

RESTORATION OF INVESTMENT CREDIT AND THE ALLOWANCE OF ACCELERATED DEPRECIATION IN THE CASE OF CERTAIN REAL PROPERTY

March 23, 1967.—Ordered to be printed

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

R E P O R T

together with

MINORITY VIEWS

[To accompany H. R. 6950]

The Committee on Finance, to which was referred the bill (H. R. 6950) to restore the investment credit and the allowance of accelerated depreciation in the case of certain real property, having considered the same, reports favorably thereon with an amendment and recommends that the bill as amended do pass.

I. SUMMARY

H. R. 6950 restores the investment tax credit and certain use of the accelerated depreciation methods effective after March 9, 1967.

The inflationary forces which the suspension of these provisions was designed to moderate have abated. These forces resulted from an unusual coincidence of circumstances; namely, a rapid increase in Vietnam defense outlays accompanied by a sharp rise in business plant and equipment spending at a time when the economy, after a prolonged expansion, was nearing full employment. The suspensions have played an important part in reducing the volume of new orders of capital goods to levels that can be sustained without inflationary strain on available capacity. The suspensions have also helped to ease pressures that brought about tight conditions in the money markets and, in particular, in the home mortgage market. Restoration of these provisions now will encourage a resumption of balanced, economic growth with high levels of employment and stable prices.

As indicated previously, the bill terminates the suspension period on March 9, 1967, rather than December 31, 1967, as provided by present law. In addition, the bill passed by the House limited the suspension of the investment credit to property delivered during the suspension period (not under one of the exceptions of present law), or where construction was by the taxpayer, to the portion of the construction occurring during the suspension period. The bill as passed by the House denied the application of the accelerated depreciation provisions only with respect to the proportion of the construction which occurred during the suspension period.

Your committee concluded that the provisions of the House bill which expanded the types of cases where the tax incentives were to be made available are discriminatory in two respects. First, they discriminate against taxpayers who postponed investments because of the suspensions. Taxpayers who ordered equipment or began construction during the suspension period, moreover, were fully aware that they would not qualify for the tax credit provisions. Second, they discriminate against those who received equipment or completed more of the construction before March 10, by denying the tax benefits to them while making them available to others who ordered equipment but because of delays did not receive delivery until after the suspension period.

In addition, the provisions of the House bill might dilute the effectiveness of future temporary tax measures undertaken in response to developments in the economy. Finally, the provisions of the House bill would reduce receipts in the coming fiscal years, a result which cannot be justified in view of the substantial deficit anticipated in the Federal budget accounts.

Your committee has therefore amended the bill passed by the House to retain the concept in present law as to property denied the benefits of the tax incentives. Thus, the investment credit will not be available with respect to property ordered or acquired, or in the case of construction by the taxpayer, property on which construction has begun during the period October 10, 1966, through March 9, 1967. In the case of the accelerated depreciation methods, they are not to be available if construction began during the suspension period or if an order for the construction was placed during that period.

The House bill also brought into effect on March 10, 1967, the new limitation on the amount of investment credit which may be claimed in any one taxable year. (The new limitation was provided in Public Law 89-800). The new limitation is 50 percent, rather than 25 percent, of tax liabilities in excess of \$25,000. Your committee's bill makes this limitation effective beginning January 1, 1968, the date which would have been applicable under the original legislation. The higher limitation will be applied on a pro rata basis in taxable years which straddle December 31, 1967. The provision of a 7-year carry-over of unused investment credits, which was also provided in Public Law 89-800, is not affected by this bill.

The bill as amended by your committee also provides that aircraft registered with the Administrator of the Federal Aviation Agency that are operated outside the United States pursuant to a contract with the Government are to qualify for the investment credit.

II. REASONS FOR THE BILL

Your committee agrees with the House that the extraordinary economic pressures have abated which in 1966 necessitated the suspension of the investment credit and of the use of accelerated methods of depreciation with respect to certain real property. It is appropriate, therefore, to restore the investment credit and the full use of accelerated methods of depreciation.

Why tax incentives for investment were suspended in 1966

The Nation's economy has expanded without interruption for 73 months since the recession low of February 1961. For over 3 years the course of the expansion was marked by an unusually high degree of price stability, as is evident from the fact that the wholesale price index remained virtually unchanged from the end of 1961 to the end of 1964. Prices rose by 2 percent in 1965, however. First, there was a sharp rise in the prices of a number of food products, and later in the year, as the demands placed upon the economy by the conflict in southeast Asia intensified, price increases spread to other areas.

Congress responded to the threat of inflation early in 1966 by approving the Tax Adjustment Act. This act reduced the disposable incomes of individuals and reduced corporate cash flow without affecting tax liabilities by placing the payment of income taxes on a more fully current basis. It also reinstated the auto and communication excise tax rates which had been reduced on January 1. The anti-inflationary impact of the Tax Adjustment Act was reinforced by the effects of the increase in social security contribution rates in January 1966 and by the administrative order accelerating the payment by employers of withheld income and social security taxes into Federal depositories which became effective in June. Through these several actions, approximately \$10 billion of business and consumer purchasing power was withheld from the economy during 1966.

These fiscal actions in combination with monetary restraint played an important part in moderating the economy's rate of advance in the spring of 1966. As the year progressed, however, inflationary pressures renewed. These pressures were the result of an unusual combination of circumstances not likely to be duplicated: Defense expenditures for Vietnam increased rapidly and business expenditures for new plant and equipment assumed boom proportions at approximately the same time the economy was nearing full employment levels of output.

Monetary restrictions of increasing severity were applied to cope with these developments, but it became evident that credit restraint, although it led to a general rise in interest rates, was falling with uneven weight on the various sectors of the economy. In particular, the home mortgage market was very seriously affected while business investment spending continued to increase. The quarterly surveys conducted by the Securities and Exchange Commission and the Department of Commerce revealed that businessmen did not scale down their investment plans during the first 9 months of 1966 despite high interest rates—the highest, in fact, in four decades—and lengthy delays in deliveries. This was particularly significant since the rate of planned investment in new plant and equipment was 17 percent

higher than the level of such spending in 1965 and 55 percent higher than the level of such spending in 1963.

The rapid expansion of business investment was reflected in a sharp increase in the credit market liabilities of corporations. Such liabilities for nonfinancial corporations increased in the first half of 1966 by an amount which, at a seasonally adjusted annual rate, was nearly double the amount they increased in 1964 and nearly three times the increase in 1961. Under conditions of credit stringency, these substantial increases in the extension of credit to corporations served to push up interest rates and divert funds from other sectors of the credit market. The supply of mortgage funds, in particular, was severely curtailed and this, in turn, was largely responsible for the sharp decline in the number of new housing starts from 1.6 million units in January 1966 to 848,000 in October, or by nearly 50 percent.

The growth in the demand for investment goods also placed severe pressure on the capacity of the industries which manufacture those goods. Operating rates reached 97 and 96 percent, respectively, in the electrical and nonelectrical machinery industries in August, well above preferred operating rates and signifying, in effect, operation at virtually the limit of capacity. New orders exceeded shipments of completed orders each month and tended to increase the backlog of unfilled orders rather than the level of production. The volume of unfilled orders for machinery and equipment, shown in table 5, increased by nearly 21 percent between January and October 1966. The backlog for orders for metal-cutting machine tools, shown in table 6, reached 11 months in November 1966, 45 percent longer than the backlog in December 1965.

With demand outstripping supply capacity, prices in the machinery and equipment industries rose significantly and labor market conditions tightened. Table 1 indicates that the wholesale price index for metalworking machinery in October 1966 was 7.8 percent above the level of July 1965 while the index for general purpose machinery was 6.8 percent above the July 1965 level. The rate of unemployment in nonelectrical machinery industries, shown in table 6, reached the low level of 1.8 percent in the third quarter of 1966 while the average amount of overtime in the first 9 months of 1966 rose 25 percent above the average in the comparable period of 1965. Similar pressures were evident in the field of commercial and industrial construction.

TABLE 1.—Wholesale price indexes of machinery and equipment
[1957-59=100]

	Machinery and equipment			Metalworking machinery and equipment		Electrical machinery and equipment	
	Con- struction	Metal- working	General purpose	Metal- working presses	Precision measur- ing tools	Wiring devices	Trans- formers and power regulators
1961.....	107.5	107.0	102.8	104.6	106.8	99.5	88.8
1962.....	107.8	109.3	103.3	106.0	109.4	99.7	85.1
1963.....	109.6	109.8	103.8	107.3	109.5	98.9	79.6
1964.....	112.4	112.6	104.4	110.7	111.7	100.7	78.7
1965.....	115.3	116.9	105.1	119.0	115.4	103.1	77.0
1965: July.....	115.3	116.5	104.7	117.7	115.9	103.6	77.0
1966:							
January.....	116.9	119.8	106.8	122.0	117.5	104.4	76.7
February.....	117.5	121.0	106.8	123.4	121.0	107.4	77.8
March.....	117.9	121.1	107.3	123.4	124.5	109.0	78.8
April.....	118.5	121.2	108.5	123.4	124.6	109.0	79.3
May.....	118.9	122.5	109.3	124.7	124.4	110.5	80.8
June.....	118.9	123.5	109.8	130.5	124.4	109.6	81.3
July.....	118.9	123.5	110.0	130.5	124.5	109.7	81.3
August.....	118.9	124.0	110.6	130.5	124.5	109.7	81.6
September.....	119.4	125.0	111.1	133.1	124.5	109.7	81.5
October.....	119.8	125.6	111.8	134.4	124.7	109.8	81.7
November.....	120.6	126.0	112.2	134.4	124.8	111.0	82.9
December.....	120.8	126.3	112.4	134.4	124.8	113.1	83.2
1967: January.....	121.1	126.4	112.9	134.4	125.0	114.9	83.3

Source: U.S. Bureau of Labor Statistics, Department of Labor.

The growth of domestic orders for investment goods in excess of the capacity of domestic suppliers encouraged domestic equipment buyers to seek out foreign suppliers who promised earlier deliveries. This effect was intensified by the rise in prices which accompanied the very high rate of capacity utilization in the domestic equipment industries. As a result, imports of capital equipment rose by an average of 13 percent a quarter in 1965 and in the first three quarters of 1966. This development had an adverse impact on the balance of payments.

Suspension of the 7-percent investment credit and of the use of accelerated depreciation with respect to buildings not entitled to the credit was expected to moderate orders for plant and equipment. Suspension of these measures discouraged producers from undertaking marginal projects. This, in turn, was expected to reduce the pressures on the industries supplying these items and thereby encourage them to return to normal production schedules.

By reducing the demand for new capital goods, the suspensions were also expected to lead to a reduction in the demand for credit by business. As a result of this, pressures on interest rates would be reduced and more funds would become available to finance home mortgages. Furthermore, the suspensions were expected to strengthen the balance of payments by reducing domestic demand to the level of domestic supply and thus curtailing the demand for imported capital goods.

The impact of the suspensions was intensified by the fact that a definite date was provided for their termination, since producers were given greater incentive to defer marginal projects. It was never intended, however, that the suspensions would remain in effect until December 31, 1966, if the underlying conditions changed and the suspensions no longer were necessary. For example, your committee's report on H.R. 17607, the bill which provided for suspension of the investment credit and accelerated depreciation on certain real property, stated:

If military requirements in southeast Asia should decrease before January 1, 1968, or if for some other reason it should become apparent that suspension of the investment credit and suspension of the use of the accelerated depreciation methods with respect to buildings are no longer necessary to restrain inflation, the Congress can promptly terminate the suspensions. The administration has also indicated that it would recommend terminating the suspension period before January 1, 1968, under such conditions.

Current situation

Current business plans for investment in new plant and equipment during 1967 indicate an increase of 3.9 percent above the level of such investment in 1966, according to the quarterly survey conducted by the Department of Commerce and the Securities and Exchange Commission in January and February. This anticipated rate contrasts sharply with the increase of 16.7 percent in plant and equipment investment which took place between 1965 and 1966. As shown in table 2, the lower rates of anticipated growth affect all industries. The railroad industry anticipates an actual decline of 25.3 percent below the level of investment expenditures in 1966.

The quarterly survey conducted in November 1966 showed an estimated increase of 6.6 percent in anticipated expenditures on plant and equipment from the second quarter of 1966 to the second quarter of 1967. The most recent survey, made in February of this year, shows a further slowdown in planned expenditures as the increase covering the same period is expected to be only 3.6 percent. These data appear in table 3. The further slowdown apparently affects virtually all industry groups, except nondurable goods manufacturing industries which now anticipate a slightly higher level of investment during the first half of this year than they did 3 months earlier. In both surveys, all industry groups, however, anticipated smaller increases in plant and equipment investment expenditures in 1967 than in 1966.

TABLE 2.—*Actual and anticipated business expenditures for plant and equipment investment, calendar years 1965, 1966, and 1967*

[In billions of dollars]

	1965 actual	1966 actual	1967 anticipated	Percentage change	
				1965-66	1966-67
All industries.....	51.96	60.63	63.00	16.7	3.9
Manufacturing.....	22.45	26.99	27.94	20.2	3.5
Durable goods.....	11.40	13.99	14.64	22.7	4.6
Nondurable goods.....	11.05	13.00	13.30	17.6	2.3
Mining.....	1.50	1.47	1.68	12.9	8.0
Railroad.....	1.73	1.98	1.48	14.2	-25.3
Transportation, not rail.....	2.81	3.44	3.94	22.3	14.7
Public utilities.....	6.94	8.41	9.15	21.1	8.8
Communications.....	16.73	18.30	18.91	9.7	3.0

Sources: Department of Commerce and Securities and Exchange Commission.

On February 20, 1967, the White House released the results of a survey of the effects of the suspension of the two investment incentives. It showed that all business planned to reduce investment outlays by \$330 million in 1966 and \$2,280 million in 1967. These statistics are shown in table 4 and are reflected in the results described in the preceding discussion.

TABLE 3.—Actual and anticipated business expenditures for plant and equipment investment, calendar quarters 1966 and 1967

[Billions of dollars; seasonally adjusted annual rates]

	1966 actual				1967 anticipations				Percentage change, 2d quarter 1966 to 2d quarter 1967	
	1st quarter		2d quarter		1st quarter		2d quarter			
	1st quarter	2d quarter	3d quarter	4th quarter	November estimate	February estimate	November estimate	February estimate	November estimate	February estimate
All industries	58.00	60.10	61.25	62.80	63.45	62.60	64.05	62.25	6.6	3.6
Manufacturing	25.60	26.80	27.55	27.75	27.85	27.60	28.45	27.70	6.2	3.4
Durable goods	13.15	13.85	14.35	14.50	14.70	14.45	15.10	14.25	9.0	2.9
Nondurable goods	12.45	12.95	13.20	13.25	13.15	13.15	13.35	13.45	3.1	3.9
Nonmanufacturing	32.40	33.30	33.70	35.05	35.60	35.05	35.60	34.55	6.9	3.8

Sources: Department of Commerce and Securities and Exchange Commission.

TABLE 4.—*Estimated reductions in plant and equipment expenditures following suspension of the investment tax credit and accelerated depreciation, by major industry groups, 1966 and 1967*

(In billions of dollars)

	Amount of reduction	
	1966	1967
All business ¹	0.33	2.28
Manufacturing.....	(²) .09	(²) .93
Mining.....	(²)	(²) .05
Public utilities.....		.37
Transportation.....	(²) .01	(²)
Communications.....		.92
Commercial.....	.23	

¹ Excludes farmers, real estate companies, and professional services.

² Less than \$5,000,000.

Sources: U.S. Department of Commerce, Office of Business Economics, and Securities and Exchange Commission.

Significant reductions in the strain on productive capacity for durable goods have become evident since the beginning of this year, and presently there are indications that production is now proceeding at a sustainable high level. The level of new orders for machinery and equipment, \$4,555 million, was 7 percent below the September level of \$4,906 million. (See table 5.) Shipments of filled orders exceeded new orders in January, and the backlogs of unfilled orders were reduced for the first month since June 1963. In the electrical machinery industry, new orders in January were 4 percent below the September level, and the operating rate fell by approximately the same percentage to 91.5 percent of capacity during the same time period. An analogous pattern developed in the nonelectrical machinery industry, as the level of new orders fell 9 percent from \$3,715 million in September to \$3,379 million in January. The operating rate was reduced only 1 percent to 95 percent of capacity from the peak level of last fall, but shipments of filled orders exceeded new orders in January and produced the first substantial decline in the level of unfilled orders in well over a year. In the machine tool industry, which is a key industry in the manufacture of producer's durable equipment, substantially higher shipments than new orders in December and January resulted in a 17-percent decline in the backlogs.

TABLE 5.—Manufacturers new and unfilled orders, durable goods industries
 (In millions of dollars, seasonally adjusted)

	Total durable goods		Nonelectrical machinery		Electrical machinery		Machinery and equipment	
	New orders	Unfilled orders	New orders	Unfilled orders	New orders	Unfilled orders	New orders	Unfilled orders
1966:								
January.....	23,578	63,803	3,427	10,475	3,462	10,147	4,450	16,181
February.....	23,741	65,110	3,317	10,613	3,332	10,358	4,584	16,575
March.....	24,888	66,762	3,529	10,857	3,489	10,581	4,587	16,785
April.....	24,197	68,250	3,538	11,169	3,612	10,909	4,788	17,273
May.....	24,276	69,609	3,553	11,468	3,466	11,061	4,845	17,762
June.....	24,593	71,308	3,609	11,757	3,487	11,318	4,753	18,142
July.....	24,371	72,651	3,426	11,820	3,744	11,567	5,092	18,683
August.....	23,612	73,286	3,774	12,230	3,603	11,793	4,813	18,986
September.....	25,274	75,591	3,715	12,524	3,676	12,056	4,906	19,333
October.....	24,244	76,382	3,647	12,611	3,579	12,189	4,816	19,499
November.....	23,027	76,170	3,675	12,818	3,507	12,310	4,647	19,602
December.....	23,960	76,415	3,582	12,816	3,358	12,279	4,603	19,614
1967: January.....	22,364	75,517	3,379	12,720	3,516	12,295	4,555	19,524

Source: Bureau of the Census, Department of Commerce.

Similarly, extremely tight labor supply conditions have eased in the machinery industries. The unemployment rate of 2.3 percent in January—although still representing a tight labor market—was the highest unemployment rate in the past 11 months, underlining another facet of the lessening demand for the output of the machinery industries, as shown in table 6. Average overtime hours in the machinery industries in November and December 1966 were only 5 percent above the level in the same months in 1965. This marks a considerable decline from the very high levels of overtime worked during the first 9 months of 1966.

TABLE 6.—Factors affecting production of capital goods

	Order backlog of metal-cutting machine tools ¹ (months)	Unemployment rates, nonelectrical machinery (percent)	Average workweek, machinery (hours, seasonally adjusted)	Average hourly earnings, contract construction	Department of Commerce composite construction cost index (1957-59=100)	Commercial and industrial construction (millions of dollars, seasonally adjusted annual rate)
1961.....	4.8	6.4	41.0	\$3.20	104	7,454
1962.....	3.9	3.7	41.7	3.31	107	7,986
1963.....	5.6	4.1	41.8	3.41	109	7,901
1964.....	6.3	3.0	42.4	3.55	112	8,978
1965.....	7.6	2.5	43.1	3.69	116	11,760
1966.....	10.8	1.9	43.8	3.87	121	13,699
1966:						
January.....	8.2	1.9	43.8	3.70	118	13,833
February.....	8.7	2.3	43.9	3.82	118	13,923
March.....	9.1	2.2	44.0	3.80	118	14,745
April.....	9.5	1.9	43.7	3.81	119	14,272
May.....	9.7	1.9	43.8	3.83	120	12,982
June.....	9.8	2.1	43.8	3.83	121	13,891
July.....	10.2	1.4	43.3	3.85	122	13,443
August.....	10.3	2.0	43.3	3.89	122	13,616
September.....	10.8	2.1	44.3	3.96	122	13,967
October.....	11.0	1.4	43.9	3.95	122	12,831
November.....	11.1	1.2	44.0	3.95	123	13,495
December.....	10.8	1.6	43.0	3.98	123	13,358
1967: January.....	(²)	2.3	43.8	4.01	123	(³)

¹ Annual figures are for Decembers of years indicated.

² Estimated annual average.

³ Not available.

Sources: U.S. Bureau of the Census, Department of Commerce; U.S. Bureau of Labor Statistics, Department of Labor.

The rates of increase in imported capital equipment slowed. The 4-percent rise in imports of capital equipment in the fourth quarter of 1966 was the smallest quarter-to-quarter increase since the middle of 1964 and substantially less than the average 13 percent rate of increase over the preceding 7 quarters. These imports, the administration has reported, in part reflect orders that had been placed earlier in 1966. Domestic producers now are in a substantially improved position to fill such orders, and prospects have improved for a leveling off in capital equipment imports.

The indexes of industrial production for all industries have fallen from the peak levels reached in 1966. In February, the index of total industrial production fell to its lowest level since May 1966. The indexes of consumer goods began a slow decline in November 1966 which was accelerated in February. Production in the equipment industries fell for the first time in February, in contrast with continuing increases—although at much slowed rates—throughout the last three months in 1966.

There is growing evidence that conditions in the money market also are easing. Interest rates, shown in table 7, have fallen from their 1966 highs. For example, interest rates on 3-month Treasury bills reached a peak in October 1966 of 5.387 percent per annum. Since that time, interest rates on these bills have declined steadily. On March 13, the Treasury marketed 3-month bills with a rate of interest of 4.31 percent per annum, more than a full percentage point below the average October rate. Interest rates on other Treasury issues, municipal bonds, corporate bonds, commercial paper, and home mortgages have generally followed a similar pattern.

TABLE 7.—Bond yields and interest rates
[Percent per annum]

Period	U.S. Government security yields			High-grade municipal bonds (Standard & Poor's) ⁴	Corporate bonds (Moody's)		Prime commercial paper, 4 to 6 months	FHA new home mortgage yields ⁵
	3-month Treasury bills ¹	3- to 5-year issues ²	Taxable bonds ³		Aaa	Baa		
1960.....	2.928	3.99	4.02	3.73	4.41	5.19	3.85	6.16
1961.....	2.378	3.60	3.90	3.46	4.35	5.08	2.97	5.78
1962.....	2.778	3.57	3.95	3.18	4.33	5.02	3.26	5.60
1963.....	3.157	3.72	4.00	3.23	4.26	4.86	3.55	5.46
1964.....	3.549	4.06	4.15	3.22	4.40	4.83	3.97	5.45
1965.....	3.954	4.22	4.21	3.27	4.49	4.87	4.38	5.46
1966.....	4.881	5.16	4.65	3.82	5.13	5.67	5.55	6.29
1965—December.....	4.362	4.77	4.43	3.56	4.68	5.02	4.65	5.51
1966—January.....	4.596	4.89	4.43	3.52	4.74	5.06	4.82	5.62
February.....	4.670	5.02	4.61	3.63	4.78	5.12	4.88	5.70
March.....	4.626	4.94	4.63	3.72	4.92	5.32	5.21	.....
April.....	4.611	4.86	4.55	3.59	4.96	5.41	5.38	6.00
May.....	4.642	4.94	4.57	3.68	4.98	5.48	5.39	.....
June.....	4.539	5.01	4.63	3.77	5.07	5.58	5.51	6.32
July.....	4.855	5.22	4.75	3.94	5.16	5.68	5.63	6.45
August.....	4.932	5.58	4.80	4.17	5.31	5.83	5.85	6.51
September.....	5.356	5.62	4.79	4.11	5.49	6.09	5.89	6.58
October.....	5.387	5.38	4.70	3.97	5.41	6.10	6.00	6.63
November.....	5.344	5.43	4.74	3.93	5.35	6.13	6.00	.....
December.....	5.007	5.07	4.65	3.83	5.39	6.18	6.00	6.81
1967: January.....	4.759	4.71	4.40	3.58	5.20	5.97	5.73	6.77
Week ended: 1967:								
Jan. 14.....	4.818	4.76	4.40	3.62	5.32	6.08	5.85	.....
Jan. 21.....	4.716	4.65	4.37	3.43	5.15	5.92	5.68	.....
Jan. 28.....	4.680	4.68	4.39	3.43	5.04	5.83	5.55	.....
Feb. 4.....	4.486	4.64	4.37	3.45	5.02	5.81	5.40	.....
Feb. 11.....	4.530	4.67	4.41	3.47	5.00	5.82	5.38	.....
Feb. 18.....	4.577	4.76	4.49	3.62	5.01	5.82	5.38	.....
Feb. 25.....	4.621	.....	.....	.....	.....	.....	.....	.....
Mar. 10.....	4.344	.....	.....	.....	.....	.....	.....	.....
Mar. 17.....	4.308	.....	.....	.....	.....	.....	.....	.....

¹ Rate on new issues within period.

² Selected note and bond issues.

³ April 1953 to date, bonds due or callable 10 years and after.

⁴ Weekly data are Wednesday figures.

⁵ Data for 1st of the month, based on the maximum permissible interest rate (6 percent beginning October 1966) and 30-year mortgages paid in 15 years.

⁶ Not charted.

Sources: Treasury Department, Board of Governors of the Federal Reserve System, Federal Housing Administration, Standard & Poor's Corp., and Moody's Investors Service.

Recent actions by the Federal Reserve Board suggest that further monetary ease will be encouraged. The Reserve Board announced that the reserves required against savings deposits by member banks would be reduced from 4 percent to 3 percent of such deposits. This action increases the ability of the member banks to make loans. The first step in the program went into effect on March 1 and increased the free reserves of member banks to a "plus" free-reserve position of \$165 million, the highest free-reserve position since December 1964. The free reserves of member banks reached a "minus" position of more than \$400 million during the period of monetary stringency in 1966. The step taken by the Federal Reserve Board was made possible by a general easing of inflationary pressures throughout the economy as well as by the easing of pressures in the capital goods industries.

The movement toward greater monetary ease has been accompanied by an increase in activity in the homebuilding industry. During the 4 months ending in January, the annual rate of increase in the amount individuals have on deposit in savings and loan institutions—the most important single source of financing purchases of single-family residences—was \$8 billion. This marks a sharp change from the preceding 6-month period in which the net inflow of funds into savings and loan institutions was a negligible \$100 million. Housing starts, shown in table 8, have increased, at seasonally adjusted annual rates, from a low point of 848,000 in October 1966 to an average of nearly 1,200,000 in January and February 1967.

TABLE 8.—Housing starts, 1961–66 annual, December 1965–January 1967 monthly

(Thousands of units)

Period	Total private and public (including farm)	Total private (including farm)	Private nonfarm			Total private (including farm)	Private nonfarm		
			Total	One family	Two or more families		Total	Government home programs	
								FHA	VA
1961.....	1,365.0	1,313.0	1,284.8	946.2	338.6	1,313.0	1,284.8	198.8	83.3
1962.....	1,492.4	1,462.7	1,439.0	967.8	471.2	1,462.7	1,439.0	197.3	77.8
1963.....	1,641.0	1,609.2	1,581.7	993.2	588.5	1,609.2	1,581.7	168.2	71.0
1964.....	1,590.7	1,557.4	1,530.4	944.5	585.9	1,557.4	1,530.4	154.0	59.2
1965.....	1,542.7	1,505.0	1,482.7	940.0	542.7	1,505.0	1,482.7	159.9	52.5
1966 ¹	1,251.6	1,219.9	1,196.5	772.9	424.3	1,219.9	1,196.5	129.1	40.5
Seasonally adjusted annual rates									
1965: December.....	103.2	102.3	100.8	58.3	42.5	1,769	1,735	189	48
1966:									
January.....	87.3	84.6	83.7	47.2	36.5	1,611	1,585	181	53
February.....	81.0	78.2	76.7	45.3	31.4	1,374	1,340	177	40
March.....	130.9	126.3	124.1	78.7	45.4	1,569	1,538	187	45
April.....	149.2	147.1	144.8	93.0	51.8	1,502	1,481	151	37
May.....	139.3	135.4	132.2	84.8	47.4	1,318	1,287	128	38
June.....	130.7	127.5	125.1	81.4	43.7	1,285	1,261	121	44
July.....	104.8	104.0	102.3	69.7	32.6	1,088	1,068	117	42
August.....	107.3	105.4	103.3	69.1	34.2	1,107	1,084	113	35
September.....	95.2	92.4	90.2	60.1	30.1	1,075	1,050	96	37
October.....	82.8	80.3	78.1	53.0	25.1	848	826	94	38
November.....	77.6	75.3	73.9	49.4	24.5	1,012	993	107	40
December ¹	65.7	63.6	62.3	38.9	23.5	1,089	1,066	105	42
1967:									
January ¹	67.1	64.4	63.0	38.7	24.3	1,282	1,251	150	59
February ¹	63.2	61.4	60.3	41.4	18.9	1,089	1,073	139	55

¹ Preliminary.

NOTE.—Data include Alaska and Hawaii.

Sources: Department of Commerce, Federal Housing Administration (FHA), and Veterans' Administration (VA).

The suspension of the investment tax credit and accelerated depreciation has contributed to the reduced rate of investment growth that was sought when the suspension was enacted. However, as the surveys cited above indicate, the continuing effect of the suspension of investment incentives can be expected to reduce the rate of expansion below the rate desirable for maintaining the balanced growth in economic activity that has characterized almost all of the 6-year period of growth that began early in 1961. Consequently, the business investment incentives need to be restored if we are to have the capital investment expansion required by a balanced, growing economy. There is good reason to expect this desirable result because the introduction of the investment tax credit late in 1962 was a significant factor in stimulating balanced growth in the past.

Delay in restoring the investment incentives runs the risk that further deterioration will result as the almost stationary level of investment expenditures—reflecting present anticipations—produces secondary reductions in output and investment in the industries which supply the investment industries. Your committee agrees with the house that prompt action is necessary to forestall any such adverse tendencies before they develop. The increased profits which the investment tax credit and accelerated depreciation provide will tend to encourage business to undertake investment which was below the line of profitability during the suspension period.

Statistics illustrating patterns of new plant and equipment expenditures since 1953 are shown in table 9 and can help to emphasize the importance of prompt action to reverse the ebbing flow of investment expenditures.

TABLE 9.—Expenditures for new plant and equipment, 1953-67

	Total (billions)	Percent of increase (+) or decrease (-)
1953.....	\$28.32	-----
1954.....	26.83	-5.3
1955.....	28.70	+7.0
1956.....	35.06	+22.2
1957.....	36.96	+5.4
1958.....	30.63	-17.4
1959.....	32.54	+6.6
1960.....	35.68	+9.6
1961.....	34.37	-3.7
1962.....	37.31	+8.5
1963.....	39.22	+5.1
1964.....	44.90	+14.5
1965.....	51.96	+15.7
1966.....	60.66	+16.5
1967 ¹	63.00	+4.0
1965: ²		
I.....	49.00	-----
II.....	50.35	+2.8
III.....	52.75	+4.8
IV.....	55.35	+4.9
1966: ²		
I.....	58.00	+4.8
II.....	60.10	+3.6
III.....	61.25	+1.9
IV.....	62.80	+2.5
1967: ²		
I.....	62.60	-0.3
II.....	62.25	-0.6
2d half.....	63.65	+1.9

¹ 1967 estimated on the basis of a survey conducted in January and February 1967.

² Quarterly totals at seasonally adjusted annual rates.

Source: Securities and Exchange Commission and the Department of Commerce.

Revenue effect

The manner in which H.R. 6950 will affect budget receipts in the current and in succeeding fiscal years is difficult to determine because it is hard to gage its economic impact. Compared to present law, both the House and your committee's version of the bill would appear to reduce receipts by restoring the investment credit and certain uses of accelerated depreciation. However, the bill can be expected to encourage higher levels of business investment spending than would be forthcoming under present law. Higher levels of investment spending in turn will mean higher incomes in the industries that supply, directly or indirectly, such goods and, in this manner, increase tax receipts.

Even if the economic impact of the bill is not taken into account, there is value in describing the hypothetical revenue effect of the bill, on the assumption that the current level of investment expenditures will be continued. That is, on the assumption that business investment plans will not be altered as a result of the enactment of this bill. The following estimates are based on this assumption.

The bill passed by the House would have reduced receipts over the fiscal years 1967 through 1970 by a total of \$1,860 million. Nearly half of this reduction would have occurred in the fiscal year 1968, a year in which a substantial deficit is currently anticipated. Under the bill approved by your committee, the reduction in receipts over the 4 fiscal years will be \$1,085 million, or \$775 million less than the reduction provided by the House bill. The reduction in receipts under your committee's bill results only from the termination of the suspension period on March 9, 1967, rather than December 31, 1967, since it does not change the effective date provided under present law for the institution of the 50-percent limitation on the amount of investment credit which may be claimed. Moreover, the revenue loss attributable to the termination of the suspension period is \$570 million less under your committee's bill than under the House bill because your committee's bill generally continues the application of the suspensions to all orders placed and construction begun during the suspension period. The effect of the House bill advancement of the effective date for the increase in the limitation on the amount of investment credit which may be claimed is estimated to be a reduction in receipts of \$205 million. Details of these estimates are shown in table 10.

TABLE 10.—Estimated revenue effect of provisions of H.R. 6950

(In millions of dollars)

HOUSE BILL

Fiscal years	Reinstatement on Mar. 10, 1967, of—		Advance date of limit on credit raised to 50 percent	Total
	Investment credit	Accelerated depreciation		
1967.....	-270		-100	-370
1968.....	-720	-10	-180	-910
1969.....	-475	-35	+25	-485
1970.....	-85	-60	+50	-95
Total, 4 years.....	-1,550	-105	-205	-1,860

FINANCE COMMITTEE BILL

1967.....	-145			-145
1968.....	-460			-460
1969.....	-400	-5		-405
1970.....	-60	-15		-75
Total, 4 years.....	-1,065	-20	0	-1,085

DIFFERENCE BETWEEN BILLS

Revenue gain of Finance over House bill, fiscal years 1967-1970.....	+485	+85	+205	+775
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III. GENERAL EXPLANATION

1. *Restoration of the investment credit and of accelerated depreciation in the case of certain real property (sec. 1 of the bill and secs. 48 and 167 of the code)*

Present law.—Public Law 89-800 enacted on November 9, 1966, suspended the 7-percent investment credit and the use of accelerated methods of depreciation with respect to certain real property. In the case of the investment credit, the suspension applies generally to machinery, equipment, and similar forms of personal property ordered, acquired, or constructed by the taxpayer for his own use during the period beginning on October 10, 1966, and ending on December 31, 1967. An exception to the general rule provides that the first \$20,000 of investment of the type that is eligible for the credit undertaken by the taxpayer during the suspension period remains eligible for the credit. Exceptions are also provided for air and water pollution abatement facilities.

In the case of accelerated depreciation, the suspension applies to buildings not eligible for the investment credit which are ordered or on which construction is begun during the suspension period (October 10, 1966, through December 31, 1967). An exception is provided in this case for buildings costing in the aggregate not more than \$50,000.

The suspensions do not apply to property whose physical construction was begun before the suspension period or which was acquired pursuant to a contract that was binding on the taxpayer on October 9, 1966, and at all times thereafter. Moreover, the suspension does not apply in certain related situations, such as in the case of certain equipped buildings and plant facilities.

House treatment of investment credit and accelerated depreciation.—The House bill amended present law to shorten the suspension period from the period beginning on October 10, 1966, and ending on December 31, 1967, to the period beginning on October 10, 1966, and ending on March 9, 1967.

The House bill also modified the definition of suspension period property provided in Public Law 89-800. Under the modification, the suspension of the investment credit would have applied to the portion of the cost (or other basis) of property constructed by the taxpayer that was attributable to construction which occurred during the suspension period. In the case of acquisitions, the suspension of the investment credit would only have applied to property acquired by the taxpayer during the suspension period.

The House bill also modified the definition of property not eligible for the accelerated depreciation methods. Under this modification, the use of the accelerated methods would have been suspended with respect to only that portion of construction attributable to the suspension period, provided the construction was begun during the suspension period.

Committee amendment.—Your committee agrees that it is desirable to terminate the suspension period because it is evident that the suspension of these tax incentives to business investment is no longer necessary. The extraordinary conditions which made the suspension necessary last fall have abated. Spending for new plant and equipment by business is no longer increasing at an unsustainable rate. A better balance has been restored between the ability of the capital goods industries to supply plant and equipment needs and the demands of investors for those goods. Monetary pressures have eased, in part because the rate of investment spending has moderated, and funds are becoming available in sectors of the money market where monetary stringency was acute last fall. In particular, more funds are flowing into the savings and loan associations which finance most home mortgages. Finally, the most recent official survey of business investment decisions suggests that if the suspension remains in effect the amount of additional investment spending this year may fail to reach a level sufficient to keep the economy growing at a maximum rate consistent with reasonable price stability. These points are discussed in greater detail in the preceding section of this report, "Reasons for the Bill."

Your committee concluded, however, that the definition of suspension period property should not be modified in the manner provided by the House bill. In part this is due to the fact that your committee considers the provisions of the House bill to be discriminatory. In the first place, the provisions discriminate against taxpayers who postponed orders or construction during the suspension period and who therefore forfeited their place in line for the delivery of new equipment. These taxpayers postponed orders because they were under the impression that they would not receive these tax incentives with respect to such property and because they felt the incentives were important enough to justify the postponement. It would be unfair to these taxpayers, who acted in the manner that was the intended purpose of the legislation, to now rescind the effect of the suspension.

In the second place, the provisions of the House bill discriminate among taxpayers who ordered similar equipment at essentially the

same time but who received the equipment at different times. Those who received delivery on or before March 9 would not be eligible for these tax provisions while those who received the equipment on or after March 10 would be eligible. This is true even though all taxpayers who ordered equipment during the suspension period did so under the expectation that they would not receive the benefit of these tax provisions.

As indicated previously, the modifications in the definition of suspension period property contained in the House bill have the effect of rescinding the suspension provisions enacted last fall for a large number of taxpayers who ordered equipment during this period or began construction during this period. The suspension of the investment credit and the related accelerated depreciation provisions were enacted in response to the conditions which existed in the economy last fall with the intent of deterring investments. Approval of the House bill would therefore set an unfortunate precedent with regard to any possible future legislation undertaken primarily to assure the continued growth and prosperity of the economy. Taxpayers might be left with the impression that they could ignore, for planning purposes, the temporary suspension of special tax incentives enacted in response to economic developments. Such a reaction would not only severely reduce the effectiveness of such fiscal actions, but would also create the possibility of hardships to taxpayers whose expectations were not fulfilled.

Finally, the definitional modifications in the House bill would result in a substantial loss of revenue to the Government. Receipts over the 4 fiscal years 1967 through 1970 would be reduced by \$570 million. A large share of this reduction, \$270 million, would occur in the fiscal year 1968. In view of the substantial deficit now projected for that fiscal year, such a reduction in receipts would appear inappropriate.

In view of the foregoing, your committee's bill retains the provisions of present law prescribing what constitutes suspension period property. Under these provisions, either the investment credit or the accelerated depreciation methods is denied for property the construction, reconstruction or erection of which began either during the suspension period or pursuant to an order made during the suspension period. In addition, the investment credit is denied in the case of property which is acquired by the taxpayer during the suspension period or pursuant to an order placed during that period.

Some have feared that denying the investment credit for orders placed during the suspension period where delivery occurs after the end of the suspension period will be relatively easily avoided by cancellations and reorders within a short time thereafter. Your committee does not intend avoidance of this order rule to occur merely by cancellation and replacement where the taxpayer as a result of the replacement is in substantially the same position after the cancellation and reorder as before. Thus, it is not contemplated, for example, that an order occurring after the end of the suspension period would be considered a new order if there was a cancellation after the end of the suspension period and the order is placed within a relatively short period of time after the cancellation with the same producer, or a related one (including brother-sister corporate relationships), if the specifications of the product obtained pursuant to the reorder are substantially the same as those specified in the earlier order occurring

during the suspension period. Your committee believes that such an order is "pursuant to an order placed" during the suspension period.

The term "order," as used in the bill, is not intended to include cases where at no expense to the taxpayer he has the use of equipment for a specified period of time and then at the end of a trial period can decide whether to buy the equipment or have it removed at the expense of the supplier. However, the prior sentence is not intended to cover warranties or any similar guaranties but applies only in those cases where the taxpayer, without regard to performance of the equipment, is free to return it without incurring any expense on his part. Similarly, it is not intended that the first sentence cover cases where the taxpayer has placed an order on which he did not receive delivery, even though he may cancel the order without obligation.

Effective date.—This provision is to be effective with respect to taxable years ending after March 9, 1967.

2. *The 50-percent limitation on the investment credit (sec. 2 of the bill and sec. 48 of the code)*

Under the terms of the act which suspended the investment credit and certain uses of accelerated depreciation (P.L. 89-800), the limitation on the amount of investment credit which may be claimed in any one taxable year is increased from 25 percent of tax liability in excess of \$25,000 to 50 percent of such liability. (The credit may be taken against the entire \$25,000 of initial tax liability.) The legislation enacting this increase provided that this change was to take effect at the conclusion of the suspension period. The House bill therefore automatically placed this increased limitation in effect beginning on March 10, 1967.

Your committee has concluded that there is no need to advance the effective date of the increased limitation. Taxpayers were informed that the new limitation would go into effect beginning with the calendar year 1968 or portions of fiscal years occurring in 1968. Many have presumably made plans on this basis. The provision of a 7-year carryforward of unused credits, which is unaffected by this bill, insures that unused credits generally will not be lost even though the effective date of the 50-percent limitation is not advanced. Thus, in most cases, this is only a delay, and not a loss, in the amount of credits which taxpayers may take. Finally, advancing the effective date of the higher limitation will reduce receipts in the fiscal years 1967 and 1968 by \$280 million. This loss is significant in view of the tight budgetary situation already facing the Government.

For the reasons given above your committee has amended the House bill to retain the effect of present law by providing that the increased limitation will not go into effect until after December 31, 1967. The limitation will therefore be effective with respect to taxable years which begin on or after January 1, 1968. The limitation will be prorated for taxable years which begin before January 1, 1968, and end after this date. The limitation will be prorated by computations which give to the 25-percent limit a weight equal to the number of days in the taxable year up to and including December 31, 1967, and which give to the 50-percent limit a weight equal to the number of days in the taxable year after December 31, 1967.

3. *Aircraft used outside the United States pursuant to a contract with the U.S. Government (sec. 3 of the bill and sec. 48 of the code)*

Under present law, property used outside the United States is not entitled to the investment credit except in certain specified situations. Under one of these exceptions, aircraft which is registered with the Administrator of the Federal Aviation Agency and which is operated to and from the United States is entitled to the investment credit. To qualify under this exception, the income tax regulations generally require that the aircraft return to the United States during the year with some degree of frequency.

It was pointed out to your committee that the Department of Defense is in the process of contracting for the transportation by air of personnel and cargo into and out of Vietnam from other points outside the United States. In order to furnish this service it will be necessary in some cases for the affected airlines to acquire additional airplanes. In most cases where there is a purchase of airplanes they would be used part of the time, at least, for transportation to and from the United States, and therefore would be entitled to the investment credit, even though also used for flights entirely outside the United States. However, because the use of the planes in the cases brought to your committee's attention may be almost exclusively outside the United States, they may not qualify. The unavailability of the investment credit in these cases makes it more difficult for the Defense Department to acquire the air transportation services that it needs. For the reasons given above, your committee amended the bill to provide, in effect, that where aircraft is registered by the Administrator of the Federal Aviation Agency and is operated outside the United States under a contract with the United States it is to be eligible for the investment credit. This exception is not to apply unless the use of the airplane under the contract constitutes the predominant use outside the United States. This, of course, does not mean that such an aircraft would qualify for the investment credit unless all other requirements of the law are met.

This amendment is applicable to taxable years ending after March 9, 1967.

IV. CHANGES IN EXISTING LAW

In compliance with subsection (4) of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown roman):

INTERNAL REVENUE CODE OF 1954

CHAPTER 1—NORMAL TAXES AND SURTAXES

Subchapter A—Determination of Tax Liability

* * * * *

PART IV—CREDITS AGAINST TAX

* * * * *

Subpart B—Rules for Computing Credit for Investment in Certain Depreciable Property

Sec. 46. Amount of credit.

Sec. 47. Certain dispositions, etc., of section 38 property.

Sec. 48. Definitions; special rules.

[Sec. 46]

SEC. 46. AMOUNT OF CREDIT.

[Sec. 46(a)]

(a) DETERMINATION OF AMOUNT.—

(1) GENERAL RULE.—The amount of the credit allowed by section 38 for the taxable year shall be equal to 7 percent of the qualified investment (as defined in subsection (c)).

(2) LIMITATION BASED ON AMOUNT OF TAX.—Notwithstanding paragraph (1), the credit allowed by section 38 for the taxable year shall not exceed—

(A) so much of the liability for tax for the taxable year as does not exceed \$25,000, plus

[(B) for taxable years ending on or before the last day of the suspension period (as defined in section 48(j)), 25 percent of so much of the liability for tax for the taxable year as exceeds \$25,000, or

[(C) for taxable years ending after the last day of such suspension period, 50 percent of so much of the liability for the taxable year as exceeds \$25,000.]

(B) for taxable years ending before January 1, 1968, 25 percent of so much of the liability for tax for the taxable year as exceeds \$25,000, or

(C) for taxable years ending after December 31, 1967, 50 percent of so much of the liability for tax for the taxable year as exceeds \$25,000.

[In applying subparagraph (C) to a taxable year beginning on or before the last day of such suspension period and ending after the last day of such suspension period, the percent referred to in such subparagraph shall be the sum of 25 percent plus the percent which bears the same ratio to 25 percent as the number of days in such year after the last day of the suspension period bears to the total number of days in such year.] *In applying subparagraph (C) to a taxable year beginning before January 1, 1968, and ending after December 31, 1967, the percent referred to in such subparagraph shall be the sum of 25 percent plus the percent which bears the same ratio to 25 percent as the number of days in such year after December 31, 1967, bears to the total number of days in such year.* The amount otherwise determined under this paragraph shall be reduced (but not below zero) by the credit which would have been allowable under paragraph (1) for such taxable year with respect to suspension period property but for the application of section 48(h)(1).

(3) LIABILITY FOR TAX.—For purposes of paragraph (2), the liability for tax for the taxable year shall be the tax imposed by this chapter for such year, reduced by the sum of the credits allowable under—

- (A) section 33 (relating to foreign tax credit),
- (B) section 35 (relating to partially tax-exempt interest),
- and
- (C) section 37 (relating to retirement income).

For purposes of this paragraph, any tax imposed for the taxable year by section 531 (relating to accumulated earnings tax), section 541 (relating to personal holding company tax), or section 1378 (relating to tax on certain capital gains of subchapter S corporations) and any additional tax imposed for the taxable year by section 1351(d)(1) (relating to recoveries of foreign expropriation losses), shall not be considered tax imposed by this chapter for such year.

* * * * *

SEC. 48. DEFINITIONS; SPECIAL RULES.

(a) SECTION 38 PROPERTY.—

(1) IN GENERAL.—Except as provided in this subsection, the term “section 38 property” means—

- (A) tangible personal property, or
- (B) other tangible property (not including a building and its structural components) but only if such property—
 - (i) is used as an integral part of manufacturing, production, or extraction or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or
 - (ii) constitutes a research or storage facility used in connection with any of the activities referred to in clause (i), or
- (C) elevators and escalators, but only if—
 - (i) the construction, reconstruction, or erection of the elevator or escalator is completed by the taxpayer after June 30, 1963, or
 - (ii) the elevator or escalator is acquired after June 30, 1963, and the original use of such elevator or escalator commences with the taxpayer and commences after such date.

Such term includes only property with respect to which depreciation (or amortization in lieu of depreciation) is allowable and having a useful life (determined as of the time such property is placed in service) of 4 years or more.

(2) PROPERTY USED OUTSIDE THE UNITED STATES.—

(A) IN GENERAL.—Except as provided in subparagraph (B), the term “section 38 property” does not include property which is used predominantly outside the United States.

(B) EXCEPTIONS.—Subparagraph (A) shall not apply to—

- (i) any aircraft which is registered by the Administrator of the Federal Aviation Agency and which is operated to and from the United States *or is operated under contract with the United States*;
- (ii) rolling stock, of a domestic railroad corporation subject to part I of the Interstate Commerce Act, which is used within and without the United States;
- (iii) any vessel documented under the laws of the United States which is operated in the foreign or domestic commerce of the United States;

(iv) any motor vehicle of a United States person (as defined in section 7701(a)(30)) which is operated to and from the United States;

(v) any container of a United States person which is used in the transportation of property to and from the United States;

(vi) any property (other than a vessel or an aircraft) of a United States person which is used for the purpose of exploring for, developing, removing, or transporting resources from the outer Continental Shelf (within the meaning of section 2 of the Outer Continental Shelf Lands Act, as amended and supplemented; 43 U.S.C., sec. 1331); and

(vii) any property which is owned by a domestic corporation (other than a corporation entitled to the benefits of section 931 or 934(b)) or by a United States citizen (other than a citizen entitled to the benefits of section 931, 932, 933, or 934(c)) and which is used predominantly in a possession of the United States by such a corporation or such a citizen, or by a corporation created or organized in, or under the law of, a possession of the United States.

* * * * *

(h) **SUSPENSION OF INVESTMENT CREDIT.**—For purposes of this subpart—

(1) **GENERAL RULE.**—Section 38 property which is suspension period property shall not be treated as new or used section 38 property.

(2) **SUSPENSION PERIOD PROPERTY DEFINED.**—Except as otherwise provided in this subsection and subsection (i), the term “suspension period property” means section 38 property—

(A) the physical construction, reconstruction, or erection of which begins either during the suspension period or pursuant to an order placed during such period, or

(B) which is acquired by the taxpayer either during the suspension period or pursuant to an order placed during such period.

(3) **BINDING CONTRACTS.**—To the extent that any property is constructed, reconstructed, erected, or acquired pursuant to a contract which was, on October 9, 1966, and at all times thereafter, binding on the taxpayer, such property shall not be deemed to be suspension period property.

(4) **EQUIPPED BUILDING RULE.**—If—

(A) pursuant to a plan of the taxpayer in existence on October 9, 1966 (which plan was not substantially modified at any time after such date and before the taxpayer placed the equipped building in service), the taxpayer has constructed, reconstructed, erected, or acquired a building and the machinery and equipment necessary to the planned use of the building by the taxpayer, and

(B) more than 50 percent of the aggregate adjusted basis of all the property of a character subject to the allowance for depreciation making up such building as so equipped is

attributable to either property the construction, reconstruction, or erection of which was begun by the taxpayer before October 10, 1966, or property the acquisition of which by the taxpayer occurred before such date.

then all section 38 property comprising such building as so equipped (and any incidental section 38 property adjacent to such building which is necessary to the planned use of the building) shall be treated as section 38 property which is not suspension period property. For purposes of subparagraph (B) of the preceding sentence, the rules of paragraphs (3) and (6) shall be applied. For purposes of this paragraph, a special purpose structure shall be treated as a building.

(5) PLANT FACILITY RULE.—

(A) GENERAL RULE.—If—

(i) pursuant to a plan of the taxpayer in existence on October 9, 1966 (which plan was not substantially modified at any time after such date and before the taxpayer placed the plant facility in service), the taxpayer has constructed, reconstructed or erected a plant facility, and either

(ii) the construction, reconstruction, or erection of such plant facility was commenced by the taxpayer before October 10, 1966, or

(iii) more than 50 percent of the aggregate adjusted basis of all the property of a character subject to the allowance for depreciation making up such plant facility is attributable to either property the construction, reconstruction or erection of which was begun by the taxpayer before October 10, 1966, or property the acquisition of which by the taxpayer occurred before such date, then all section 38 property comprising such plant facility shall be treated as section 38 property which is not suspension period property. For purposes of clause (iii) of the preceding sentence, the rules of paragraphs (3) and (6) shall be applied.

(B) PLANT FACILITY DEFINED.—For purposes of this paragraph, the term “plant facility” means a facility which does not include any building (or of which buildings constitute an insignificant portion) and which is—

(i) a self-contained, single operating unit or processing operation,

(ii) located on a single site, and

(iii) identified, on October 9, 1966, in the purchasing and internal financial plans of the taxpayer as a single unitary project.

(C) SPECIAL RULE.—For purposes of this subsection, if—

(i) a certificate of convenience and necessity has been issued before October 10, 1966, by a Federal regulatory agency with respect to two or more plant facilities which are included under a single plan of the taxpayer to construct, reconstruct or erect such plant facilities, and

(ii) more than 50 percent of the aggregate adjusted basis of all the property of a character subject to the allowance for depreciation making up such plant facilities is attributable to either property the construction, reconstruction, or erection of which was begun by the tax-

payer before October 10, 1966, or property the acquisition of which by the taxpayer occurred before such date,

such plant facilities shall be treated as a single plant facility.

(D) COMMENCEMENT OF CONSTRUCTION.—For purposes of subparagraph (A)(ii), the construction, reconstruction, or erection of a plant facility shall not be considered to have commenced until construction, reconstruction, or erection has commenced at the site of such plant facility. The preceding sentence shall not apply if the site of such plant facility is not located on land.

(6) MACHINERY OR EQUIPMENT RULE.—Any piece of machinery or equipment—

(A) more than 50 percent of the parts and components of which (determined on the basis of cost) were held by the taxpayer on October 9, 1966, or are acquired by the taxpayer pursuant to a binding contract which was in effect on such date, for inclusion or use in such piece of machinery or equipment, and

(B) the cost of the parts and components of which is not an insignificant portion of the total cost, shall be treated as property which is not suspension period property.

(7) CERTAIN LEASE-BACK TRANSACTIONS, ETC.—Where a person who is a party to a binding contract described in paragraph (3) transfers rights in such contract (or in the property to which such contract relates) to another person but a party to such contract retains a right to use the property under a lease with such other person, then to the extent of the transferred rights such other person shall, for purposes of paragraph (3), succeed to the position of the transferor with respect to such binding contract and such property. The preceding sentence shall apply, in any case in which the lessor does not make an election under subsection (d), only if a party to such contract retains a right to use the property under a long-term lease.

(8) CERTAIN LEASE AND CONTRACT OBLIGATIONS.—Where, pursuant to a binding lease or contract to lease in effect on October 9, 1966, a lessor or lessee is obligated to construct, reconstruct, erect, or acquire property specified in such lease or contract, any property so constructed, reconstructed, erected, or acquired by the lessor or lessee which is section 38 property shall be treated as property which is not suspension period property. In the case of any project which includes property other than the property to be leased to such lessee, the preceding sentence shall be applied, in the case of the lessor, to such other property only if the binding leases and contracts with all lessees in effect on October 9, 1966, cover real property constituting 25 percent or more of the project (determined on the basis of rental value). For purposes of the preceding sentences of this paragraph, in the case of any project where one or more vendor-vendee relationships exist, such vendors and vendees shall be treated as lessors and lessees. Where, pursuant to a binding contract in effect on October 9, 1966, (i) the taxpayer is required to construct, reconstruct, erect, or acquire property specified in the contract, to be used to produce one or more products, and (ii) the other

party is required to take substantially all of the products to be produced over a substantial portion of the expected useful life of the property, then such property shall be treated as property which is not suspension period property. Clause (ii) of the preceding sentence shall not apply if a political subdivision of a State is the other party to the contract and is required by the contract to make substantial expenditures which benefit the taxpayer.

(9) CERTAIN TRANSFERS TO BE DISREGARDED.—

(A) If property or rights under a contract are transferred in—

(i) a transfer by reason of death, or

(ii) a transaction as a result of which the basis of the property in the hands of the transferee is determined by reference to its basis in the hands of the transferor by reason of the application of section 332, 351, 361, 371(a), 374(a), 721, or 731,

and such property (or the property acquired under such contract) would not be treated as suspension period property in the hands of the decedent or the transferor, such property shall not be treated as suspension period property in the hands of the transferee.

(B) If—

(i) property or rights under a contract are acquired in a transaction to which section 334(b)(2) applies,

(ii) the stock of the distributing corporation was acquired before October 10, 1966, or pursuant to a binding contract in effect October 9, 1966, and

(iii) such property (or the property acquired under such contract) would not be treated as suspension period property in the hands of the distributing corporation, such property shall not be treated as suspension period property in the hands of the distributee.

(10) PROPERTY ACQUIRED FROM AFFILIATED CORPORATION.—

For purposes of this subsection, in the case of property acquired by a corporation which is a member of an affiliated group from another member of the same group—

(A) such corporation shall be treated as having acquired such property on the date on which it was acquired by such other member,

(B) such corporation shall be treated as having entered into a binding contract for the construction, reconstruction, erection, or acquisition of such property on the date on which such other member entered into a contract for the construction, reconstruction, erection, or acquisition of such property, and

(C) such corporation shall be treated as having commenced the construction, reconstruction, or erection of such property on the date on which such other member commenced such construction, reconstruction, or erection.

For purposes of the preceding sentence, the term "affiliated group" has the meaning assigned to it by section 1504(a), except that all corporations shall be treated as includible corporations (without any exclusion under section 1504(b)).

(11) **CERTAIN TANGIBLE PROPERTY CONSTRUCTED DURING SUSPENSION PERIOD AND LEASED NEW THEREAFTER.**—Tangible personal property constructed or reconstructed by a person shall not be suspension period property if—

(A) such person leases such property after the close of the suspension period and the original use of such property commences after the close of such period,

(B) such construction or reconstruction, and such lease transaction, was not pursuant to an order placed during the suspension period, and

(C) an election is made under subsection (d) with respect to such property which satisfies the requirements of such subsection.

(12) **WATER AND AIR POLLUTION CONTROL FACILITIES.**—

(A) **IN GENERAL.**—Any water pollution control facility or air pollution control facility shall be treated as property which is not suspension period property.

(B) **WATER POLLUTION CONTROL FACILITY.**—For purposes of subparagraph (A), the term “water pollution control facility” means any section 38 property which—

(i) is used primarily to control water pollution by removing, altering, or disposing of wastes, including the necessary intercepting sewers, outfall sewers, pumping, power, and other equipment, and their appurtenances; and

(ii) is certified by the State water pollution control agency (as defined in section 13(a) of the Federal Water Pollution Control Act) as being in conformity with the State program or requirements for control of water pollution and is certified by the Secretary of Interior as being in compliance with the applicable regulations of Federal agencies and the general policies of the United States for cooperation with the States in the prevention and abatement of water pollution under the Federal Water Pollution Control Act.

(C) **AIR POLLUTION CONTROL FACILITY.**—For purposes of subparagraph (A), the term “air pollution control facility” means any section 38 property which—

(i) is used primarily to control atmospheric pollution or contamination by removing, altering, or disposing of atmospheric pollutants or contaminants; and

(ii) is certified by the State air pollution control agency (as defined in section 302(b) of the Clean Air Act) as being in conformity with the State program or requirements for control of air pollution and is certified by the Secretary of Health, Education, and Welfare as being in compliance with the applicable regulations of Federal agencies and the general policies of the United States for cooperation with the States in the prevention and abatement of air pollution under the Clean Air Act.

(D) **STANDARDS FOR FACILITY.**—Subparagraph (A) shall apply in the case of any facility only if the taxpayer constructs, reconstructs, erects, or acquires such facility in furtherance of Federal, State, or local standards for the

control of water pollution or atmospheric pollution or contaminants.

(13) **CERTAIN REPLACEMENT PROPERTY.**—Section 38 property constructed, reconstructed, erected, or acquired by the taxpayer shall be treated as property which is not suspension period property to the extent such property is placed in service to replace property which was—

(A) destroyed or damaged by fire, storm, shipwreck, or other casualty, or

(B) stolen,

but only to the extent the basis (in the case of new section 38 property) or cost (in the case of used section 38 property) of such section 38 property does not exceed the adjusted basis of the property destroyed, damaged, or stolen.

(i) **EXEMPTION FROM SUSPENSION OF \$20,000 OF INVESTMENT.**—

(1) **IN GENERAL.**—In the case of property acquired by the taxpayer by purchase for use in his trade or business which would (but for this subsection) be suspension period property, the taxpayer may select items to which this subsection applies, to the extent of an aggregate cost, for the suspension period, of \$20,000. Any item so selected shall be treated as property which is not suspension period property for purposes of this subpart (other than for purposes of paragraphs (4), (5), (6), (7), (8), (9), and (10) of subsection (h)).

(2) **APPLICABLE RULES.**—Under regulations prescribed by the Secretary or his delegate, rules similar to the rules provided by paragraphs (2) and (3) of subsection (c) shall be applied for purposes of this subsection. Subsection (d) shall not apply with respect to any item to which this subsection applies.

(j) **SUSPENSION PERIOD.**—For purposes of this subpart, the term “suspension period” means the period beginning on October 10, 1966, and ending on **[December 31, 1967]** *March 9, 1967*.

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SEC. 167. DEPRECIATION.

(a) **GENERAL RULE.**—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

(b) **USE OF CERTAIN METHODS AND RATES.**—For taxable years ending after December 31, 1953, the term “reasonable allowance” as used in subsection (a) shall include (but shall not be limited to) an allowance computed in accordance with regulations prescribed by the Secretary or his delegate, under any of the following methods:

(1) the straight line method.

(2) the declining balance method, using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the method described in paragraph (1),

(3) the sum of the years-digits method, and

(4) any other consistent method productive of an annual allowance which, when added to all allowances for the period commencing with the taxpayer’s use of the property and including the taxable year, does not, during the first two-thirds of the useful

life of the property, exceed the total of such allowances which would have been used had such allowances been computed under the method described in paragraph (2).

Nothing in this subsection shall be construed to limit or reduce an allowance otherwise allowable under subsection (a).

(c) **LIMITATIONS ON USE OF CERTAIN METHODS AND RATES.**— Paragraphs (2), (3), and (4) of subsection (b) shall apply only in the case of property (other than intangible property) described in subsection (a) with a useful life of 3 years or more—

(1) the construction, reconstruction, or erection of which is completed after December 31, 1953, and then only to that portion of the basis which is properly attributable to such construction, reconstruction, or erection after December 31, 1953, or

(2) acquired after December 31, 1953, if the original use of such property commences with the taxpayer and commences after such date.

* * * * *

(i) **LIMITATION IN CASE OF PROPERTY CONSTRUCTED OR ACQUIRED DURING THE SUSPENSION PERIOD.**—

(1) **IN GENERAL.**—Under regulations prescribed by the Secretary or his delegate, paragraphs (2), (3), and (4) of subsection (b) shall not apply in the case of real property which is not section 38 property (as defined in section 48(a)) if—

(A) the physical construction, reconstruction, or erection of such property by any person begins during the suspension period, or

(B) an order for such construction, reconstruction, or erection is placed by any person during the suspension period. Under regulations prescribed by the Secretary or his delegate, rules similar to the rules provided by paragraphs (3), (4), (7), (8), (9), and (10) of section 48(h) shall be applied for purposes of the preceding sentence.

(2) **EXCEPTION.**—Paragraph (1) shall not apply to any item of real property selected by the taxpayer if the cost of such property (when added to the cost of all other items of real property selected by the taxpayer under this paragraph) does not exceed \$50,000. Under regulations prescribed by the Secretary or his delegate, rules similar to the rules provided by paragraph (2) of section 48(c) shall be applied for purposes of this paragraph.

(3) **SUSPENSION PERIOD.**—For purposes of this subsection, the term “suspension period” means the period beginning on October 10, 1966, and ending on **[December 31, 1967]** *March 9, 1967*.

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V. MINORITY VIEWS OF SENATOR ALBERT GORE

The "nervous Nellies" in the White House and the Treasury Department have evidently decided that a threatened slowdown in the economy requires a disorderly retreat from a previously adopted plan of fiscal policy action. It is disquieting to note that all too many currently in the tax policy kitchen cannot stand the slightest suggestion of heat from the business community, particularly big business.

Early in 1966, after it became clear to everyone that there would be an increase in capital outlays of some 17 percent over 1965, and with the knowledge that 1965 had shown an increase of some 16 percent over 1964, the administration stoutly and successfully resisted efforts by me and others to suspend the investment tax credit for a cooling-off period.

Later in the year, after most economic indicators were suggesting the beginning of an economic slowdown, or at least a leveling off, but during a money panic triggered in part by the administration's dumping of participation certificates on the market, it was insisted by the administration that national salvation lay in a suspension of the investment credit.

Now we are told that the investment credit should be restored because the latest surveys show that business plans only a modest 4-percent increase over 1966 for the current year. Clearly the 16-and 17-percent advances were unsustainable. Is a further increase of 4 percent on top of these too-rapid advances disastrous? It would seem that if a cooling-off period is desirable, such a modest advance, but still an advance from a very high level, would be a healthy factor and the cooling-off period might well be allowed to continue in effect for a few more months.

Chairman Martin of the Federal Reserve Board put the dollar figures in good perspective in testifying before the Finance Committee. He stated that special surveys conducted by the Commerce Department and by the Securities and Exchange Commission indicated that "businessmen reported that the tax law changes induced them to reduce their capital spending plans for 1967 by \$2.3 billion below what otherwise would have been spent." He was referring to last fall's suspension of the investment tax credit and accelerated depreciation for certain buildings. He went on to say that "the amounts of actual and planned spending reductions involved are small, relative to the \$60 billion annual rate at which capital outlays are running."

One must conclude, then, that either the administration fears a recession, based on factors other than the slowdown in plant and equipment expenditures, and now seeks to pump money into the corporate sector, or that the administration has merely seized this moment of apparent economic slowdown as an excuse to fatten the coffers of the large corporations by an unconscionable tax cut.

I prefer to think that the administration fears a recession, and now seeks pellmell to pump funds back into the corporate sector by way of this tax cut, primarily for the benefit of big business.

I do not subscribe to this recession theory, I am very much concerned about the burgeoning deficit. But if we can afford to forgo revenue, and if we do, in fact, need to pump up the economy, the consumer sector is more in need of stimulation.

It appears to me that we face three inescapable facts in considering this bill:

Fact No. 1: By enacting this bill we will be cutting taxes for corporations when there is no demonstrated need.

As pointed out above, there is no collapse in plant and equipment expenditures. This year will see a still further advance, although not a large one, over the too-rapid advances we experienced in 1965 and 1966.

On the other hand, although a recession is not now predictable, there has been an increasing wariness on the part of consumers. Consumer expenditures have slowed and the saving rate has jumped up markedly. Although there is no shortage in productive capacity, there is a shortage of purchasing power and if any segment of the economy needs encouragement, it is consumers.

The slowdown in the automobile industry is characterized by an excess in inventory of unsold automobiles. Would this indicate a need for a tax incentive for more automobile productive capacity or for more consumer demand for the automobiles already manufactured and for the production of which idle capacity already exists?

Fact No. 2: Cutting taxes for corporations at this time is an indication of a decision to use fiscal policy to pump up the economy. But the administration, at the same time, is inconsistently pursuing restraint in expenditures where such expenditures might be more useful. Highway funds have been impounded, and although it was recently announced that they would be released, the final release will not take place until after July 1. But we are urged to give corporations a tax break now. The Bureau of the Budget is sitting on some \$94 million badly needed for farm loans. We cannot afford to make these good loans, but we can afford to give away millions immediately to a relatively few large corporations. We must defer action to boost social security benefits for the elderly who are in dire straits. But we cannot afford to wait another month to cut corporate taxes.

One wonders whether administration spokesmen are being candid, consistent, or neither.

Fact No. 3: The enactment of this measure will kill any chance of adopting the President's proposed tax surcharge. As a result, the deficit may well approach \$20 billion for fiscal year 1968. I, for one, cannot face such a prospect with equanimity, particularly since we have continued to run deficits through the past few years of unprecedented prosperity.

In view of these facts, it seems to me that we need to look beyond this particular bill. We need to reexamine, in the light of the practicalities of political life, some of the tenets of the "new" economics.

We are all Keynesians to some degree, and I am sure that every Member of the Senate believes in the active use of the powers of government to help regulate the economy under certain circumstances. But are we capable of intelligently juggling our tax patterns and tax rates? Are we not doing more harm than good with an on-again-off-again tax policy, the only constant being continuous and increasing deficits?

To begin with, forecasting is not sufficiently precise to allow policy to be pinpointed. And, second, timing will always be questionable when political activists must be counted on to arrive at decisions, and additional political forces must be called into play to transform decisions into action.

As a matter of fact, many of our current problems can be directly traced to the massive tax cut of 1964. I am a firm believer in the active use of the powers of government to promote socially and economically worthwhile goals. But I seriously question whether we are now on the right track. Given the present state of the science of economics and the art of forecasting economic trends, and the reluctance of political forces to take the hard decisions, I think we might be well advised to set up an equitable tax system which would bring in ample revenues during normal or average times. Fiscal policy could then be implemented largely through variations in the pattern of Government expenditures.

As for this bill, it should be defeated. It does not seem to me to be wise to cut any taxes at this time, particularly for corporations. But if the decision has been made that we can and should cut taxes, and the choice is between types of taxes, it is preferable that we start in the consumer sector.

The Congress has already acted to phase out the automobile excise tax, with the exception of 1 percent. It has also decided that the excise tax on telephone service should be removed. I would propose, then, that these taxes be taken off now, rather than restore the investment credit now. I shall offer an amendment to accomplish this when the bill is debated in the Senate. But I do want to make it clear that, in my best judgment, our fiscal plight will not permit a large loss of revenue now. Defeat of the bill altogether, therefore, would be preferable.

ALBERT GORE.

