieu of 103 percent of its 1976 FUTA wages in computing the credit. A similar limit applies in 1978. That is, the maximum credit for a new business established in 1977 is 25 percent of half of its 1977 FUTA wages. The same principle applies to businesses operating prior to 1977, and thus the provision affects rapidly expanding businesses as well as new businesses.[4]

Reduction of wages deduction

The committee amendment requires that a taxpayer's deduction for an employee's wages or salary be reduced by the dollar amount of the new jobs tax credit for wages and salaries paid in the taxable year.

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[3] For example, assume in 1976 an employer had 10 employees and paid total wages of $100,000. If each employee earned at least $4,200, the employer's FUTA wage base for 1976 was $42,000. If the employer replaced those workers with 20 part-time employees at the beginning of 1977, the 1977 FUTA wage base would be $84,000 (20 times $4,200). Nonetheless, no new jobs tax credit would be allowed for 1977, because 1977 total wages ($100,000) would be the same as 1976 total wages. If, on the other hand, in 1977 the 10 employees earned $110,000 in total wages and the employer hired two additional employees earning $5,000 each, the employer's 1977 FUTA wage base would be $50,400, total wages would be $120,000, and the employer would have a new jobs tax credit of $1,785 (25% × $7,140). This credit is based on an increase of $7,140 in 1977 FUTA wages ($50,400) over 103 percent of 1976 FUTA wages (103% × $42,000=$43,260). The total wage limitation of $15,000 ($120,000—105% × $100,000) is greater than the FUTA wage base increase ($7,140) and therefore does not limit the credit. If in 1977 the wages of the 10 earlier employees had decreased to $97,500, the total 1977 wages would have been $107,500 and the credit would have been limited to $625: 25% × $2,500 ($107,500—(105% × $100,000)=$2,500).

[4] For example, assume a business has 2 employees in 1976, each of whom earns at least $4,200. In 1977, the business employs 12 workers, each of whom earns at least $4,200. Without the limitation, the employer, whose 1976 FUTA wages were $8,400, could be entitled to a credit for 10 out of 12 of its employees, a total of $10,437 (25%×($50,400—(103%×$8,400)=25%×($50,400—$8,652)). With the limitation, the employer substitutes $25,200 (50%×$50,400) for $8,652, and is entitled to a maximum credit of $6,300 (25%×($50,400—$25,200)=25%×$25,200).

This reduction is applied without regard to the 100-percent-of-tax limitation.[5]

The reduction is allocated among members of a controlled group of corporations or entities under common control as is the credit (see *Controlled groups*, below).

In the case of entities, such as partnerships, which pass through the credit but do not pass through deductions as such, the dollar amount of the credit, computed by the partnership prior to any allocation, reduces the deduction for wages and salaries otherwise allowable to the partnership. In addition to partnerships, this rule is applied to subchapter S corporations and estates and trusts, as well as to certain regulated investment companies, real estate investment trusts, and cooperatives.

The committee believes the reduction of wage deductions is necessary to eliminate any situation where the credit would give an employer an incentive to pay an employee not to work. For example, under the House bill, an unincorporated employer in the 70 percent marginal tax bracket could have received for each $1 paid to an employee (up to $4,200) 40¢ of credit and 70¢ of reduced tax because of wage deductions, resulting in an increase in after-tax income of 10¢. Even with a 25 percent credit, if the employee also qualifies for the WIN credit (20¢ on $1), the increase in after-tax income for this unincorporated taxpayer would be 15¢. Of course, the reduction for wage deductions reduces the effective rate of the credit.[6]

Election

The election of the new jobs tax credit will be made by an employer upon filing the tax return for the last taxable year beginning in 1977 (or the employer's first taxable year, if later). The election is binding for the 2-year period of the new jobs tax credit; an employer electing the new jobs tax credit will not be eligible for the 2-percent increase in the investment tax credit for those years. The election applies to all taxable years beginning in 1977 and 1978, including those beginning before the election is first made. Because it is the employer which makes the election, the election will be made by the entity, in the case of entities which flow through income (for example, a partnership, a subchapter S corporation, an estate or trust, certain regulated investment companies, real estate investment trusts, and cooperatives). After 1978, all taxpayers will be eligible for the 2-percent increase in the investment tax credit for 1979 and 1980.

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[5] For example, assume an employer would be entitled to a $20,000 new jobs tax credit. The taxpayer would reduce its wage deduction by $20,000, in determining its tax liability. If the tax liability were $18,000 (taking into account the reduction of the wage deduction), a total of $18,000 credit could be used. Only $2,000 could be carried back or forward, and no reduction of deductions for wages and salaries paid in the years to which the credit is carried would be required because of the carryover or carryback.

[6] The amount of the effective rate depends on the marginal tax rate of the taxpayer. For example, the effective rate is reduced from 25 to 13 percent for a corporate taxpayer at the 48 percent marginal rate, but only to 20 percent for a small business taxpayer at the 20 percent marginal rate.

For the new jobs tax credit to be available to members of a controlled group, each member of the group must elect the credit. If one member does not elect the credit, only the extra 2-percent investment tax credit will be available to members of the group.

In the case of changes in business form, such as incorporation of an unincorporated business, mergers, and divisions, the Secretary is to prescribe regulations for continuation of the election. The committee is concerned that the changes are not used to avoid the binding election, and has provided for regulations to prevent any possible abuse of the election through these changes in form.

If a lessor elects the new jobs tax credit, the extra 2-percent investment tax credit can nonetheless be passed through to the lessee under the investment tax credit rules, and may be claimed by the lessee if the lessee does not elect the new jobs tax credit.

Although the election is binding for 2 years, it may be revoked if the taxpayer files an amended return for the first year.

Eligible employees and employers

The committee amendment applies to the same employees and employers as the House bill.

The amendment provides the credit only for employees of a trade or business of the employer. This provision excludes, for example, maids, chauffeurs, and other household employees. The amendment does not allow a credit unless more than half of the employee's wages are for services in the employer's trade or business.

The committee concluded that the new jobs tax credit should apply only to employment within the United States (that is, the 50 States and the District of Columbia). Consequently, an employee's wages are taken into account only if more than one-half of the wages are for services performed in a trade or business in the United States.[7]

Agricultural employees

Generally, agricultural employers will not be covered by the FUTA system until 1978. In order to make the credit available to them, the amendment provides that farmers can determine unemployment insurance wages for 1976, 1977, and 1978, on the basis of their social security tax (FICA) records, counting wages up to $4,200 (rather than the higher FICA limits) for each employee. The agricultural rules are exactly like those provided in the House bill. Under the amendment, an employee who is paid by an employer (employers under common control are not aggregated for this purpose) both as an agricultural employee and as a nonagricultural employee will be considered under the agricultural rules if the employee's wages are

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[7] The test to determine whether more than one-half of an employee's wages are for services in a U.S. trade or business is applied with respect to all of the employee's remuneration (that is, without regard to the $4,200 FUTA limit). The test is applied to each separate employer without treating related employers as a single employer (see *Controlled groups*, below). For example, if an employee was paid $15,000 in wages by one employer for foreign services and $10,000 in wages by a related employer for U.S. services in a trade or business, the $10,000 wage payment would be taken into account.

excluded from FUTA tax (under the FUTA rules for agricultural labor) for any pay period.[8]

Railroad employees

The wages of employees for railroad service, as determined under the FUTA provisions of the Code (sec. 3306(c)(9)) are excluded from FUTA. Instead, the employer contributes a percentage of these wages to a fund maintained under the Railroad Unemployment Insurance Act (RUIA). In order to make the credit available to railroad employers, the amendment provides (in precisely the same manner as the House bill did) that they are to use $\frac{7}{8}$ of their RUIA wage base in lieu of the FUTA wage base. The RUIA system is based on wages up to $400 per month ($4,800 annually). The $\frac{7}{8}$ ($4200/$4800) computation is designed to equate RUIA wages with FUTA wages.

Some affiliates of railroad employers pay FUTA rather than RUIA. In these cases, of course, the affiliate will use the FUTA wage base to compute unemployment insurance wages.[9]

Under the amendment, the railroad rule supersedes the agricultural rule so that wages paid by a railroad for agricultural services will be taken into account solely under the railroad rules.

Excluded employees

The same employees are excluded under the committee amendment as were excluded under the House bill. The amendment excludes employees who are not covered under the FUTA system and who are not farm or railroad employees. Accordingly, the credit is not provided for self-employed persons, for employees of employers who are excluded under the FUTA minimums, and for certain persons in the fishing industry.[10]

The amendment also provides that employees of governments and tax-exempt organizations do not qualify for the credit regardless of any other provision. In general, these organizations do not pay income tax, and because the credit is not refundable, they could not receive any benefits from it. Furthermore, the employees of many tax-exempt organizations are not now covered by the FUTA system, and they could not easily be brought into the system. Finally, State and local

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[8] Assume, e.g., that during all but one pay period of 1976, an employee performed nonagricultural labor. During one pay period, the employee was paid for 15 hours of agricultural labor and 10 hours of nonagricultural labor. The employee was excluded from FUTA during that one pay period (under sec. 3306(d) of the Code) and therefore is excluded from the regular FUTA rules under the bill. Any FUTA wages reported by the employer for this employee are to be subtracted from the employer's FUTA base. In their place, the employer is to use FICA records of the employee's wages (up to $4,200).

[9] An employee's unemployment insurance wages will be determined under the RUIA system if more than one-half of the employee's wages are paid for railroad service. Employers that are members of a controlled group are not aggregated for this purpose.

[10] An employer is not liable for FUTA taxes unless (1) wages of at least $1,500 are paid during any calendar quarter in the calendar year or preceding calendar year or (2) the employer employed at least one person on each of 20 days (each in a different week) during the calendar year or preceding calendar year (sec. 3306(a) of the Code).

Wages for persons employed in fishing are excluded from FUTA unless they are working on a vessel weighing more than 10 tons or unless the service is in connection with commercial salmon or halibut fishing (sec. 3306(c)(17) of the Code).

governments are eligible for countercyclical revenue sharing and would be eligible for public service jobs programs being presented to the Congress.

Self-employed persons

The committee amendment provides the same special rules for self-employed persons that were provided by the House bill.

These special rules are included to insure that a new jobs tax credit will not be artificially created by a person merely because of a change in the form of a business. Without these rules, a sole proprietor who was self-employed in 1976 and earned $10,000 from the business in that year could incorporate the business at the beginning of 1977, become an employee of the corporation, and be entitled to a new jobs tax credit for employing himself or herself. If his or her wages were at least $4,200 in 1977, the credit could be $525 (25 percent of one half of $4,200) because no unemployment insurance wages or total wages were paid by the corporation in 1976.

In this case, the amendment adds to the employer's base of unemployment insurance wages in 1976 the first $4,200 of 1976 net earnings from self-employment attributable to the unincorporated business. Consequently, the individual's change in status from self-employed to employee will not give rise to any new jobs tax credit for 1977.[11] In the year a person's status changes to "employee", only the person's FUTA wages are taken into account as unemployment insurance wages; the person's net earnings from self-employment are to be disregarded for purposes of determining the credit for that year. For example, if the change in status takes place during 1977, the 1977 net earnings from self-employment attributable to the business are not taken into account in computing the credit for 1977 (but that amount is taken into account as 1977 wages for purposes of computing the credit for 1978).

Changes in business form

If the amendment contained no explicit rules for the change in ownership of a business, a person who begins business in 1977 or 1978 by buying and operating an existing business would be entitled to a new jobs tax credit even if the number of employees in that business were not increased; the credit would be allowed because the buyer would not have paid unemployment insurance wages or total wages for the year before the business was acquired. Also, the sale of a unit of a business in 1977 or 1978 could cause the seller to lose any new jobs tax credit even though employment increased in the part of the business that was retained. To solve these problems, the amendment includes special rules for computing the new jobs tax credit where a business changes hands. These special rules are the same as those that were provided in the House bill.

Acquisitions.—Under the amendment, if an employer acquires the major portion of a trade or business (or the major portion of a separate unit of a trade or business) from another person during a year, the new jobs tax credit for any year ending after the acquisition is to be

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[11] This rule also applies to an independent contractor who earns self-employment income derived from contracts with an existing trade or business in 1976 or 1977 and who changes status to become an employee of that trade or business in the following year.

computed as if the business had not changed hands. Accordingly, if a business were sold in mid-1977 (after the employees had been paid FUTA wages) the unemployment insurance wages (and total wages) paid by the buyer in 1977 are computed both for 1977 and 1978, as if the buyer had been the owner of the business throughout 1977.

Under these rules, the committee intends that an employer should not be treated as acquiring the major portion of a trade or business (or of a separate unit of a trade or business) merely because the employer acquires assets used in that trade or business. The committee intends that this determination be made on the basis of whether the acquisition involves the transfer of a viable trade or business which can be operated by the employer. Generally, for this purpose, the committee regards the transfer of goodwill as an indication that a trade or business has changed hands; however, the committee does not consider the fact that employees of the seller become employees of the buyer to be determinative.

For example, if a company buys equipment used by a restaurant business, and has the equipment installed in its own restaurant at another location, the buyer would be considered to have purchased business assets rather than a major portion of a trade or business. On the other hand, if the buyer bought the equipment and used it in the operation of a restaurant at the same location, the transaction could be considered a sale of the restaurant business if goodwill was transferred (whether or not the buyer paid separately for the goodwill). Of course, the purchase of a franchise and equipment not previously used in the vicinity would probably not be considered the acquisition of a business.

In addition to allocating the credit between the buyer and seller of a business, the acquisition rule prevents an employer from artificially creating a new jobs tax credit where, for example, an independent contractor buys facilities and hires the employees of a taxpayer and then "leases" them back to the taxpayer. In this case, even though the transfer might increase the work force of the contractor, it would not entitle the contractor to a new jobs tax credit for any year ending after the transfer because, having acquired a major portion of a separate unit of the former employer's business, the contractor would be treated as if it had paid the wages of the employees of that unit before the acquisition.[12]

Dispositions.—As a part of the rules for computing the credit where a business has changed hands, the amendment provides that in determining the new jobs tax credit for any year ending after a disposition, the disposing employer's credit is to be computed as if it did not pay unemployment insurance wages to the employees of the business (or separate unit) that changed hands. This provision permits an employer who operates two businesses to sell one of them and nevertheless earn a new jobs tax credit for employment increases in the retained business. However, this relief is not provided unless the disposing employer furnishes the acquiring person with the information needed under the acquisition rules described above.

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[12] Of course, where the employer has arranged to have its employees' wages paid by a payroll agency, any credit with respect to those employees would be allowed to the employer rather than to the agency.

Controlled groups

Generally, all employees of all corporations that are members of a "controlled group of corporations" are to be treated as if they were employees of the same corporation. The controlled group provisions, which are the same under the committee amendment as they were under the House bill, prevent arbitrary results under the credit rules where a business is operated by two or more related companies instead of one company. Generally, under the controlled group rules, the credit allowed the group is the same as if the group were merged into a single company.

The amendment applies the same controlled group test (50-percent control) that applies under rules limiting benefits and contributions under tax-qualified pension plans (sec. 415(h)). Because regulations have already been issued under the controlled group rule as it applies to pension plans, many employers who would be affected by the rule under the credit provisions are familiar with it.

A comparable rule is provided in the case of partnerships, proprietorships, and other trades and businesses (whether or not incorporated) which are under common control (as determined under regulations), so that all employees of such organizations generally would be treated as if they were employed by a single person. For example, if two persons are the only partners in a partnership, and each partner owns 50 percent of one corporation, the amendment provides that the partnership and the corporation are to be treated as a single employer.

These rules, for example, prevent the allowance of the new jobs tax credit solely because an employee of a parent company transfers to a subsidiary company at the beginning of a calendar year. If the employee was paid $10,000 by the parent in 1976 and is paid $10,000 by the subsidiary in 1977, the transfer will cause an increase in FUTA wages ($4,200) and total wages ($10,000) paid by the subsidiary in 1977. For 1977, however, the transfer will cause a reduction in the FUTA wages and total wages paid by the parent, compared to 1976. Because the common control rule combines the parent's decrease with the subsidiary's increase, the transfer will not affect the 1977 new job tax credit for the group.

Allocation of credit

The committee amendment provides the same rules as the House bill for allocating credit earned by a controlled group. The amendment provides that any credit earned by the group is to be apportioned to members of the group on the basis of their proportionate contributions to the increase in unemployment insurance wages. For example, if the unemployment insurance wages paid by a parent company increased by $21,000, those of subsidiary A increased by $12,600, and those of subsidiary B decreased by $25,200, the net increase would be $8,400 and the credit would be $2,100. In this case, the credit allowed to the parent would be $1,312.50 ($2,100× ($21,000÷ ($21,000+ $12,600))) and the credit allowed subsidiary A would be $787.50 ($2,100× (12,600÷ ($21,000+$12,600))). No credit would be allowed to subsidiary B. (The deductions allowed the parent and subsidiary A for wages would be reduced by $1,312.50 and $787.50, respectively.)

The rules for apportioning the credit to partners, shareholders of an electing small business corporation (a subchapter S corporation), or the beneficiaries of a trust or estate are generally the same as under the investment tax credit. However, in order to assure that the credit will not be applied against a partner's, shareholder's, or beneficiary's tax on income from other sources, the amendment limits the credit allowed to a partner, etc., to the proportionate part of the tax for the year allocable to the taxpayer's interest in the particular partnership, etc., from which the credit is derived. For example, if a partner's income tax for the year were $4,780 (before taking into account a general tax credit of $180, investment credit of $1,000 derived from the partnership, and investment credit of $600 derived from another business), and if the partner's taxable income reduced by the zero bracket amount) were $25,000 and income allocable to the interest in the partnership [13] were $15,000, the credit allowed for the year could not exceed $1,800 (($4,780 − $1,780) × ($15,000 ÷ $25,000)). Consequently, if the partner's share of the new jobs tax credit from the partnership for the year were $2,000, the credit allowed for the year would be $1,800 and a credit of $200 could be carried back or forward to other years, subject to the same limitation (that is, if the person has paid sufficient tax with respect to income derived from an interest in that partnership).

Pensions or any other payments to a partner which are not derived from the partnership interest are, of course, not income from an interest in the partnership, and therefore the new jobs tax credit could not offset tax on such income.

Under the amendment, if the employer is a partnership whose taxable year is a fiscal year, a partner whose taxable year is the calendar year will claim the new jobs tax credit allocated from the employer for the calendar year (1978 and 1979) in which the employer's fiscal year ends. (Similar rules apply to a beneficiary of a trust or estate and a shareholder of a subchapter S corporation.)

For example, assume *A*, a calendar year taxpayer, is a sole proprietor and also is a partner in a partnership which has adopted a fiscal year ending June 30. Assume the proprietorship and the partnership both increase employment sufficiently to earn new jobs tax credits in both 1977 and 1978. On *A*'s 1977 return, *A* claims the credit from the sole proprietorship. The credit rules do not apply to the partnership until its taxable year beginning in 1977, and that partnership taxable year does not end until June 30, 1978. Therefore, *A* is not allowed a credit attributable to the partnership on *A*'s 1977 return. On the 1978 return, *A* is allowed a new jobs tax credit for the sum of *A*'s 1978 increase in employment by the sole proprietorship plus the 1977 increase in employment in the partnership. On *A*'s 1979 return, *A* is allowed the credit for the 1978 increase in partnership employment.

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[13] The taxable income of the partner allocable or apportionable to the partner's interest in the entity equals the partner's gross income from the entity reduced by deductions. The deductions which reduce this taxable income are (1) those attributable to activities of the entity and (2) the portion of deductions not attributable to any activity, such as charitable contributions, which are apportioned to income from the entity (on the basis of gross income). These deductions are subtracted in full from the gross income of the entity, that is, without being reduced by any part of the zero bracket amount. The total taxable income of the partner must, of course, be reduced by the zero bracket amount in order to take into account all the partner's deductions.

Nonrefundability

As under the House bill, the committee amendment provides that the new jobs tax credit is nonrefundable; that is, it cannot exceed the taxpayer's income tax liability. Also, the amendment provides that the new jobs tax credit is to be allowed after all other nonrefundable credits have been allowed.

If, after applying all other nonrefundable credits, a person's remaining tax liability for a year is less than the new jobs tax credit, the excess credit can be carried back 3 years (including carrybacks to years before the enactment of the credit) and carried forward 7 years, beginning with the earliest year. This is the usual rule for carrybacks and carryovers of income tax credits.

Short taxable years

The short taxable year provision of the committee amendment is identical to that provided in the House bill. Under the amendment, if an employer has more than one taxable year beginning in a calendar year (because, e.g., the employer began business during the calendar year and adopted a fiscal year ending in that same calendar year), the credit is allowed for the last taxable year beginning in the calendar year. The credit is allowed for the last taxable year beginning in a calendar year so that the employer may use employment tax returns (due shortly after the end of the calendar year) as the basis for claiming the credit.

Effective date

The new jobs tax credit applies for taxable years beginning after December 31, 1976.

The temporary increase in the investment credit applies to a qualified investment for the period January 1, 1977, through December 31, 1980. The provision applies to property acquired and placed in service during that 4-year period, qualified progress expenditures made in that period, and the portion of qualified property completed by the taxpayer in the period 1977 through 1980.

These business tax reductions are on an elective basis for the first 2 years, but for the last 2 years, only the additional 2 percentage point increase in the investment tax credit is available. Thus, for 1977 and 1978 the business tax reduction will be, on an elective basis, either an additional 2 percentage points of the investment tax credit (generally from 10 percent to 12 percent) or a 25-percent new jobs tax credit. After 1978, the additional 2 percentage point investment tax credit will be available to all businesses for 1979 and 1980.

Revenue effect

The estimated revenue loss from both tax credits is $0.9 billion in fiscal year 1977, $2.4 billion in 1978, and $2.4 billion in 1979. The increase in the investment credit will reduce revenues by $0.5 billion in fiscal year 1977, $1.2 billion in 1978, $1.6 billion in 1979, $2.0 billion in 1980 and $1.3 billion in 1981. The revenue loss from the new jobs tax credit is estimated at $0.4 billion in fiscal year 1977, $1.2 billion in 1978 and $0.8 billion in 1979.

E. EXTENSION OF 1977 INDIVIDUAL AND CORPORATE TAX REDUCTIONS THROUGH 1978

1. Extension of Individual Tax Reductions (sec. 203 of the bill and secs. 42 and 43 of the Code)

Present law

Two individual income tax reductions, enacted in the Tax Reduction Act of 1975 and subsequently enlarged and extended in the Revenue Adjustment Act of 1975 and the Tax Reform Act of 1976, are scheduled to expire at the end of 1977. These are the general tax credit and the earned income credit.

General tax credit.—The general tax credit equals the greater of (1) $35 for each taxpayer, spouse or dependent or (2) 2 percent of the first $9,000 of taxable income. It is a nonrefundable tax credit; that is, it is limited to the amount of tax liability.

Earned income credit.—The earned income credit equals 10 percent of the first $4,000 of earned income. The credit is reduced by 10 cents for each dollar of earned income or adjusted gross income (AGI) above $4,000, which generally means that the credit is phased out as AGI rises from $4,000 to $8,000. It is available only to persons who maintain a household for a child who is under 19, is a student or is a disabled adult dependent. The earned income credit is a refundable credit; that is, it can exceed tax liability.

Reasons for change

The committee's analysis of the current economic situation led it to the conclusion that it would be inappropriate to withdraw from the economy the fiscal stimulus provided by the 1977 individual income tax reductions. Allowing these tax cuts to expire at the end of 1977 would more than counteract the additional fiscal stimulus provided by the other sections of this bill.

In deciding the duration of this tax cut extension, the committee took into account the necessity for comprehensive tax reform legislation during the 95th Congress. The role of both the general tax credit and the earned income credit will have to be reconsidered as a part of such legislation, and the committee felt that extending these tax cuts beyond 1978 would, in effect, predetermine part of the appropriate tax reform package.

Explanation of provisions

General tax credit.—The House bill extends the general tax credit through 1978. (In addition, as discussed above under "Revision of the Standard Deduction, Tax Tables, Tax Rate Schedules, Withholding and Filing Requirements," the bill modifies the general tax credit for the aged and the blind and for married persons who file separate returns.) The bill provides that the general tax credit be reflected in

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lower withheld taxes through 1978 in the same manner that it has been reflected in withholding rates in 1977. The committee amendment does not change the House provision.

Earned income credit.—The House bill extends the earned income credit through 1978. There is a technical amendment to the Tax Reform Act of 1976 making the credit available to 1977–78 fiscal year taxpayers, since that Act inadvertently denied the credit to these persons. These provisions of the committee bill are the same as in the House bill, except that the committee bill does not include an authorization for an appropriation for that part of the earned income credit that exceeds tax liability. Under the Third Concurrent Resolution on the Budget for Fiscal Year 1977, the entire earned income credit is treated as a reduction in receipts.

The committee bill deletes from the House bill a provision modifying the availability of the credit to persons receiving aid to families with dependent children (AFDC) and other aid or assistance from Federal, State or local income maintenance programs.

To be eligible for the earned income credit, a person must "maintain a household" for a child who is under 19, a student or a disabled dependent. "Maintaining a household" means providing more than one-half the support for that household, and AFDC and other payments with respect to children are treated as support for those children not provided by the parents.

The House bill modifies the earned income credit by providing that, for purposes of the earned income credit, "maintaining a household" shall be defined by not taking into account any aid or assistance for any child under any Federal, State or local program. The committee deleted this provision because it provides special treatment to AFDC recipients unavailable to other persons.

Effective date

The extension of the general tax credit applies to taxable years ending after December 31, 1977, and ceases to apply to taxable years ending after December 31, 1978. The extension of the earned income credit applies to taxable years ending after December 31, 1977, and beginning before January 1, 1979.

Revenue effect

The one-year extension of the general tax credit will reduce budget receipts by $6.8 billion in fiscal year 1978 and $3.9 billion in fiscal year 1979. The one-year extension of the earned income credit will reduce receipts by $1.3 billion in fiscal year 1979.

2. Extension of Certain Corporate Income Tax Reductions (sec. 301 of the bill and secs. 11 and 821 of the Code)

Present law

Prior to the 1975 Tax Reduction Act, corporate income was subject to a 22-percent normal tax and a 26-percent surtax (for a total tax rate of 48 percent). However, the first $25,000 of corporate income was exempt from the surtax. As a result, the first $25,000 of corporate income was taxed at a 22-percent rate and the income in excess of $25,000 was taxed at a 48-percent rate.

In the Tax Reduction Act of 1975, the surtax exemption was increased to $50,000 and the normal tax was reduced to 20 percent on the initial $25,000 of taxable income. This resulted in a 20-percent rate on the first $25,000 of taxable income, a 22-percent rate on the next $25,000 of income, and a 48-percent rate on taxable income in excess of $50,000. These changes were extended by the Revenue Adjustment Act of 1975 through June 30, 1976.

The Tax Reform Act of 1976 extended the reduction in the normal tax rates and the increase in the surtax exemption through December 31, 1977, and applied these changes to mutual insurance companies.

Reasons for change

The temporary changes in the corporate surtax exemption provided by the 1975 Tax Reduction Act were adopted for two reasons: first, to grant tax relief to small businesses which were not likely to derive substantial benefits from the liberalizations in the investment credit in that Act because they are not capital intensive; and second, to provide temporary tax relief to small business as part of a program of tax reduction designed to help stimulate the economy and promote economic recovery. These reasons for increasing the surtax exemption and lowering the normal corporate tax rate continue to apply in the current economic climate.

Explanation of provision

The committee bill extends the reduction in the normal tax rates and the increase in the surtax exemption through December 31, 1978. Thus, the corporate rate structure will continue to be 20 percent on the first $25,000 of corporate taxable income, 22 percent on the next $25,000, and 48 percent on taxable income above $50,000. This is the same as the provision in the House bill.

Effective date

This provision applies to all taxable years ending after December 31, 1977, and before January 1, 1979.

Revenue effect

This provision will reduce budget receipts by $1.0 billion in fiscal year 1978 and $1.3 billion in fiscal year 1979.

F. POSTPONEMENT OF CERTAIN PROVISIONS OF THE TAX REFORM ACT OF 1976

1. Sick pay (sec. 401 of the bill and sec. 105(d) of the Code)

Present law

Under present law, the revisions in the sick pay provision made by the Tax Reform Act of 1976 apply to taxable years beginning after December 31, 1975. The 1976 Act repealed the prior sick pay provision and substituted a new disability income exclusion of $100 a week, which is available only to taxpayers under age 65 who have retired on disability as permanently and totally disabled. The maximum amount excludable is reduced dollar-for-dollar for adjusted gross, income (including disability income) in excess of $15,000. Thus, a taxpayer who receives $5,200 in disability income and $15,000 (or more) in other income, which together equal $20,200 (or more), is not entitled to any exclusion.

The 1976 Act also provided that, upon reaching age 65, the taxpayer can begin to recover his or her investment in an annuity arrangement under section 72. A special rule allows certain permanently and totally disabled retirees who determine that they will not be able to claim any (or little) sick pay exclusion to benefit from the section 72 exclusion before age 65. Under this rule, in order to claim the section 72 annuity exclusion, the taxpayer must make an irrevocable election not to seek the benefits of the disability income exclusion for that year and all subsequent years.

The 1976 Act also provided several transitional rules. One of the transitional rules allows taxpayers who retired on disability before January 1, 1976, and who were entitled to a sick pay exclusion on December 31, 1975, also to benefit from the section 72 annuity exclusion before age 65, if they make an irrevocable election not to claim the disability income exclusion.

Reasons for change

Although the Tax Reform Act of 1976 did not become law until October 4, 1976, the revisions in the sick pay exclusion were made applicable back to January 1, 1976. Even though the House version of the tax reform bill, which passed on December 4, 1975, changed the sick pay provision prospectively (by applying the revisions to taxable years beginning after December 31, 1975), most of the taxpayers affected by the change were not aware of it. Consequently, many taxpayers were surprised to learn, at the end of 1976 or early in 1977, that the sick pay exclusion was not available for 1976. For many of these taxpayers this change meant a large and unexpected final tax payment with their 1976 returns. For many taxpayers retired on disability pensions, such a large unanticipated cash payment represented a serious hardship. The committee believes that individual taxpayers should be given more advance warning when a change of this magnitude is made

Explanation of provision

The bill generally changes the effective date of the sick pay exclusion made by the Tax Reform Act of 1976 from taxable years beginning after December 31, 1975, to taxable years beginning after December 31, 1976.

However, some taxpayers already relied on the changes made by the 1976 Act when they filed their tax returns. Other taxpayers may prefer to file returns under the new provision.

Among those who have already filed, some have begun to recover their contributions to a pension plan, either because they made one of the irrevocable elections provided by the 1976 Act for claiming the section 72 annuity exclusion, or because they reached age 65 during 1976 and, believing the prior sick pay exclusion unavailable, had begun to recover their investment in their annuity contracts under section 72. If the effective date of the provision were changed and no other amendment provided, such a taxpayer would be required to "undo" the election or recovery of contributions and file an amended return.

To avoid this problem and to assist those taxpayers who prefer the tax treatment provided in Tax Reform Act changes to the tax treatment under the old sick pay provision, the committee amendment permits taxpayers under age 65 who have already made elections or would like to elect the section 72 exclusion on their 1976 tax returns, as well as those taxpayers age 65 and older who simply claimed the annuity exclusion because they believed the new disability exclusion unavailable, to benefit from the annuity exclusion, "as if" the Tax Reform Act disability income exclusion still applied to 1976, if they wish. Those who wish to change their "irrevocable" elections or to undo their recoveries of contributions for 1976 are also permitted to do so by the committee amendment.

Thus, taxpayers who make (or have made) an "irrevocable election" on their 1976 tax returns still may begin to recover the investments in their annuity contracts in 1976. If these taxpayers wish to claim the old sick pay exclusion in 1976, they must revoke these elections and file amended returns. Taxpayers who revoke these elections may then elect to begin recovering their annuity costs in 1977 or a subsequent year.

Taxpayers who reached age 65 before January 1, 1977, were too old to claim the new disability exclusion for 1976 and could begin in 1976 to recover their contributions to their annuity arrangements in accordance with the provisions of the Tax Reform Act of 1976. Under the committee amendment, these taxpayers may if they have not reached mandatory retirement age) elect to claim the old sick pay exclusion for 1976 and file amended returns. They would then start to recover the contributions to their annuities in their taxable years beginning in 1977, when the new provision becomes generally effective.

Taxpayers who reached an initial or minimum retirement age before January 1, 1977, were under age 65 on December 31, 1976, and erroneously began recovering their annuity contributions without making irrevocable elections may make their elections for 1976 retroactively. In that event, they still may recover their annuity contributions in 1976 unless the election is subsequently revoked. Alternatively, by filing amended returns, these taxpayers may claim the old sick pay exclusion in 1976.

A taxpayer electing to claim the old sick pay exclusion for 1976 may be liable for an additional tax if the amount of that exclusion is less than the amount excludable under section 72.

A taxpayer who makes an election for 1976 to recover his or her contributions to an annuity arrangement, in accordance with the 1976 Act rules, may revoke that election at any time before the expiration of the statute of limitations for the 1976 tax return. However, under the committee amendment, the statute of limitations is then automatically extended (if necessary) to be sure that the Service will have at least one year after the revocation to examine the return and determine whethe rthis revocation results in an increase in tax liability for 1976. In effect, this means that the statute of limitations will not be extended if the revocation occurs within 2 years after the filing of the 1976 return. In general, the statute of limitations will be extended only if the revocation is made during the third year. If the statute of limitations is extended for this reason, then it wil be extended only for purposes of determining a deficiency attributable to the revocation; that is, this extension will not open up the statute of limitations as to any other issues on the 1976 tax return.

The Internal Revenue Service has already printed and distributed the Federal income tax forms and instructions for 1976. Both the forms and instructions are based on the law as amended by the Tax Reform Act of 1976. The Service believes that for most taxpayers who wish to have the old sick pay rules continued for 1976, the only feasible method of administering a change in the effective date will be to have taxpayers file amended returns for 1976 and claim refunds. However, in those instances where the change in tax treatment (from cost recovery under sec. 72 to sick pay exclusion under sec. 105(d)) has no tax consequences for 1976, the Service may advise taxpayers that they can simply restore to the annuity basis (or "cost") on their returns for 1977, the amounts that would have otherwise been excluded as sick pay (under sec. 105(d)) during tax year 1976, and begin to recover their contributions in tax year 1977; in this way, these taxpayers will not have to file amended returns for 1976. Another group that should file amended returns—but with increased tax liabilities rather than claims for refunds—are those taxpayers for whom the old sick pay exclusion (under sec. 105(d)) provides a lesser tax benefit for 1976 than cost recovery (under sec. 72), but who nevertheless wish to use the old rules for 1976 because that course in their cases is expected ultimately to provide greater aggregate tax benefits.

The Service anticipates that this provision will increase the number of individual amended returns for 1976 by about 1 million more than the approximately 900,000 amended returns filed in a normal year. The Service estimates that processing the extra amended returns will cost about $6 million.

Effective date

The provision generally changes the effective date of the sick pay changes made by the Tax Reform Act of 1976 from taxable years beginning after December 31, 1975, to taxable years beginning after December 31, 1976. This change is effective on October 4, 1976 (the date of enactment of the Tax Reform Act of 1976).

Revenue effect

This provision will reduce budget receipts by $327 million in fiscal year 1977.

2. *The Tax Treatment of Income Earned Abroad by U.S. Citizens in Private Employment (sec. 402 of the bill and sec. 911 of the Code)*

Present law

The Tax Reform Act of 1976 made several changes in the taxation of individuals working abroad which are effective for taxable years beginning after December 31, 1975. Under the law in effect prior to the Tax Reform Act, U.S. citizens could exclude up to $20,000 of income earned abroad during a period in which they were overseas for 17 out of 18 months or during a period they were bona fide residents of a foreign country or countries (sec. 911). In the case of individuals who had been bona fide residents of foreign countries for three years or more, the exclusion was increased to $25,000 of earned income. Individuals electing the standard deduction were not allowed to claim the foreign tax credit for foreign taxes paid.

The Tax Reform Act of 1976 generally reduces the earned income exclusion for individuals working abroad to $15,000 per year (the Act retains a $20,000 exclusion for employees of charitable organizations). In addition, the Act makes three modifications in the computation of the exclusion.

First, the Act provides that any individual entitled to the earned income exclusion is not to be allowed a foreign tax credit with respect to foreign taxes allocable to the amounts that are excluded from gross income under the earned income exclusion. Second, the Act provides that any additional income derived by individuals beyond the income eligible for the earned income exclusion is subject to U.S. tax at the higher rate brackets which would apply if the excluded earned income were not so excluded. Third, the Act makes ineligible for the exclusion any income earned abroad which is received outside the country in which earned if one of the purposes of receiving such income outside of the country is to avoid tax in that country. In addition to these changes made in the computation of the exclusion, the Act provides an election to an individual not to have the earned income exclusion apply. This provision of the Act also allows individuals taking the standard deduction to claim the foreign tax credit.

Reasons for change

The application of the changes to the earned income exclusion to all income earned by individuals abroad beginning on January 1, 1976, substantially increased the tax burden of many of these taxpayers. Prior to the enactment of the Tax Reform Act of 1976 on October 4, 1976, these individuals did not know that they would be liable for substantially higher taxes and thus many had not saved the money to pay the increased taxes. As a consequence, the changes in the exclusion caused a particular hardship for 1976.

Explanation of provisions

The amendment delays the effective date for the changes made by the Act to the taxation of individuals working abroad (i.e., the changes to the exclusion and the change allowing the foreign tax credit to individuals claiming the standard deduction) so that the changes do not apply until taxable years beginning after December 31, 1976.

Effective date

This provision is effective on date of enactment.

Revenue effect

The one-year delay in the effective date will result in a decrease in budget receipts of $38 million. This is comprised of a decrease in budget receipts of $45 million resulting from the delay in the effective date of the changes made by the Tax Reform Act to the earned income exclusion, and an increase in budget receipts of $7 million resulting from the delay in the effective date of the provision allowing individuals electing the standard deduction to claim the foreign tax credit.

3. *Relief From Interest, Additions to Tax, and Penalties Attributable to Application to 1976 of Provisions of the Tax Reform Act of 1976 (secs. 403, 404, and 405 of the bill)*

Present law

Under existing law, if the withholding of income taxes from wages does not cover an individual's total income tax liability, the individual, in general, is required to file estimated tax returns and make estimated tax payments. Also, corporations are normally required to make quarterly estimated tax payments. An underpayment of an estimated tax installment will, unless certain exceptions are applicable, result in the imposition of an addition to tax which is currently computed at a rate of 7 percent per annum on the amount of underpayment for the period of underpayment (secs. 6654 and 6655, with the rate as determined under sec. 6621). The Internal Revenue Code requires the payment of interest (currently at a rate of 7 percent per annum) on the amount of an underpayment of tax liability from the last date for paying tax on any amount which should be shown on a return, without regard to any extension of time for payment (sec. 6601, with the rate as determined under sec. 6621).

The Code also requires employers to deduct and withhold income tax from employees' wages (sec. 3402(a)) and imposes an addition to tax of 5 percent on the amount of the underpayment in the case of a late deposit of withheld taxes (sec. 6656(a)), as well as a 100-percent penalty for willful failure to collect, account for, and pay over the taxes required to be withheld (sec. 6672).

Reasons for change

The Tax Reform Act of 1976, enacted on October 4, 1976, made several changes which increased tax liabilities from the beginning of 1976.

In prior legislation (such as the Tax Reform Act of 1969) which the Congress passed late in the year but which imposed tax increases from the beginning of the year, the Congress, as a matter of equity and custom, has relieved taxpayers of any liability for additions to tax, interest, and penalties with respect to increases in estimated tax resulting from increases in tax liability arising for that year under the legislation. Relying on Congressional assurances that the failure to provide such relief in the 1976 Act was an oversight which would be remedied, the Commissioner of Internal Revenue announced that the Internal Revenue Service would defer assessing any additions to tax with respect to increased estimated tax liabilities for 1976 taxable years caused by the Tax Reform Act of 1976, in anticipation of legislative action.

However, in the absence of specific legislative relief, the Service would eventually have to enforce the law and assess the additions to tax, interest, and penalties, because of underpayments of tax or failures to withhold and deposit income tax which are attributable to the tax-increasing provisions of the 1976 Act. Moreover, in cases where the Service may have assessed an addition to tax because of an underpayment of estimated tax—the taxpayer, for example, may have indicated the addition to tax on an already-filed return—there is no authority to abate the assessment in the absence of further statutory change.

The committee believes it is appropriate to grant to taxpayers affected by the 1976 legislation relief from additions to tax, interest, and penalties, similar to that which has traditionally been granted in connection with earlier legislation where provisions were enacted with retroactive application.

Explanation of provision

The committee amendment is designed to relieve taxpayers from additions to tax, interest, and penalties (but not liability for tax) attributable to changes in the tax law which were made applicable to 1976 by the Tax Reform Act of 1976.

Thus, the committee amendment allows individual taxpayers until April 15, 1977, and corporations until March 15, 1977 (the final filing dates for calendar year returns), to pay their full 1976 income tax liabilities without incurring any additions to tax on account of underpayments of estimated tax, to the extent that the underpayments are attributable to changes in the law made by the Tax Reform Act of 1976.

The committee amendment also relieves employers of any liability for failure to withhold income tax during 1976, on any type of remuneration which was made taxable by the 1976 Act.

In addition, the committee amendment provides relief for taxpayers with short taxable years or with fiscal years ending before December 31, 1976. No interest is to be due in such cases on underpayments attributable to changes made by the 1976 Act through April 15, 1977, for individual taxpayers, and through March 15, 1977, for corporations.

In determining the extent of the relief accorded a taxpayer under this bill, only the effects of the tax-increasing provisions of the 1976 Act are to be taken into account; the tax-reducing provisions are to be disregarded in these computations. Thus, the tax-reducing provisions of the 1976 Act are not to be netted against the tax-increasing provisions for this purpose.

For example, assume that Mr. A has filed his income tax return for 1976, showing a total liability of $2,000; that the 1976 Act's change from a deduction for child care expenses to a credit for such expenses reduced A's tax by $300; that the 1976 Act's change in the partnership provisions increased A's tax by $500; that A had no taxes withheld from his income and paid $1,200 in estimated taxes in $300 installments during 1976; and that A does not qualify for any of the exemptions from underpayment of estimated tax.

Under present law, A is treated as having underpaid his estimated tax by the amount by which 80 percent of the tax liability shown on his return (that is, 80 percent of $2,000, or $1,600) exceeds his estimated tax payments ($1,200). This is a total shortfall of $400. As a result, A is treated as having underpaid his estimated by $100 for each of the four installments, and the 7-percent addition to tax is calculated on this amount.

Under the bill, for purposes of applying the estimated tax provisions to 1976, A is to be treated as having shown a tax liability of $1,500 on his return (the $2,000 actual amount, reduced by the $500 increase resulting from the 1976 Act's partnership provisions). Since 80 percent of $1,500 (that is, $1,200) does not exceed A's estimated tax payments (also $1,200), A is to be treated as not having underpaid his estimated tax for 1976. This result is unaffected by the $300 tax saving to A which is attributable to the 1976 Act's child care provisions.

In cases where the Internal Revenue Service has assessed or assesses additions to tax, interest, or penalties attributable to provisions of the 1976 Act which increased income or tax liability for 1976 taxable years; and which are forgiven by this committee amendment, the Service is to abate those assessments. When the Service sends taxpayers notices of such assessments with regard to 1976 taxable years, it is to include with those notices information about the relief provisions of this committee amendment in order to assist taxpayers in obtaining abatements. Also, where such assessments have already been made, the Service is to notify the taxpayers about the relief provisions of this committee amendment as soon as feasible after the enactment of this bill.

Provisions similar to this amendment were included in the Tax Reform Act of 1969 (sec. 946 of the 1969 Act) and the Revenue Act of 1971 (sec. 207 of the 1971 Act).[1]

Effective date

The provisions of this amendment take effect on the date of enactment.

Revenue effect

This provision is estimated to reduce revenues in fiscal year 1977 by $15 million.

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[1] Because neither of these Acts eliminated exclusions of income in circumstances where the elimination of the exclusions had the effect of requiring wage withholding on previously excludable amounts, neither Act contained a provision similar to the section of the bill which would relieve employers of the duty to withhold on such amounts.

By contrast, the 1976 Act had the effect of requiring withholding for 1976 on certain amounts which, but for the enactment of the 1976 Act, would have been excludable from income.

G. OTHER PROVISIONS ADDED BY THE COMMITTEE

1. Deductions for Expenses Attributable to Use of Residence to Provide Day Care Services (sec. 406) of the bill and sec. 280A of the Code)

Present law

Under the code, no deductions are allowed for personal, living, and family expenses except as expressly allowed (sec. 262). Generally, under this provision, expenses and losses attributable to a dwelling which is occupied by a taxpayer as his or her personal residence are not deductible. However, deductions for interest, certain taxes, and casualty losses attributable to a personal residence are expressly allowed under other provisions of the tax laws (secs. 163, 164 and 165). Prior to the Tax Reform Act of 1976, if a portion of the residence was used in the taxpayer's trade or business or for the production of income, a deduction would be allowed for an allocable portion of the expenses incurred in maintaining such personal residence.

The Tax Reform Act of 1976 added a new section to the Code (sec. 280A) which provides, in part, that no deductions shall be allowed with respect to a dwelling unit which is used by the taxpayer as a residence, unless specifically excepted from this new section and otherwise allowable. The provisions of this section apply to individuals, trusts, estates, partnerships, and electing small business corporations. This provision does not apply to a corporation (other than an electing small business corporation).

The general disallowance provision, however, does not apply with respect to certain expenses which are otherwise allowable as deductions; for example, the deductions allowable for interest (sec. 163), certain taxes (sec. 164) and casualty losses (sec. 165) may still be claimed as deductions without regard to their connection with the taxpayer's trade or business or income producing activities.

In the case of a taxpayer who exclusively uses a portion of a dwelling unit on a regular basis as his principal place of business, as a place of business which is used by patients, clients, or customers in meeting or dealing with the taxpayer in the normal course of his trade or business, or in the case of a separate structure which is not attached to the dwellings, in connection with the taxpayer's trade or business, an allocable portion of ordinary and necessary trade or business expenses paid or incurred in connection with such trade or business use will be allowed as a deduction. However, the amount of the deduction is subject to a limitation discussed below. In addition, in the case of an employee, a deduction is allowable only if the business use is for the convenience of the employer.

Exclusive use of a portion of a taxpayer's dwelling unit means that the taxpayer must use a specific part of a dwelling unit solely for the purpose of carrying on his trade or business. The use of a portion of a dwelling unit for both personal purposes and for the carrying on of a trade or business does not meet the exclusive use test. Thus, for example, a taxpayer who uses a den in his dwelling unit to write legal briefs, prepare tax returns, or engage in similar activities, as well for personal purposes, will be denied a deduction for the expenses paid or incurred in connection with the use of the residence which are allocable to these activities.

Under the Act, an exception to the exclusive use test is provided in the case of a taxpayer whose trade or business is selling products at retail or wholesale and whose dwelling unit is the sole fixed location of such trade or business. Under this exception, the ordinary and necessary expenses allocable to space (within a dwelling unit) which is used as a storage unit for inventory will not be disallowed. However, the space must be used on a regular basis and must be a separately identifiable space suitable for storage.

In addition to the exclusive use test, the Act requires that the portion of the residence used for trade or business purposes must be used by the taxpayer on a regular basis in order for the allocable portion of the expenses to be deductible. Expenses attributable to incidental or occasional trade or business use of an exclusive portion of a dwelling unit would not be deductible.

The provision does not permit a deduction for any portion of expenses paid or incurred with respect to the use of a dwelling unit which is used by the taxpayer both as a residence and in connection with income producing activities (sec. 212). For example, no deduction will be allowed if a taxpayer who is not in the trade or business of making investments uses a portion of his residence (exclusively and on a regular basis) to read financial periodicals and reports, clip bond coupons and perform similar activities because the activity is not a trade or business.

In the case of an employee, a deduction for the portion of the ordinary and necessary business expenses attributable to the use of a residence which are paid or incurred in connection with the performance of services as an employee will be allowable only if, in addition to satisfying the exclusive and regular use tests, the use is for the convenience of his employer. If the use is merely appropriate and helpful, no deduction attributable to such use will be allowable.

The Act also provides an overall limitation on the amount of deductions that a taxpayer may take for the business use of the home. The allowable deductions attributable to the use of a residence for trade or business purposes may not exceed the amount of the gross income derived from the use of the residence for that trade or business reduced by the deductions which are allowed without regard to their connection with the taxpayer's trade or business (e.g., interest and taxes). In the case where gross income is derived both from the use of the residence and from the use of facilities other than the residence, a reasonable allocation (based on the facts and circumstances of each case) is to be made to determine that portion of the gross income derived from the use of the residence. With respect to the deductions which are allocable to the trade or business use of the residence, deductions allowable without regard to whether the activity is a trade or business are to be deducted first. Any remaining gross income may then be reduced (but not below zero) by the remaining allowable deductions which are allocable to such use.

In determining the deductible amount attributable to the business use of the home, the general rule is that any reasonable method of allocation may be used. In all cases involving the dual use of a home, the allocation of expenses attributable to the portion of the residence used for business purposes will take into account the space used for those purposes, e.g., a percentage of the expenses based on the square feet of that portion compared to the total square feet of the residence. In addition, a further allocation based on time of use was required when the portion of the residence was not exclusively used for business purposes. In Rev. Rul. 62–180, 1962–2 C.B. 52, 54, the Internal Revenue Service took the position that, after allocating expenses attributable to a den used for business and personal purposes on the basis of space, a further allocation must be made on the basis of time of use to reflect the dual use. For purposes of the latter allocation, the Service ruled that the allocation should be made on the basis of availability for use rather than actual use, i.e., the ratio of time actually used for business purposes to the total time it is available for all uses. However, in *George W. Gino*, 60 T.C. 304, 314 (1973) (followed in *Lena M. Anderson*, T.C. Memo, 1974–49)), the Tax Court held that such expenses should be allocated on the basis of actual business use as compared with actual total use. The issue concerning the allocation of expenses for a portion of a residence used for business and personal purposes is no longer relevant where the exclusive use test applies.

Reasons for change

It has been pointed out that the exclusive use test will rarely be satisfied in the case of the use of a personal residence to provide certain day care services. Typically, the portion of the residence used to provide these services will also be used for personal purposes. In these cases, it is not practicable to cordon off a portion of the residence to be devoted exclusively to provide day care services. However, where a portion of the residence is used for personal purposes and day care services, the committee believes that this type of business activity in the residence will ordinarily result in incurring incremental expenses attributable to the residence beyond those which have been incurred if the residence had been used solely for personal purposes. For example, it has been pointed out that this type of business activity will usually result in additional wear and tear on the residence which would be reflected in depreciation in the value of a home owned by the taxpayer providing the services, additional repair and maintenance expenses, and additional utilities expenses.

Explanation of provision

The committee amendment would provide an exception from the general disallowance rule and the exclusive use test for expenses allocable to the use of any portion of a residence in the trade or business of providing day care services to children, handicapped individuals and elderly persons. For this purpose, the term "handicapped individual" would mean an individual who is physically or mentally incapable of caring for himself. An "elderly person" would mean a person who had attained age 65.

The deductible business expenses would be limited to the amount by which the gross income from day care services exceeds the allocable portion of the property taxes, mortgage interest, etc., which are deductible in any event.

In addition, a special allocation rule based on time of use would be provided. As under present law, an allocation of expenses would first be made on the basis of the space in the residence used for furnishing the day care service, i.e., the expenses attributable to the portion used for day care would be determined on the basis of the floor space for that portion compared to the floor space for the entire residence. Then, the amount of expenses allocable to the space used for providing day care services would be allocated between business use and personal use on the basis of the special allocation rule. The amount deductible (before application of the overall limitation based on gross income) would be determined by multiplying the expenses allocable on the basis of space by a fraction, the numerator of which is the total hours of use for providing day care services and the denominator of which is the total time available for all uses (168 hours for each week during the taxable year).

Effective date

This amendment would apply to taxable years beginning after December 31, 1975.

Revenue effect

It is estimated that this provision would reduce budget receipts by $20 million in fiscal year 1977, $17 million in fiscal year 1978 and $17 million in fiscal year 1979.

2. Legislators Travel Expenses Away From Home (sec. 407 of the bill and sec. 162 of the Code)

Present law

Under present law, an individual is allowed a deduction for traveling expenses (including amounts expended for meals and lodging) while away from home in the pursuit of a trade or business (sec. 162 (a)). These expenses are deductible only if they are reasonable and necessary in the taxpayer's business and directly attributable to it. "Lavish or extravagant" expenses are not allowable deductions. In addition, no deductions are allowed for personal, living, and family expenses except as expressly allowed under the code (sec. 262).

Generally, under section 262, expenses and losses attributable to dwelling unit which is occupied by a taxpayer as his personal residence are not deductible. However, deductions for interest, certain taxes, and casualty losses attributable to a personal residence are expressly allowed under other provisions of the tax laws (secs. 163, 164, and 165).

A taxpayer's "home" for purposes of the deduction of traveling expenses generally means his principal place of business or employment. Where a taxpayer has more than one trade or business, or a single trade or business which requires him to spend a substantial amount of time at two or more localities, his "home" is held to be at his principal place of business. A taxpayer's principal place of business is determined on an objective basis taking into account the facts and circumstances in each case. The more important factors to be considered in determining the taxpayer's principal place of business (or tax home) are: (1) the total time ordinarily spent by the taxpayer at each of his business posts, (2) the degree of business activity at each location, (3) the amount of income derived from each location, and (4) other significant contacts of the taxpayer at each location. No one factor is determinative.

In 1952, a provision was adopted with respect to the living expenses paid or incurred by a Member of Congress (including a Delegate or Resident Commissioner). Under these rules, the place of residence of a Member of Congress within the congressional district which he represents in Congress is considered his tax home. However, amounts expended by the Member within each taxable year for living expenses are not deductible in excess of $3,000. Therefore, a Member of Congress (who does not commute on a daily basis from his congressional district) can deduct no more than $3,000 of his expenses of living in the Washington, D.C. area. Prior to the Tax Reform Act of 1976, no rule similar to the special rules for ascertaining the place of residence for a Member of Congress applied in the case of a State legislator. As a result, the tax home of a State legislator was determined in accordance with the general rule described above.

The Tax Reform Act of 1976 provided an election for the tax treatment of State legislators for taxable years beginning before January 1, 1976. Under this election, a State legislator may, for any such taxable year, treat his place of residence within his legislative district as his tax home for purposes of computing the deduction for living expenses. If this election is made, the legislator is treated as having expended for living expenses an amount equal to the sum of the daily amount of per diem generally allowed to employees of the U.S. government for traveling away from home, multiplied by the number of days during that year that the State legislature was in session, including any day in which the legislature was in recess for a period of four or less consecutive days. In addition, if the State legislature was in recess for more than four consecutive days, a State legislator may count each day in which his physical presence was formally recorded at a meeting of a committee of the State legislature. For this purpose, the rate of per diem to be used is to be the rate that was in effect during the period for which the deduction was claimed. In addition, the total amount of deductions allowable pursuant to this election is not to exceed the amount already claimed under a Federal income tax return filed by a State legislator before May 21, 1976. For this purpose, amounts shall be considered claimed under a return even though the taxpayer treated his living expenses as an offset against any reimbursement of per diem he received from the State legislature and, therefore, did not actually set forth these expenses as a deduction on his income tax return. The election is to be made at such time and in such manner as provided under Treasury regulations.

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These limitations apply only with respect to living expenses incurred in connection with the trade or business of being a legislator. The 1976 Act did not impose a limitation on living expenses incurred by a legislator in connection with a trade or business other than that of being a legislator. As to other trade or businesses, the ordinary and necessary test of prior law will continue to apply.

Reasons for change

The provisions which allow a State legislator to treat his place of residence within his legislative district as his tax home for purposes of computing the deduction for living expenses only apply to taxable years beginning on or before December 31, 1975. The committee believes this provision should be extended for a one-year period during which time the problem can be given further consideration and a permanent rule can be developed.

Explanation of provision

The committee amendment extends the provision adopted by the Tax Reform Act of 1976 for one year, or to taxable years beginning before January 1, 1977.

Effective date

This amendment would apply to taxable years beginning before January 1, 1977.

Revenue effect

This provision will result in a revenue reduction of $3 million for fiscal year 1977.

3. Increased Authorization for the Work Incentive (WIN) Program (Sec. 601 of the bill)

The Work Incentive (WIN) Program is designed to assist families on welfare become independent through training, placement, and other services. Federal funds pay 90 percent of the cost of the program. The Administration has included $365 million in the 1978 budget for the Work Incentive Program. The committee's amendment to the bill would authorize an additional $435 million in each of fiscal years 1978 and 1979 for employment and supportive services for welfare recipients, with no requirement for State matching funds.

Present funding levels allow full participation in the program by only one-fourth of WIN registrants. Seventy-five percent of the current 2.2 million persons registered during a given year receive no services other than registration and appraisal. The committee's amendment would enable the Secretary of Health, Education, and Welfare and the Secretary of Labor to provide the kinds of services needed to help significant numbers of welfare recipients prepare for and find employment. This includes coaching and orientation to employment and job development and placement assistance. In addition, supportive services, including child care, are to be provided when necessary.

The WIN program is directed at those who most need help in finding and holding a job—employable recipients of aid to families with dependent children (AFDC). Increasing the level of activity under the WIN program will result in promoting the employment of recipients, thereby increasing their income. It will also help to reduce the welfare caseload and reduce the unemployment rate. For these reasons, the Committee believes that the amendment is an important element of the economic stimulus package.

4. Amortization of certain expenditures for child care facilities (sec. 602 of the bill and sec. 188 of the Code)

Present law

Section 188 of the Code, which was enacted in the Revenue Act of 1971 for five years (and thus expired at the end of 1976), provided that a taxpayer may elect to amortize expenditures for child care facilities over a 5-year period instead of using other depreciation methods. Expenditures eligible for the amortization election included capital expenditures made to acquire, construct, reconstruct or rehabilitate child care facilities. The Secretary of the Treasury was given responsibility to issue regulations with respect to the amortization election and to define the property that could qualify as a child care facility.

Congress intended that the five-year amortization be applicable only to facilities or portions of facilities that could be constructed, renovated or remodeled specifically for use as child care facilities. The provision applied to buildings and equipment, or portions of them, actually used for the provision of child care services in which children received such personal care, protection and supervision as would be required to meet their needs in the absence of their parents. This included a room or rooms, or play equipment and materials particularly suited to the needs of children being cared for during the day. The provision did not apply to general purpose rooms used for many purposes, for example, a room used as an employee recreation center during the evening, nor to a room or a part of a room which is simply screened off for use by children during the day. Such special facilities as kitchen facilities connected to the child care center or area or special children's toilet facilities could be included within the provision.

Property eligible under the provision did not include property located outside the United States.

The 5-year amortization was available only with respect to qualified expenditures made after December 31, 1971, and before January 1, 1977. This provision was provided for a limited duration to give Congress an opportunity to review the effectiveness of the provision after five years.

When this provision was enacted in 1971, collateral amendments were made to other sections of the Code. The rule for recapture of depreciation for personal property (sec. 1245) was amended to provide that gain realized on the disposition of property eligible for amortization as a child care facility was to be subject to recapture on disposition as ordinary income to the extent of these amortization deductions. The Act also amended the minimum tax provisions (sec. 57) to provide that the excess of amortization deductions over depreciation deductions that otherwise would be allowed (including accelerated depreciation) was to be treated as a tax preference. In addition, necessary conforming amendments were made to provide for the treatment of amortization deductions in the cases of estates and trusts and exchanges made in obedience to orders issued by the Securities and Exchange Commission.

An amendment to the investment credit provisions (sec. 48) provided that property for which an election was made to take five-year ratable amortization could not be treated as eligible for the investment credit.

Reasons for change

The committee recognizes that expansion of the availability of child care is an essential element in broadening job opportunities for mothers. A credit against tax liability has been provided to meet the expenses of a taxpayer for child care. There also is need to make child care facilities available for working parents. Although public funds have been made available to increase the number of child care facilities, the committee believes that it is desirable to encourage private businesses to furnish child care facilities for their employees.

In the absence of this election to take 5-year amortization, an employer may use the provisions available in present law for depreciation of tangible property used in a trade or business. Tangible personal property, such as machinery or equipment, is eligible for accelerated rates of depreciation, such as, double declining balance and sum-of-the-year's digits, and also shortening of the guideline levels by as much as 20 percent under the asset depreciation range (ADR). It is possible to use a combination of accelerated rates and ADR lives to speed up appreciably the recovery of an asset's cost. New buildings and structures (other than residential property) may be depreciated using the 150 percent declining balance method. In addition, the investment credit, which is 10 percent through 1980 and under this bill will be raised to 12 percent for 1977 through 1980, may be taken for machinery and equipment, but it is not available on buildings and structures.

After reviewing the foregoing considerations, the current economic situation and prospects for the near future, and the extent of participation in the labor force by mothers (both parents and single parents), the Committee concluded that it is desirable to continue the availability of this provision and to make available to the taxpayer the choice among several forms of tax incentives.

Explanation of provision

The committee bill reinstates as of January 1, 1977 the 5-year amortization for certain expenditures for child care facilities without any change from prior law. By making the provision effective from the start of this year, the committee eliminated any discontinuity between the termination of this amortization election on December 31, 1976, and its extension by action of the 95th Congress. As a result, a taxpayer who planned in 1976 to install equipment for a child care facility in 1977 will be able to carry out his plans without losing the opportunity to make the election for 5-year amortization.

Effective date

The continuation of the 5-year amortization under section 188 with respect to a child care facility applies to expenditures made after December 31, 1976, and before January 1, 1982.

Revenue effect

The decrease in revenues from this amendment is expected to be less than $5 million in each fiscal year 1977 through 1982.

H. STUDY OF ECONOMIC AND EMPLOYMENT EFFECTS OF TAX REDUCTIONS

(Sec. 501 of the Bill)

The committee believes that there should be a greater effort to examine the economic and employment effects of tax changes after they have been enacted. Such an examination will assist Congress in making future decisions on tax policy. In addition, it will provide a systematic review of the economic forecasts that are made by federal government agencies and are used in making economic policy.

The committee's amendment to the bill provides for a series of studies on the economic impact of the principal tax changes in the bill—the refund of 1976 individual income taxes and related payments, and the new jobs tax credit and the investment credit. By May 15, 1977, the Department of the Treasury, the Council of Economic Advisers, the Congressional Budget Office and the Board of Governors of the Federal Reserve System are to submit forecasts of the growth rate of real gross national product, the rate of inflation and the rate of unemployment for the eight calendar quarters beginning with the second quarter of 1977. These forecasts are to include separate estimates of the impacts on these variables of the tax refund and related payments, the elective jobs tax credit and the investment credit (with special attention to the increase in the investment credit in this bill). These forecasts, the underlying assumptions, and a description of the methodology employed are to be submitted to the Senate Committee on Finance and House Committee on Ways and Means.

In addition, the committee's amendment provides that within 60 days of the end of each calendar quarter, starting with the second quarter of 1977, these same agencies will submit a second set of reports to the tax-writing committees of Congress. These reports will evaluate each agency's original economic forecasts of the gross national product, the unemployment rate and the inflation rate, and the effect of each of the temporary tax changes on these variables, and indicate reasons for any significant errors in the forecasts.

The House bill contained no similar provision.

V. COSTS OF CARRYING OUT THE BILL AND VOTE OF THE COMMITTEE IN REPORTING H.R. 3477, AS AMENDED

Budget Effect

In compliance with section 252(a) of the Legislative Reorganization Act of 1970, the following statement is made relative to the costs incurred in carrying out H.R. 3477, as amended by the committee. The committee estimates that the budget (effect of) this bill for fiscal years 1977–1979 is as shown in the following tabulation:

Summary of Estimated Budget Effect of the Tax Reduction and Simplification Act of 1977, Fiscal Years 1977–79

[In billions of dollars]

Category	Fiscal year 1977	Fiscal year 1978	Fiscal year 1979
1. Refund of 1976 individual income taxes	−8.6		
2. Payments to beneficiaries of various programs	−1.8		
Subtotal—refunds and payments	−10.4		
3. Increase and revision of the standard deduction	−2.0	−7.6	−6.0
4. Elective business tax credits:			
Investment credit	−0.5	−1.2	−1.6
New jobs credit	−0.4	−1.2	−0.8
Subtotal—business tax credits	−0.9	−2.4	−2.4
5. 1-year extension of tax cuts:			
Individual [1]		−6.8	−5.2
Corporate		−1.0	−1.3
Subtotal—tax cut extensions		−7.9	−6.5
6. Other tax provisions: Amortization of child care facilities and modification or postponement of certain provisions of the Tax Reform Act of 1976	−0.4	−([2])	−([2])
7. Authorizations for WIN program		−0.4	−0.4
Total	**−13.7**	**−18.4**	**−15.4**

[1] Consists of the general tax credit and earned income credit (the earned income credit extension has no budget effect, however, until fiscal 1979).

[2] Less than $50,000,000.

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

Consultation with Congressional Budget Office on Budget Estimates

In accordance with section 403 of the Budget Act, the committee advises that the Director of the Congressional Budget Office has examined the committee's budget estimates (as shown in part III of this report) and agrees with the methodology used and the resulting dollar estimates for those items.

New Budget Authority

In compliance with section 308(a)(1) of the Budget Act, and after consultation with the Director of the Congressional Budget Office, the committee makes the following statement with respect to new budget authority in this bill. The changes made by this bill involve new budget authority of $3.1 billion for fiscal year 1977, consisting of $1.3 billion in payments of tax refunds in excess of individual income tax liability and $1.8 billion for payments to certain beneficiaries of various income maintenance programs. The bill also involves new budget authority and outlays of $15 million for fiscal year 1978 for the payment authorized to the governments of American Samoa, Guam, and the Virgin Islands.

In addition, the bill authorizes $435 million for the Work Incentive (WIN) Program for each of the fiscal years 1978 and 1979. Appropriations are required before outlays may be made for this program.

Allocations of Budget Authority

The decisions of the committee that have been made for H.R. 3477 allocate budget authority and budget outlays in fiscal year 1977 in a manner that is consistent with the allocations under S. Con. Res. 10, the Third Concurrent Resolution on the Budget for Fiscal Year 1977, and the further allocations made by the committee in its report, Senate Report 95-62.

It is believed that the budget authority made available in this bill will not provide financial assistance to State and local governments.

Tax Expenditures

In compliance with section 308(a)(2) of the Budget Act with respect to tax expenditures, and after consultation with the Director of the Congressional Budget Office, the committee makes the following statement. The changes made by this bill involve new tax expenditures for the increase in the investment tax credit or the new jobs tax credit for businesses amounting to $0.9 billion for fiscal year 1977, $2.4 billion for fiscal year 1978 and $2.4 billion for fiscal year 1979. The bill includes increased tax expenditures of $1.3 billion for fiscal year 1979 as a result of the one-year extension of the refundable earned income credit and also increased tax expenditures from the extension of the current corporate tax reductions amounting to $1.0 billion for fiscal year 1978 and $1.3 billion for fiscal year 1979.

In addition, the bill adds the following new tax expenditures:

(1) Five-year amortization of child care facilities will increase tax expenditures by less than $5 million in each fiscal year 1977-1981;

(2) Postponement from January 1, 1976, to January 1, 1977, of the effective date for the changes in the sick pay exclusion (enacted in the Tax Reform Act of 1976) increases tax expenditures by $327 million in fiscal year 1977;

(3) Postponement of the effective date, from January 1, 1976, to January 1, 1977, of the changes in the exclusion for income tax earned abroad (enacted in the Tax Reform Act of 1976) will increase tax expenditures by $38 million in fiscal year 1977; and

(4) Extending the $35 per person credit to the additional personal exemptions for age and blindness will increase tax expenditures by $77 million in fiscal year 1978 and $79 million in fiscal year 1979.

Vote of the Committee

In compliance with section 133 of the Legislative Reorganization Act of 1946, the following statement is made relative to the vote by the committee on the motion to report the bill. H.R. 3477, as amended by the committee, was ordered favorably reported by the following rollcall vote: In favor: 10 (Senators Long, Talmadge, Ribicoff, Nelson, Gravel, Bentsen, Hathaway, Haskell, Matsunaga, and Moynihan). Opposed: 8 (Senators Byrd, Curtis, Hansen, Dole, Packwood, Roth, Laxalt, and Danforth).

VI. REGULATORY IMPACT OF THE BILL

Pursuant to Rule XXIX of the Standing Rules of the Senate, as amended by S. Res. 4 (February 4, 1977), the committee makes the following statement concerning the regulatory impact that might be incurred in carrying out the provisions of this bill.

A. *Numbers of individuals and businesses who would be regulated.*—All the provisions of the bill affect taxpayers, except the recipients of the $50 special payments, who are generally in a position of reducing their tax liabilities in one or more years.

B. *Economic impact of regulation on individuals, consumers, and businesses affected.*—Under title I, the individuals affected by the provisions will receive tax rebates or special payments that will provide them with a one-time increase in their purchasing power; the tax provisions in the remaining titles, in one or more years, generally reduce tax liabilities and increase the after-tax income of the taxpayers who are affected by those provisions.

C. *Impact on personal privacy.*—The provisions of this bill make negligible changes in those provisions of Federal law affecting the personal privacy of taxpayers.

D. *Determination of the amount of paperwork.*—Title I involves no paperwork by taxpayers; title II will simplify the individual income tax return for most of the taxpayers who will use the revised form; for title III, taxpayers will be able to use existing information to determine the business tax incentive to choose. As many as 4 million business taxpayers that elect the new jobs tax credit may have to submit one additional tax form to indicate their election of the credit. The costs of submitting such information and the time needed to assemble the required information will vary among taxpayers, depending upon the number of employees involved and the accounting system used by each taxpayer; for title IV, taxpayers will be able to use existing information in taking advantage of the new provisions; about 1 million taxpayers who will benefit from the change of the effective dates for the sick pay and income earned abroad provisions will file amended returns for 1976, because tax forms for 1976 already have been distributed and have been based on the January 1, 1976, effective date enacted in the Tax Reform Act of 1976.

In the case of each change made in titles III and IV, taxpayers should have no adverse economic impact as a result of any regulations promulgated thereunder.

VII. CHANGES IN EXISTING LAW

In the opinion of the committee, it is necessary in order to expedite the business of the Senate, to dispense with the requirements of subsection 4 of rule XXIX of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the bill, H.R. 3477, as reported).

VIII. MINORITY VIEWS OF SENATORS CURTIS, HANSEN, DOLE, PACKWOOD, ROTH, LAXAL, AND DANFORTH

The Tax Reduction and Simplification Act of 1977 is ill advised in concept and timing. We strongly disagree on the steps needed to correct the current lag in economic recovery, specifically the kinds of programs necessary to stimulate business investment and productivity growth. We believe that a better approach would be a combination of proposals built upon the foundation of a permanent tax cut for individuals. In addition, we recommend the reduction of corporate taxes; a program of tax credits to employers encouraging them to hire long-term unemployed; incentives to encourage energy conservation and the development of new energy technologies; and a variety of other tax modifications intended to encourage individual and business investment.

Permanent Tax Cuts

Unless consumer and business spending and investment are stimulated in an effective manner, we will have slow growth in the years ahead accompanied by high rates of unemployment. Current economic growth rates have been reduced by a lack of both consumer and business confidence, the lack of appropriate labor force skills, a shortage of energy, low levels of capital formation and the heavy tax burden on the private sector. We need to embark on a program of permanent tax reduction and job-oriented action programs in order to provide the incentive needed to encourage consumer and business confidence.

We strongly urge the use of permanent tax reductions rather than a one-shot $50 rebate for stimulating the economy. The distribution of this rebate by the Federal Government will cost $10.1 billion in 1977 funds which the Government will have to borrow, thus increasing the rapidly growing Federal deficit. The rebate will do little to increase demand or supply because Government borrowing and the lack of sufficient long-term incentives to stimulate business will counter any temporary effects on the rebate. Past experience and a Harris poll in January indicate that by and large the proposed rebate will not be spent on capital purchases, but will be either saved or used to pay off debts.

The worst part of the $50 rebate and the $50 payment to nontaxpayers is the fact that people know that they are receiving payments from a government which already has experienced deficits in 15 of the last 16 years. While there are some who won't get any payment, many will get double payments because of the problems of program administration.

We would provide the most economic stimulus for all working Americans through permanent individual tax cuts. Such action would help offset the effects inflation has had in increasing taxes and thereby decreasing purchasing power of all Americans. The Joint Committee on Taxation has calculated that in 1976 the tax increase from inflation

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amounted to $5.1 billion, or 3.6 percent of individual income tax liability.

A permanent tax cut would help assure continued economic expansion, and would offset the inflation-induced tax increases. Because permanent tax cuts will be reflected week after week in workers' take-home pay, because of reduced withholding, workers will have the confidence to step up spending and take on new obligations. A $50 rebate simply does not provide the reinforcement needed to stimulate long-term economic growth.

Although there is some fear that permanent tax cuts will erode the Federal revenue base, we have but to look back on the history of the actual experience of this country with tax reductions since World War II to see that in all but one case permanent tax cuts created only a 1-year reduction in individual income tax revenue, usually much less than the amount of tax cuts, with revenues increasing the following year. As may be seen from the chart below, only in one case, 1948, was there a 2-year recovery period. In all others, including the early 1970's, there was actually an increase in revenues in the very years when permanent tax cuts were given. The chart clearly shows that tax reductions do not result in large revenue losses.

INDIVIDUAL INCOME TAXES (AS REPORTED IN RETURNS)

[In billions of dollars]

	Amount	Tax reduction
Year:		
1944	16.216	
1945	17.050	
1946	16.076	*
1947	18.076	
1948	15.442	*
1949	14.538	
1950	18.375	
1951	24.228	
1952	27.803	
1953	29.431	
1954	26.666	*
1955	29.614	
1956	32.732	
1957	34.394	
1958	34.335	
1959	38.645	
1960	39.464	
1961	42.225	
1962	44.903	
1963	48.204	
1964	47.153	*
1965	49.530	*
1966	56.087	
1967	62.920	
1968	76.638	
1969	86.568	
1970	83.787	*
1971	85.240	*
1972	93.360	*
1973	107.901	
1974	123.560	
1975 (estimate)	120.514	*
1976 (estimate)	140.414	*

* Years in which taxes were substantially reduced.

Not only does the history of the permanent tax cut show that the revenues will actually be increased, but permanent tax cuts provide a much greater stimulus to the economy than temporary tax cuts. As President John F. Kennedy stated in 1963:

> The largest single barrier to full employment of our manpower and resources and to a higher rate of economic growth is the unrealistically heavy drag of Federal income taxes on private purchasing power initiative and incentive * * * no doubt a temporary tax cut could provide a spur to our economy—but a long-run problem compels a long-run solution.

President Kennedy realized that the economy and the tax base grows when the private sector is strengthened. We should realize that the economy and tax base is weakened when you siphon resources from the productive private sector into the ever-growing government sector.

Recently, in testimony before the Joint Economic Committee, Bert Lance, Director of the Office of Management and Budget, admitted that permanent tax cuts have paid for themselves within 1 year and indicated that he would personally prefer permanent, rather than temporary, tax cuts. The Joint Economic Committee annual report for 1977 states that tax rebates have the disadvantage that a lower proportion tends to be spent than would occur if the tax change were permanent. The report also points out that the rebate has little secondary effect on business investment because businessmen are aware that the rebate-induced rise in consumer spending is only temporary. Clearly, a permanent tax cut would be much more effective than a temporary tax rebate.

One of the arguments advanced in favor of the administration's temporary tax rebate proposal is that they provide financial flexibility to achieve major tax reform next year. Such arguments are a disgrace. We should not hold the American middle class and its working people hostage, withholding from them the right to keep a greater proportion of what they earn all in the name of tax reform. It would be improper for us to withhold from the American people their right to permanent tax cuts which barely make up for the effects of inflation which has affected everyone. There is considerable evidence that among those Senators who are going along with the President's proposal for a $50 rebate many are not convinced of the wisdom of the rebate. Since there is little new or promising in the type of stimulus which a tax rebate would give, we strongly oppose such action.

Standard Deduction

Although we are agreed that the standard deduction for heads of household (single taxpayers with dependents) should be at the same amount as will be allowed for married couples filing joint returns, we are concerned that the committee has reduced the standard deduction for single people from $2,400 to $2,200. This will result in an untimely tax increase, averaging $51, for approximately 2 million single taxpayers. We are also concerned that the increased standard deduction grants no reduction for many taxpayers with identical incomes who choose to itemize their deductions, many of whom are homeowners. It also has been estimated that the change in the standard deduction adversely impacts by over $300 million the charitable contributions made by millions of middle-income Americans, since the higher standard deduction reduces the tax incentives for charitable giving.

Business Climate

The stimulus package this committee proposes gives the American worker and small businessman little to look forward to with hope and will provide this Congress with nothing to look backward on with pride. It fails to recognize that continued economic growth is dependent upon and will demand increased levels of private investment.

Investment is the key to productivity and increased productivity is the prerequisite to price stability and higher real wages. Our material level of well-being has resulted from the fact that Americans work more efficiently and much of that efficiency can be related to the high investment levels associated with each newly created job.

There are several proposals which were rejected by this committee that in addition to the increase in the investment tax credit and the new jobs tax credit would have provided stimulus and encouraged the American people to invest in the free enterprise system rather than making them constantly concerned that the huge government deficits we have been creating will lead to more inflation.

We support the additional 2 percent increase in the investment tax credit which is intended to encourage business to make more investments in equipment since it will, in effect, lower the cost of capital to business, thereby stimulating production and employment.

We also support the concept of the new jobs tax credit as a step toward helping to get our high unemployment under control. This approach could be labeled a "people's tax credit" because its only purpose is to put Americans back to work. Its incentives are aimed at getting the private sector involved rather than creating make-work Government jobs. Private sector jobs will reduce Government spending and will also encourage business to invest further in facilities and equipment. The jobs credit gives business the clear signal that this Congress is attempting to curb future inflation and deficits which would slow the recovery of our economy. The idea of a tax incentive tied directly to increased employment deserves congressional support. Any jobs credit must be broad-based to provide most businesses the opportunity to benefit from it. Needless restrictions such as the 103 percent employment base will only cut back on the jobs created without any real advantage.

The failure of this committee to provide for a permanent reduction of the corporate tax rate is critical since such a stimulus to small businesses is a crucial element for long-term growth and expanded employment opportunities. A permanent corporate tax reduction for small business of 18 percent for the first $100,000 would have encouraged investment and expansion primarily by small competitive businesses. Such action is required if we are to encourage investment and business expansion for the creation of jobs and to promote longer term economic growth to sustain the recovery beyond the immediate 1977–78 period. Not only do we believe that small business is critical to the continuation of a healthy free enterprise system but we are convinced that the bias in favor of small business which this incentive would have provided would have resulted in a particularly favorable impact on employment. The major reason for this result is the fact that the fastest growing sector of the economy is in the service-oriented businesses which are mostly small businesses and labor intensive.

Energy

We regret that the committee failed to address our national energy problems. The committee reversed an earlier position and rejected a proposal it had passed less than a year ago providing tax credits for residences and businesses and for installing geothermal and solar energy equipment. We believe that this was a timely proposal, especially in view of the shortage of energy supply and the unemployment the harsh winter caused.

We further believe that adoption of this proposal would have shown the committee's commitment to energy conservation and development of new technologies. The committee's failure to take any action is a regrettable delay in the formulation of a national energy policy.

Conclusion

We believe that the specifics of this bill, its random $50 payments, double payments for some Americans and no payments for others, payments too small to encourage any major purchases of capital goods and its limited one-shot impact are an insult to the already overtaxed American. We are told that all that is needed now is a temporary stimulus and that the need for more tax reform will be best accomplished if it is accompanied by permanent tax reductions later this year.

Are we to hold the American middle class and its working people hostage, withholding from them the right to keep a greater proportion of what they earn, all in the name of tax reform? Do we want the American people to believe that this committee and the Congress must be pressured by the politically popular notion of lower taxes before we bring about tax reform?

The answer to both questions must be emphatically "no." Inflationary effects on taxpayers justify a rate reduction now. Effective economic stimulation through a permanent tax reduction is needed now. To delay permanent tax reduction in the name of tax reform is to deceive the American people. A permanent reduction in tax rates will stimulate spending by increasing the after-tax incomes of consumers on a longer term basis, and will increase the incentives for employees to work and businesses to increase production and investment, thus accelerating job formation and economic growth.

Carl T. Curtis.
Clifford P. Hansen.
Robert J. Dole.
Bob Packwood.
William V. Roth, Jr.
Paul Laxalt.
John C. Danforth.

IX. SUPPLEMENTAL VIEWS OF SENATORS HANSEN, DOLE AND LAXALT

H.R. 3477 is officially entitled the Economic Stimulus and Tax Reduction Act of 1977. If it is to serve as an economic stimulus, then a fundamental component of economic growth has been totally ignored. The legislation is devoid of any provision which would address our serious national energy problems.

During the period 1955 through 1976, the use of energy, the growth of our economy and of employment levels are so closely related as to be almost mirror images of one another. While this legislation does address employment by providing a jobs credit and an investment tax credit and does address the necessity for economic growth by providing a short-term stimulus, it totally ignores any relationship of employment and economic growth to the production and development of energy. Nonetheless it is a fact that for each additional 4 million jobs created there is an increase in energy consumption of 1 billion barrels of oil (or equivalent) and an increase in GNP of approximately $100 billion. Figures from the Departments of Interior, Commerce, and Labor indicate that this country is going to need sufficient energy to provide 19 million additional jobs by 1985. This assumes an unemployment factor of a low 4 percent. To employ this many additional persons will require that we increase our energy supply by approximately 48 percent.

If we are to avoid economic stagnation and unacceptable unemployment, we have but two choices. We may either undertake an all out effort to maximize development and production of domestic energy sources, or we will become ever more dependent on insecure and costly foreign sources.

In this economic stimulus package, the administration has overlooked energy, the one essential component of both jobs and economic growth. Moreover, the administration has also disregarded the importance of individual energy conservation.

During the 94th Congress, the House passed by a vote of 291–130, H.R. 6860, which was added as an energy package to the Tax Reform Act of 1976. The legislation provided for tax credits to encourage energy conservation and the development of new energy technologies. These energy conservation measures include:

(1) Residential insulation credit (30 percent of first $750, to a maximum credit of $225);

(2) Residential solar or geothermal equipment credit (40 percent of first $1,000 plus 25 percent of next $6,400 to maximum credit of $2,000);

(3) Residential heat pump credit with a maximum credit at $1,000;

(4) Business insulation credit at the current rate of investment credit;

(5) Business solar and geothermal equipment credit (special 20 percent investment credit);

(6) 12 percent credit for certain energy equipment; and several other minor energy conservation provisions.

This energy package passed the Senate 73–2, but was deleted during the conference on the bill in order to expedite agreement on the main provisions of the act.

The committee reversed, by a vote of 8–10, an earlier position and rejected the same proposal that the Senate had passed less than a year ago. The committee made this decision on the assurance of the administration that the President's energy package would contain a tax section with provisions to encourage conservation and to encourage development of new energy technologies. We decry this delay, and point to it as just another instance of procrastination in the development of a national energy policy. Six years ago the Senate passed Senate Resolution 45, a National Fuels and Energy policy study. No report has ever been filed, and Congress has failed, over these 6 years, to show its willingness to be firmly committed to any energy policy.

The necessity for conservation is self-evident. In January this year for the first time, petroleum consumption exceeded 20 million barrels per day. Imports of petroleum exceeded domestic production. We are approaching 50 percent foreign dependency, where as as recently as 9 years ago we had the ability to produce more oil and natural gas than we consumed. Yet in light of these compelling facts, Congress merely sits and waits for yet another proposal to be brought to them to study for yet a longer time, thus asserting again the "study and wait" approach to our energy problems.

But what Congress has done is worse than study and wait. Instead, it has taken seven specific steps to penalize oil and gas production. These are as follows:

1. March 29, 1975—Enactment by Congress of Tax Reduction Act of 1975, substantially repealing percentage depletion for about 85 percent of domestic oil and gas. This longstanding tax policy has been left intact for some 100 other extractive industries.

2. February 1, 1976—Rollback of approximately $1.50 per barrel for new crude oil.

3. July 1, 1976—Imposition of a price freeze on all domestic crude oil.

4. September 16, 1976—Enactment of Tax Reform Act of 1976. Drilling by independents will be seriously inhibited by the penalty tax on intangible drilling expenditures. Unfortunately, this provision penalizes most seriously those who most aggressively are exploring for and developing oil and natural gas resources. Independents who committed substantial capital resources to drilling last year are only now discovering the tax effect of subjecting their IDC's to the 15 percent minimum tax. For many, their increased tax liabilities for 1976 can be met only by reducing their drilling budgets for 1977. This tax treatment is counterproductive where we can least afford it, because it is imposed directly on drilling expenditures rather than on income.

5. December 31, 1976—A rollback of 20 cents per barrel for new domestic crude oil and continuation of existing price freeze on crude oil.

6. February 1, 1977—A retroactive doubling of rental fees on most oil and gas leases on Federal onshore lands.

7. March 1, 1977—A rollback on U.S. crude oil prices of 45 cents per barrel on new oil.

We urge the committee, the Congress, and the administration to meet the Nation's economic goals by recognizing the vital role the development of our domestic energy sources would bring about. To date, the Congress has acted only to penalize the development of our energy sources, at the cost of expanded economic growth for our country. We call on the Congress to reverse this dangerous direction.

CLIFFORD P. HANSEN.
ROBERT J. DOLE.
PAUL LAXALT.

X. ADDITIONAL VIEWS OF SENATORS DOLE AND HANSEN

The Finance Committee is to be commended for its inclusion of a job tax credit in H.R. 3477. We have long been supporters of this concept and believe the job tax credit deserves an opportunity to prove itself.

However, it is our belief that the jobs tax credit should be targeted directly at those most in need of employment assistance—the 1,200,000 who have been unemployed for 26 weeks or longer. We may introduce a job tax credit amendment aimed at the long-term unemployed which we hope will receive further consideration during Senate debate on the tax stimulus package.

We should put the incentive where it will help the people who need it most. Those workers who have been unemployed for long periods of time deserve special consideration. Federal programs, such as the WIN incentive, are ample precedent for this kind of emphasis on special benefits to disadvantaged workers.

Our provision will give the credit for any increase above the Federal Unemployment Tax (FUTA) base. This provision would make the job tax credit available to all firms who have any expansion in their wage base over the previous year. The committee provision would be available only to those companies with 1977 unemployment insurance wages over 103 percent of the 1976 total.

This restriction in the committee bill would eliminate thousands of companies from benefiting from any job-expansive incentive. There are a great many states, particularly in the northeast, and many individual industries where the percentage increase in private payrolls will be less than 3 percent. These industries would be unqualified for the committee's job tax credit even if they expand their employment.

It is precisely the companies that have had no expansion that need the incentives most. A company that expands at 3 percent a year is probably in a fairly good financial situation and may be expanding even further with or without incentives. The greatest need for additional hiring incentive is in those companies and industries where the growth has been less than 3 percent. For example, in the construction industry last year, there was a 1.3 percent decrease in payrolls, and only a small increase is expected this year. This is an industry where the incentive is greatly needed. Yet the committee provision would provide little or no assistance to small growth industries.

The option of an additional 2 percent investment tax credit in our view should be retained. The option of a higher investment tax credit or the new job tax credit provides a growth incentive for both capital intensive and labor intensive industries.

In addition to the basic employment tax credit, we believe that a supplemental incentive for the employment of the handicapped is essential. The Finance Committee did not include this provision in its bill. A 10 percent supplemental credit for hiring the handicapped was included by the House, but we believe this is not a meaningful incentive to put these people to work.

The committee's job tax credit provision is a step in the right direction. However, we feel that the committee provision is in need of further improvement.

In our view, the persons who have been without work the longest should be the ones to receive the major benefit from the limited Federal funds that are to be used for a job tax credit. Therefore, we may raise these matters during consideration of the Tax Reduction Act in the Senate.

ROBERT J. DOLE.
CLIFFORD P. HANSEN.

XI. ADDITIONAL VIEWS OF SENATOR ROTH

I concur in large part with the views expressed by the minority, but there are several points concerning the need for a permanent tax rate reduction which deserve further emphasis.

As the minority views express, this legislation, particularly the tax rebates and the rebates to nontaxpayers, is ineffective, inequitable and insulting, and one of the most expensive April Fool's jokes ever played on American taxpayers. The $50 tax rebate is a cheap token of Congress' esteem for the working taxpayer, and it will do very little to get the economy moving again.

While Americans have traditionally anticipated that hard work and perseverance would produce upward mobility, the crushing tax burden on American workers has slowed the economy down and increased the prospects of downward mobility for too many Americans. The major challenge facing Congress is to develop policies to create a buoyant economy and to assure taxpayers that their incomes will grow, that more and more of their income will not be swallowed up by inflation and higher taxes, and that their jobs will not be eliminated.

A $50 tax rebate will not increase anyone's confidence in the future, and it will not inspire business to increase production and create permanent new jobs. There is a considerable amount of doubt whether the tax rebates will provide the type of economic growth needed to offset inflation and reduce unemployment. The Congressional Budget Office, the Joint Economic Committee, and a substantial body of economic experts all believe that rebates are not as effective as permanent tax reductions in stimulating long-term economic growth. In addition, a number of the supporters of the tax rebates on the committee have publicly expressed their doubts about the economic effectiveness of the rebates. It is distressing that politics is more important than good economics.

The minority views endorse the belief that the best way to stimulate long-term economic growth is through a permanent reduction in individual income taxes. A 10 percent permanent rate reduction for all taxpayers is in my opinion, the best way to stimulate the long-term economic expansion needed to assure upward mobility for all Americans. An across-the-board tax rate reduction for all workers is the same type of solution President John F. Kennedy proposed, and Congress enacted, in the early 1960's to get the country moving again. Jack Kennedy realized then, as we should realize now, that the heavy tax burden on our workers and businesses was primarily responsible for slow economic growth, reduced consumer purchasing and investment power, and higher rates of unemployment. Now, as then, we need to take action to build confidence in the economy. Although some fear that permanent tax cuts will result in massive revenue losses and erode the Federal revenue base, the minority views correctly illustrate that tax reductions stimulate the economy so much that Federal revenues increase, even though taxes are reduced. The Kennedy tax rate reductions provide perhaps the best historical proof that tax rate reductions create more permanent, taxpaying jobs; produce a greater increase in GNP; and expand the economy and the tax base enough to produce more, not less, Federal revenues. Although Kennedy's Treasury Department estimated a 6-year revenue loss of $89 billion from the tax cuts, revenues actually increased by $54 billion, as the following chart illustrates:

[In billions of dollars]

Year	1963	1964	1965	1966	1967	1968	Total
U.S. Treasury estimated revenue losses	2.4	5.2	13.3	20	23.7	24.4	89
Actual revenue gains	7	6	4	14	19	4	54
Difference in estimates							143

Permanent tax rate reductions will also provide tax relief to middle-income taxpayers, the most ignored men and women in America. The legislation approved by the committee provides virtually no tax relief to middle-income taxpayers. Almost 80 percent of all individual income taxes are paid by taxpayers earning more than $15,000, yet more than 80 percent of the tax relief provided by the increased standard deduction approved by the committee will go to taxpayers with incomes less than $15,000. Taxpayers who itemize their deductions, such as those who own a home or have large medical expenses, will receive no tax relief at all from this provision. These taxpayers, particularly those families where both the husband and wife work, should not be denied tax relief. I strongly support providing tax relief and assistance to lower income people and senior citizens on fixed incomes, the ones who have been most affected by the rising food, fuel, and housing prices. But I believe we should reduce the tax burden on all workers.

The high rates of taxation are strangling private initiative, reducing production and investment, and retarding economic growth and the creation of meaningful jobs. This represents a very real threat to all working Americans, and it especially threatens minorities, the poor, women, and young people who expect upward mobility in the future. Our Nation was built on the premise of excellence and productivity, where performance and ability is rewarded. We must recognize that the heavy tax burden on working Americans, and particularly the denial of tax relief to certain workers, threatens to push this country into a rut of mediocrity and no-growth.

A permanent reduction in the tax burden on all workers will increase the incentives and rewards for work, increasing production and investment, stimulating economic growth, and creating hundreds of thousands of jobs in the private economy.

As long as taxpayers are forced to send more and more of their income to Washington, less money is spent, saved, and invested in the private economy. A 10-percent reduction in all tax rates would expand the economy faster, create more jobs, and result in a smaller deficit than the tax rebate program approved by the Senate Finance Committee. Permanent tax cuts will restore the Nation's confidence in the economy and the future, and stimulate the long-term economic expansion needed to assure upward mobility for all Americans.

William V. Roth, Jr.

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