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SUMMARY

OF THE

Economic Recovery Tax Act of 1981

As Ordered Reported by the

COMMITTEE ON FINANCE
UNITED STATES SENATE

Prepared by the Staff of the

COMMITTEE ON FINANCE
UNITED STATES SENATE

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COMMITTEE ON FINANCE

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I. INTRODUCTION

This pamphlet provides a summary of the tax cut provisions of H.J. Res. 266, as ordered reported by the Senate Finance Committee on June 25, 1981. The tax reduction provisions were added as an amendment in the form of a substitute to a House-passed measure, H.J. Res. 266 (to provide for a temporary increase in the public debt limit). The pamphlet also includes a description of a tax indexing provision which will be offered as a committee amendment to H.J. Res. 266.

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

II. OVERVIEW OF FINANCE COMMITTEE BILL

Individual tax rate reductions

There will be across-the-board reductions in individual income tax rates which will reduce tax liability by approximately 1¼ percent in 1981, 11 percent in 1982, 18 percent in 1983 and 23 percent in 1984 and future years. These reductions in tax liability will be reflected in corresponding reductions in withheld taxes of 5 percent on October 1, 1981, a further 10 percent on July 1, 1982, and another 10 percent on July 1, 1983.

The highest tax rate will be reduced from 70 to 50 percent for 1982 and subsequent years.

The maximum rate of tax on capital gains will be reduced to 20 percent for transactions occurring after June 10, 1981.

Deduction for two-earner married couples

In 1982 a married couple will receive a deduction of 5 percent of the first $30,000 of the earnings of the spouse with the lesser amount of earnings. For 1983 and subsequent years, the deduction will be 10 percent.

Accelerated cost recovery system

The committee bill will completely revise the Federal income tax treatment of depreciation and the investment tax credit.

The cost of tangible personal property generally will be recovered using a prescribed accelerated depreciation method over a 15-year, 10-year, 5-year, or 3-year period, depending on the type of property.

The cost of most real property will be recovered over a 15-year recovery period, using a prescribed accelerated depreciation method.

The bill will allow a full investment credit for all eligible 15-year, 10-year and 5-year recovery property and a 6 percent credit for all eligible 3-year recovery property.

Investment tax credit for rehabilitation

The present 10-percent investment credit for rehabilitation of industrial and commercial structures and the rapid amortization provisions for certified historic structures will be replaced by a 15-percent credit for rehabilitation of structures 30 or 40 years old, a 20-percent credit for structures at least 40 years old, and a 25-percent credit for certified historic structures.

Individual retirement savings

The limits on deductible contributions to individual retirement accounts (IRA's) will be raised from the lesser of 15 percent of earnings or $1,500 to the lesser of 100 percent of earnings or $2,000 ($2,250 for a spousal IRA).

Active participants in employer-sponsored and Government plans will be made eligible for IRA's with a $1,500 limit on deductible contributions ($1,625 for a spousal IRA).

Active participants in employer-sponsored and government plans will also be allowed to deduct voluntary contributions to their plan, with a $1,500 limit.

Retirement savings for the self-employed

The limit on deductible contributions to self-employed retirement plans (Keogh or H.R. 10 plans) will be increased to the lesser of 15 percent of earnings or $15,000. Up to $150,000 of earnings will be taken into account under a plan.

Interest and dividend exclusion

The $200 ($400 for joint returns) partial exclusion of dividend and interest income will be permitted to revert to prior law as of December 31, 1981, a year earlier than it would under present law.

Tax exempt saving certificates

The bill provides for depository institution tax-exempt savings certificates. Such certificates would have a 1-year maturity, would earn interest at a rate of 70 percent of the 1-year Treasury bill interest rate and must be established at a depository institution between October 1, 1981 and September 30, 1982. The maximum amount of tax exempt interest on such savings certificates for all taxable years may not exceed $1,000 ($2,000 for joint returns).

The savings certificates cannot be redeemed before maturity or used as collateral for a loan without losing their tax exemption.

Research and experimentation credit

The bill provides for a 25-percent credit for incremental research and experimentation wage expenditures. The incremental increase is measured against a 3-year rolling base period.

Increased charitable deduction for equipment for research purposes

The bill will expand the existing exception to the general rule limiting the amount of charitable deduction for contributions of ordinary income property for contributions by a corporation of new tangible personal property of an inventory nature used by a college or university for research purposes including research training.

Estate and gift taxes

The unified credit will be increased over the next 5 years from its current level of $47,000 to $192,800. When fully phased in there will be no estate or gift tax imposed in transfers of up to $600,000.

The marital deduction for gifts and bequests to spouses will no longer be limited.

The present $3,000 annual gift tax exclusion for gifts to any one donee will be raised to $10,000.

Nine changes in the current use valuation rules for farm or closely held business real property are provided. Four technical changes in estate and gift taxation are also provided.

Windfall profit tax credit for royalty owners

For 1981 and subsequent years, there will be a credit for royalty owners equal to the first $2,500 of windfall profit tax liability.

Reduction of windfall profit tax on new oil

The bill will reduce, beginning in 1983, the tax on newly discovered oil, ultimately reducing the rate to 15 percent.

Income earned abroad

The present deductions and exclusions for income earned abroad will be replaced by an exclusion for the first $50,000 of such income plus 50 percent of the next $50,000. There will also be a deduction for excess housing costs.

Commodity tax straddles

Under the bill much of the uncertainty surrounding commodity futures transactions will be removed by new rules relating to the tax treatment of commodities, including futures contracts, forward contracts, and other interests in such property, cash-and-carry transactions, certain short term government obligations issued at a discount, and various related transactions. The new rules seek to prevent the deferral of income and the conversion of ordinary income and short term capital gain into long term capital gain while preserving the liquidity and efficiency of the markets.

Incentive stock options

The bill will create a new class of stock options similar to the restricted and qualified stock options provided prior to 1976. An employee receiving an incentive stock option to buy his employer's stock would be taxed only at the time he sells the stock acquired under the option. The gain on such sale would be taxed at long-term capital gains rate if the stock were held for more than 12 months.

Small business provisions

The maximum number of shareholders allowable in a subchapter S corporation will be increased from 15 to 25, and certain simple trusts will be allowed as shareholders.

The minimum accumulated earnings credit under the accumulated earnings tax on corporate income retained beyond the reasonable needs of the business will be increased from $150,000 to $250,000.

A limited amount of capital investment may be written off in the year the property is placed in service ($5,000 for calendar years 1982 and 1983, $7,500 for 1984 and 1985, and $10,000 for 1986 and thereafter).

The $100,000 limitation on the amount of used property eligible for the regular investment tax credit will be eliminated. Previously claimed investment tax credits will be recaptured upon sale of the equipment.

Employee stock ownership plan credit

Beginning January 1, 1983, a tax credit will be allowed based upon a percentage of an employer's payroll for contributions of employer securities to a tax credit employee stock ownership plan

(TRASOP or tax credit ESOP) and the existing investment-based TRASOP will expire.

Certain other modifications to the rules governing ESOP's and TRASOP's are also provided.

Deduction for motor carrier operating authorities

Motor carriers will be allowed a deduction equal to the adjusted basis of all motor carrier operating authorities held on July 1, 1980. The deduction will be taken ratably over a 60-month period.

Indexing individual rate bracket, personal exemption, and zero bracket amount

The committee agreed to offer an amendment to the tax reduction bill. The amendment provides that the individual rate brackets, personal exemption and zero bracket amount will be adjusted for inflation beginning January 1, 1985.

III. EXPLANATION OF THE BILL

A. Individual Income Tax Rate Reductions

Background

Under present law, individual income tax rates range from 14 to 70 percent with a maximum tax rate of 50 percent on earned income.

Explanation of committee provisions

1. Across-the-Board Rate Reduction

The bill will reduce marginal tax rates for individuals by 25 percent across-the-board. The reduction will be accomplished in three steps: a 5-percent rate reduction on October 1, 1981, a 10-percent rate reduction on July 1, 1982, and a second 10-percent rate reduction on July 1, 1983.

These rate reductions will result in an actual tax reduction of slightly more than 1 percent in 1981, about 11 percent in 1982, 18 percent in 1983, and 23 percent in 1984. The actual reduction in tax liability is less than the flat percentage reductions of 10 percent in 1982, 20 percent in 1983, and 25 percent in 1984 primarily because each subsequent reduction is applied to a tax base already reduced by prior reductions.

The proposed rate reductions will reduce the amount of tax before credits. Since the amount of the earned income credit is not changed, the percentage reduction in tax after credits can be greater than 25 percent for low-income taxpayers.

On the other hand, the percentage reduction in tax for individuals with high levels of wage income will be slightly less than the average percentage reduction for all individuals. The reason for this result is that earned income, presently subject to a top marginal rate of 50 percent, will still be subject to a top marginal rate of 50 percent after the 25-percent rate reduction becomes effective.

2. Tax on Investment Income

Effective January 1, 1982, the top marginal rate of 70 percent will be reduced to 50 percent for all income, regardless of source. This will eliminate the difference in tax treatment between wage and investment income.

Since 60 percent of net long-term capital gains are deducted from income under current law, the top tax rate for individuals on capital gains will be lowered from 28 percent to 20 percent by a reduction in the maximum tax rate from 70 percent to 50 percent. In order not to discourage sales or exchanges of capital assets in the last half of 1981, the maximum effective tax rate on capital gains for individuals will be reduced to 20 percent effective for sales or exchanges after June 10, 1981.

In order to conform the existing alternative minimum tax to the reduction in the maximum regular tax on capital gains, the top alternative tax rate will be reduced to 20 percent.

3. Rate Schedules

The liability reductions for calendar year 1981 amount to only 1¼ percent of present law tax before credits. The 1¼ percent tax reduction in 1981 effectively lowers the maximum tax rate on personal service income to 49⅜ percent, although for 1982 and later years this ceiling rate will return to 50 percent.

For calendar years 1982, 1983, and 1984 rate reductions will be reflected in the marginal tax rate tables and the schedules appearing in the tax return packages. The full 25-percent tax reduction will first apply in calendar year 1984.

4. Phase-in of Withholding Rates

Withholding rates for employees will be reduced 5 percent on October 1, 1981. They will be reduced an additional 10 percent on July 1, 1982. They will be reduced the final 10 percent on July 1, 1983.

B. Deduction for Two-Earner Married Couples

Background

The income tax law generally treats a married couple as one tax unit which must pay tax on its total taxable income. While married couples may elect to file separate returns, the tax law is structured so that filing separate returns leads to a tax increase for almost all couples compared to filing a joint return. Different rate schedules apply to single persons and to single heads of households (persons who maintain households for certain relatives). The rate schedules for singles gives them about one-half the benefit of income-splitting. Married couples cannot take advantage of these reduced rate schedules even if they file separate returns. Along with other provisions of the law, the different rate schedules give rise to a marriage penalty when persons with relatively equal incomes marry and a marriage bonus when persons with relatively unequal incomes marry. In general, if two persons' combined income is allocated between them more evenly than 80 percent to 20 percent, their combined income tax liability will increase when they marry.

Explanation of committee provision

The bill will allow two-earner married couples who file a joint return to take a deduction from gross income in arriving at adjusted gross income in order to minimize the marriage penalty. Taxpayers may claim this deduction even though they do not itemize their personal deductions. The deduction will equal 10 percent (5 percent for taxable years beginning in 1982) of the first $30,000 of earnings of the spouse with the lower amount of earnings. Thus, the maximum deduction will be $1,500 for taxable years beginning in 1982 and $3,000 for subsequent taxable years.

C. Accelerated Cost Recovery System

Background

Present law provides a variety of methods of capital cost recovery for different kinds of assets. The most important of these methods is depreciation, which requires that the deduction for capital costs be spread over the estimated useful life of the asset and corresponds generally to the diminution in value of the asset. In theory, recovery of capital costs over an asset's useful life permits the measurement of net income produced from use of the asset by matching income with expenses incurred to produce the income. In recent years, however, the real value of depreciation allowances has been eroded by inflation. Since taxpayers may deduct only the historical cost of plant and equipment over a number of years, inflation reduces the real value of depreciation deductions and overstates true profits.

The second principal method of cost recovery is amortization. Under amortization, the recovery of capital costs occurs over some fixed, arbitrary period of time unrelated to the asset's useful life. Certain limited classes of assets (like movies and railroad property) are depreciated under other methods.

For most kinds of tangible personal property, taxpayers may also claim an investment tax credit (ITC) in addition to their depreciation deductions. The ITC is generally 10 percent of the cost of the asset, but this rate is reduced to 6⅔ percent for assets depreciated over a 5- or 6-year life and 3⅓ percent for assets depreciated over a 3- or 4-year life.

Explanation of committee provision

The committee bill provides for the accelerated cost recovery system proposed by the administration subject to certain amendments.

The committee's Accelerated Cost Recovery System ("ACRS") provides for much faster write-off of capital expenditures for tangible property by means of simplified rules. It provides five classes, each with a standard schedule of deductions, to be taken over a fixed recovery period. The bill assigns depreciable machinery, equipment, and real estate to classes with recovery periods of 3, 5, 10, or 15 years and provides accelerated recovery over those periods. Intangible assets are not included within the system.

The 3-year class consists of automobiles, light trucks, machinery and equipment used in research and development activities, and assets (such as special tools) with a current guideline life under the Asset Depreciation Range ("ADR") of 4 years or less. Expenditures for these assets will be written off in 3 years. An investment credit of 6 percent will also apply to this class.

Except as noted below, all other outlays for machinery and equipment are assigned to a 5-year class, including single purpose agricultural structures and certain petroleum storage facilities. Public utility property for which the present ADR midpoint lives are 18 years or less would be assigned to this class. Additions to this class will be written off according to an accelerated 5-year schedule. The full 10-percent investment credit will be allowed for this class.

Public utility property for which the present ADR midpoint lives exceed 18 years but do not exceed 25 years, railroad tank cars and real estate covered by the ADR system with a lower limit of 10 years or less (theme parks) will be written off over 10 years. The 10-percent investment credit applies to public utility property in this class and railroad tank cars, but is not generally available for real property.

Public utility property for which present ADR midpoint lives exceed 25 years will be written off over 15 years and will be eligible for the full 10-percent investment credit.

Depreciable real estate which is not 10-year property will be written off over 15 years on a composite basis. No investment credit is allowed for property in this class.

Until 1985, the recovery percentages for 3-, 5-, and 10-year property and 15-year utility property will approximate the use of the 150-percent declining balance method for the early years and the straight-line method for the remainder of the recovery period. The recovery for 15-year real property will be based on use of the 200-percent declining balance method (switching to straight line). The recovery percentages for 3-, 5-, and 10-year property and 15-year utility property will be increased for property placed in service after 1984. For such property placed in service in 1985 the percentages will be based on the use of the 175-percent declining balance method for the first years, switching to the sum-of-the-years digits method for the remaining years. For such property placed in service after 1985, the rates will be based on the use of the 200-percent declining balance method for the first year and the sum-of-the-years digits method for the remaining years. The rates for all tangible personal property placed in service before 1985 will be as follows:

ACCELERATED COST RECOVERY SCHEDULE

CLASS OF INVESTMENT

[In percent]

Ownership year	3-year	5-year	10-year	15-year (long-lived utility property)
1	25	15	8	5
2	38	22	14	10
3	37	21	12	9
4		21	10	8
5		21	10	7
6			10	7
7			9	6
8			9	6
9			9	6
10			9	6
11				6
12				6
13				6
14				6
15				6
Total	100	100	100	100

Additional percentages based on 200 percent declining balance rate switching to straight-line over 15 years will be provided for real property.

Under the committee bill, taxpayers may use, instead of the prescribed rates, rates based on use of the straight-line method over the otherwise applicable recovery period, the longer period used for earnings and profits purposes, or the period used to compute earnings and profits for assets in the next longer recovery class. For example taxpayers may elect to depreciate 3-year property over 12 years. Real property making such longer extended recovery period election will be depreciated over 45 years. Such election must be made with respect to the entire recovery class for the year. In addition, the net operating loss and investment credit carry-over periods are extended from 7 to 10 years generally and from 9 to 10 years for certain transportation companies.

Gain or loss is generally recognized on disposition of an asset. Gains on property in the 3-, 5-, and 10-year classes will be recognized as ordinary income to the extent of prior capital recovery deductions (section 1245 rules). Similarly, for property in the 15-year class (unless a straight-line recovery is elected) other than residential real estate and low income rental property, section 1245 recapture will apply. Residential real estate and low income rental property will be to section 1250 recapture if the lessor's investment equals at least 10 percent. Investment credits are subject to recapture as described below under the caption "Small Business".

Cost recovery for earnings and profits purposes (determining dividends) will be computed on a straight-line basis for property in the 3-, 5-, 10-, and 15-year classes over periods of 5, 12, 25, and 35 years, respectively. An exception is provided for the computation of earnings and profits for foreign corporations similar to that under present law.

The recovery period for foreign assets will be their respective ADR guideline periods as of January 1, 1981. The rate of recovery will be based on use of the 200-percent declining balance method in the early years and the straight-line method in the later years of the recovery period. For foreign real property, recovery will be over 35 years under the 150-percent declining balance method (switching to straight-line). Flexibility similar to that provided for domestic assets is provided for foreign assets.

For noncorporate lessors of machinery and equipment in the 3-, 5-, 10, and 15-year classes, the excess of the recovery deduction over the deduction based on use of the straight-line method over 5, 8, 15 and 22 years, respectively, will be a preference item for purposes of the minimum tax. For real estate, the excess of the recovery deduction over the deduction based on a 15-year straight-line recovery will be a preference item.

A safe harbor is provided for leasing transactions involving new personal recovery property for corporate lessors. In general, these transactions will be treated as leases for tax purposes if the lessor's investment is at least 10-percent of the cost of the property and the lease period does not exceed the life of the property. Factors such as whether the tax benefits of ownership must be taken into account in determining whether the lessor has a profit motive, whether the property is limited use property, and the existence of a fixed price put or call option on the property under the terms of the governing contract will not prevent treatment of the transaction as a lease.

The bill extends the at-risk rules to the investment credit allowed under ACRS. However, an exception is provided for amounts borrowed from third party banks and similar institutions.

The bill also provides additional rules relating to railroad property depreciated under the retirement-replacement-betterment method and transition rules therefor.

The committee bill retains a rule intended to discourage the demolition or substantial alteration of a certified historic structure. Consistent with the policy of current law, where property is constructed, reconstructed, or used on a site which was occupied by a historic structure which itself is demolished or substantially altered, the committee bill provides that the recovery allowance for such property must be computed using the straight-line method over 15 years. Other provisions of the bill relating to historic structures are described in the section captioned "Investment Credit for Rehabilitated Buildings."

ACRS will be effective for property acquired or placed in service after December 31, 1980, subject to certain limitations which restrict tax-motivated transactions designed to bring property into ACRS.

D. Investment Credit for Rehabilitated Buildings

Background

Under present law, a 10-percent investment tax credit is available for the rehabilitation of nonresidential buildings which are held for business or investment purposes and are over 20 years old.

Present law also allows taxpayers to amortize over 60 months the capital expenditures incurred in a certified rehabilitation of a certified historic structure. When a taxpayer elects this 60-month amortization, he may not take the investment tax credit.

Explanation of committee provision

The provision replaces the 10-percent investment credit for rehabilitation expenditures with a new credit of 15 percent for the rehabilitation of buildings that are 30 to 40 years old and a 20-percent credit for rehabilitation of buildings that are at least 40 years old. A 25-percent credit is provided for qualified rehabilitation expenditures of certified historic buildings.

The 15- and 20-percent credits will be limited to nonresidential industrial and commercial structures and are also limited to substantial rehabilitations. The 25-percent credit will be available for the rehabilitation of all income-producing certified historic structures.

The present 60-month amortization for certified historic structures will be repealed. Certain other allowable accelerated depreciation will not be permitted to be used in conjunction with the rehabilitation credit. Moreover, a taxpayer will not be permitted to claim both the energy credit and the rehabilitation credit with respect to the same rehabilitation expenditures.

The provision will be effective for qualifying rehabilitation expenditures incurred after December 31, 1981.

E. Individual Retirement Savings

Background

Under present law, an individual is entitled to deduct the amount invested in an individual retirement account, annuity, or bond (referred to collectively as "IRA's"). The annual deduction is limited generally to the lesser of 15 percent of compensation or $1,500. The $1,500 limit is increased to $1,750 if (1) the contribution is equally divided between an employee and the spouse of the employee, and (2) the spouse has no compensation for the year. IRA's with the $1,750 limit are sometimes referred to as "spousal IRA's".

An individual is denied an IRA deduction for a taxable year if the individual is an active participant at any time during that year in a tax-qualified employer-sponsored pension, profit-sharing, or stock bonus plan, a tax sheltered annuity program, or a government plan.

Explanation of committee provision

The bill will allow any employee who is not an active participant in an employer-sponsored or government plan to make an annual deductible contribution of up to $2,000 to an IRA. Subject to the $2,000 limit, an individual may contribute up to 100 percent of his compensation to his IRA.

An employee who is an active participant in an employer-sponsored or government plan will also be allowed to establish an IRA and receive a deduction annually for contributions up to the lesser of $1,500 or 100 percent of compensation.

The bill will also allow a participant in an employer-sponsored plan to deduct annually up to $1,500 of voluntary contributions to his employer-sponsored plan. Penalties similar to those imposed under the IRA provisions will be imposed upon early withdrawal of such contributions from the plan. However, rollover rules will be provided to allow contributions to be transferred to an IRA, for example, upon termination of employment, without incurring any withdrawal penalty.

The current spousal IRA rules will be replaced by provisions allowing an employee to establish two IRA's, including one on behalf of his or her nonworking spouse. The combined deductible limit for both accounts will be $2,250 ($1,625 in the case of an active employer-plan participant).

The provision will apply for taxable years beginning after December 31, 1981.

F. Retirement Savings for the Self-Employed

Background

Under present law, a qualified retirement plan generally must be established by an employer for the benefit of employees and their beneficiaries. For plan qualification purposes, a sole proprietor is considered both an employee and his or her own employer, and a partnership is considered the employer of each partner. A sole proprietorship or a partnership may adopt a tax-favored retirement plan, referred to as a Keogh plan or H.R. 10 plan, for both common law employees and for the proprietor or partners.

The maximum deductible contribution to a Keogh plan on behalf of a self-employed individual is the lesser of $7,500 or 15 percent of the individual's net earnings from self-employment. The 15-percent limitation is applied only to the self-employed individual's first $100,000 of earned income. As a result, a self-employed individual must contribute at a rate of at least 7½ percent for his employees to obtain a $7,500 deduction for himself.

Explanation of committee provision

The bill will increase the maximum deductible contribution to a Keogh plan to $15,000. The percentage limit (15 percent of net earnings from self-employment) will remain unchanged.

The 15-percent limitation will be applied to a self-employed individual's first $150,000 of earned income. However, rules are provided to insure that common law employees are not disadvantaged by this provision.

The provision will apply for taxable years beginning after December 31, 1981.

G. Exclusion of a Portion of Dividend and Interest Income

Background

Under present law, an individual may exclude from gross income up to $200 ($400 on a joint return) of dividend and interest income received from domestic sources. After 1982, this exclusion is scheduled to revert to prior law, under which the exclusion was limited to $100 of dividends received by an individual ($200 on a joint return, if each spouse had at least $100 in dividends).

Explanation of committee provision

The bill will permit the partial exclusion to revert to prior law as of December 31, 1981, a year earlier than it will under present law.

H. Tax-Exempt Savings Certificates

Background

Present law has no provision for tax-exempt savings certificates.

Explanation of committee provision

The bill will provide for a lifetime exclusion from income of a maximum of $1,000 ($2,000 for joint returns) of interest income earned on depository institution tax-exempt savings certificates. Such tax-exempt savings certificates must have a 1-year maturity, earn interest at a rate of 70 percent of the 1-year Treasury bill rate, and must be established at an institution described in Internal Revenue Code section 116(c)(1) (A) or (B) between October 1, 1981 and September 30, 1982. There is no provision for tax-exempt savings certificates to be issued after September 30, 1982.

If a tax-exempt savings certificate is redeemed before maturity or is used as collateral or security for a loan, the interest on the certificate will be fully taxable and any interest on the certificate excluded in prior years will be incredible in income in the year of the redemption or pledge.

Interest on indebtedness used to purchase or carry tax-exempt savings certificate will not be deductible.

I. Incentives for Research and Experimentation

Background

Under present law research and experimental expenditures may be immediately expensed or, alternatively, amortized over 60 months.

While research and experimental expenditures are not specifically defined in the present Internal Revenue Code, that term has been interpreted by Treasury regulations, Internal Revenue Service rulings, and court cases. The regulations define the term to mean "research and development costs in the experimental or laboratory sense." This includes generally "all such costs incident to the development of an experimental or pilot model, a plant process, a product, a formula, an invention or similar property, and the improvement of already existing property of the type mentioned," as well as the cost of obtaining a patent on such property. The term does not include expenditures such as those for the ordinary testing or inspection of materials or products for quality control or those for efficiency surveys, management studies, consumer surveys, advertising or promotions.

Explanation of committee provision

The bill allows a nonrefundable 25-percent income tax credit for incremental wages paid or incurred carrying on a trade or business, for services performed in conducting research and experimentation will be allowed. The credit will be in addition to the immediate expensing or 60-month amortization of research and experimental expenditures under present law. The definition of research and experimentation is unchanged from present law. It is intended that the Internal Revenue Service may, over time, provide further guidance as to this definition so long as such guidance is not inconsistent with the approach of the existing regulations and administrative practice under current law.

The credit will apply only to the extent research wage expenditures for the taxable year exceed the average amount of research wage expenditures in a 3-year rolling base period. In computing the credit only wage expenditures for research conducted within the United States will be taken into account. Research funded by government and research in the social sciences or humanities will not qualify.

The credit is also available to the extent the taxpayer reimburses another person (such as a research firm or a university) for wages paid for services in conducting research on behalf of the taxpayer. To prevent the utilization of the research tax credit for tax shelter purposes, the credit allowable to individuals may only offset tax attributable to the income from the trade or business with respect to which the research and experimental wage expenditure was incurred.

The provision will be effective for research wages paid or incurred after June 30, 1981, in taxable years ending thereafter.

J. Increased Charitable Deduction for Equipment for Research Purposes

Background

In general, the charitable deduction allowed for a contribution of property must be reduced by the amount of any ordinary gain which the taxpayer would have realized had the property been sold for its fair market value at the date of the contribution. Thus, a donor of appreciated ordinary income property (property the sale of which would not give rise to long-term capital gain) generally can deduct only the basis in the property, rather than its full fair market value.

This reduction requirement does not apply in full for contributions by corporations of certain types of ordinary income property donated for the care of the needy, the ill, or infants. In the case of such a qualifying charitable contribution of inventory, the exception generally allows a deduction equal to the sum of the taxpayer's basis in the property plus one-half of the unrealized appreciation. However, in no event is a deduction allowed for an amount which exceeds twice the basis of the property.

Explanation of committee provision

The bill will expand the existing exception to the general rule limiting the amount of charitable deduction for contributions of ordinary income property. The expanded exception will apply to charitable contributions, by a corporation, of new tangible personal property which is of an inventory nature, and which is used by a college or university for research and experimental purposes, including research training. To qualify, the donated property will have to be constructed by the taxpayer, and the contribution must be made within 2 years of substantial completion of the property. The term "research and experimentation" has the same meaning as under Internal Revenue Code section 174.

The amendment will be effective with respect to charitable contributions made after December 31, 1981, in taxable years ending after that date.

K. Estate and Gift Taxation

Background

Under present law, estate and gift tax liability is determined by computing the gross gift or estate tax and then subtracting the available unified credit. The amount of the unified credit is $47,000, which results in no estate or gift tax being imposed on transfers of up to $175,625.

An unlimited gift tax marital deduction is available for transfers between spouses for the first $100,000 of gifts. An additional deduction is allowed for 50 percent of the interspousal lifetime transfers in excess of $200,000. An estate tax marital deduction is available for property passing from a decedent to the surviving spouse up to the greater of $250,000 or one-half of the adjusted gross estate. Transfers of community property or terminable interests do not qualify for either marital deduction.

Under present law an annual exclusion of $3,000 per donee is allowed with respect to gifts of present interests in property. A gift by either spouse may be treated as made one-half by each.

In addition, present law allows family farms and real property used in a closely held business to be included in a decedent's gross estate at current use value, rather than at full fair market value. However, the gross estate cannot be reduced by more than $500,000 under current use valuation.

Explanation of committee provisions

1. Unified Credit

The committee agreed to increase the amount of the unified estate and gift tax credit from $47,000 to $192,800 over a period of 5 years. With the full $192,800 credit there will be no estate or gift tax on transfers aggregating $600,000. During each year of the phase-in period no estate tax return will be required unless the gross estate exceeds the amount excluded by the unified credit in effect for that year.

The phase-in will provide, in effect, a $225,000 exclusion in 1982, a $275,000 exclusion in 1983, a $350,000 exclusion in 1984, a $450,000 exclusion in 1985, and a $600,000 exclusion in 1986 and thereafter.

2. Unlimited Marital Deduction

The bill also provides an unlimited marital deduction for both estate and gift tax purposes. No transfer tax will be imposed on transfers to a spouse, no matter how large the transfer. Transfers of terminable interests will not qualify for the marital deduction, but transfers of community property will qualify. With regard to property held in joint tenancy by spouses with right of survivorship, each spouse will be deemed to hold one-half of the value of the property regardless of who furnished consideration.

3. Annual Gift Tax Exclusion

The bill will increase the present $3,000 annual gift tax exclusion to $10,000 per donee. Thus, a husband and wife could transfer $20,000 per donee each year without being subject to gift tax.

4. Current Use Valuation: Farm or Other Business Real Property

The bill will also make the following modifications in the rules governing current use valuation:

(1) The material participation requirement for qualifying for current use valuation will have to be met only until the date upon which the decedent retires or becomes disabled. Also, the required trade or business use could be that of the decedent or of a member of the decedent's family. Under present law, there must have been material participation in the farm or business by the decedent or his family in 5 out of the 8 years immediately preceding the decedent's death.

(2) With regard to farm or other business real property inherited from a spouse, if that property had qualified for current use valuation in the spouse's estate, an "active management" rather than a material participation test will be applied. "Active management" means making the management decisions, rather than making daily operating decisions.

(3) Benefits from reduced valuation are to be recaptured if the property is transferred to nonfamily members or ceases to be used for the farming or business purpose within 10 years of the decedent's death, rather than 15 years as under present law. The present rule governing the amount of recapture between the 10th and 15th year after the decedent's death will be repealed.

(4) There will be no recapture of the benefits from reduced valuation if a qualified heir engages in active management of the property where the qualified heir is the surviving spouse of the decedent, a minor, a student, or is disabled.

(5) Like-kind exchanges of qualified real property pursuant to Code section 1031 will not trigger a recapture of the benefits from reduced valuation, provided that the exchange is solely for real property to be used for the same qualified use as the original qualified property. To the extent the change is not entirely for qualified property, a proportionate amount of the recapture tax will be due.

(6) In the case of special benefits from involuntary conversions, a qualified heir will not need to make an election to secure these benefits.

(7) Crop-share rentals from actual tracts of comparable land can be used in applying the formula valuation method on the same basis as cash rentals.

(8) Upon recapture of the benefits from reduced valuation, the basis of the property will be stepped up to fair market value on the date of the decedent's death.

(9) With respect to woodlands, timber will be conseidered part of the qualified real property in the estate for purposes of section 2032A.

With regard to timber for which current use valuation is elected, the difference between current use valuation and fair market value will be recaptured upon severance or disposition before severance of the timber.

5. Technical Changes

The bill also will make the following technical estate and gift tax changes:

(1) The existing provisions of the estate tax law which permit deferred payment of estate tax where an estate consists largely of interests in closely held business will be coordinated.

(2) Gifts which are includible in the gross estate by reason of having been made within 3 years of death will be valued on the date of gift rather than at the date of death. The estate will continue to receive a credit for any gift taxes imposed on the gift.

(3) A disclaimer by a donee or heir that is not effective to pass title under local law will still be considered a qualified disclaimer for estate and gift tax purposes if the disclaimant timely transfers the property interest to the person who would have received the property had the disclaimant predeceased the original holder.

(4) If more than 50 percent of the closely-held business that qualifies for deferred payment is disposed of, the extension of time for payment is no longer available and unpaid tax is due on demand. Under present law, such acceleration occurs when only one-third of the closely held business is disposed of.

A 6-month grace period will also be allowed before payment is accelerated for the unpaid tax due.

L. Windfall Profit Tax Royalty Owners Credit

Background

Present law permits qualified royalty owners to receive a credit or refund of up to $1,000 against the windfall profit tax imposed on the removal of their royalty oil during calender year 1980. The credit is available only to individuals, estates, and family farm corporations, and not to other corporations or trusts. The credit may be claimed in 1981 either as a credit against income tax or as a refund of the windfall profit excise tax.

Explanation of committee provision

The bill will increase the credit to $2,500 and make it permanent. The bill generally will retain the present law rules relating to eligibility for the credit and will make adjustments to accommodate the increase in the credit. It also contains a rule that, as with percentage depletion and the special windfall profit tax rates for independent producers, denies the royalty owners credit to royalty interests in proven properties transferred after June 9, 1981.

The provision will also direct the Secretary of the Treasury to provide by regulations for a procedure so that royalty owners whose windfall profit tax would not exceed $2,500 in any year would have no windfall profit tax withheld, and so that royalty owners who do not use such a procedure may adjust income tax withholding to accommodate any overpayment of windfall profit tax due to the credit.

This provision will be effective for oil produced in calendar years beginning after December 31, 1980, and taxable years ending after such date.

M. Windfall Profit Tax Reduction for Newly Discovered Oil

Background

Under current law, newly discovered oil is subject to a 30-percent rate of tax under the windfall profit tax.

Explanation of committee provision

The bill will reduce, in the future, the rate of windfall profit tax on newly discovered oil. The rate will be reduced from 30 percent to 25 percent on January 1, 1983, to 20 percent on January 1, 1985, and to 15 percent on January 1, 1986. The definition of newly discovered oil will not be changed from the present definition in the windfall profit tax provisions of the Internal Revenue Code.

N. Foreign Earned Income

Background

U.S. citizens and residents are taxed on income earned overseas, but are allowed a credit for foreign taxes paid. Prior to the Foreign Earned Income Act of 1978, U.S. citizens working abroad could exclude up to $20.000 of foreign earned income each year if they were bona fide residents of a foreign country for an entire taxable year. The exclusion was increased to $25,000 for persons resident in a foreign country for three or more years (former Code Section 911).

The 1978 changes replaced the section 911 exclusion with a new system of itemized deductions designed to offset specific excess costs of working overseas. The items covered include general cost of living, housing, education, and home-leave costs. Eligibility requirements are basically the same as under old section 911.

Explanation of committee provisions

The bill will provide broader and simpler tax relief for foreign earned income in order to encourage Americans to work abroad. For each year the first $50,000 of foreign earned income, plus half of the next $50,000, could be excluded from tax at the election of the taxpayer. No foreign tax credit or deductions attributable to the excluded amount would be allowed. If the taxpayer does not elect the exclusion, full foreign earnings would be taxable and the ordinary foreign tax credit would be available.

The bill also provides a separate exclusion for expenses incurred for reasonable housing in excess of a base amount. The base would be 16 percent of the salary of a GS-14 U.S. Government employee, step 1 (currently $6,059). With respect to each exclusion, the amount would be prorated on a daily basis for individuals who are eligible for only part of a tax year.

The required period of physical presence in a foreign country or countries in order to qualify for the exclusion would be shortened to 11 out of 12 months rather than the present 17 out of 18 months. In addition, the benefits of the exclusions would be extended to individuals whose foreign earned income is paid by the U.S. Government but who do not qualify for the exclusion for certain allowances provided under section 912 of the Internal Revenue Code.

The conditions under which a camp located in a foreign country would qualify as the employer's business premises for purposes of the exclusion for meals and lodging under section 119 would also be clarified.

The new provisions would be effective for taxable years beginning after December 31, 1981, and would replace both the exclusion allowed under section 911 for employees of charities or in camps in hardship areas, and the deductions allowed under section 913 for certain itemized expenses that relate to the excess cost of living overseas.

O. Commodity Tax Straddles

Background

Tax-motivated commodity transactions have received substantial attention in the Congress and in the press. A variety of techniques have permitted the deferral of income, the conversion of ordinary income into capital gain or the conversion of short-term capital gain into long-term capital gain. There has been substantial concern with the revenue loss and with the adverse effect of tax straddles on the self-assessing income tax system.

Several different general techniques may be identified: two examples have received particular attention. First is the commodity straddle (exclusive of Treasury bill straddles). The taxpayer seeking to defer capital gain income and convert short term capital gain to long term capital gain can establish a commodity straddle consisting of offsetting long and short positions, generally in the same or a similar commodity. A price move in the underlying commodity will produce a gain in one position and a loss of approximately equal magnitude in the other, the taxapyer will close the loss leg in the first tax year, retaining the position having the offsetting, unrealized gain, reestablish a position substantially identical to the one just sold, and dispose of these legs in the next tax year. By claiming the full amount of the loss on the leg disposed of in year one, the taxpayer can defer an amount of income and, if the unrealized gain is in the long position, possibly convert short term to long term capital gain.

Second is the Treasury bill straddle. By taking offsetting positions in Treasury bill futures the taxpayer can arguably achieve the deferral described above. Additionally, because Treasury bills are ordinary assets and Treasury bill futures are capital assets, the use of Treasury bill straddles may permit the conversion of ordinary income into capital gain. Additional shelter techniques include cash and carry shelters and broker-dealer shelters.

Current law provides wash sale rules and short sale rules for securities. Such rules are designed to prevent many of the deferral and conversion techniques currently available for taxpayers engaged in commodity transactions through stock and securities transactions. Although many issues have not yet been decided in the courts, many taxpayers believe that present law imposes few limits on the use of commodity positions to achieve these same ends. Similarly, although current law provides limited rules for imputation of interest on deferred payments (section 483), imputation of interest on obligations issued at a discount (section 1232), denial of interest deductions on certain payers believe that present law imposes few clear limits on the use of commodity positions to achieve these same ends. Similarly, although current law provides limited rules for imputation of interest on deferred payments (section 483), imputation of interest on obligations issued at a discount (section 1232), denial of interest deductions on certain investments and certain corporate obligations (sections 163(d) and 279), and capitalization of interest on certain construction period loans (section 189), none of these rules applies particularly to the use of the interest deduction to convert ordinary income into capital gain income as cash and carry tax shelters in commodities.

Explanation of committee provision

The bill provides a comprehensive set of rules governing commodity straddles, cash-and-carry transactions and related transactions designed to prevent conversion of ordinary income into capital gains and the deferral of income.

Regulated futures contracts will be marked to market on disposition or at the end of the tax year without regard to whether they constitute part of a straddle. That is, futures contracts traded on an exchange that provides for a system of variation margin will be valued at their fair market value and taxed on such gain or loss at such times. As a result, only the net gain or loss on a straddle consisting of futures contracts would be reported. This rule avoids most of the tracing problems inherent in an offsetting position approach. Such a rule should be simpler to apply for taxpayers and simpler to enforce for the IRS.

Losses from positions such as unregulated futures contracts, forward contracts and other straddles, will be deferred to the extent there are unrealized gains in offsetting positions. However, such deferred losses cannot exceed such net unrealized gains. Moreover, these rules will not apply to positions in nonregulated contracts if identified by the taxpayer as part of a straddle. Thus, taxpayers will have an incentive to identify contracts to prevent unrealized appreciation in one leg from causing the deferral of losses from other offsetting positions on which the taxpayer has recognized a loss. The Secretary of the Treasury is authorized to issue regulations extending to commodities positions the short sale and the wash sale rules.

The general rules will apply to positions in tangible personal property that is actively traded (except stock), including certain stock options. The proposal thus takes a much narrower approach than several earlier proposals. In determining whether positions constitute a straddle a set of broad presumptions will apply. To secure compliance with this rule taxpayers will be required to disclose open, unidentified positions at year end. The failure to disclose such open positions will, absent cause, permit the assessment against a taxpayer who is assessed a deficiency of a penalty for negligence.

In the case of mixed straddles consisting of positions of one or more regulated futures contracts and one or more other positions, a taxpayer may make a one-time election to have such straddles treated under the mark-to-market approach or the nonregulated future rules. In the case of unidentified mixed straddles or in the absence of an election, regulated futures contracts will be subject to the mark-to-market rule but the entire straddle will be otherwise subject to the loss deferral rules of the general provision.

Taxpayers will be required to capitalize interest and carrying charges for certain offsetting positions. Taxpayers will be denied a current deduction but permitted an increased basis in the asset, thus reducing capital gain and increasing capital loss on disposition.

Broad rules will exempt identified inventory and commercial hedging transactions from the general rules governing regulated futures contracts. The hedge exception will not, however, reach hedges entered into outside the ordinary course of a taxpayer's trade or business. Because of the breadth of the hedging exception, to prevent its use by tax shelters the rule will not be available to certain syndicates. However, the Secretary of the Treasury will have authority to exempt certain syndicates from the exception to the general hedging rule. Moreover, taxpayers who engage in bona fide hedges will not be permitted to account for gains and losses on such hedges in a manner that will manipulate income.

Under the bill, short-term Treasury bills held for investment will, like long-term bonds, be capital assets.

Dealers will be required to identify securities held for investment (and entitled to capital gain and loss treatment) on the day such securities are acquired. A transitional rule which permits identification of securities within 1 day after acquisition will apply for calendar year 1981.

Gains on straddles off the regulated commodity exchanges will generally be taxed at long- or short-term capital gains depending upon holding period unless the taxpayer elects to include such position under the market-to-market rule. Regulated futures contracts will be taxed at a maximum rate of 32 percent, based upon 60-percent long-term capital gains and 40-percent short-term capital gains.

The bill provides that a disposition of a capital asset which gives rise to taxable income or recognizable loss would qualify as a capital transaction without regard to whether the transaction otherwise qualified as a sale or exchange. This rule should help to remove the uncertainty which confronts taxpayers and the IRS in such transactions under current case law.

The bill amends the general rules which prohibit the carryback of capital losses by individuals and instead permit individuals to carry back losses for 3 years against gains on regulated futures contracts and identified mixed straddles that are marked to market. The bill will not extend the new carryback rules to other, off exchange, capital losses.

The committee's bill will generally be effective for positions entered into after June 23, 1981. Taxpayers may also elect to have the rules of the proposal apply to property held on such date. No identification requirements for hedges will apply, however, to property acquired earlier than January 1, 1982. The bill will thus permit existing unrealized appreciation to be brought within the system but does not provide an averaging rule for such gain.

P. Incentive Stock Options

Background

Under present law, if a stock option has a readily ascertainable value at the time it is granted to an employee, it is taxed to the employee at ordinary income rates at the time of receipt.

If a stock option does not have a readily ascertainable value at the time granted, the difference between the value of the stock and the option price is included in the employee's income and taxed as ordinary income at the time the option is exercised. At present, except for publicly traded stock options, most stock options would not be held to have a definitely ascertainable value.

The employer is generally allowed a business expense deduction equal to the amount included in the employee's income.

Explanation of committee provision

The bill will create a special class of stock options referred to as "incentive stock options." An employee receiving an incentive stock option to buy his employer's stock will be taxed only at the time he sells the stock acquired under the option. The gain on sale of the stock would be taxed at capital gains rates.

The employer will be denied any business deduction relating to the grant of an incentive stock option.

The committee bill will permit changes in terms of existing plans, as well as shareholder approval, within 12 months after enactment in order to conform to the incentive stock option rules without triggering existing provisions which would consider new options to have been granted.

An incentive stock option plan may provide that taxable cash payments to the employee at the time of exercise, that incentive stock options may include restrictions not inconsistent with the requirements of the incentive stock option rules, and must provide that a later issued option may not be exercised before previously issued option.

Incentive stock option plans may have a term of no longer than 20 years.

Q. Small Business

1. Subchapter S Corporations

Background

Subchapter S was enacted to minimize the effect of Federal income taxes on the form in which a business is conducted by permitting incorporation and operation of certain small businesses without the incident of income taxation at both the corporate and shareholder levels. Subchapter S rules allow a corporation engaged in an active trade or business to elect to be treated for income tax purposes in a manner similar to that accorded partnerships. The income or loss of eligible electing corporations is not taxed to the corporation but each shareholder reports a share of the corporation's income or loss in proportion to his share of the corporation's stock.

In order to be eligible for a subchapter S election, a corporation must have 15 or fewer shareholders and, with certain exceptions, a trust may not be a shareholder of the corporation.

Explanation of committee provision

The bill increases the permitted number of shareholders from 15 to 25 and permits certain additional trusts to be shareholders of electing small business corporations. The provision applies to taxable years beginning after December 31, 1981.

2. *Increase in Minimum Accumulated Earnings Credit*

Background

In addition to the regular corporate income tax, an accumulated earnings tax of 27½ percent to 38½ percent is imposed on accumulated corporate earnings where the accumulation occurs in an attempt to avoid the income tax with respect to the corporation's shareholders. In computing the base on which the tax is imposed, there is excluded an amount equal to the earnings and profits of the taxable year which are retained for reasonable needs of the business. This is known as the accumulated earnings credit. The minimum is presently $150,000. Thus, a corporation may accumulate $150,000 of its earnings before any accumulated earnings are subject to the tax.

Explanation of committee provision

The bill increases the minimum accumulated earnings credit to $250,000. However, this increase does not apply to specified service corporations whose principal business consists of the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting. The provision applies to taxable years beginning after December 31, 1981.

3. *Expensing*

Background

Under the Accelerated Cost Recovery System (ACRS) there is no special first year depreciation allowance for small business. Thus, a small business may depreciate its assets over their respective recovery periods as determined under ACRS to the same extent allowable for other taxpayers.

Explanation of committee provision

The bill permits the immediate write-off (expensing) of a limited amount of capital investment. The permitted amount that may be written-off in the year property is placed in service will be $5,000 for calendar years 1982 and 1983, $7,500 for 1984 and 1985, and $10,000 for 1986 and thereafter. This provision will permit the taxpayer to elect either to write-off such costs immediately or to write-off such costs over the asset's recovery period under ACRS.

4. *Investment Credit for Used Property*

A 10-percent regular investment tax credit is allowed for both new and used qualified property. There is, however, a $100,000 limitation on the amount of used property that is eligible for the regular investment tax credit each year. As a result, a taxpayer can claim a maximum regular investment tax credit of only $10,000 on used property for each taxable year.

Explanation of committee provision

The bill will eliminate the $100,000 limitation on the amount of used property eligible for the regular investment tax credit. There will, however, be recapture of previously claimed investment tax credits based on the sales price of the used property. This change will eliminate the need to keep track of holding periods on property for recapture purposes.

R. Employee Stock Ownership Plan Credit

1. General

Background

An employee stock ownership plan (ESOP) and a tax credit employee stock ownership plan (TRASOP) are both employee benefit plans which are designed to give employees the chance to acquire stock ownership in their company. The ESOP and TRASOP usually do this without requiring employees to spend any of their own money. Both types of plans are "qualified" under the Internal Revenue Code and must satisfy its requirements.

2. ESOP's

Background

The ESOP is designed to invest primarily in employer stock, and may borrow the funds necessary to purchase employer stock from the employer or its shareholders (leveraged ESOP). When the ESOP borrows money, the employer generally guarantees to the lender that the ESOP will repay the loan and that the employer will make annual payments to the ESOP sufficient in amount to permit the ESOP to make its annual payments on the indebtedness. Since the ESOP is qualified, the annual contributions by the employer to repay ESOP loan principal and interest are tax deductible, generally up to 15 percent of compensation paid or accrued to employees under the plan during the taxable year. The annual addition to an employee's account consisting of employer contributions, reallocations of forfeited benefits, and a portion of employee contributions (if any) under the plan are generally limited to not more than $41,500 ($25,000 adjusted for inflation since 1974) or 25 percent of compensation if less.

Explanation of committee provision

The bill will allow employers to deduct up to 25 percent of compensation for employer contributions to repay ESOP loan principal and unlimited deductions to pay interest on an ESOP loan. The contribution to repay interest and certain forfeitures of employer stock acquired with the proceeds of a loan to an ESOP will be exempt from the 25-percent and dollar limits on annual additions. This increased exemption from the limits on the annual addition for a leveraged ESOP will be disallowed where the benefits flow disproportionately to highly compensated employees. However, the 25-percent limitation will continue to apply to other allocations to a participant's account.

This provision applies to taxable years beginning after December 1, 1981.

3. TRASOP's

Background

In order to encourage an employer to make contributions to a TRASOP, the employer is allowed an additional 1 percent investment tax credit on any qualified investment for contributions of its securities to the plan. In addition, an employer is allowed an extra investment tax credit of up to one-half of 1 percent for contributions to a TRASOP if the contributions are matched by equal employee contributions.

Explanation of committee provision

The bill will terminate, the present 1½ percent additional investment tax credit with respect to qualified investments after December 31, 1982. A tax credit based on a percentage of the payroll of employees participating in a TRASOP employer's payroll will be allowed for contributions of employer securities to the plan. The percentage of payroll eligible for the credit will be 0.50 percent in 1983, 0.75 percent in 1984 and 1 percent in 1985 and thereafter. This provision applies to taxable years beginning after December 31, 1982.

In addition, the bill will amend the exceptions to the present law which require that TRASOP securities must be held in a plan for 84 months after allocation to permit a TRASOP distribution upon the sale of all or substantially all of the assets of a division of a corporation or the stock of a subsidiary. The provision will be effective for taxable years beginning after January 1, 1975.

4. Stock Bonus Plans and Financial Institutions

The bill will also shorten the required period for a "put option" (requiring an employer to repurchase its securities distributed to plan beneficiaries if the securities are not readily tradable). The bill will make the put option requirement applicable to distributions from a stock bonus plan but deletes the put option requirement for securities of certain banks and similar financial institutions. The provision applies to taxable years beginning after December 31, 1981.

S. Deduction for Motor Carrier Operating Authorities

Background

On July 1, 1980, the Motor Carrier Act of 1980 was enacted. The Act eliminated the requirement for a showing of public convenience and necessity for granting certificates of operating authority by the Interstate Commerce Commission. Existing operators claimed that the relaxed standard for granting certificates results in a significant loss in the value of their operating rights. The Interstate Commerce Commission has required that the value assigned to certificates of operating authority in the regulated books of motor carriers be written off in one year. Generally, court decisions have denied a loss deduction where the value of an operating permit decreases as a result of legislation expanding the number of permits issued.

Explanation of committee provision

The bill will allow motor carriers a deduction equal to the adjusted basis of all motor carrier operating authorities held on July 1, 1980. The deduction must be taken ratably over a 60-month period. The provision is designed to compensate motor carriers for the diminution in value of their operating authorities.

IV. COMMITTEE AMENDMENT: INDEXING INDIVIDUAL RATE BRACKETS, PERSONAL EXEMPTION, AND ZERO BRACKET AMOUNT

Background

Under the present progressive rate schedules for the individual income tax, the upper and lower limits of each rate bracket are stated in nominal dollar amounts. In addition, the Internal Revenue Code contains numerous fixed dollar terms, such as the zero bracket amount, the personal exemption, and limits on various credits and deductions. An increase in nominal income results in a higher effective tax rate as more income is taxed at the marginal rate and as taxpayers move into higher marginal rate brackets. To the extent that increases in nominal income represent a response to inflation (as income rises to keep pace with the cost of living) the progressive rate structure results in an increase in the effective tax rate relative to real income (as measured by purchasing power).

Committee amendment

To deal with this problem, the committee agreed to a separate provision to be offered as a committee amendment to the bill.

The amendment will provide that the individual rate brackets, personal exemption, and zero bracket amount (formerly the standard deduction) will be adjusted for inflation beginning January 1, 1985. The minimum and maximum dollar amounts for each rate bracket, the zero bracket amount, and the personal exemption (currently $1,000) will be adjusted upward by a factor equal to the percentage increase in the Consumer Price Index in the most recently completed fiscal year over the Consumer Price Index in the preceding fiscal year. Accordingly, the adjustment to be made effective January 1, 1985, will be based on the Consumer Price Index for fiscal year 1984, which will end on September 30, 1984. Similar adjustments will be made in the tax tables for each subsequent taxable year.

Withholding tables reflecting the cost-of-living adjustments will be prescribed before the beginning of the year for which the adjustments are to be effective. The gross income levels above which an income tax return is required, as prescribed by section 6012(a) of the Code, will also be altered to reflect the cost-of-living adjustments.

The provision will apply to taxable years beginning after December 31, 1984.

V. ESTIMATED REVENUE LOSS

The committee agreed that the tax cut bill would not exceed the following revenue loss projections: $2.1 billion in fiscal year 1981, $38 billion in fiscal year 1982, $93.4 billion in fiscal year 1983, and $149.6 billion in fiscal year 1984.

These revenue loss limits are based on Treasury Department estimates of the revised administration tax cut bill. The Joint Committee on Taxation has prepared a tentative reestimate of these figures as follows: $1.5 billion in fiscal year 1981, $38.3 billion in fiscal year 1982, $91.8 billion in fiscal year 1983, and $150 billion in fiscal year 1984.

Preliminary estimates indicate that the committee bill will not exceed the target revenue loss projections. The initial estimates project that the committee bill will reduce revenues by the following amounts: $1.6 billion in fiscal year 1981, $37 billion in fiscal year 1982, $91.7 billion in fiscal year 1983, and $149.2 billion in fiscal year 1984.

These estimates are below the revenue loss limits as estimated by the Treasury or under the initial Joint Committee reestimate, except for a $100 million excess over the Joint Committee figure for fiscal year 1981. The Joint Committee on Taxation has not yet finalized these figures.