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ACT TEMPORARILY CONTINUING SURCHARGE AND EXCISES, REPEALING INVESTMENT CREDIT, ETC.

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Mr. Williams of Delaware, from the Committee on Finance submitted the following

REPORT

[To accompany H.R. 12290]

The Committee on Finance, to which was referred the bill (H.R. 12290) to continue the income tax surcharge and the excise taxes on automobiles and communication services for temporary periods, to terminate the investment credit, to provide a low-income allowance for individuals, and for other purposes, having considered the same, reports favorably thereon without amendment and recommends that the bill do pass.

I. SUMMARY

This bill (H.R. 12290) continues the anti-inflationary fiscal program of the Revenue and Expenditure Control Act of 1968. The bill provides for the following actions:

(1) It continues the existing income tax surcharge on individuals and corporations until January 1, 1970, at which time the surcharge is reduced to 5 percent and then terminated as of July 1, 1970.

(2) It postpones for 1 year the schedule reduction in the present excise taxes on passenger automobiles and communications services.

(3) It repeals the investment credit as of the end of April 18, 1969, but makes provision for construction begun and binding contracts in effect on or before that date, as well as other situations where there was a substantial commitment by that date.

(4) It provides for the 5-year amortization of air and water pollution control facilities completed or acquired in 1969 and subsequent years (except to the extent an investment credit is available and is taken with respect to them) where the facilities have been certified by the appropriate State and Federal agencies.

(5) By adopting a low-income allowance it removes from the tax rolls about 5.2 million returns near or below "poverty levels." This change is applicable to the calendar year 1970 and later years. Through the present minimum standard deduction and the new low-income allowance this provides a minimum income of $1,100 plus personal exemptions for those with families of eight or less, before any income tax is imposed.

The temporary continuation of the surcharge (although at a reduced level from January 1 on) is considered by the committee to be an essential part of any program to reduce gradually present inflationary pressures. While in the past the surcharge has not exerted the full impact on inflationary pressures intended at the time it was imposed, nevertheless, conditions are changing and the surcharge, if continued in effect together with other governmental policies, should reduce present inflationary pressures without endangering our full-employment economy. The persistence of inflationary pressures makes it clear that a continuation of the surcharge is necessary. Without the surcharge we run the serious risk of excessive economic activity and the consequent pressure on prices, a growing inflationary psychology, a shift from a projected budget surplus (in the unified budget) to a significant deficit, the necessity of increased reliance on further monetary restraint, including still higher interest rates, and greater international pressure on the dollar abroad with the possible consequence of upsetting the present international monetary stability.

The bill substitutes the repeal of the investment credit for the continuation of one-half of the surcharge from January 1, 1970, on. This action is made necessary primarily by the substantial increase (12.6 percent) in expected investments in plant and equipment in the current year and the failure of monetary policy to contain this expansion. The bill repeals rather than suspends the investment credit, because during a suspension period there not only is no special inducement to investment but also a positive deterrent to investment as well, since investments deferred become eligible for a credit at a later date. This double economic effect, combined with the administrative complexity in "turning the investment credit off and on," suggested the repeal rather than suspension of this provision was preferable. The bill also phases out the investment credits allowed in 1971 through 1974 (generally as a result of prior binding contracts or the transition rules) at the rate of one-tenth of 1 percentage point a month during this period. These reduced credits in this period better equate the situation of those with long leadtime items with those where delivery of items can be obtained on the basis of shorter periods.

The low income allowance provided by this bill will remove from the tax rolls about 5.2 million returns of those who presently are at or below the "poverty level." It was concluded that to impose tax on persons at these levels could not be justified, especially during a period when inflationary price rises were consuming their already to low incomes.

The estimated revenue gained from this bill in the fiscal year 1970 is $9.26 billion. A full analysis is presented at the end of this report in the appendix. The revenue effect of the various provisions in the fiscal year 1970 is summarized as follows:

[In billions of dollars]

Surcharge extension	+7.64
Repeal of investment credit (no exemptions)	+1.35
Excise extension	+.54
Low income allowance	-.27
Amortization of antipollution facilities	(1)
Total revenue gain	+9.26

1 Negligible in fiscal year 1970.

II. REASONS FOR BILL

A. TEMPORARY EXTENSION OF THE SURCHARGE

The committee believes the extension of the 10-percent income tax surcharge until January and then the phaseout of the surcharge at a 5-percent rate until July 1, 1970 (coupled with the other increases provided by this bill) is essential to continue the anti-inflation posture of the Revenue and Expenditure Control Act of 1968. At the same time the Senate has already expressed its view on the other important aspect of that act by placing a ceiling of $192.9 billion on expenditures (in the second supplemental appropriation bill of 1969).

Temporary extension of the surcharge, no matter how otherwise distasteful this may be, is necessary if the Congress is to supply needed fiscal restraint to aid in the containment of present inflationary pressures. Not only is this temporary continuation of the surcharge essential to limit the actual funds available for expenditures in the total economy, but also it is essential as a mark of congressional determination to bring inflation under control and to maintain the value of the dollar, both at home and abroad. An expression of this determination, through the temporary continuation of the surcharge, is essential to the reversal of the present psychology of inflation, which feeds on its own expectation of price increases, thereby creating its own demand for still further wage and price increases.

1. Restraint of the 1968 surcharge

Reasons for slowness of effect.—While in the past the surcharge has exerted a useful restraint on the economy and prices, it is clear that it has not yet exerted the full impact intended at the time it was imposed. In part, this lack of effectiveness was due to the unfortunate easing of monetary policy in the last half of 1968 which offset some of the restraining effect of the surcharge. This policy was reversed about the first of 1969, however, and should, therefore, no longer deter the effectiveness of the surcharge if it is continued until next June.

In part, the slowness of the effect of the surcharge has been attributable to the extent of the growth of inflationary pressures during the long period before it was possible to obtain sufficient expenditure restraint. These pressures increased the length of the time which otherwise would have elapsed before the effects of fiscal action are generally felt. In the case of the surcharge, the time lag in consumer response has been substantially longer than the one which followed the 1964 tax reduction. The impact of the surcharge was delayed because consumers did not initially reduce their spending as their disposable incomes decreased; instead their first response was to reduce their rate of saving.

Present evidence of effect of surcharge.—Nevertheless, there is evidence that the 1968 surcharge has had a restraining effect. The rate of increase in the gross national product, for example, has slowed down from 10.9 percent in the quarter of 1968 in which the surcharge was enacted to 7.4 percent in the first quarter of this year.

TABLE 1.—*Annual rate of increase in GNP (seasonally adjusted change from previous quarter)*

Year and quarter:	Percent increase over prior quarter
1968:	
I	10.3
II	10.9
III	8.8
IV	7.7
1969: I	7.4

At the same time there is evidence that because of the surcharge, consumption is less than otherwise might be expected; had consumers spent the same percentage of personal income after imposition of the surcharge as they did in the prior four quarters, consumption would have been higher in each quarter after mid-1968, with the increase amounting to about $6 billion by the first quarter of 1969. The administration has indicated that the cumulative effect on the gross national product of this higher level of consumption, taking account of the normal multiplier effect of higher consumption, would have been to raise the gross national product by some $11 billion. It is reasonable to assume that this higher level of product would have exerted even greater pressure on prices, and the rate of inflation would have been even higher than that which actually has taken place.

2. Persistence of inflationary pressures

Even though it is evident that the surcharge has provided some restraint, it also is evident that the problem of inflation still exists. The gross national product and prices are still increasing at excessive rates. The increase in prices has, in fact, accounted for a large portion of the increase in gross national product. This can be seen by comparing the increases in current dollar and real gross national product since the first quarter of 1968. As shown in table 2, over this period the real (or constant dollar) increase in gross national product has been only 43 percent of the current dollar increase and the proportion has been steadily declining, reaching less than one-third for the first quarter of 1969 increase. Prices, of course, are much slower to respond to fiscal restraint than is the gross national product. Our experience has been that there is an appreciable lag between the time the rate of increase in output slows and price increases begin to moderate. This suggests that the current slowdown in the rate of growth of gross national product can be expected to be reflected in a slower rate of inflation later in the year, but only if the present policy of fiscal restraint is maintained.

TABLE 2.—QUARTERLY INCREASES IN GNP IN CURRENT AND CONSULTANT DOLLARS (BILLIONS OF DOLLARS SEASONALLY ADJUSTED ANNUAL RATES)

Yearend quarter	Increase in current dollar GNP over previous quarter (1)	Increase in real GNP over previous quarter (1958 prices) (2)	Real GNP increase as a percent of current dollar increase (2)+(1) (3)
1968:			
II	21.7	10.7	49.3
III	18.1	8.9	49.2
IV	16.4	6.1	37.2
1969: I	15.9	5.1	32.1
1968 I to 1969 I	72.1	30.8	42.7

Prices have been increasing at both the wholesale and retail levels and, recently, the increases have accelerated. Wholesale prices, which have increased by 4 percent since last year, have increased at a rate of 6 percent since February. Moreover, between April and May they spurted upward by eight-tenths of 1 percent, an annual rate of increase of nearly 10 percent. Similarly, the consumer price index, which has increased 5.4 percent since last April, has increased at an annual rate of 7.4 percent since January of this year. Between March and April, the annual rate increase was still higher; namely, 7.6 percent.

Although the increase in consumption and real gross national product has moderated in recent months, industrial production is still expanding at a substantial rate. The index of industrial production has increased by 5.2 percent since May of last year but between April and May increased by six-tenths of one percent, or at an annual rate of nearly 7 percent.

TABLE 3.—CONSUMER PRICE INDEX, WHOLESALE PRICE INDEX, AND INDEX OF INDUSTRIAL PRODUCTION, MONTHLY SINCE MAY 1968

	Consumer price index (1957-59=100)	Wholesale price index (1957-59=100)	Index of industrial production (1957-59=100)
1968:			
May	120.3	108.5	164.2
June	120.9	108.7	165.8
July	121.5	109.1	166.0
August	121.9	108.7	164.6
September	122.2	109.1	165.1
October	122.9	109.1	166.0
November	123.4	109.6	167.5
December	123.7	109.8	168.7
1969:			
January	124.1	110.7	169.1
February	124.6	111.1	170.1
March	125.6	111.7	171.3
April	126.4	111.9	171.8
May	(1)	[2] 112.8	[2] 172.8

[1] Not available.
[2] Preliminary.

3. *Consequences of no action*

The continuation of the present surcharge until next January (and then phasing it out at a lesser rate for the next 6 months) was a step the committee took with reluctance, because it does not like to continue, even temporarily, the present heavy tax burdens. Nevertheless, it recognized that the consequences of failing to extend the surcharge were much worse. These consequences could be catastrophic: the creation of an excessive level of economic activity and consequent pressure on prices; an inflationary psychology; a shift from a projected unified budget surplus to a deficit; increasing monetary restraint and still higher interest rates; and greater international pressure on the dollar resulting from a higher level of imports and the reaction of foreign dollar holders to lack of fiscal responsibility. It should also be borne in mind that the change which would occur in the case of the "administrative budget" in the absence of this bill would be an increase in this deficit of from $5.4 billion to $14.6 billion.

On excessive economic activity.—The effect on economic activity which may result from a failure to extend the surcharge (in combination with the failure to repeal the investment credit and extend the present excise tax rates) can be analyzed by examining the revenue impact of the bill. The estimated increase in revenue from the committee's bill is $9.26 billion for fiscal year 1970. This suggests growth in gross national product by the end of fiscal 1970, if the proposal is not adopted, of more than $9 billion even before the multiplier effect is taken into account. Such additional demand clearly would exert considerable pressure on prices. Projections indicate that by the second half of 1969, in the absence of this revenue measure, quarterly increases in gross national product might approach an 8 percent annual rate—at least twice the rate of any real increase in capacity which could occur. Moreover, as indicated below, the inflationary psychology, enlarged and expanded by the failure to extend the surcharge, might well cause price increases to occur sooner than the increase in demand alone would imply. In fact, the pressure on prices resulting from failure to extend the surcharge would probably occur during the very period the price increases could be expected to slow down in response to the current easing of demand pressures—if the surcharge is temporarily continued. In other words, failure to extend the surcharge in 1969 would be likely to nullify the effect on prices the 1968 surcharge otherwise would have had.

On inflationary psychology.—The committee believes that "inflationary psychology" is extremely important in the present situation. The way in which inflationary psychology has operated and is likely to continue operating, if the surcharge is not extended, is through the actions of workers and businesses to protect themselves from decreasing real incomes. Wage demands would tend to be larger, in order to offset expected price increases and businessmen would stockpile inventory. Actions like these would increase costs and businesses would attempt to pass these on in higher prices. In addition, businesses, anticipating future price increases, would attempt to raise their prices enough to cover these increases as well as those that have already taken place. Prospects of significantly higher prices for plant and equipment in the near future would also encourage businesses to invest now rather than later and, in this manner, contribute further to the excessive demand. This process is the all too familiar wage-price spiral which has proved so difficult to stop in the past, but which can be controlled by the continued application of fiscal restraint.

If the surcharge is not extended, this psychology, which already has gained momentum, will be reinforced and contribute to a further acceleration of inflation. Once the economy generates momentum in a particular direction, it becomes increasingly difficult to slow it down quickly or easily. The committee believes that in this situation the policy of the Government should be that of maintaining a high level of revenues, as is provided by this bill, and of closely controlling Government expenditures. The committee believes that such a policy will not lead to an increase in unemployment or the possibility of "overkill" in the present situation.

When a balanced policy of the type indicated above is followed, it may take some time to become effective. It may also take time for the public to become convinced that it will work. It appears that we are at the point now where part of the public is convinced that there will be a lessening of price increases in the future and part of the public remains skeptical. If the surcharge is extended and the investment credit repealed, this should not only directly reduce inflationary pressures, but also gradually remove the inflationary psychology, as more and more people become convinced that inflation will be controlled. If workers and businesses do not believe that inflation will be controlled, they can be expected to act in ways that will make inflation far more difficult to control. In the absence of the surcharge extension, their expectations could become a self-fulfilling prophecy. But with the extension of the surcharge, the committee is thoroughly convinced that there will be no basis for this inflationary psychology.

On the impact on the budget.—The impact on the Federal budget for the fiscal year 1970 of failing to extend the surcharge (and failing to repeal the investment credit and extend the excise taxes) would be a shift from a projected surplus of $5.2 billion to a deficit of $4.0 billion in the unified budget, based on the administration's May 20 expenditure figures, the receipts provided by present law and the revenue gain from the bill. If the Federal funds accounts are used—formerly referred to as the administrative budget—a projected deficit of $5.1 billion for the year would be increased to a deficit of $14.3 billion. The projected budget surplus (+) or deficit (−) with, and without the committee's bill, is as follows:

[In billions of dollars]

	Projections with bill	Projections without bill
Federal funds (administrative budget)	−5.1	−14.3
Trust funds	+10.3	+10.3
Unified budget	+5.2	−4.0

In addition to shifting the budget from a restraining influence to an expansive one, the absence of the revenue from these tax proposals would have a highly undesirable effect on the money markets. It would mean that the Government would become a net borrower of funds in the money market rather than a source of funds to offset borrowing of others. This shift would impose additional pressure on an already tight money market and would drive interest rates even higher. The failure to provide the revenues involved in this bill would also require an upward revision of the present debt ceiling of $377 billion which was established by the committee on the explicit assumption that the surcharge would be extended.

On the effect of monetary policy.—Another consequence of not extending the surcharge would be to shift the burden of restraining the economy still more heavily toward monetary policy. Monetary policy, however, might find it virtually impossible to assume this burden, given the already record interest rates. Such a shift would require still higher interest rates in an attempt to ration a still smaller supply of credit. Higher interest rates ration the available supply of credit, not necessarily according to the needs of the economy, but rather according to who can best pay the higher cost of credit, which often depends on the ability of the borrower to pass the higher interest costs along to others. This type of credit rationing would have serious consequences for small business, housing, and State and local financing—perhaps more serious than those observed in the 1966 "credit crunch."

In short, the monetary authorities, in the absence of the surcharge extension, might well be forced to choose between two highly undesirable positions: Driving interest rates to unprecedented levels that would seriously distort the economy, or not tightening credit enough to restrain further massive inflationary increases.

On our international balance-of-payments position.—The impact on the international position of the dollar of not continuing the surcharge clearly would be serious. The international monetary system in recent years has been through some difficult times and its current stability and future prospects, to a significant extent, depend on how foreign holders of dollars view the ability and willingness of the United States to bring its inflation under control by appropriate fiscal restraint. The reactions of these holders in 1968 to the initial imposition of the surcharge was clear evidence of the importance they attach to our actions with respect to the surcharge. These foreign holders of dollar balances will be much more willing to continue their holdings—rather than move to gold or other strong currencies—if they believe we will follow an economic policy of fiscal and monetary restraint in order to reduce our level of imports relative to our exports.

Should Congress indicate its unwillingness to follow a policy of restraint by refusing to extend the surcharge, and the inflation is not contained, but instead accelerates, it can be expected that this will have an adverse effect on our balance of payments. If our prices rise relatively faster than prices abroad, imports will be priced more attractively than domestic products. At the same time our exports, which would then cost more, will be less attractive to foreigners than goods from other countries. The severity of our balance of payments is underlined by examining the trend in the balance of our merchandise trade in recent years. Traditionally, a favorable balance in this account has offset unfavorable balances in other accounts, such as services. However, our favorable merchandise balance has consistently declined in recent years from a balance of $6.6 billion in 1964 to a balance of $3.5 billion in 1967. Then, as our prices rose in 1968, the balance declined much more rapidly to a scant $100 million in 1968 and during the first quarter of 1969 declined still further to a negative balance of $1.2 billion on an annual rate basis (although this latter decline was partially due to the east coast dock strike).

TABLE 4.—MERCHANDISE BALANCE OF TRADE

[In millions of dollars]

	Exports	Imports	Balance
1964	25,297	18,648	+6,649
1965	26,244	21,516	+4,728
1966	29,174	25,539	+3,635
1967	30,463	26,983	+3,480
1968	33,373	33,273	+100
1969 (1st quarter annual rate)	29,504	30,716	−1,212

Unless the inflationary pressures are brought under control it can be expected that our imports will continue to increase more rapidly than our exports and our balance of payments position will continue to deteriorate.

Should the present trends be allowed to continue and especially if they accelerate, dollars would become increasingly unattractive for foreigners to hold. The result could be expected to be increased pressure on the dollar and on our gold stocks. This pressure could increase the drain on our gold supply making it increasingly difficult to maintain the present price of gold.

The importance of the dollar as a reserve currency has been an important factor in the willingness of foreigners to hold dollars and, of course, is an important reason for our maintaining the confidence of the world in the stability of the dollar. This becomes increasingly important since we are currently working to increase the supply of foreign exchange reserves through the implementation of the Special Drawing Rights of the International Monetary Fund. The deterioration of the dollar's role as a reserve currency and the failure to provide increasing foreign exchange reserves would inhibit the expansion of world trade, including U.S. exports. The committee believes we must not risk these consequences for the international exchange system by failing to extend the surcharge.

4. Expenditure control

In conjunction with the imposition of the surcharge, the Revenue and Expenditure Control Act of 1968 required a reduction of $6 billion in the amount of Federal expenditures proposed for fiscal year 1969 in the January budget. The same considerations which led the Congress to endorse expenditure reductions at the time the surcharge was imposed point to the desirability of expenditure control now at the time of the extension of the surcharge. Continuation of the surcharge without expenditure control would permit expenditures to increase and offset the anti-inflationary effects of the surcharge. While no such limitation is included in this bill, the Senate has, in fact, already acted to impose expenditure limits for fiscal year 1970. In the second supplemental appropriations bill of 1969, expenditures in fiscal 1970 were limited by Congress to $191.9 billion, $1 billion less than the administration's estimate of budget outlays for fiscal year 1970, as revised on April 15, 1969. In addition, the Congress action placed a dollar limit of $2 billion as to the extent to which the President could adjust the ceiling for social insurance trust funds, veterans pensions compensation and insurance, interest, and farm price supports (CCC).

5. Revenue effect of continuation of the surcharge

It is anticipated that the revenue effect of continuing the surcharge in the form reported by the committee will be to increase receipts by $7.6 billion in the fiscal year 1970, with $5.6 billion of this being attributable to individuals and $2.0 billion to corporations.

In the fiscal year 1971 there will be no increase in tax liabilities attributable to the continuation of the surcharge since the surcharge (at the 5-percent rate) is terminated as of the beginning of that fiscal year. However, because of the lag in collections behind the time of imposition of the tax it is expected that the surcharge will account for $1.2 billion of collections in the fiscal year 1971, of which $.4 billion will be attributable to individuals and $0.8 billion attributable to corporations.

As a result the continuation of the surcharge for 1 year, as provided by this bill (at 10 percent until January 1 and 5 percent from that date until June 30), is expected to result in additional revenue collections over the 2 fiscal years, 1970 and 1971, of $8.9 billion, of which $6.0 billion is attributable to individuals and $2.9 billion to corporations.

B. CONTINUATION OF PRESENT EXCISE TAXES ON PASSENGER AUTOMOBILES AND COMMUNICATIONS SERVICES

At a time when economic conditions require the continuation of the surcharge on individual and corporate income taxes at a rate of 10 or 5 percent for another year, the committee concluded that it would be inappropriate to permit scheduled excise tax reductions during this period to occur. For that reason this bill provides for the continuation of the 7 percent manufacturer's automobile excise tax for another year, or until January 1, 1971. It also provides for the postponement of the reductions in the automobile excise tax scheduled for future years for 1 additional year in each case. On a similar basis, the bill provides for a continuation of the communications service tax on local and toll telephone and teletypewriter exchange services. The present 10 percent tax under the bill will be continued for another year, or until January 1, 1971. Future scheduled reductions also will occur 1 year later than provided under present law.

It is estimated that the continuation of these excise taxes at present rates for 1 more year will result in a revenue increase of $540 million in the fiscal year 1970, of which $300 million is attributable to the passenger automobile tax and $240 million to the tax on communication services. In the fiscal year 1971 these extensions are expected to raise revenues by $1.07 billion of which $540 million is attributable to the passenger automobile excise tax and $530 million to the excise tax on communication services.

C. REPEAL OF THE INVESTMENT CREDIT

The bill substitutes for the one-half of the surcharge from January 1970 on, the repeal of the investment tax credit. In taking this action, it was recognized that the stimulus to investment, which this credit provides, contributes directly to increasing present inflationary pressures. It was also concluded that a tax credit of this type which encourages spending for investments is inappropriate and inconsistent with national economic policy that applies a surcharge on individual and corporation income tax liabilities, in part at least, to restrain spending by business and consumers. The evidence of present heavy expenditures in the investment sector of the economy suggests that the removal of this special inducement to spending will be of special assistance in bringing inflation under control. Moreover, the revenue it provides makes possible the reduction of the income tax surcharge from 10 percent to 5 percent on January 1, 1970, rather than continuing the full 10 percent rate until June 30, 1970.

Although the investment credit was a stimulus to investment designed to increase our capital investment during the period of lagging demand during the early 1960's, sustained full employment has eliminated the need for this type of encouragement to investment. Businessmen, in response to the credit and other factors, have spent almost $400 billion on plant and equipment since 1962. Moreover, in the period since the enactment of the credit, the economy has been brought to full employment, the level of business investment has been raised, productive capacity has been expanded, and efficiency of production has reached very high levels. Continuously expanding markets and high profit levels should provide sufficient investment incentive in the future even without the investment credit.

The repeal of the credit is particularly desirable at this time because the credit is contributing to a level of investment which is unsustainable and is exerting substantial inflationary pressure. In short, the credit has fulfilled its purpose of increasing investment during a period of slack demand and has "outlived its usefulness" as a longrun stimulant to investment.

Continued availability of the investment credit during the present inflationary period serves to offset the effects of anti-inflationary fiscal and monetary policies. While tight money, budgetary surpluses, and higher taxes generally serve to discourage investment during an inflationary period, the investment credit significantly reduces their effects. Tight monetary policy is partially neutralized because the investment credit increases the supply of internal funds and reduces a firm's need to enter the money market to finance new investment. Higher taxes tend to reduce the internal supply of funds, but the investment credit tends to restore the supply. As a result, business firms can advance their investment plans to get ahead of anticipated higher prices in the near future, and their additions to otherwise normal current investment demand contributes to even higher prices. This investment does not increase the long-run growth of productive capacity because the investment would have been made anyway, although at a later date, but it does tend to reduce post-inflation investment. Inflation-motivated investment also tends to drive up the cost of plant and equipment, thus contributing to a cost structure of the economy which may be permanently higher than it would have been if investment had taken place more gradually.

1. Current level of investment

Table 5 shows how expenditures for producers' durable equipment—composed primarily of equipment eligible for the investment credit—have been increasing as a percentage of gross national product. As is indicated in the table, the ratio rises when purchases of producers' durable equipment increase proportionately faster than the gross national product. In the last two quarters for which data are available, the ratio of these purchases to GNP has been 7.27 percent and

7.46 percent, which is as high and higher than the last previous high of 7.28 percent in the fourth quarter of 1966, when Congress suspended the investment credit.

TABLE 5.—GROSS NATIONAL PRODUCT AND PURCHASES OF PRODUCERS' DURABLE EQUIPMENT, 1966 TO 1969 QUARTERLY, IN SEASONALLY ADJUSTED ANNUAL RATES

[In billions of dollars]

Period	Gross national product	Purchases of producers' durable equipment: Actual	Purchases of producers' durable equipment: Percent of GNP
1966:			
I	$728.4	$50.0	6.86
II	740.4	51.7	6.98
III	753.3	53.7	7.13
IV	768.2	55.9	7.28
1967:			
I	772.2	54.5	7.06
II	780.2	55.5	7.11
III	795.3	55.6	6.99
IV	811.0	57.3	7.07
1968:			
I	831.2	59.0	7.10
II	852.9	58.5	6.86
III	871.0	61.3	7.04
IV	887.4	64.5	7.27
1969: I	903.3	67.4	7.46

Business plans for new plant and equipment during 1969, shown in table 6, indicate a planned increase of 12.6 percent over the 1968 investment levels. This compares with an increase of 3.9 percent in 1968 over 1967 and a 1.7-percent increase between 1966 and 1967. Increases in 1965 and 1966 over the preceding years were 15.7 and 16.7 percent, respectively, and those years of investment boom produced backlogs of orders for producers' equipment that involved delays of 10 months or more before expected delivery. At the end of April 1969, the order backlog for machine tools was approximately nine times as great as monthly shipments.

TABLE 6.—EXPENDITURES FOR NEW PLANT AND EQUIPMENT, 1962–69

[Dollar amounts in billions]

	1962	1963	1964	1965	1966	1967	1968	1969
Total expenditures for new plant and equipment	$37.31	$39.22	$44.90	$51.96	$60.63	$61.66	$64.08	[1] $72.17
Annual percentage change	8.6	5.1	4.5	15.7	16.7	1.7	3.9	12.6

[1] Department of Commerce-Securities and Exchange Commission survey estimate.

2. Interaction of investment credit and tight monetary policy

Because the investment credit tends to reduce the effectiveness of a tight monetary policy, its presence apparently makes it necessary to impose more severe monetary restraints than would otherwise be necessary. Since the monetary restraints are much broader in their application than the investment credit, this results in distortions in other areas of the economy where the credit is not applicable. This effect presents special hardships to residential housing, small businesses and investments by State and local governments.

The effects of the tight monetary policy have been particularly evident since the beginning of 1969. Its most recent manifestation was the increase in the prime rate to 8½ percent on June 9, 1969 (the rate of interest major commercial banks charge their highest rated borrowers on loans). The pressure of monetary policy on commercial banks is shown by the reserve position of member banks. Free reserves of member banks—the difference between excess reserves and borrowings at Federal Reserve banks—have been in deficit throughout the past year, but the deficits have increased substantially during the past half year. Estimates of the net deficit have changed from —$301 million at the end of December 1968 to —$906 million on June 11, 1969. This deficit in the level of free reserves is more than 50 percent above the —$583 million deficit in free reserves on September 28, 1966, the highest level reached before the investment credit was suspended in October 1966.

3. Repeal instead of suspension

In 1966 when faced with inflationary pressures which were so strong that a tight monetary policy alone did not provide sufficient economic restraint, Congress suspended the investment credit. That action produced the restraint on investment expenditures intended, but because the credit was suspended, rather than repealed, as the restoration date drew closer the effect was not merely to remove the special inducement to investment but also to provide a positive deterrent to investment as well. In the suspension period, not only was no investment credit available, but if taxpayers postponed their investments past a specified date they would again be eligible for the credit on these investments. This double effect proved to be too strong, and it became necessary, largely because of this, to restore the credit some 7 months earlier than planned. This, of course, suggests now that action is again necessary with respect to the investment credit, that it be repealed rather than suspended.

In addition, the investment credit does not lend itself well to suspension, restoration, and then suspension again. Investment plans are made on the basis of the availability of the investment credit and various commitments are then made on this basis. Then, when the credit is suspended, taxpayers are caught in various states of commitment to invest. On one hand, the result is the need for a series of special provisions in a bill suspending or repealing the credit (included in the 1966 act and also in this bill) which provides for those cases where a facility has not been put in service but there is a substantial commitment for specific investments and where the injury from removal of the credit is substantial. On the other hand, no matter where in the planning-commitment process the line is drawn, or how carefully, as to the cases covered or not covered by the investment credit, it is of necessity somewhat arbitrary and unsatisfactory to those in the planning-commitment process who just miss eligibility for the credit.

It was decided to phaseout the investment credit to reduce the inequity that arises between taxpayers because different leadtimes for the needed equipment determined whether a firm had signed a binding contract before April 19, 1969. For example, even though two manufacturers planned to place machinery in service on the same date, one of them would have entered into a binding contract before April 19, 1969, simply because construction of the machinery required that an order be placed 2 years before use was planned as compared with

6 months for the other manufacturer. In order to reduce this inequity between businesses, and to assure that eligibility for the investment credit would not last indefinitely, a phaseout rule was adopted. Under the phaseout, the 7-percent credit will be reduced by one-tenth of 1 percentage point for each month after December 1970 before the equipment is placed in service, and the credit will not be available for equipment placed in service after December 1974. Thus, the credit will be 6.9 percent for equipment placed in service during January 1971, 2.2 percent for equipment placed in service during December 1974, and zero for all equipment placed in service during January 1975 or later

Still another problem involved in "turning the credit off and on" relates to the carryovers of unused investment credits. Generally, the allowable credit in any year is limited to 50 percent of the tax liability as otherwise computed (above the first $25,000 of liability). Investments in the current year are treated as those which first generate the allowable credits. Following this, credits generated in past years which, because of the limitation could not be used in those years, may be carried forward (or credits of future years carried back) to the year in question, up to the amount of tax liability remaining under the limitation. The effect of this unused credit carryover provision has been to store up some $2 billion of unused credit carryovers which may be used in the first year in which there is insufficient investment to offset the 50-percent limitation. As a result, in many cases, any decline in allowable investment credit occurring because of the suspension or repeal of the credit could be offset by carryovers of credit to that year (if measures were not taken to prevent this result). 1966, credits were allowed during the suspension period with respect to carryovers only to the extent that investments (even though ineligible for credit) were not made during the suspension period. These credits have been referred to as "simulated credits."

However, objections have been raised as to the complexity of these rules. Yet, if the carryovers of unused credits are not to offset most of the revenue gained from the repeal of the credit, some restriction needs to be provided with respect to these carryovers. (As indicated in the general discussion below, credit carryovers in this bill are subject to a special 20-percent restriction in any year from the date of repeal on.)

Because of the double economic effect of suspension of the investment credit and because of the administrative problems involved in turning the investment credit off and on, the investment credit has been repealed rather than suspended. Moreover, even though an investment credit may have been useful in the past in inducing investment in periods when there was a large deficiency of investment, it is not clear that we will be faced with the same type of problem in the future. For this reason also, the credit has been repealed rather than suspended. If the need should, in the future, arise for a further stimulant to investment, the Congress will then be free to consider various alternative types of treatment. Moreover, it is not clear, once the appropriate rate of investment has been restored, whether in the future special inducements to investment will again become necessary. It may well be that the normal incentives of potentially greater profits in the context of a stable growth, full employment economy will provide the investment needed without resort to special devices to stimulate investments which, on occasion, appear to give rise to investment booms.

4. Revenue effect of repeal of the credit

It is anticipated that the revenue effect of repealing the investment tax credit will be an increase in receipts of $1.35 billion in fiscal year 1970, with $930 million attributable to corporation income tax and $420 million to the individual income tax. In fiscal year 1971, the repeal is expected to increase receipts by $2.6 billion, with $2 billion attributable to the corporation income tax and $0.6 billion to the individual income tax.

D. AMORTIZATION OF POLLUTION CONTROL FACILITIES

The committee recognizes that an important challenge facing our Nation today is the problem of environmental pollution. Our rivers, lakes, streams, and air are becoming increasingly polluted. moreover, this is a problem which affects both the rural sections of our country and also our urban complexes. Industrial and human wastes and sewage are increasingly contaminating our rivers and our air is being increasingly polluted by industrial contaminants.

Congress has addressed itself to the air and water pollution problem in legislation which it has passed in recent years. This legislation has laid a foundation for dealing with the pollution problem. In order to deal effectively with the Nation's air and water pollution problem, however, a significant part of the task must be met by private industry. In effect, private industry is being asked to make an investment which in part is for the benefit of the general public. moreover, quite often it costs relatively more to deal with the pollution problem in the case of an existing plant than to plan a new plant in such a way as to reduce its polluting effects. It also has been estimated that factories which efficiently curb pollution through the installation of antipollution equipment may face significant increases in costs. moreover, expenditures for pollution control equipment generally do not result in any increase in the profitability of a plant.

At the present time companies which install antipollution equipment involving property of a type for which the investment credit is available receive, in effect, an incentive through the investment credit for dealing with the pollution problem. The repeal of the investment credit in this regard could have an undesirable effect on the efforts made by private industry to combat the pollution problem were another type of incentive not made available.

In view of the possible undesired effect on pollution control of repealing the investment credit and the increasing magnitude of the air and water pollution problem facing the Nation today, it is believed that it is appropriate to provide an incentive to private industry for antipollution efforts. However, it appears more appropriate to permit the rapid recovery of the costs involved, rather than to permit a return in excess of total costs. Accordingly, the bill provides that the cost of new pollution control facilities (which are appropriately certified by the relevant State and Federal authorities) may be amoritzed over a 5-year period. Since quite often these facilities have a useful life of 10 to 20 years or more, the usual depreciation deduction each year is relatively small. The larger deduction provided by allowing the recovery of the taxpayer's costs over the shorter 5-year period will provide a greater incentive for the installation of effective pollution control equipment.

It is recognized that the incentive provided in the bill is not a complete answer to the pollution problem. The need for broader and more effective pollution control standards remains. The amortization deduction provided by the bill, however, should be a useful component of the Nation's total efforts to deal with the pollution problem. It will ease the impact on private industry of the additional costs which it must incur for pollution control facilities and, thus, should encourage private industry to cooperate in the required efforts.

E. LOW-INCOME ALLOWANCES

The minimum standard deduction was enacted by Congress in 1964 to relieve from income tax persons with low incomes. Since that time increasing knowledge about the economic conditions of the poor and the erosion of their inadequate purchasing power by inflationary price increases has highlighted the urgency of providing them additional relief.

Although this bill is basically concerned with providing sufficient revenues to contain existing inflationary pressures, the committee believed that it was appropriate to relieve from tax those persons at or below the "poverty level" who are still subject to income tax. This is a continuation of the program initiated in this regard in 1964. The committee concluded that it was entirely appropriate to relieve these persons from any income tax at this time in recognition of the fact that they have suffered most from the inflationary price increases which have occurred in the past year.

The relationship between "poverty income levels" and income levels at which taxation presently begins is shown in table 7. This table shows (in col. 2) a recent estimate of income levels for families of different sizes required in order to obtain a minimum level of goods and services.

This is compared with the present starting level of income taxation (col. 1) for families of different sizes. Under present law the starting level of taxation is determined by the number of $600 exemptions available to a family combined with the minimum standard deduction ($300 for the first exemption and $100 for each additional exemption). This table also shows (in cols. 3 and 4) the estimated number of poor family units, according to family size, and also the number of these which are presently subject to tax.

The bill adds to the minimum standard deduction an amount sufficient to bring the starting level of taxation virtually up to the "poverty level" in the case of all families with 8 persons or less. In 1964 it was estimated that the adoption of the minimum standard deduction removed 1.5 million persons from the tax rolls. The low income allowance provided by this bill removes an additional 5.2 million returns from the tax rolls, almost all at or below the "poverty level," and produces a reduction in tax for another 7 million returns. Thus, a total of 12 million returns will either be relieved from tax entirely or will pay a lower tax than under existing law.

The relief provided in this bill is accomplished by adding an amount which, together with the minimum standard deduction, provides for

$1,100 of nontaxable income in the case of all family units with 8 or less persons. The excess of the $1,100 over the minimum standard deduction is referred to as the "additional allowance". The $1,100 plus the $600 for each personal exemption represents the level of nontaxable income for different size families. Thus, in the case of a single individual with a $600 exemption this brings the level at which taxation starts up from $900 to $1,700. Table 8 shows the starting level of taxation for families of different sizes (see col. 4 in that table). Under the bill the additional tax-free income provided is phased out gradually on the basis of a reduction of $1 in the amount of the additional allowance for every $2 by which the taxpayer's adjusted gross income exceeds the maximum nontaxable amount. Table 8 (col. 5) shows the income levels at which the additional allowance provided by this bill is fully phased out and disappears. This table (in col. 6) also indicates the tax relief for those at the new level where taxation begins. This relief, in the case of a single person with $1,700 of income, amounts to $117. For those with larger numbers in the family this amount tapers off to a level of $14 for a family of eight.

On the basis of a full year of operation, it is estimated that the low income allowance provided by this bill will reduce revenues by $625 million. However, since the low income allowance is not effective until the calendar year 1970, the revenue reduction in the fiscal year ending June 30, 1970 is expected to be only $270 million.

TABLE 8.—LOW-INCOME RELIEF PROPOSAL

Number in family (Col. 1)	"Poverty level" [1] (Col. 2)	Present level at which tax starts (Col. 3)	New level at which tax starts (Col. 4)	Level at which benefit disappears (Col. 5)	Present tax on income in col. 4 (Col. 6)
1	$1,735	$900	$1,700	[2] $3,300	$117
2	2,240	1,600	2,300	3,700	100
3	2,755	2,300	2,900	4,100	86
4	3,535	3,000	3,500	4,500	74
5	4,165	3,700	4,100	4,900	60
6	4,675	4,400	4,700	5,300	46
7	5,180	5,100	5,300	5,700	28
8	5,785	5,800	5,900	6,100	14

[1] The 1969 poverty levels are assumed to be 6 percent above the HEW nonfarm level for 1966.
[2] Above $3,250 the regular 10 percent standard deduction is more beneficial.

III. GENERAL EXPLANATION

A. Continuation of Income Tax Surcharge

(Sec. 2 of the bill and sec. 51 of the code)

Present law.—Under present law the income tax surcharge which was imposed at an annual rate of 10 percent by the Revenue and Expenditure Control Act of 1968 is scheduled to expire as of June 30, 1969. Thus, under present law in the case of calendar year taxpayers, the rate of the surcharge for 1969 presently is 5 percent when the entire year is taken into account. However, tax withholding on wages for periods before June 30, 1969, reflects the full 10 percent surcharge, and after that date reflects no surcharge at all.

Explanation of provision.—As indicated previously, the committee believes that economic and budgetary conditions require the continuation of the income tax surcharge. Accordingly, the bill provides that the income tax surcharge is to be continued at the full 10-percent annual rate until December 31, 1969, and at a 5-percent annual rate for the period between January 1, 1970, and June 30, 1970. Thus, in the case of a calendar year taxpayer, the rate of the surcharge will be 10 percent for 1969 and 2½ percent for 1970.[1]

To keep individuals as nearly current as possible in the payment of their tax liabilities, the bill provides that the wage withholding tables presently in effect (that is, which take into account the surcharge at a 10-percent annual rate) are to continue in effect until December 31, 1969. New wage withholding tables reflecting the surcharge at the reduced 5 percent annual rate are to be applicable for the period from January 1, 1970, to June 30, 1970.[2]

In addition, this bill provides that taxpayers who pay their income taxes by quarterly payments of estimated tax are to increase their estimated tax payments to take the continuation of the surcharge into account. The additional payments of estimated tax required by the continuation of the surcharge are to be paid ratably over the remaining installments for the taxpayer's taxable year, beginning with the first installment which is due on or after 30 days after the enactment of the bill. The effect of this provision on the estimated tax for the entire taxable year is to be taken into account in determining payments required to be made on the remaining installment dates in order for the taxpayer to avoid penalty for underpayment of estimated tax.

Taxpayers, however, are not to be subject to a penalty for underpayment of the estimated tax for any period prior to the date of the first installment occurring 30 days or more after the enactment of the bill if they would not have been subject to a penalty under existing law. In other words, the amendments made by the bill are not to be taken into account in determining the applicability of a penalty for under payment of estimated tax prior to the time the bill becomes effective.

The other provisions of existing law dealing with the manner in which the surcharge applies and is computed are not changed by the bill except for a conforming amendment relating to the required amount of minimum distributions which a domestic corporation must receive from its foreign subsidiaries in order to avoid including undistributed earnings of foreign subsidiaries in its own income.

B. Continuation of Excise Taxes on Communications Services and on Automobiles

(Sec. 3 of the bill and secs. 4061 and 4251 of the code)

Present law.—The excise tax on passenger automobiles (imposed on the manufacturer's sales price) presently is 7 percent through December 31, 1969. Under present law there is a reduction of the rate after that time to 5 percent during 1970, 3 percent during 1971, and 1 percent during 1972. The tax then is repealed as of January 1, 1973.

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[1] In the case of a fiscal year taxpayer, the surcharge is at an annual rate of 10 percent for the period ending December 31, 1969, and at an annual rate of 5 percent for the period beginning January 1, 1970, and ending June 30, 1970. The rate for any fiscal year, only a part of which is in the 10-percent of 5-percent surcharge period, is to be determined by a propration of the two periods on a daily basis.

[2] As discussed in part E below, the wage withholding tables for periods beginning on or after January 1, 1970, also will take the low income allowance contained in sec. 6 of the bill into account.

The excise tax on amounts paid for local and toll telephone services and teletypewriter exchange services is 10 percent prior to January 1, 1970. On that date, present law provides that the rate is to begin a gradual reduction to 5 percent during 1970, to 3 percent during 1971, and to 1 percent during 1972. The tax would then be repealed as of January 1, 1973.

Explanation of provision.—As indicated above, the committee believes that it is appropriate in view of budgetary and economic conditions to postpone, for 1 year, the scheduled reductions in the excise taxes on passenger automobiles and communications services. Accordingly, the bill provides that the current rates are to continue through 1970 and each subsequent scheduled reduction is to be postponed 1 year. Under the bill, the schedules of rates for the excise taxes on passenger automobiles and communications services are as follows:

Year	Rate (percent) Automobiles	Rate (percent) Communications services
1970	7	10
1971	5	5
1972	3	3
1973	1	1
1974	(1)	(1)

1 Tax is repealed.

TABLE 7.—BEGINNING TAX LEVELS AND POVERTY LEVELS

Family size	Exemption and minimum standard deduction (1)	"Poverty income levels" 1969 [1] (2)	Estimated number of poor family units (thousands) Total (3)	Estimated number of poor family units (thousands) Taxable (4)
1	$900	$1,735	4,620	1,150
2	1,600	2,240	2,600	620
3	2,300	2,755	880	150
4	3,000	3,535	640	120
5	3,700	4,165	520	50
6	4,400	4,675	430	40
7 or more [2]	5,800	5,755	940	50
Total family units			10,630	2,180

1 Assumed to be 6 percent above the HEW nonfarm "poverty levels" for 1966.
2 Averages 8 per family.

C. Repeal of Investment Credit

(Sec. 4 of the bill and secs. 46, 47, and 49 of the code)

Present law

Present law provides a 7-percent tax credit (3 percent for public utility property) with respect to qualified investment. In general terms, the investment credit is available with respect to: (1) tangible personal property; (2) other tangible property (not including buildings and structural components) which is an integral part of manufacturing, production, etc., or which constitutes a research or storage facility; and (3) elevators and escalators. In addition, the property must be depreciable property and have a useful life of 4 years or more. New property fully qualifies for the credit but in the case of used property only an amount up to $50,000 can be taken into account in any year. Property with a useful life of from 4 to 6 years qualifies for the credit to the extent of one-third of its cost. For property with a useful life of 6 to 8 years, qualification is with respect to two-thirds of the investment, and for property the estimated useful life of which is 8 years or more, the full amount qualifies.

The amount of the investment credit taken in any year may not exceed the first $25,000 of tax liability (as otherwise computed) plus 50 percent of the tax liability in excess of $25,000. Investment credits which because of this limitation cannot be used in the current year may be carried back to the 3 prior years and used in those years to the extent permissible within the limitations applicable in those years, and then, to the extent of any amount still remaining, carried forward and used to the extent permissible under the applicable limitations, in the succeeding 7 taxable years.

Explanation of provision

1. *Repeal of investment credit (sec. 4(a) of the bill and sec. 49(a) of the code).*—The bill provides that the investment credit is not to be available with respect to property, the physical construction, reconstruction, or erection of which is begun after April 18, 1969, or which is acquired by the taxpayer after that date. As a result, the investment credit is not to be available for property acquired after April 18, 1969, by a taxpayer even though the construction of the property began before that date. The bill also provides certain exceptions to this general rule under which the investment credit is to be available in the case of property which is constructed (reconstructed or erected) or acquired under a binding contract entered into before April 19, 1969, or in other transitional situations which are discussed below. The binding contract rule and other transition rules provided in the bill are in general the same as the rules provided by Congress in 1966 in connection with the suspension of the investment credit.

The construction of property is to be considered as begun when work of a significant nature has begun with respect to the property. This means that if the foundation or installation is significant and this has begun, the construction of the property will be considered to have begun. Also, if manufacturing on important parts of the property has begun, construction will be considered as commenced. Similarly, if assembly of parts (other than for inventory) has begun, this too will indicate the beginning of the construction of the property. However, construction of a facility or equipment will not be considered as begun if work has begun only on minor parts or components of it. For example, in the case of the construction of a transistor to be used in a computer, the beginning of the construction of the transistor will not mean the beginning of the construction of the computer.

It appears that a number of companies may have difficulty in identifying, under their accounting systems, whether a particular item placed in service was acquired on or before April 18, 1969, or pursuant to contracts that were binding on that date. The problem arises where the companies regularly acquire (or manufacture themselves) and maintain a large stock of identical or similar pieces of property to be placed in service as needed. The accounting systems may not identify, with respect to each item, the date it was acquired or constructed (or the date the contract for its acquisition was entered into). In these situations, the companies are to assume that the first items put in service after April 18, 1969, were those they had on hand or under a binding contract on that date.

2. Phaseout of credit (sec. 4(a) of the bill and sec. 49(d) of the code).—The investment credit is available at the time property is placed in service or, in other words, when the depreciation begins. The bill provides that the 7-percent investment credit which would otherwise be available in the case of property placed in service after 1970 (generally because the property qualified under the binding contract or other transition rules) is to be reduced by one-tenth of 1 percentage point for each full calendar month after November 1970 and before the time when the property is placed in service. Thus, property placed in service in January 1971 will be eligible for a credit of 6.9 percent. In the case of property placed in service in October 1971, a 6 percent credit will be allowable since there are 10 full calendar months between November 1970 and October 1971. The credit allowable with respect to property placed in service in July 1974 will be 2.7 percent since there are 43 months between November 1970 and July 1974. Under the phaseout procedure provided in the bill, no credit will be allowable for property placed in service after 1974, As a result, a taxpayer who pl ced prcperty in service in 1975 or a later year will not receive an investment credit even though, for example, the property was acquired by the taxpayer pursuant to a binding contract which had been entered into before April 19, 1969.

3. Carryovers of unused investment credits (sec. 4(b) of the bill and sec. 46(b) of the code).—As indicated above, at the end of 1968, taxpayers had approximately $2 billion of unused investment credits. If these unused credits were allowed to be carried over and used without limitation (other than the general 50 percent of tax liability limitation), much of the revenue gain and economic restraint which could otherwise be expected in the fiscal year 1970 arising from the repeal of the investment credit would be eliminated. To avoid this effect, the bill provides a limit on the amount of unused credits which may be carried over to 1969 and each subsequent year.

Under the bill the amount of unused credits which a taxpayer can claim as carryovers to any year beginning after 1968 will be subject to a special limitation. The special limitation provides that the credit taken, attributable to the carryovers, cannot exceed 20 percent of the aggregate amount of the taxpayer's unused investment credits which otherwise would have been available as carryovers to the year in question after 1968, or any prior year after 1968 if the carryovers to that year are higher than in the current year (the aggregate carryovers are computed by taking into account carryforwards from prior years and carrybacks from subsequent years; carrybacks from subsequent years retroactively increase the limitation). This limitation on the amount of unused credits which may be used as carryovers in a year applies in 1969 and in each subsequent taxable year.

The special limitation provided by the bill on the use of carryovers is in addition to the general 50 percent of tax liability limitation on the amount of investment credit which a taxpayer may claim in a year. The rules of present law regarding the order in which unused credit carryovers to the current year from two or more other years are to be used in the current year (the unused credits of the earliest year involved are used first, then the unused credits from the next earliest year are used, and so forth) are to continue to apply. The bill also retains the present length of the carryover periods (3 years back and 7 years forward).

The operation of the limitation provided by the bill may be illustrated by the following example. Assume a calendar year taxpayer has $500 of unused investment credits from years prior to 1969 which otherwise would be available as carryovers to 1969. Under the limitation provided by the bill, a $100 limit (20 percent of $500) would be placed on the amount of carryovers which the taxpayer could use in 1969 and in each subsequent year. If in this case the $500 of unused credits were composed of $150 of unused credits arising from the year 1962 and $350 of unused credit arising from the year 1968, the $50 of the carryover from 1962 which could not be used in 1969 because of the $100 limitation would not be available for use as a carryover in a subsequent year because the 7-year carryover period would have expired.

If the taxpayer in this example should place property in service in 1972 which is eligible for the investment credit (generally because of the binding contract rule or another transition rule) and as a result of the 50 percent of tax liability limitation in 1972 there should be an unused investment credit in that year, the fact that the unused credit would otherwise be available as a carryback to 1969 would operate to retroactively increase the limitation on the use of carryovers in 1969. For example, if the unused credit arising from the investment in 1972 were $300, this would have the effect of increasing the amount of unused credits which otherwise could be carried over to 1969 to $800 (the $500 of carryforwards from years prior to 1969 and the $300 carryback from 1972), Accordingly, the limit on the use of carryovers in 1969 would be retroactively increased to $160 (20 percent of $800). Under the basic rule that the carryovers to a year which are actually used in that year are considered to be the unused credits arising from the earliest year involved, the retroactive increase of the carryover limitation from 1969 to $160 means that all of the taxpayer's $150 of unused credits arising from the year 1962 then become usable as a carryover in 1969.

The new $160 limitation on the use of unused credit carryovers in this example would continue to apply in each of the years after 1969 unless the aggregate amount of unused credits otherwise available as carryovers to one of those years (taking into account both carryforwards of remaining unused credits and carrybacks of unused credits arising from subsequent investments under the binding contract rule or another transition rule) exceeded $800 (the carryover amount used in determining the $160 limitation). In such a case, a new limitation based on the higher amount of carryovers would be determined which then would be applicable in that year and in subsequent years.

4. Binding contracts (sec. 4(a) of the bill and sec. 49(b)(1) of the code).—Under the bill the investment credit is to be available with respect to property which is constructed (reconstructed or erected) or acquired pursuant to a contract that was binding on the taxpayer at the close of April 18, 1969, and at all times thereafter. This provison applies only to contracts in which the construction, reconstruction, erection, or acquisition of property is itself the subject matter of the contract, and does not apply to a contract with a person other than the builder or supplier under which the taxpayer becomes obligated to construct, reconstruct, erect, or acquire property. A supplier for this purpose need not be the person who manufactures the property which is being acquired but may be a distributor or other type of middleman. (To the extent so-called third party leases and contracts are intended to be covered, see subsequent discussion.) Thus, a contract with a financial institution, a bond underwriter, or a labor union under which the taxpayer is obligated to acquire property is not covered by this provision.

Whether or not an arrangement between a taxpayer and a builder or supplier constitutes a contract is to be determined under the applicable local law. A contract for this purpose may be oral or written. However, in the case of an oral contract, the taxpayer must establish by appropriate evidence that the contract was, in fact, entered into before the close of April 18, 1969. This may be done by memorandums, the conduct of the parties or other evidence that a contract was in fact entered into. State law as to the effect of "part performance," and as to when a seller has accepted an order will apply.

A binding contract for purposes of this provision exists only with respect to the property which the taxpayer is obligated to accept under the contract. Thus, when prior to April 19, 1969, a taxpayer had contracted to purchase a lathe but not the motor to run the lathe, the investment credit is denied under this rule only with respect to the motor (but see special 50-percent rule for machinery and equipment set forth below). In addition, where a contract obligates a taxpayer to purchase a specified number of items and also grants him an option to purchase additional items, the contract is binding on the taxpayer only to the extent of the items he must purchase. Similarly, where the taxpayer is bound under a contract to purchase either of two or more specified items, this rule applies only to the extent of the contract price of the least costly of the items which may be selected.

A contract may be considered binding on a taxpayer even though (*a*) the price of the item to be acquired under the contract is to be determined at a later date, (*b*) the contract contains conditions the occurrences of which are under the control of a person not a party to the contract, or (*c*) the taxpayer has the right under the contract to make minor modifications as to the details of the subject matter of the contract. These rules may be illustrated by the following examples:

A contract to buy a specified type, grade, and amount of steel, the price to be the market price on the day of delivery, may be a binding contract. A contract which is conditioned upon obtaining of a certificate of convenience and necessity from a public utilities commission may be a binding contract. Where, under a contract to purchase a machine tool, the purchaser has the right to modify the specifications for the tool to reflect current technological advances, the contract may be a binding contract. Similarly where a contract contains a condition which is under the control of one of the parties to the contract and this party is obligated (either by the specific terms of the contract itself or by operation of State law) to use his best efforts to secure the occurrence of the condition, the existence of the condition in the contract does not prevent the contract from being one which is binding on the taxpayer. For example, if a contract to purchase equipment is conditioned upon the supplier being able to supply the equipment within a specified period of time and the supplier is obligated to use his best efforts to satisfy this condition, the contract may be a binding contract.

On the other hand a contract which is binding on a taxpayer on April 18 will not be considered binding at all times thereafter if it is substantially modified after that date. A waiver of a right to cancel upon a price change is an example of a substantial modification.

A contract under which the taxpayer has an option to acquire property is not a contract that is binding on the taxpayer for purposes of this provision unless the amount paid for the option is forfeitable (if the taxpayer does not exercise his option), is to be applied against the purchase price of the property (if the taxpayer exercises his option) and then only if the amount paid for the option is not nominal. Similarly, a contract which limits the damages to be recovered, in the event of a breach by the purchaser, to the amount of a deposit or to liquidated damages is not a binding contract if the deposit or the liquidated damages are nominal in amount. In determining whether a deposit, or liquidated damages, or the amount paid for an option is nominal, the size of the deposit, etc., relative to the contract price of the property which is the subject matter of the contract is to be taken into account. If the deposits, etc., are a significant portion of the price of the item, the contract may be a binding contract. For example, a deposit of $50,000 in connection with a contract to acquire property at a price of $1 million is a significant portion of the contract price.

Where an order for the purchase of property may be canceled by the purchaser within a specified period of time, such as 90 days, the order is a contract binding on the purchaser if the period of time had expired before April 19, 1969, or the right to cancel the contract had been terminated before that date by partial performance with the buyer's consent. Similarly, the right of a buyer under a contract for the acquisition of property to cancel the contract if the seller raises the selling price (a so-called price escalation clause) does not prevent the contract from being binding on the buyer until the buyer becomes entitled to exercise his cancellation rights.

If a taxpayer who had entered into a contract for the construction of property prior to April 19, 1969, completes the contract himself because of the default of the other contracting party, the taxpayer is considered to have a binding contract to the extent that he was bound on the contract prior to the default.

There would not be a binding contract if the property to be supplied is not specifically identified and determined before April 19, 1969. Thus, for example, if a financier has agreed with an airline to buy planes and lease them to the airline when requested (whether or not some maximum is provided), there is no binding contract as to those planes which were not requested before April 19. However, this is not intended to foreclose the allowance of the investment credit in the case of a contract to lease, which in all respects was binding on the lessor on or before April 18, 1969, where the lessee was not required to take a specified amount of the property in question if the lessor retained the investment credit with respect to the property. In this case, the party having the investment credit has a binding contract.

5. Equipped building rule (sec. 4(a) of the bill and sec. 49(b)(2) of the code).—It is realized that once construction on a building has begun there are likely to be commitments which make it necessary to complete the building as well as to acquire machinery and equipment,[1]

[1] The term "machinery and equipment" is generally used here to denote property which is of a type that is eligible for the investment credit.

and appurtenances necessary to the operation of the building. Therefore, the bill contains a rule which, in general, provides that where construction on a building has begun, before April 19, 1969, and the cost of the building plus any machinery and equipment for it which has been ordered (under a binding contract) or constructed before April 19, 1969, represents more than half of the entire cost of the building and planned equipment, the entire equipped building project and incidental appurtenances are to be eligible for the investment credit to the extent they would otherwise qualify for the credit. Where the costs incurred before April 19, 1969, do not equal more than half the cost of the equipped building, each item of machinery and equipment is to be treated separately (as provided in existing law) for purposes of determining whether the item qualifies for the investment credit.

It is recognized, of course, that there are various types of commitments which are made before physical construction has commenced or a binding contract has been entered into which, although they occurred before April 19, do not result under the bill in the allowance of the investment credit. In part, there were not taken into account because their varied nature makes it impossible to specify with certainty in the statute those cases where the investment credit would be available and those cases where it would not.

The equipped building rule provided in the bill specifies that the investment credit is to be available with respect to the equipment and machinery to be used in the completed building, and also incidental machinery, equipment, and structures adjacent to the building (referred to here as appurtenances) which are necessary to the planned use of the building, where the following conditions are met:

(a) The construction (or reconstruction or erection) or acquisition of the building, machinery, and equipment was pursuant to a specific plan of a taxpayer in existence on April 18, 1969; and

(b) More than 50 percent of the adjusted basis of the building and the equipment and machinery to be used in it (as contemplated by the plan) was attributable to property on which either construction has begun before April 19 or which was acquired or under binding order before April 19.

In applying this 50-percent test, the machinery or equipment ordered or constructed before that date which are taken into account include the cost of essential parts or components ordered subsequently which, under the special machinery and equipment rule (explained below), are to be eligible for the investment credit. This rule, of course, does not allow the taxpayer to add machinery and equipment with respect to a building under construction at will, since the building and equipment must be a part of a specific plan of the taxpayer in existence before April 19, 1969. While this plan may be modified to a minor extent after that date (and the property involved still come under this rule), nevertheless, there cannot be substantial modification in the plan if this equipped building rule is to apply. The plan referred to here must be a definite and specific plan of the taxpayer which, in one form or another, is available as evidence of the tapayer's intentions.

The equipped building rule can be illustrated by an example where the taxpayer has a plan providing for the construction of a $100,000 building with $80,000 of machinery and equipment to be placed in the building and used for a specified manufacturing process. In addition, there may be other structures or equipment, here called appurtenances, which are incidental to the operations carried on in the building which are not themselves located in the building. Assume that the incidental appurtenances have a further cost of $30,000. These appurtenances might include, for example, an adjacent railroad siding, a dynamo or water tower used in connection with the manufacturing process, or other incidental structures or machinery and equipment necessary to the planned use of the building. Of course, appurtenances, as used here, could not include a plant needed to supply materials to be processed or used in the building under construction. In this case, if construction on the building had begun but no equipment had been ordered, and the appurtenances had not been constructed or placed under binding order, nevertheless, the entire equipped building and appurtenances, to the extent property of a type qualifying for the investment credit was involved, would be eligible for the investment credit. This can be seen by the following analysis of this example: the cost of the equipped building in this case was $180,000 and since construction on the building had commenced. the machinery and equipment, even though not under binding order, would be eligible for the investment credit as a result of this rule. This is true because the building cost represents more than 50 percent of the total $180,000. In this connection, it should be noted that the additional cost of the appurtenances, $30,000, is not taken into account for purposes of determining whether the percentage requirement is met. However, the investment credit would be available with respect to these appurtenances since the 50-percent test is met as to the equipped building.

Although the above example is one in which the construction of the building had commenced while the machinery and equipment had not been ordered, in other cases the reverse may be true. If the machinery and equipment contracted for is the major portion of the total cost in such a case, the investment credit is to be available with respect to the entire equipped building (to the extent eligible for the investment credit) even though the construction of the building itself has not commenced.

6. *Plant facility rule (sec. 4(a) of the bill and sec. 49(b)(3) of the code)*.—The bill also provides a plant facility rule which is comparable to the equipped building rule (explained in No. 5 above) to provide for cases where the facility is not housed in a building.

Under modern practices many production facilities, which in the past were housed in buildings, are erected out in the open. This has been made possible by improved technology and is desirable in many of these cases for reasons of safety and economy. The plant facility provision provides, in effect, two rules. The first of these rules is applicable where construction of the facility at the site had not commenced on April 18, 1969. The second rule covers the situation where such construction had commenced.

Under the first rule, if a taxpayer, pursuant to a plan in existence on April 18, 1969, constructed, reconstructed, or erected a plant facility (or portion thereof) and more than 50 percent of the aggregate adjusted basis of the depreciable property which makes up the facility is attributable to either (1) property the construction, reconstruction, or erection of which was begun by the taxpayer before April 19, 1969, or (2) property the acquisition of which by the taxpayer occurred before that date, then all property of the type which is generally eligible for the investment credit which makes up the facility is to continue to be eligible for the credit. This rule only applies if the plan under which the facility is constructed, etc., is not substantially modified after April 18, 1969, and before the facility is placed in service.

In determining whether the 50-percent requirement of this rule is met, installation costs and engineering costs which are capitalized and have been incurred prior to April 19, 1969, are to be taken into account. In addition, such costs which had not been incurred prior to that date but which are attributable to property construction, etc., of which had begun prior to April 19, or property which had been acquired prior to April 19 are to be taken into account for this purpose.

As in the case of the equipped building rule, property on order under a binding contract in effect on April 18, 1969 (and thereafter), is included in determining whether the facility meets the 50-percent requirement. The rules dealing with binding contracts (explained in No. 4 above) are applicable to this provision. Similarly, property which qualifies under the special machinery and equipment rule (explained in No. 7 below) is to be included in determining whether the facility meets the 50-percent requirement.

This provision defines a plant facility to be a facility which meets the following requirements. The facility must not include a building, other than buildings which constitute an insignificant portion of the facility. In addition, it must be (1) a self-contained, single operating unit or processing operation, (2) located on a single site, and (3) identified on April 18 ,1969, in the purchasing and internal financial plans of the taxpayer as a single unitary project.

The fact that the facility does not produce a commercially marketable product is irrelevant in determining whether or not a particular facility is a plant facility for purposes of this provision. Furthermore, the fact that a single operating unit or processing operation is connected by pipes, conveyor belts, etc., to one or more other units or processing operations in an integrated processing or manufacturing system does not cause the whole system to be a plant facility. Examples of self-contained, single-operating units or processing operations which may constitute a plant facility under this rule are a railroad switching yard, a railroad bypass route, and an ethanolamines unit.

The second rule of the plant facility provision relates to the construction, reconstruction, or erection of a plant facility which was commenced before April 19, 1969. Under this rule, if pursuant to a plan of a taxpayer in existence on April 18, 1969, the taxpayer constructed, reconstructed, or erected a plant facility, and the construction, etc., was commenced before April 19, 1969, then all property of the type which is generally eligible for the investment credit which makes up the facility is to continue to be eligible for the credit. For this purpose, construction, etc., of a plant facility is not to be considered to have commenced until it has commenced at the site of the plant facility. (This latter rule does not apply if the facility is not to be located on land and, therefore, where the initial work on the facility must begin elsewhere.) In this case, as in the case of the commencement of construction of a building, construction begins only when actual work at the site commences; for example, when work commences on the excavation for footings, etc., or pouring the pads for the facility, or the driving of foundation pilings into the ground. Preliminary work, such as clearing a site, test drilling to determine soil condition, excavation to change the contour of the land (as distinguished from excavation for footings), does not constitute the beginning of construction, reconstruction or erection.

The plant facility provision contains a special rule applicable where a certificate of convenience and necessity has been issued to a taxpayer before April 19, 1969, by a Federal regulatory agency. The special rule applies where the certificate is applicable to two or more plant facilities which are included under a single plan of the taxpayer to construct, reconstruct, erect or acquire the plant facilities and more than 50 percent of the aggregate basis of all of the depreciable property making up the facilities is attributable either (i) to property the construction, reconstruction, erection of which was begun before April 19, 1969, or (ii) property the acquisition of which occurred before that date. In such a case, the plant facilities are to be treated as a single plant facility and will not be subject to the repeal of the investment credit.

7. *Machinery and equipment rule (sec. 4(a) of the bill and sec. 49(b)(4) of the code).*—The general rule as to what constitutes construction (reconstruction or erection) of machinery and equipment has been discussed above (see No. 1 above). Similarly, where binding contracts have been entered into before April 19, 1969, the rules for machinery and equipment generally applicable have also been discussed above (see No. 4 above). In general, these rules provide that the construction begins when the production or assembly commences. In addition, the investment credit is also available with respect to machinery and equipment covered by a binding contract entered into before April 19, 1969. Under these rules, however, only the specific equipment and machinery commenced or ordered under a binding contract are eligible for the investment credit.

The bill also contains a provision that deals with machinery and equipment which was only partially on order, or under construction, on April 18, 1969. Under this rule the investment credit will continue to be available with respect to any machinery or equipment, more than 50 percent of the parts or components of which were on hand on April 18, 1969, or are acquired pursuant to a binding contract which was in effect on that date.

The parts and components which are on hand or on order (under a binding contract) on April 18 must be held for, or have been ordered for, use in the machinery or equipment. This 50-percent requirement is to be determined on the basis of cost, and for the rule to apply, the cost of the parts and components must not be an insignificant portion of the total cost of the item of machinery or equipment.

Thus, for example, if there were a binding order on April 18, 1969, for the acquisition of the frame of an airplane, parts and components necessary for the airplane to become a functioning unit would also be eligible for the investment credit (even though not on order at that time) if these remaining parts and components did not account for 50 percent or more of the total cost of all the parts and components of the airplane. Accordingly, if the motors, galley, seats, navigation, and radio equipment and necessary spare parts acquired at the time the plane is put into operation had not been ordered before April 19, but constituted less than 50 percent of the total cost of the plane, the investment credit will be available not only with respect to the airframe but also with respect to this machinery and equipment as well.

This special rule is applicable to machinery and equipment wholly apart from any application the equipped building rule or the plant facility rule (explained above) may have because of the interrelationship of the machinery and equipment with a building and plant facility. However, a piece of machinery or equipment which continues to receive the investment credit under this rule is to be included in determining whether the equipped building or plant facility, of which it is a part, meets the 50-percent requirement of the equipped building or plant facility provisions.

8. *Certain leaseback transactions (sec. 4(a) of the bill and sec. 49(b)(5) of the bill).*—It is common practice for a business to enter into binding contracts for the purchase of machinery and equipment used in its trade or business wherein the machinery and equipment is sold to a third person but leased back by the person initially ordering the property. In such cases the person entering into the purchase contract initially is committed to purchase the article. For that reason the bill provides that where binding contracts have been entered into on or before April 18, 1969, and the property involved is transferred to a third party, the property is to be eligible for the investment credit, despite the repeal provided by the bill, if certain conditions are met.

The bill provides that when a person who is a party to a binding contract transfers his rights in the contract (or the property covered by the contract) to another person and a party to the contract retains a right to use the property under a lease, then to the extent of the transferred rights, this other person is to succeed to the position of the transferor with respect to the binding contract and the property.

The lease may be for any term unless the lessor decides not to exercise his statutory election to permit the lessee to claim the investment credit, in which case the lease must be for a term of at least 1 year. If the lessee subsequently loses the right to use the property, such as by returning it to the lessor upon termination of the lease, this would be treated as a disposition of the property by the lessor which would bring into play the rules which cause a recapture of the investment credit previously allowed with respect to property where it is disposed of prior to the end of the useful life of the property used in determining the amount of credit allowed. A lessee would not be treated as losing his right to use the property if he transferred the lease in a transfer of the type which is to be disregarded in determining whether the investment credit is available (see No. 10 below), such as a transfer by reason of death, so long as the person to whom the lease is transferred retains the right to use the property. A lessee also would not be treated as losing his right to use the property where he subleases the property unless the sublease is in effect a sham transaction. In other words, if the lessee normally would have returned the property to the lessor and the lessor then would have leased the property to another person, but instead the lessor and lessee, in effect, arrange to accomplish the same result by means of a sublease, the subleasing will be treated as a disposition of the property by the lessor.

The provision described above is not applicable where the election was made and the credit passed on to the lessee, because, in those cases, the recapture provisions automatically come into play if the lessee's right to use the leased property terminates before the expiration of the period on which the investment credit originally is based. The rule provided in the bill also covers the case where a person obligated under a pre-April 19 binding contract is only one of two or more joint lessees under the leaseback arrangement.

The types of arrangements which are covered by this provision include:

(*a*) cases where the user of the machinery and equipment has a binding contract to purchase machinery and equipment on April 18, 1949, and subsequently transfers the contract to purchase the property to a third party from whom the user leases back the right to use the property;

(*b*) cases where, under a contract binding on April 18, 1969, to purchase machinery, equipment, or a building, a business obtains delivery of the property, immediately transfers the property (before using it) to a third party, and leases the property back;

(*c*) cases where a builder or supplier of machinery, equipment, or buildings entered into a lease arrangement with a business before April 19, 1969, and subsequent to that time sells the property involved to a third person subject to the lease arrangement referred to.

In the first two illustrations above, the investment credit is available because the third party (by succeeding to the position of the user and the business, respectively) is treated as having acquired property pursuant to a contract which was binding on him as of April 18 (see No. 4 above). In the third illustration, the credit is available because the third person (by succeeding to the position of the builder or supplier) is treated as having constructed the property pursuant to a binding contract to lease in effect on April 18. Under the exception for property constructed pursuant to certain leases (discussed in No. 9 below), property so constructed is eligible for the investment credit.

9. *Certain leases involving third parties (sec. 4(a) of the bill and sec. 49(b)(6) of the code).*—The bill also provides for certain situations where binding contracts or leases have been entered into between parties prior to April 19, 1969, which require the construction or acquisition of machinery and equipment under the terms of the lease or contract arrangements, even though the situations do not involve a binding contract of the type described earlier between the person who will use the property and the person who will construct or supply it.

Under the bill, where a binding lease or contract is in effect on April 18, 1969, under which the lessor or lessee (or both) is obligated to construct (reconstruct or erect) or acquire machinery and equipment which is specified in the lease or contract, then the investment credit is to continue to be available with respect to any property constructed under the lease or contract. In cases where a project includes property in addition to that covered by a specific lease arrangement this rule is to apply to the other property only if binding leases and contracts in effect on April 18, 1969, covered real property representing at least a quarter of the entire project. (This is to be determined on the basis of the rental value of the different parts of the project.) This limitation is designed to prevent a large project from being covered merely because of minor or incidental lease agreements in effect on April 18, 1969. As indicated previously, this provision applies to sales contracts as well as lease contracts.

The types of cases covered by this provision include, for example, a situation where a builder of a shopping center may have entered into a lease agreement with a tenant for a major store building in a shopping center before April 19, 1969, and in connection with this lease agreement the builder agrees to build a specified number of shopping center units. In exchange for this agreement, the major store tenant agrees to equip and operate the store to be leased to him. In other cases, parties may have agreed to construct and lease industrial plants to businesses and in exchange the businesses agree to equip the plants with machinery and equipment necessary for the businesses, either directly or under a sale and lease-back arrangement.

Where the bill provides that the property to be provided must be specified in the lease or contract, this is not intended to preclude the property being specified in a separate document of which both parties were fully aware at the time of the lease or contract agreement. Nor is it required that all of the property be specified in detail at that time so long as the general types and amount of property are fairly determinable at the time the lease or contract is entered into.

The bill also provides a modification of the rule set forth above in the case of a binding contract or contracts entered into before April 19, 1969 involving the construction, etc., or acquisition of property specified in an order of a Federal regulatory agency for which an application was filed before April 19, 1969. In such cases if the property is to be used to transport one or more products under the contract or contracts, the investment credit is to continue to be available for the property if one or more parties to the contract or contracts must take, of provide, more than 50 percent of the products to be transported over a substantial portion of the expected useful life of the property.

An example of the type of case covered by this provision would be a situation where a company has entered into a binding contract to transport fuel through a pipeline for another party who will provide more than 50 percent of the fuel to be transported over a substantial portion of the estimated useful life of the pipeline. The provision would be applicable in this case, however, only if the company had filed prior to April 19, 1969, its application with the Federal regulatory agency for an order permitting it to construct the pipeline.

10. *Rules where property is transferred at death, etc. (sec. 4(a) of the bill and sec. 49(b)(7) of the code).*—The bill provides that in determining whether property is to be treated as if acquired or under binding contract before April 19, 1969 (and therefore is eligible for the investment credit), certain transfers are to be disregarded. These are cases where it seems appropriate for the transferee "to step into the shoes" of the transferor.

The first transfer where the transferee is treated the same as the transferor is a transfer by reason of death. Under this provision, property (or a contract to purchase property) with respect to which the investment credit would be available in the hands of the decedent continues to be eligible for the investment credit in the hands of the person who acquires the property from the decedent.

This same treatment is also applied to certain specified transfers in which the basis of the property in the hands of the transferee is determined by the reference to its basis in the hands of the transferor. The specified transfers are—

(*a*) transfers to a corporation upon the liquidation of a subsidiary (sec. 332 of the code),

(*b*) transfers to a controlled corporation (sec. 351 of the code),

(*c*) transfers pursuant to corporate reorganizations (secs. 361, 371(a), and 374(a) of the code),

(*d*) transfers of property to a partnership by a partner in exchange for an interest in the partnership (sec. 721 of the code), and

(*e*) transfers by a partnership to a partner (sec. 731 of the code.

In addition, where under a special provision of the code (sec. 334(b)(2)), the acquisition by a corporation of the stock of another corporation and the liquidation of the acquired corporation is treated as the purchase of the assets of the liquidated corporation for purposes of computing the basis of the assets acquired, the transfer of the assets is to be disregarded in determining whether the credit is to be available if the stock of the distributing corporation was either acquired before April 19, 1969, or pursuant to a binding contract to acquire the stock which was in effect on April 18, 1969, or both.

11. Property acquired from affiliated corporations (sec. 4(a) of the bill and sec. 49(b)(8) of the code).—It is a common practice in some affiliated groups of corporations for the group to do its purchasing outside the group through one of the corporations which is a member of the group. In these situations it is believed that acquisitions by, and binding contracts of, the purchasing member of the group should be considered as acquisitions by, or contracts of, the corporation for which they are made, for purposes of the bill. For this reason, the bill provides that property acquired by a corporation which is a member of an affiliated group for another member of the same group is to be treated as having been acquired by the other member on the date it was acquired by the purchasing corporation; and that where a binding contract for the construction, reconstruction, erection, or acquisition of property has been entered into by the one member of a group, the corporation on whose behalf the contract was made is to be treated as having entered into the contract in the date on which it was entered into by the other member. In addition, the corporation is to be treated as having commenced construction, etc., of any property on the date on which another member commenced construction, etc.

The bill also provides that a contract between members of an affiliated group is not to be treated as a binding contract, insofar as such members are concerned (for purposes of the binding contract rule, the other transition rules, and the provision disallowing the investment credit in certain situations involving leased property, see No. 15 below). Generally, although a contract between members of an affiliated group may be legally binding, it is not binding as a practical matter. It is not intended that, because the bill deals expressly with contracts between two members of an affiliated group while remaining silent as to other contracts between related parties, the inference is to be made that such other contracts which are not in fact binding because of the relationship of the parties are to be treated as binding for purposes of the bill.

12. Barges for ocean-going vessels (sec. 4(a) of the bill and sec. 49(b)(9) of the code).—Another type of situation where property is constructed pursuant to a binding contract in effect on April 18, 1969, which is covered by the bill, even though it is not a binding contract between the person who will use the property and the person who will construct it, involves barges for use on ocean-going vessels in certain situations where the vessels were under a binding contract on April 18, 1969, but the barges had not been ordered by that time. In essence these are situations where the ocean-going vessel, the so-called mother ship, and the barges it is designed to carry are complementary parts of a total ship. Although the mother ship otherwise would be eligible for the investment credit (pursuant to the binding contract rule), the barges which, in effect, are an integral part of that ship would not otherwise be eligible for the credit.

To recognize the fact that these situations involve a total project which was substantially under binding contract on April 18, 1969, the bill provides that, in the case of an ocean-going vessel (1) which is eligible for the investment credit (because of the binding contract rule), (2) which is designed to carry barges, and (3) which is constructed under a binding contract in effect on April 18, 1969, to which the Maritime Administration of the Commerce Department is a party, the investment credit is so be allowable with respect to the barges which are constructed (reconstructed or erected) or acquired for use on the vessel. This provision, however, only applies where the barges are specified in the binding contract for the construction of the ocean-going vessel and, moreover, does not apply to a greater number of barges than the number specified in that binding contract. The investment credit also is to be allowable under this rule for any machinery and equipment which is to be installed in the barges covered by the rule, if the machinery and equipment is necessary for the planned use of the barges.

13. Certain new design products (sec. 4(a) of the bill and sec. 49(b)(10) of the code).—Cases have arisen which involve situations where taxpayers had undertaken a project to produce products of a new design pursuant to binding contracts which had been entered into prior to April 19, 1969. In order for the party undertaking the project to continue it, it is necessary for that party to obtain or construct certain machinery and equipment. The bill, in effect, provides that the investment credit is to be allowable with respect to the machinery and equipment (if it is placed in service before 1972) in these situations, generally, if a significant portion of the project had been completed prior to April 19, 1969.

Specifically, this provision of the bill covers situations where a taxpayer had undertaken prior to April 19, 1969, a project to produce a product of a new design pursuant to binding contracts in effect prior to that date, if the binding contracts were fixed-price contracts (except that the contracts may include a price escalation provision which is applicable where there is a change in pay rates) and if the binding contracts covered more than 60 percent of the entire production of the newly designed product to be delivered prior to 1973. In addition, this provision of the bill is applicable only where prior to April 19, 1969, more than 50 percent of all depreciable property (determined on the basis of the aggregate adjusted basis of the property) required to be constructed (reconstructed or erected) or acquired to carry out the binding contracts either was under construction (reconstruction or erection) by the taxpayer, had been acquired by the taxpayer, or was under a binding contract for construction or acquisition. In applying this 50-percent test, certain productive items (jigs, dies, templates, and similar items) which are specifically designed for, and are only suitable for use in, the manufacture or assembly of the newly designed product under the project are to be considered as property which was under a binding contract for construction on April 18, 1969, if these items were described in written engineering and internal financial plans of the taxpayer in existence on that date. It is sufficient for this purpose that the plans of the taxpayer generally describe the productive items.

In situations where the conditions described above are met, the investment credit is to be available with respect to the tangible personal property which is required to carry out the binding contracts pursuant to which the project had been undertaken to the extent the property is placed in service by the taxpayer prior to 1972.

The newly designed product which is the subject of the project undertaken by the taxpayer must, in fact, be a product which is substantially changed from products previously produced by the taxpayer. In other words, a product will not be considered to be of a new design if it is basically merely a new model of a product previously produced by the taxpayer. For example, a project by an airplane manufacturer to produce a new model of an existing commercial airplane produced by the taxpayer, which new model had only a somewhat larger passenger carrying capacity and a moderately longer range than the existing model, would not be considered a project to produce a product of a new design. On the other hand, an airplane designed for commercial use would be considered a product of a new design if it had a substantially greater carrying capacity than the existing models of commercial planes produced by the taxpayer.

14. Replacements for property stolen or destroyed by casualty (sec. 4(c) of the bill and sec. 47(a)(4) of the code).—Present law provides for the recapture of the investment credit where property with respect to which the credit was allowed is disposed of prior to the end of the useful life of the property which was used in determining the amount of the credit originally allowed. One of the types of dispositions which may bring the recapture rules into play is where the property is stolen, or damaged, or destroyed by casualty (referred to here as "casualty property"). Where the casualty property is replaced by property which is eligible for the investment credit, however, present law contains rules which basically have the effect of preserving the investment credit with respect to the casualty property.

Under present law one of two rules applies where casualty property is replaced. Under the first rule, there is no recapture with respect to the casualty property, but there is a reduction in the amount of the investment credit allowable on the replacement property for the portion attributable to the compensation received from insurance or otherwise with respect to the casualty property. Under the second rule, there is no reduction in the investment credit allowable with respect to the replacement property, but the regular recapture rules apply to the the casualty property. In determining which of these rules is applicable, the reduction in the investment credit allowable with respect to the replacement property which would occur under the first rule is compared with the reduction which would occur under the second rule as a result of applying the recapture provisions to the casualty property. The rule under which the reduction is the greater is the one which is applicable. As indicated, however, the basic effect of these rules is to preserve the investment credit with respect to the casualty property.

In order to continue essentially the same treatment after the repeal of the investment credit, the bill provides that the recapture rules will not apply to casualty property where the casualty occurs after April 18, 1969. The bill also provides that in the case of a casualty or theft prior to April 19, 1969, where the casualty property is replaced on or after that date (with property that would be eligible for the investment credit if it had not been repealed), the rules of present law are to continue to apply to the extent they have the effect of reducing or eliminating the recapture of the credit with respect to the casualty property. In other words, if the first rule of present law would be applicable, there would be no recapture with respect to the casualty property (but the otherwise reduced credit with respect to the replacement property would not be allowed). If the second rule of present law would be applicable, the effect of the normal recapture which would apply with respect to the casualty property could be offset to the extent an unreduced investment credit would have been allowable with respect to the replacement property.

15. Certain leased property (sec. 4(a) of the bill and sec. 49(c) of the code).—The bill provides, in effect, that the investment credit is not to be allowed in certain situations involving leased property where it is likely that the lessor has changed his usual manner of doing business primarily to obtain the benefits of an investment crdeit which otherwise would be disallowed.

Specifically, the bill provides that in the situations where—

(i) property is leased after April 18, 1969 (other than pursuant to a binding contract to lease entered into before April 19, 1969),

(ii) the property is eligible for the credit in the hands of the lessor but would not be eligible for the credit if acquired by the lesser, and

(iii) the property is of the same kind which the lessor ordinarily sold to customers before April 19, 1969, or ordinarily leased and passed credit through to the lessee before that time,

then neither the lessor nor the lessee may receive an investment credit with respect to the property.

In these situations, if the lessor had continued his usual manner of doing business, the leased property would not have been eligible for the credit since it would have been acquired by the purchaser or the lessee after April 18, 1969. It appears, however, that the lessor by changing his method of doing business could (in the absence of this provision) obtain the benefits of a credit because the property either had been acquired by him before the repeal date or is, in effect, treated as having been so acquired under the binding contract rule or another transition rule.

D. Amortization of Pollution Control Facilities

(Sec. 5 of the bill and Sec. 168 of the Code)

Present law.—Under present law a taxpayer may claim an investment credit with respect to pollution control facilities to the extent they involve property of a type for which the investment credit generally is available.

Explanation of provision.—As indicated in part II of the report, it was concluded that, in view of the possible impact of the repeal of the investment credit in the area of air and water pollution control and the seriousness of the present pollution problem, it is appropriate to provide an incentive for the development of new pollution control facilities in the form of allowing these facilities to be amortized over a 5-year period rather than to be depreciated over their longer useful lives.

Under the provision contained in the bill, a taxpayer (including an estate or trust) would be allowed, at his election (under regulations prescribed by the Treasury Department) to amortize any certified pollution control facility over a period of 60 months. The 60-month period with respect to a facility would begin either with the month after that in which the facility was completed or acquired, or with the next taxable year, whichever the taxpayer elected. The amortization deduction provided by the bill for any month would be in place of the regular depreciation deduction which would be allowable for that month under section 167 with respect to the facility. A taxpayer who elected the amortization deduction with respect to a facility however, would still be eligible to receive the additional first-year depreciation allowance provided under section 179 with respect to that facility. However, no investment credit would be available for any facility with respect to which the 5-year amortization deduction had been elected.

The amortization deduction provided by the bill would be available only with respect to a "certified pollution control facility," which generally is defined as that part of any depreciable property which is used to abate or control water or atmospheric pollution or contamination by removing, altering, disposing or storing of pollutants, contamianants, wastes or heat, and which is appropriately certified. The amortization deduction would be available only with respect to a facility the construction (reconstruction or erection) of which is completed by the taxpayer after 1968, or which is acquired after 1968, if the original use of the property commences with the taxpayer after that time. Only that portion of the basis of property constructed (reconstructed or erected) by the taxpayer which is properly attributable to construction (reconstruction or erection) after 1968, is to be taken into account for purposes of the amortization deduction.

As indicated, the amortization deduction would be available only with respect to a pollution control facility which is certified by the appropriate State and Federal authorities. In the case of water pollution, the State certifying authority means the State water pollution control agency as defined in the Federal Water Pollution Control Act, and the Federal certifying authority is the Secretary of the Interior. In the case of air pollution, the State authority is the air pollution control agency as defined in the Clean Air Act, and the Federal authority is the Secretary of Health, Education, and Welfare.

Under the certification required by the bill, it would be necessary with respect to any pollution control facility for the State authority to certify to the Federal authority that the facility had been constructed (reconstructed or erected) or acquired in conformity with the State program or requirements regarding the abatement or control of water or air pollution or contamination. It would be further necessary for the Federal authority to certify to the Secretary of the Treasury with respect to any pollution control facility that the facility (1) met minimum performance standards (which would be required to be promulgated by the Federal authority from time to time for this purpose and which would take technological advances into account and specify the tolerance of such polutants and contaminants as is appropriate), (2) was in compliance with the applicable regulations of Federal agencies, and (3) was in furtherance of the general policies of the United States for cooperation with the States in the prevention and abatement of water or air pollution under the Federal Water Pollution Control Act or the Clean Air Act, respectively.

The bill further provides that the Federal certifying authority could not certify any facility to the extent it appeared that the costs of the facility would be recovered over its actual useful life through profits arising from the recovery of wastes or otherwise in operaing the facilty. A certification also could not be made to the extent it appeared that the facility would be constructed or acquired without regard to considerations regarding the control or abatement of air or water pollution. These limitations are designed to insure that the incentive for controlling air and water pollution provided by the amortization deduction is not available in situations where it, in effect, would provide a windfall to taxpayers, i.e., where the cost of the facility is recovered through byproducts derived from its operation or where the facility would have been constructed without regard to the abatement of air or water pollution. This latter category would cover, for example, the situation where a new plant contained a facility which had the effect of controlling pollution, such as a special sewer line or smokestack, but which actually was installed for the effective operation of the plant rather than for pollution control purposes.

Where only a part of a plant or other property is appropriately certified as a pollution control facility, the bill provides that the adjusted basis of the property is to be properly allocated between the certified portion and the uncertified portion in accordance with regulations prescribed by the Treasury Department.

As noted above, where a taxpayer elects the amortization deduction provided under the bill for certified pollution control facilities then no investment credit may be claimed with respect to the facility. Thus, if a taxpayer has property which generally would be eligible for the investment credit and part or all of the property also is eligible for rapid amortization, if he claims rapid amortization with respect to the property (or a portion of it) he may not claim an investment credit with respect to the same property (or portion). This may occur where the construction of a property was completed after 1968 (or acquired after that date) but either because the construction of the property began before, or it was acquired before, April 19, 1968 (or because of the binding contract rule or some other transition rule) the taxpayer generally could claim an investment credit with respect to the property.

With respect to property for which the amortization deduction provided by the bill has been elected, the bill further provides for the recapture of the excess amortization deductions claimed (i.e. excess of those deductions over the deductions which would have been allowable if depreciation had been taken with respect to the property) and also for the application of the regular depreciation recapture rules (whether real or personal property is involved), treating the amortization deductions claimed with respect to the property for this purpose as if they were, in effect, depreciation deductions. In other words, to the extent a gain arising on the disposition of a pollution control facility, with respect to which the amortization deduction has been allowed, is in fact attributable to the allowance of that deduction, the gain is to be treated as ordinary income.

The amortization deduction provided by the bill may be discontinued by a taxpayer at any time. If a taxpayer does discontinue the amortization deduction, then he may depreciate the property starting with the first month to which the amortization deduction is not applicable. A taxpayer who does discontinue the amortization deduction, however, would not be entitled to any further amortization deduction with respect to that facility.

The amendments made by this section of the bill are to be applicable with respect to taxable years ending after 1968.

E. Low Income Allowance

(Sec. 6 of the Bill and Secs. 3 and 141 of the Code)

Present law.—Under present law, a taxpayer may deduct his personal exemptions and also either his itemized deductions or the standard deduction from his adjusted gross income in order to determine his taxable income. The standard deduction is the larger of the 10 percent standard deduction (10 percent of adjusted gross income) or the minimum standard deduction, but in neither case may it exceed $1,000 ($500 in the case of a married individual filing a separate return). The minimum standard deduction is intended for low-income taxpayers and provides for a $200 deduction ($100 in the case of a separate return filed by a married taxpayer) plus $100 for each personal exemption allowed.

Explanation of provision.—While the action taken in 1964 providing for the minimum standard deduction provided some relief for low income individuals, it still left some 5.2 million returns at or below the recognized "poverty level" who are still paying income taxes. It appears inappropriate to ask individuals with incomes below this minimum standard to share in the burden of income taxes. This would be particularly inappropriate at the present time when rising prices have made more difficult their problem of income maintenance.

Accordingly, the bill supplements what in the past has been called the "minimum standard deduction" to raise the minimum amount of exempt income for a family unit of eight or less to $1,100, plus the number of $600 exemptions available to the family unit. For those with incomes above the minimum levels, the additional allowance provided by this bill is phased out gradually so that there is not a substantial "notch" or unusually high marginal rate in effect immediately above the level where the new allowance is provided.

Under the bill, the new "low income allowance" consists of an amount called the "basic allowance" (formerly known as the minimum standard deduction) and the "additional allowance" (the new feature added by this bill). The basic allowance (as is true of the minimum standard deduction under present law) generally amounts to $200, plus $100 for each personal exemption allowed to the taxpayer up to a total of $1,000. In effect, this allowance terminates at this point since this is the level of the maximum standard deduction.

The additional allowance in the case of families with 8 or fewer exemptions adds a sufficient amount to the basic allowance in the case of different size family units so that the total tax-free income level, in addition to personal exemptions, in the case of each of these family units is $1,100. Thus, in the case of a single person entitled to one exemption the amount added to the $300 basic allowance is $800; in the case of a family unit of 2 members, the amount added to the $400, available under the basic allowance, is $700. As the amount of the basic allowance increases (by $100 for each exemption), the additional allowance added by this bill (in order to maintain a uniform $1,100 of tax-free income per family unit) decreases (by $100). Thus the differentiation as to starting tax levels for different size family units is to be based solely on the difference in the number of $600 exemptions available to a family unit. This treatment is provided because an analysis of poverty levels for families of different sizes, made by HEW, indicates that the poverty income level increases by approximately $600 above a basic $1,100 amount for each additional person in the family unit.

The interaction of the basic and additional allowances to provide a uniform $1,100 tax-free amount (in addition to exemptions) is shown in table 9. This is shown by the number of persons in the family unit. For comparative purposes this table also shows the exempt amount under present law for each family size.

TABLE 9.—COMPARISON OF NONTAXABLE LEVELS OF INCOME UNDER PRESENT LAW AND UNDER THE LOW-INCOME ALLOWANCE

	Present level of nontaxability			New level of nontaxability				
					Low-income allowance			
Family size	Total, (3)+(4)	Personal exemptions	Minimum standard deduction	Total, (3)+(6)	Total allowance, (7)+(8)	Basic allowance	Additional allowance	Level at which additional allowance is reduced to zero
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1	$900	$600	$300	$1,700	$1,100	$300	$800	[1] $3,300
2	1,600	1,200	400	2,300	1,100	400	700	3,700
3	2,300	1,800	500	2,900	1,100	500	600	4,100
4	3,000	2,400	600	3,500	1,100	600	500	4,500
5	3,700	3,000	700	4,100	1,100	700	400	4,900
6	4,400	3,600	800	4,700	1,100	800	300	5,300
7	5,100	4,200	900	5,300	1,100	900	200	5,700
8	5,800	4,800	1,000	5,900	1,100	1,000	100	6,100
9	6,400	5,400	1,000	6,400	1,100	1,000	0	[2]
10	7,000	6,000	1,000	7,000	1,000	1,000	0	[2]

[1] The low-income allowance would no longer be utilized by the single individual above the AGI level of $3,250, since the ordinary 10-percent standard deduction is more generous than the basic allowance plus the additional allowance for single persons with incomes $3,250 or more.

[2] Additional allowance not available.

The additional allowance provided by this bill is "phased out" as the income of the taxpayer increases. For each $2 of additional adjusted gross income above the nontaxed "poverty level" ($1,100 plus $600 for each personal exemption), the additional allowance is decreased by $1.

Thus, the $800 additional allowance made available in the case of single persons gradually is eliminated over an income span of $1,600 and terminates as shown in table 9 at an income level of $3,300 ($1,600 plus the $1,700 nontaxed level). Above the level at which the additional allowance is phased out, the taxpayer may use the greater of the basic allowance, or the regular 10-percent standard deduction, as under present law.

The low-income allowance in operation will be simple since in all cases where both the basic and additional allowance are available, the low-income allowance is built into the optional tax tables and is available to a taxpayer only if he uses these tables. This is done by expanding the optional tax tables which presently cover under $5,000 of adjusted gross income to cover also adjusted gross income levels up to $6,100.[1] Only taxpayers electing the standard deduction may use the low-income allowance and taxpayers with adjusted gross incomes below $6,100 ($5,000 under existing law) can only obtain the standard deduction by using the optional tax tables. As a result the tax table will be the only method of computing tax for those claiming the full low-income allowance (that is, both the basic and additional allowances).

In the case of married individuals filing separate returns, generally the additional allowance is not available. This is because only by analyzing the total income of the family unit is it possible to determine the additional low income allowance required to avoid the imposition of tax on family income below the "poverty level." Therefore, generally the only low-income allowance available for married couples filing separately is the amount allowed them as a "minimum standard deduction" under present law; namely, $100 for each spouse, plus $100 for each exemption up to a total of $500. This is the basic allowance in such cases under the bill.

While the bill generally provides that married individuals filing separate returns are not to have the benefit of the additional allowance provided by this bill, it recognized a problem exists in the case of a family abandoned by one of the parents. To provide for cases of this type the bill specifies that a married individual, under certain conditions, may obtain the full low income allowance (both the basic and the additional allowance) even though filing a separate return. In addition, such an individual when electing the 10 percent standard deduction may deduct an amount up to $1,000, rather than only up to $500 as provided by present law. This result is obtained by treating such an individual as if she, or he, were a single individual. To qualify for this status the individual must:

(1) file a separate return;

(2) maintain as her, or his, home a household which is the principal place of abode of a dependent;

(3) the dependent in question must be a son or duaghter (or stepson or stepdaughter);

(4) the individual must be entitled to a dependency deduction for the son or daughter;

(5) the individual must furnish more than one-half the cost of maintaining the household; and

[1] The level below which taxpayers may request the Internal Revenue Service to compute their tax is also raised from $5,000 to $6,100.

(6) during the entire taxable year the individual's spouse must not be a member of the household in question.

The bill provides that the wage-withholding tables are to be revised to take the low-income allowance into account for periods beginning on and after January 1, 1970.

Table 10 shows the number of tax returns that will benefit from the low-income allowance and the number of returns that will be made nontaxable, by type of return and by adjusted gross income (AGI) classes. About 90 percent of the tax relief will benefit taxpayers with AGI below $3,000 (see table 11). An estimated 11,770,000 returns will benefit from the low-income allowance, and 5,226,000, or 44 percent, will become nontaxable. Of the total returns benefiting, 9,107,000, or 77 percent, will be taxpayers with AGI below $3,000, and all but 1 percent of the others who benefit will be in the $3,000 to $5,000 AGI class. About 92 percent of the returns that will be made nontaxable are in the below-$3,000 AGI class; virtually all the rest have AGI between $3,000 and $5,000.

TABLE 10.—LOW-INCOME ALLOWANCE OF $1,100[1] WITH 50-PERCENT PHASEOUT[2]—NUMBER OF RETURNS BENEFITING AND NUMBER OF RETURNS MADE NONTAXABLE

[By type of return and adjusted gross income class, in thousands]

Adjusted gross income class (thousands)	Single and separate returns	Joint and survivor returns	Head of household returns	Total [3]
NUMBER OF RETURNS BENEFITING				
$0 to $3	8,097	822	188	9,107
$3 to $5	1,100	1,303	161	2,563
$5 to $7	12	82	5	99
$7 and over				
Total	9,209	2,207	354	11,770
NUMBER OF RETURNS MADE NONTAXABLE				
$0 to $3	4,245	469	97	4,812
$3 to $5	79	292	30	401
$5 to $7	10	5		15
$7 and over				
Total	4,333	766	127	5,226
NUMBER OF RETURNS SHIFTING FROM ITEMIZED TO STANDARD DEDUCTION				
$0 to $3	455	114	41	610
$3 to $5	42	112	11	165
$5 to $7		1		1
$7 and over				
Total	497	227	51	775

[1] Including present law minimum standard deduction.
[2] The low-income allowance decreases by $1 for each $2 of adjusted gross income above the maximum nontaxable amount of adjusted gross income.
[3] Detail will not necessarily add to totals because of rounding.

It is estimated that in a full year of liability the features of the low-income allowance added by this bill will result in a revenue loss of $625 million. In the fiscal year 1970, however, the revenue loss is expected to be only $270 million since this includes only a partial year of operation for the provision.

TABLE 11.—*Revenue loss from the low income allowance of $1,100 in combination with present law minimum standard deduction with the allowance decreasing $1 for each $2 by which adjusted gross income exceeds the maximum nontaxable amount (including personal exemptions)*

FULL YEAR EFFECT AT ESTIMATED 1969 LEVELS OF INCOME

Adjusted gross income class	*Revenue loss (in millions)*
$0 to $3,000	$552
$3,000 to $5,000	72
$5,000 to $7,000	1
$7,000 and over	-----
Total	625

The reduction in tax liability under the bill from present law for a single person, a married couple and a married couple with two dependents is presented in Table 12. It shows the income level at which taxation begins and ends under the low income allowance and the change in taxation. For a single person, taxation under the proposal will begin at $1,700 of adjusted gross income, which is subject to $117 income tax under present law. A married couple pays $100 income tax under present law at $2,300 adjusted gross income which will become the beginning taxable income level under the proposal. At the comparable AGI level of $3,500, a married couple with two dependents pays $74 income tax under present law. At income levels where the low income allowance disappears, the income tax liability is identical under present law and the bill.

TABLE 12.—TAX DECREASE FROM THE LOW INCOME ALLOWANCE OF $1,100 IN COMBINATION WITH PRESENT LAW MINIMUM STANDARD DEDUCTION WITH THE ALLOWANCE DECREASING $1 FOR EACH $2 BY WHICH ADJUSTED GROSS INCOME EXCEEDS THE MAXIMUM NONTAXABLE AMOUNT (INCLUDING PERSONAL EXEMPTIONS)

Adjusted gross income	Tax liability: Under present law [1]	Tax liability: Under low income allowance [2]	Tax change: Amount	Tax change: Percent
SINGLE PERSON				
$1,000	$16	0	−$16	−100.0
$1,699 [3]	113	0	−113	−100.0
$1,700 [4]	117	$3	−114	−97.4
$2,000	163	66	−97	−59.5
$3,000	333	308	−25	−7.5
$3,249 [5]	367	365	−2	−.5
$3,250 [6]	376	376	0	
$4,000	504	504	0	
$5,000	671	675	[7] +4	+.6
MARRIED COUPLE, WITH NO DEPENDENTS				
$1,000	0	0		
$2,000	$58	0	−$58	−100.0
$2,299 [3]	96	0	−96	−100.0
$2,300 [4]	100	$3	−97	−97.0
$3,000	204	153	−51	−25.0
$3,699 [5]	302	300	−2	−.7
$3,700 [6]	310	310	0	
$4,000	358	358	0	
$5,000	501	505	[7] +4	+.8
MARRIED COUPLE, WITH 2 DEPENDENTS				
$1,000	0	0		
$2,000	0	0		
$3,000	$4	0	−$4	+100.0
$3,499 [3]	67	0	−67	−100.0
$3,500 [4]	74	$5	−69	−93.2
$4,000	144	110	−34	−23.6
$4,499 [5]	211	209	−2	−.9
$4,500 [6]	219	219	0	
$5,000	290	294	[7] +4	+1.4

[1] Without tax surcharge; tax liability from the optional tax table where applicable.
[2] Without tax surcharge, tax liability from the optional tax table with the table extended to $6,100 for every exemption status.
[3] Highest income rendered nontaxable under the low income allowance.
[4] Lowest income subject to tax under the low income allowance.
[5] Highest income benefitting from the low income allowance.
[6] Lowest income not benefitting from the low income allowance.
[7] This tax increase results from the optional tax table which when extended would impose the tax on $5,025 on incomes from $5,000 to $5,050 inclusive.

TABLE 13.—ESTIMATED BUDGET RECEIPTS AND DEFICIT (–) UNDER PRESENT LAW; ESTIMATED INCREASE IN RECEIPTS AND ESTIMATE BUDGET AND SURPLUS (+) UNDER BILL FISCAL YEAR 1970.

[In millions]

	Budget receipts under present law		Increase (+) or decrease (–) in receipts under bill					Total budget receipts under bill
	In January budget	In May 20 revision	Extension of tax surcharge	Law income allowance	Repeal of investment credit	Excise tax extension	Total	
Individual income taxes	$83,200	$84,900	+$5,600	–$270	+$420		$+5,750	$90,650
Corporation income taxes	36,100	35,800	+2,040		+930		+2,970	38,770
Social insurance taxes and contributions (trust funds)	43,868	44,368						44,368
Excise taxes	14,798	14,998				+$540	+540	15,538
Estate and gift taxes	3,400	3,500						3,500
Customs duties	2,300	2,200						2,200
Miscellaneous receipts	3,109	3,109						3,109
Total budget receipts	186,775	188,875	+7,640	–270	+1,350	+540	+9,260	198,135
Expenditures estimated by Budget Bureau as of May 20, 1969		192,900						192,900
Deficit (–) or surplus (+)		–4,025						+5,235

TABLE 14.—ESTIMATED INCREASE IN RECEIPTS UNDER BILL, FISCAL YEAR 1971

[In millions]

	Increase (+) or decrease (–) in receipts under bill					
	Extension of tax surcharge	Low-income allowance	Repeal of investment credit	60-month amortization of pollution control facilities	Excise Tax extension	Total
Individual income taxes	+$400	–$625	+$630	–$5		+$400
Corporation income taxes	+840		+1,940	–45		+2,735
Excise taxes					+$1,070	+1,070
Total	+1,240	–625	+2,570	–50	+1,070	+4,205

TABLE 15.—EFFECT OF 10 PERCENT SURCHARGE ON INDIVIDUAL INCOME TAX LIABILITY BY ADJUSTED GROSS INCOME CLASS[1]

[1969 levels of income]

Adjusted gross income class	Tax after credits before surcharge (millions)	10 percent surcharge (millions)	Tax after surcharge (millions)
$0 to $3,000	$1,169	$51	$1,220
$3,000 to $5,000	3,320	270	3,590
$5,000 to $7,000	5,591	504	6,095
$7,000 to $10,000	11,792	1,155	12,947
$10,000 to $15,000	18,494	1,860	20,354
$15,000 to $20,000	9,184	927	10,112
$20,000 to $50,000	13,988	1,419	15,408
$50,000 to $100,000	6,659	673	7,332
$100,000 and over	7,686	776	8,461
Total	77,884	7,635	85,520

[1] Single returns with less than $148, joint returns with less than $293, and head-of-household returns with less than $223 in tax liability are not subject to surcharge.

Note: Detail will not necessarily add to totals because of rounding.

TABLE 16.—NUMBER OF INDIVIDUAL INCOME TAX RETURNS IN 1969 AFFECTED BY THE 10 PERCENT SURCHARGE BY ADJUSTED GROSS INCOME CLASS

[In thousands of returns]

Adjusted gross income class	Number of taxable returns	Number of returns with tax increase: Presently taxable	Presently nontaxable [1]	Total	Number of returns with no tax increase	Percent with no tax increase
0 to $3,000	10,053	3,234	3	3,237	6,819	67.8
$3,000 to $5,000	9,562	6,774	5	6,781	2,788	29.2
$5,000 to $7,000	9,779	8,514	6	8,520	1,265	12.9
$7,000 to $10,000	13,815	13,439	9	13,448	376	2.7
$10,000 to $15,000	13,062	13,043	7	13,050	19	.1
$15,000 to $20,000	3,852	3,849	(2)	3,849	3	.1
$20,000 to $50,000	2,594	2,594	4	2,598	(2)	(2)
$50,000 to $100,000	340	340	(2)	340	(2)	(2)
$100,000 and over	95	95	(2)	95	(2)	(2)
Total	63,152	51,883	34	51,917	11,269	17.8

[1] Surcharge is computed before application of the foreign and investment tax credits and may be sufficient to make taxable some returns having such credits.
[2] Less than 500 or 0.05 percent.

Note: Detail will not necessarily add to totals because of rounding.

TABLE 17.—EFFECT OF 10 PERCENT, 5 PERCENT AND 2½ PERCENT SURCHARGE ON INDIVIDUAL INCOME TAX LIABILITY BY ADJUSTED GROSS INCOME CLASS [1]

[1969 levels of income]

Adjusted gross income class	10 percent surcharge (millions)	5 percent surcharge (millions)	2½ percent surcharge (millions)
0 to $3,000	$51	$26	$13
$3,000 to $5,000	270	135	68
$5,000 to $7,000	504	252	126
$7,000 to $10,000	1,155	578	289
$10,000 to $15,000	1,860	930	465
$15,000 to $20,000	927	464	232
$20,000 to $50,000	1,419	710	355
$50,000 to $100,000	673	336	168
$100,000 and over	776	388	194
Total	7,635	3,818	1,909

[1] Single returns with less than $148, joint returns with less than $293 and head-of-household returns with less than $223 in tax liability are not subject to the 10 percent surcharge. The exempt levels are slightly higher under the 5 percent surcharge and the 2½ percent surcharge.

Note: Details will not necessarily add to totals due to rounding.

IV. CHANGES IN EXISTING LAW

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

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