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TAX REFORM ACT OF 1969
H.R. 13270

STATEMENT OF THE HONORABLE DAVID M. KENNEDY,
SECRETARY OF THE TREASURY

COMMITTEE ON FINANCE
UNITED STATES SENATE
RUSSELL B. LONG, *Chairman*

SEPTEMBER 4, 1969

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Note: As indicated on page 19 in Assistant Secretary Cohen's statement, a "more detailed memorandum making further recommendations" will not be available to the Committee on Finance until a later date. At such time, they will be printed as a separate document and made available to the general public.

TREASURY DEPARTMENT
Washington, D. C.

This Statement is Totally Embargoed Until Actual Delivery Time, Scheduled for 10 A.M., Thursday, September 4, 1969

STATEMENT BY THE HONORABLE DAVID M. KENNEDY
SECRETARY OF THE TREASURY
BEFORE THE
SENATE FINANCE COMMITTEE
ON
THE TAX REFORM ACT OF 1969
10:00 A.M., THURSDAY, SEPTEMBER 4, 1969

Mr. Chairman and members of the Committee:

The Tax Reform Act of 1969 is a milestone in tax legislation. The Administration strongly urges its enactment at the earliest practicable date.

While we endorse its enactment, we believe that the bill should be improved in a number of respects. Broadly, these are:

-- the long-run revenue loss in the bill of approximately $2.4 billion should be scaled down by about half;

-- the balance of tax shifts in the bill (a $7.3 billion reduction for individuals and a $4.9 billion increase for corporations) should be redressed by including a 2-point reduction in the corporate tax rate;

-- a number of structural changes in the bill should be modified, some because they go too far, others because they do not go far enough.

Let us make no mistake about the nature of the legislation approved by the House of Representatives. H.R 13270 is not only the most sweeping tax reform measure in the

history of the Internal Revenue Code. It also embodies a significant amount of tax reduction. Reduction of this type and amount at this time can be questioned on three grounds.

First, action now to reduce the national tax burden by a net $2.4 billion annually would represent a significant decision with respect to national priorities. To the extent future revenues are today committed for such reduction, they cannot be used to support important Government programs. (It should be noted that the $2.4 billion projected revenue loss is expressed in terms of today's income levels. With incomes expected to rise significantly in the next decade, the revenue loss would be much higher.)

The Administration's concern over the proposed cuts in individual taxes does not mean that we attach a low priority to this goal. But tax reduction cannot be carried out without due consideration for other national needs. The extent to which we can responsibly curtail our defense outlays has to be determined by future events, many of which are beyond our control. Domestically, the Congress has enacted programs which call for increased spending in future years. This

Administration is committed to renovation of national welfare programs and to an imaginative program of revenue-sharing with State and local governments. Proposals also will be forthcoming to promote additional hiring and training of the hard-core unemployed and to foster investment in poverty areas.

The nation is committed to the goal of adequate housing for all of its citizens. Recent studies demonstrate that Federal surpluses, which would bring down interest rates and stimulate the flow of funds into mortgages, may well be the best way in which to promote such housing.

Even though this Administration is determined to pursue a prudent spending policy, we simply do not know enough about the future to commit ourselves today to the degree of tax reduction embodied in H. R. 13270. In our suggested changes, we have not attempted to attain a precise balancing of estimated increases and decreases over the period. Indeed, revenue estimating is far too imperfect a science for that purpose. However, we urgently recommend that you reduce the expected shortfall in H. R. 13270 by approximately half, to $1.3 billion.

The second major question concerning the tax reduction in H. R. 13270 is whether it is equitable. The largest cuts are appropriately centered in the lowest brackets. But, in too many instances, certain taxpayers are given reductions much higher than others in comparable economic circumstances.

Our recommendations would reduce these inequities by:

> Restorying the "phase-out" in the proposed Low Income Allowance, but at a rate of $1 tax for $4 income as contrasted with the $1 to $2 curve in President Nixon's original proposal. This still would remove five million taxpayers, including almost all of those at the poverty level, from the Federal tax rolls.
>
> Raising the present standard deduction of 10 percent with a $1,000 ceiling to 12 percent with a $1,400 ceiling, instead of 15 percent with a $2,000 ceiling.
>
> Liberalizing taxation of single persons as compared to married couples through a new rate schedule rather than allowing head-of-household status to those single persons over 35.

The third shortcoming of H. R. 13270 is that it is weighted in favor of consumption to the potential detriment of the nation's productive investment. To be sure, President Nixon recommended on April 21 the repeal of the 7 percent investment tax credit. Such repeal represents over half of the $4.9 billion increase in corporate taxes in

the bill. While the Administration's position on repeal of the investment tax credit is unchanged, we are concerned about the bias in the bill against investment in favor of consumption. Such overweighting, embodied in the proposed treatment of capital gains as well as corporate tax increases, could impede economic growth in the years ahead by curtailing the incentive to make productive investments.

To help guard against this drag on growth, the Administration strongly recommends that the tax rate on corporate profits be reduced by one point in calendar year 1971 and an additional point in 1972. This would reduce corporate taxes by an estimated $800 million in 1971 and $1.6 billion by 1972 (in terms of today's profit levels), thereby reducing the net increase in corporate taxes in H. R. 13270 from $4.9 billion to $3.5 billion (after other recommended adjustments). This change in the bill would not be unfair to individuals. Their tax relief, concentrated in the lower brackets, would still amount to a gross amount of $7.3 billion and a net figure of $4.8 billion.

Although no one can forecast perfectly the trend of the economy in the next two years, the Administration's current

timetable in its anti-inflationary program would allow for growth-inducing corporate tax reduction in 1971 and 1972. If not, the situation with respect to the entire program of tax relief in H. R. 13270, individual as well as corporate, will have to be re-evaluated in the light of then existing conditions.

Investment in the years ahead may also be impeded by the proposed changes in tax treatment of capital gains. We believe these changes go too far. Our original proposals were designed to prevent excesses rather than fundamentally alter such tax treatment. Accordingly, we recommend retention of the 6-month holding period, as contrasted with the extension to one year in H. R. 13270. In addition, we favor retention of the maximum 25 percent rate on capital gains, except in cases of very large gains relative to ordinary income. In these instances, which would affect a relatively small number of individuals, the rate could rise as high as 32-1/2 percent, or to half the new top bracket rate of 65 percent.

Our recommendations concerning capital gains taxation and other provisions of H. R. 13270 are outlined in detail

in Assistant Secretary Cohen's statement, which has been submitted to the Committee. Before responding to questions, I would like to summarize several of these recommendations.

1. Petroleum Taxation

In its tax proposals of April 22, the Administration made no recommendation for change in percentage depletion as it affects the petroleum industry, except to include such depletion in the Limit on Tax Preferences (LTP) and the Allocation of Deductions Rule (ADR). We recommended that intangible drilling costs that would otherwise be capitalized also be included in the LTP and ADR. Further, we proposed that certain sales of production payments be treated as loans to avoid manipulation of income and losses in mineral transactions.

The House of Representatives accepted our proposals relating to production payments. It included percentage depletion and intangible drilling costs in the Allocation of Deductions but dropped them from the Limit on Tax Preferences. The House action also disallowed percentage depletion on foreign operations and reduced depletion on domestic operations from 27-1/2 to 20 percent.

Although the Administration did not recommend a cut in domestic percentage depletion, we accept the House approach to increasing the share of the national tax burden borne by the petroleum industry. But this cut in domestic depletion will not close the loophole which permits a wealthy oilman to pay little or no Federal income tax. . To do so, we recommend that the Senate restore percentage depletion to the LTP. However, intangible drilling costs, included originally in the Administration's LTP proposal, should be restored to the LTP only for investors and not for those individuals who receive 60 percent or more of their income from oil and gas operations.

2. Financial Institutions

The Administration does not object to the provisions of H. R. 13270 which would base bad debt losses of commercial banks, mutual savings banks, and savings and loan associations on actual experience -- subject to a 10-year carryback and a 5-year carry forward for net operating losses. But we are concerned about the continued heavy reliance on investment restrictions to promote a flow of money into residential construction. Such restrictions limit the ability of the

thrift institutions to compete for savings during periods of tight money. They also fail to recognize other important national goals.

We therefore recommend a special tax deduction for each of these three institutions, designed to encourage the flow of credit not only into residential construction, but also into other socially preferred uses, such as guaranteed loans to college students and loans guaranteed by the Small Business Administration. At the outset, this deduction could consist of 5 percent of gross interest income from such loans. However, the deduction could not serve in any year to reduce the taxable income of any such institution to an amount less than 60 percent of taxable income, adjusted to include the full amount of dividend income and tax-exempt interest.

The result of these provisions would be to create tax equity among these competing institutions, enhance their competitive ability relative to other outlets for savings, and encourage the flow of money into uses determined by the Congress to be socially preferable.

3. <u>Other Provisions</u>

Five other Administration recommendations should be noted:

- H. R. 13270 goes too far in taxing foundations. We recommend that the proposed 7-1/2 percent tax on income be replaced by a 2 percent "supervisory tax," which would raise sufficient funds for an adequate audit program in the Internal Revenue Service.

- In order to make certain that the bill does not unduly restrict donations of property to charities, colleges, and other tax-exempt activities, we recommend deletion of the provision which would include appreciation on such property in the Limit on Tax Preferences and the Allocation of Deductions.

- The personal deduction allowed for State gasoline taxes should be repealed. Inasmuch as the State tax is, like the Federal tax, essentially a user charge, the existing deduction in effect shifts the burden of those taxpayers who itemize to the general taxpayer. Repeal would raise the average tax on those who itemize by $10 to $15.

- The House bill goes beyond the Administration's recommendations and includes interest on State and local bonds in the LTP. The Administration opposes this inclusion for the same reasons we gave on April 22 -- there are constitutional doubts as to inclusion as well as the possibility of adverse repercussions in the market for State and local securities. However, we recommend as we did in April that the full amount of tax-exempt interest be included in the Allocation of Deductions rule, without the 10-year phase-in contained in the House bill.

-- To simplify compliance by millions of low-income individuals, persons not subject to tax under the new higher levels resulting from the Low Income Allowance should not be required to file returns.

Mr. Chairman, I repeat that the bill before you is a milestone in tax legislation. Almost all of the sixteen substantive tax proposals which President Nixon submitted to the Congress in April, including the Limit on Tax Preferences and the Low Income Allowance, are included in the bill. The House Ways and Means Committee, as a result of its exhaustive hearings, added a number of constructive measures to those proposed by the Administration. The resulting legislation was overwhelmingly approved by the House of Representatives.

Now it is up to the Senate. I am confident that this Committee will proceed with the same determination shown in the House and that we can look forward to final enactment of H. R. 13270, appropriately modified, before the end of 1969.

In the words of President Nixon, such enactment will represent a long step toward making taxation, if not popular, at least fair for all of our citizens.

TREASURY DEPARTMENT
WASHINGTON, D.C.

This Statement is Totally Embargoed Until Actual Delivery Time, Scheduled for 10:00 A.M., Thursday, September 4, 1969.

STATEMENT OF THE HONORABLE EDWIN S. COHEN
ASSISTANT SECRETARY OF THE TREASURY FOR TAX POLICY
BEFORE
THE SENATE FINANCE COMMITTEE
ON THE PROVISIONS OF H.R. 13270
THE TAX REFORM ACT OF 1969
SEPTEMBER 4, 1969, 10:00 A.M.

Mr. Chairman and Members of the Committee:

It is my pleasure to join in Secretary Kennedy's statement and to present the Administration's position on the specific provisions of H.R. 13270, the Tax Reform Act of 1969.

The bill in its present form when fully effective provides tax relief of $9.7 billion to individuals and also contains certain incentive provisions which involve a revenue loss of $0.8 billion--a total revenue reduction of $10.5 billion. These are offset by revenue raising provisions which in the long run will total $8.1 billion (including $3.3 billion from repeal of the investment credit), resulting in a net revenue loss of $2.4 billion. In some years in the early 1970's the net revenue loss will be about $1.0 billion higher. The bill would commit at this time revenues which may be needed for programs of high priority, such as President Nixon's family assistance plan, the Administration's program for revenue

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sharing with state and local governments, and other vital measures. The size of this revenue loss requires that the tax relief provisions of the bill be carefully evaluated.

The provision giving $4.5 billion of rate reductions to individuals represents reasonable, equitable tax relief. The other broad impact of the bill--the individual relief provisions other than rate reduction--converting the Administration's proposed Low Income Allowance to a flat minimum standard deduction allowance of $1,100, extending the standard deduction to 15 percent with a $2,000 maximum, extending head-of-household treatment to all single persons over age 35, and extending special relief to widows and widowers, provide disproportionately high tax reduction in many instances. In effect, these various benefits cumulate in some of the income brackets, particularly with respect to single persons, and create some serious imbalances in the allocation of the total tax relief. While there is merit in these changes, in the aggregate they go too far and should be cut back. The imbalances,we believe, should be corrected.

The bill would result in a net long-term shift in tax burden between corporations and individuals as follows:

Individuals: $-7.3 billion

Corporations: $+4.9 billion

The resulting shift in emphasis of this magnitude from investment to consumption is in our judgment inadvisable.

The Administration recommends a revised program of tax relief for both individuals and corporations designed to decrease the revenue loss in the bill, distribute the tax relief among individuals more equitably, and reduce to an acceptable degree the shift in emphasis from investment to consumption. This revised program would provide substantial relief for individuals of the same general types as are contained in the bill. The program also calls for a corporate rate reduction ultimately reaching two percentage points -- relief of the same general magnitude as the individual rate reductions.

This revised program would result in a long-term revenue loss of $1.3 billion per year, approximately half as much as the $2.4 billion revenue loss which would result from the House bill. It

would result in a net increase in corporate taxes of $3.5 billion and a reduction for individuals of $4.8 billion. While this still represents some shift in emphasis from investment to consumption, it is one that is much less severe than that provided in the House bill and is one that is warranted by the economic conditions which we expect to prevail in the year 1972 and thereafter, when it will have its principal effect.

The general composition of the bill by rate reduction, reform, relief and incentive, for individuals and corporations, is shown in Table 1. Table 2 contains a list of the specific provisions in the House bill in the order that I will discuss them, with the long-run revenue estimate of the House bill and the proposed Treasury change. Table 2 also provides a table of contents for those topics in the following discussion.

I have attached at the end of this statement tables showing the effects of the principal provisions on a typical married taxpayer at various income levels. There is also a

Table 1

Comparison of House Bill and Treasury Proposal by Principal Feature in Terms of Long Run Revenue Effect

	House Bill	Treasury Proposal	Difference (-) is increased revenue loss or decreased gain
	(............ $ millions ....)		
Rate Reduction and Relief Provisions			
Individual			
Rate reduction..........................	-4,498	-4,705	-207
Standard deduction......................	-4,025	-1,690	2,335
Single person...........................	- 650	- 445	205
Other...................................	- 500	- 500	-
Total...................................	-9,673	-7,340	2,333
Corporation			
Rate reduction..........................	-	-1,600	-1,600
Incentive Provisions			
Individual..............................	- 70	- 70	-
Corporation.............................	- 760	- 440	320
Total Rate Reduction, Relief and Incentive ...	-10,503	-9,450	1,053
Reform Provisions			
Individuals			
Investment credit repeal................	600	600	-
Other...................................	1,815	1,975	160
Total...................................	2,415	2,575	160
Corporations			
Investment credit repeal................	2,700	2,700	-
Other...................................	2,970	2,830	-140
Total...................................	5,670	5,530	-140
Total Individuals and Corporations Reform	8,085	8,105	20
Total:			
Individuals.............................	-7,328	-4,835	2,493
Corporations............................	4,910	3,490	-1,420
Combined	-2,418	-1,345	1,073

Office of the Secretary of the Treasury
Office of Tax Analysis

September 2, 1969

Table 2

Long Run Revenue Effects of H.R. 13270
as Passed by the House and
Proposed Treasury Changes by Major Provision

Page number in following discussion		Long Run Revenue Effects		
		House Bill	Current Treasury proposal	Difference (- is greater revenue los[s])
		(.......... $ millions ....)		
	Tax relief - Individuals			
7	Rate reduction	-4,498	-4,705 1/	-207 2/
8	Low income allowance - minimum standard deduction	-2,652	-920	1,732
9	Standard deduction	-1,373	-770	603
10	Single persons	-650	-445	205
13	Reporting by low income taxpayers	--	--	--
14	Earned income rate limit	-100	-100	0
15	Gasoline tax deduction	0	390	390
	Tax relief - Corporations			
15	Rate reduction	0	-1,600	-1,600
	Others			
16	Foundations	100	25	-75
21	Exempt organizations - unrelated business income	20	20	0
23	Charitable contributions	20	20	0
27	Farm losses	20	50	30
30	Interest deductions	20	0	-20
32	Moving expenses	-100	-100	0
32	Limit on tax preferences	85	60	-25
32	Allocation	460	480	20
38	Income averaging	-300	-300	0
38	Restricted property	*	*	*
39	Deferred compensation	25	0	-25
41	Accumulation trusts	70	70	0
42	Multiple corporations	235	235	0
43	Corporate securities	70	70	*
44	Stock dividends	*	*	*
46	Foreign income	65	50	-15
52	Financial institutions	460	410	-50
57	Regulated utilities	310	310	0
60	Tax-free dividends	80	80	0
61	Natural resources	600	600	0
63	Capital gains and losses of individuals	635	425	-210
68	Capital gains of corporations	175	175	0
68	Real estate	1,005	1,005	0
69	Cooperatives	*	*	*
70	Subchapter S	*	*	*
74	Investment credit repeal	3,300	3,300	0
74	Amortization of freight cars	-100	0	100
74	Amortization of pollution equipment	-400	-180	220
72	Taxation of state and local bonds	*	*	*
	Total	-2,418	-1,345	1,073

Office of the Secretary of the Treasury
Office of Tax Analysis

September 2, 1[9]

*Less than $2.5 million.
1/ 1979, calendar year liability
2/ Increase due to broader tax base associated with a lower standard deduction.

table showing by adjusted gross income classes the pattern of total tax change under the bill and under the proposed changes. It demonstrates that our program continues but moderates the pattern of the House bill of heavier reductions in the bottom brackets, cuts of about 5 percent in the middle brackets, and an increase in the top brackets.

The Administration's position on the provisions of the House bill is as follows. A separate more detailed memorandum making further recommendations as to various matters is also being submitted to the Committee.

1. Tax Relief--Individuals (Secs. 801, 802, 803, 804, 805*)

Rate Reductions. The $4.5 billion rate cut in the bill does not discriminate between itemizers and nonitemizers, between homeowners and tenants, between married persons and single persons, between heads of households supporting dependents and single persons without this burden, or between taxpayers with different sources of income. The Administration recommends retention of the $4.5 billion rate cut ** in the form contained in the House bill because it provides such even-handed nondiscriminatory relief.

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*References are to section numbers of H.R. 13270.

**The rate cuts will cost $4.7 billion under our proposals because our changes in the standard deduction broaden the income base.

Low Income Allowance. The Administration in April 1969, recommended a Low Income Allowance designed to relieve persons and families with incomes below the poverty level from any tax liability. To reduce the revenue loss from this additional special deduction, and to direct its impact at those below or near the poverty level, it was to be "phased-out," i.e., the special Allowance was to be reduced at the rate of 50 cents for each dollar of income over the specified "poverty" levels. This limited the bulk of the relief to persons with incomes below $5,000. The Allowance in this form would have relieved over 5 million presently taxable persons from any tax liability, would have reduced the tax of 7 million more persons, and would have resulted in an annual revenue loss of only $625 million. The Low Income Allowance in this form was favorably reported in H.R. 12290 by this Committee.

The present bill contains the Low Income Allowance but provides for the phase-out for the year 1970 only. Thus, the bill completely eliminates the phase-out for 1971 and subsequent years, resulting in an additional revenue cost of $2.0 billion.

The Administration recommends that the phase-out be retained but be stretched out by application at the rate of 25 cents for each dollar of income above the poverty level. This will extend the tax benefits provided by the Allowance to somewhat higher brackets where they are justified, but without converting the Allowance to a minimum standard deduction of $1,100, which is the effect of the House bill. The Low Income Allowance with this extended phase-out will result in a revenue loss of $920 million in lieu of the $625 million as originally proposed. It will thus save some $1.7 billion of the cost of outright elimination of the phase-out.

Standard Deduction. The provisions of the House bill increasing the standard deduction over a three-year period from the present 10 percent, with a ceiling of $1,000, to a level of 15 percent, with a ceiling of $2,000, should be changed. The increase should be limited to a level of 12 percent with a ceiling of $1,400. This more limited extension of the standard deduction would still result in major simplification since some 4 million taxpayers will be able to switch from itemizing their deductions to the standard deduction.

The combined effect of the rate reduction, the Low Income Allowance and standard deduction increase will be to reduce taxes for some 63 million taxpayers and to remove some 6 million persons completely from the tax rolls. The revenue cost of the standard deduction liberalization in this more limited form will be $770 million as compared to $1,373 million cost of the House bill provision.

Single Persons. The tax burden on single persons is disproportionately high in relation to that of married persons who enjoy the benefits of income splitting. However, in our judgment the provision of the House bill extending head-of-household treatment to all single persons age 35 and over is not the best means of dealing with this inequity. While a test based on maintenance of a household might have been devised, it would have been extremely difficult to administer where the taxpayer had no dependents, and in any event, the inequity to be corrected is the disparity in burden between single persons, whether or not they have dependents, and married couples. It seems preferable to reserve more favorable treatment for individuals who both maintain households and support dependents, as opposed to single persons who do not,

but yet also narrow the tax differential between single and married persons. Further, the selection of age as a dividing line for preferential treatment seems arbitrary and bears no relationship to actual ability to pay.

Accordingly, in lieu of the provisions of the House bill, the Administration recommends that a new rate schedule be adopted for single persons. This schedule would be constructed so that the difference between single person rates and married couple rates would be narrowed; no single person with the same taxable income as a married couple would pay a tax more than 20 percent greater than the tax paid by the married couple. The head-of-household rates would be reserved for persons maintaining a household for the support of dependents, and would continue to fall approximately halfway between the new single person rate schedule and the rates applicable to married couples. This proposed maximum 20 percent differential reflects a reasonable judgment of the additional costs of living of married couples and their ability to pay as compared to single persons.

The provision of the bill extending without limitation split income treatment to surviving spouses with dependents (rather than for only two years after the death of the spouse, as provided by existing law) should be deleted. A surviving spouse will become entitled to head-of-household treatment after the two-year period if the surviving spouse continues to support a dependent, and there is no rational basis for providing more favorable treatment to a surviving spouse than to any other head of household. The limited two-year period following the other spouse's death is appropriate because this is a period of transition, but we believe the split income benefits should not be extended beyond this period as the House bill provides.

The revenue cost of the lower rate schedule for single persons and heads of households, after deleting the unlimited extension of split income treatment for surviving spouses, would be $445 million as compared to the $650 million cost of the House bill provision.

Reporting by Low Income Taxpayers. To simplify compliance by millions of low income individuals, the Administration recommends a liberalization of the filing requirements. Under present law (not changed by the House bill), an individual is required to file a return if his gross income is $600 or more, except that an individual over 65 years of age is required to file a return only if his income is $1,200 or more. Consequently, 5 million nontaxable individuals with incomes which exceed these levels but which are less than the amounts exempted from tax by the Low Income Allowance would still be required to file returns. Since the Low Income Allowance is built into the withholding provisions of the bill, many of these persons will not be filing for refunds. The filing requirements should be raised to the new nontaxable levels.

Earned Income Rate Limitation. The Administration strongly supports the provisions of the House bill placing a 50 percent maximum tax rate on earned income. This limitation will provide an important incentive to the earning of income by personal services, both by employees and self-employed persons. Many of the devices for conversion of ordinary income into capital gain, and for deferment of income, have been nurtured out of the natural desire of persons who have reached high earned income levels to avoid the burden of very high rates. With a 50 percent top marginal rate on earned income, the successful executive or professional man will be more inclined to concentrate his efforts in the field in which he is qualified and devote less of his attention to intricate means of minimizing the effect of high tax rates. Particularly when coupled with the many provisions of the bill which eliminate or curb existing tax avoidance techniques, we think the 50 percent ceiling rate on earned income represents a substantial improvement in the law.

Gasoline Tax Deduction. The Administration recommends that the personal deduction allowed for state gasoline taxes be repealed. It is appropriate to discontinue this deduction as a part of an over-all program of rate reductions and liberalization of the standard deduction. The state tax, like the Federal tax, is essentially a user charge for highway facilities paid by those who use the highways. As a user charge, the existing deduction simply shifts part of the burden of those taxpayers who itemize to the general taxpayer. No other nonbusiness user charges are deductible. The proposed repeal of the deduction would not affect state gasoline taxes paid for business purposes. The revenue gain from repeal would be $390 million, an average tax increase from this change of about $10 - $15 to taxpayers who itemize their deductions.

2. Tax Relief--Corporations

The Administration recommends a corporate rate reduction of two points, a one-point reduction effective in 1971 and a full two-point reduction effective in 1972 and thereafter. The present corporate

rate, including the surcharge, is 52.8 percent for the calendar year 1969. This will reduce to 49.2 percent for the calendar year 1970 if the surcharge is extended at 5 percent for half the year as recommended by the Administration. The regular 48 percent rate, which would otherwise be effective for 1971, should be reduced to 47 percent for that year. The rate should be further reduced to 46 percent for 1972 and subsequent years. This program of continuing reduction will provide an important offset to the provisions of the bill withdrawing incentives to investment, such as the repeal of the investment credit. This rate reduction would result in a revenue loss of $800 million in 1971 and $1.6 billion in 1972 and thereafter.

3. Private Foundations (Sec. 101)

Much of the property of private foundations derives from the income, gift and estate tax deductions allowed for contributions to their creation or support and from the income tax exemption enjoyed by the organizations. The Federal Government thus has a vital interest in insuring that their assets are properly applied. The provisions of the House

bill dealing with private foundations will tend to insure that their property is devoted solely to charitable purposes. Private foundations will thus become an even more useful as a flexible source of support for achievement of new levels of thought and action, relieving the burdens of government.

In summary, the House bill would regulate certain activities of foundations. Self-dealing between a private foundation and its substantial contributors would be prohibited. Foundations would be required to distribute the greater of their income or 5 percent of the value of their corpus on a relatively current basis. Where a business is controlled by a foundation, or by a foundation and its substantial contributors, the foundation would be required within a 10-year period to limit or dispose of its interest unless common control is otherwise eliminated. These provisions were recommended by the Administration to the Congress in substantially the form contained in the bill.

The bill prohibits grass-roots lobbying, and it also proscribes other activities designed to influence legislation even though they represent only an insubstantial part

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of the foundation's activities. Existing law with respect to political activities would not otherwise be changed except that activities which influence the outcome of any public election would be significantly restricted. Individual grants would be prohibited unless made pursuant to an objective and nondiscriminatory procedure. Certain transactions with government officials which might raise substantial questions of propriety would also be prohibited. We regard these rules as necessary restrictions on foundation activity which will not interfere with attainment of their charitable objectives.

Penalties for violations would be imposed in the form of a graduated series of sanctions designed to compel compliance. Foundation managers would not be penalized for any such improper act unless carried out by them with knowledge that it constituted a violation of these provisions. For example, reliance on the advice of counsel would be sufficient defense for a manager.

The provision of the bill on this subject which requires the most careful evaluation is the imposition of a 7-1/2 percent tax on investment income, including capital gains, of a private foundation. We have

concluded that a tax designed to raise revenue from private foundations cannot be justified once the other restrictions imposed on them by the bill have been enacted to insure that their funds will be used solely for charity. That is, there is no reason to reduce funds available for charitable activities by a tax once their tax exempt status has been justified in the first instance.

However, the Administration considers that it is unfair to require taxpayers in general to pay the increasing cost of administering the audit program for these organizations when such program is required to insure that charity receives the full benefit of foundation resources. Thus, the Administration recommends an annual supervision tax of 2 percent of private foundation investment income. This will raise about $25 million per year in the long-run effect (about $17 million in 1970), which approximates the estimated audit cost.

The bill also contains special provisions granting permanent exemption for two existing private foundations from those provisions designed to prohibit foundation control of operating businesses. We do not believe these two foundations can appropriately be distinguished from other foundations

which are subject to the bill; the reasons for applying the business holdings rule to existing foundations--an assurance that their assets, interests, and activities are totally committed to their charitable function--apply equally to these two foundations. We believe these two special exemptions should be eliminated from the bill.

The bill fails to provide an exemption from the business holding requirements where an organization's charter precludes disposition of certain business interests, although it does provide that these requirements are suspended while efforts are being made to secure court authorization of charter amendment. Even if disposition of business holdings is ultimately found by the court to be prohibited, the sanctions of the bill would then be applicable. The House Ways and Means Committee was concerned that if a permanent exemption were granted, the courts would tend to deny permission to amend the instrument. There is, however, a permanent exemption from the income pay-out rules for those organizations which are required by their governing instruments to accumulate income and which find it impossible to effect a change. It appears that the provision pertaining to dispositions of business

holdings is too stringent and should be changed to conform to the income pay-out rule.

4. Other Exempt Organizations (Sec. 121)

The provisions of the bill dealing with other exempt organizations adopt the Administration's recommendation to extend the application of the unrelated business tax. The business income of churches and other exempt organizations from commercial transactions in direct competition with tax-paying business would no longer be tax exempt. Further, borrowing by a tax exempt organization to purchase income producing assets which are unrelated to the exempt functions of the organization would be discouraged by taxing all such debt financed income, including investment income. This prevents a tax exempt organization from extending its tax shelter to a nonexempt seller through inflation of the price.

Investment income used to finance the social activities of members of social clubs and similar groups would be taxed, since in this situation it relieves the members of personal expense which otherwise would be paid by them out of after tax income.

Finally, rents, interest, and royalties from controlled subsidiaries of any tax exempt organization would be taxed. This will prevent avoidance of the unrelated business tax by transferring active business operations to taxable organizations while siphoning off the profits from such operations in the form of "passive" income (representing deductible payments to the taxable organization).

The bill also codifies previously existing Treasury regulations defining activities such as advertising, which will be treated as unrelated business. On the other hand, it eases the qualification requirements for voluntary employee beneficiary associations which are in reality health and welfare trusts established pursuant to collective bargaining agreements.

The Administration supports these basic provisions of the House bill. However, these provisions are only a beginning step in resolving the tax problems which exist with respect to exempt organizations. These problems are presently being given further intensive study. For example, the Treasury Department is presently re-examining the requirements for exempt status and the consequences of loss of exemption.

Additional recommendations in this area will be presented to Congress as soon as they can be developed.

5. <u>Charitable Contributions</u> (Sec. 201)

The bill provides in general for an increase in the limitation on the charitable contributions deduction from 30 percent to 50 percent for gifts to churches, educational institutions, and publicly supported charities, as recommended by the Administration. This will provide even greater incentive for private support of these institutions in the United States. Charitable gifts of appreciated property will remain subject to the 30 percent limit. Since we are recommending that appreciation in such property be removed from the Limit on Tax Preferences and the Allocation of Deductions rules, as hereinafter explained, we believe that the retention of the 30 percent limit for such gifts is appropriate. However, in its present form in the bill, it could have an unintended harsh result in some cases. A significant portion of the charitable deduction may be denied where the appreciation in the contributed property is nominal. This provision should be changed so that (a) the appreciation element in charitable gifts of property may not exceed 30 percent of adjusted gross

income, and (b) the basis of the property would be counted against the additional 20 percent allowance.

In order to limit some of the present tax advantages of gifts of appreciated property in particular cases, the bill provides that taxpayers making such contributions under certain specified circumstances must either: (a) limit their deduction to the cost or other basis of the property, or (b) take the larger deduction based on the fair market value of the property and include the appreciation in income. This treatment is to apply to gifts of property which would give rise to ordinary income if sold by the taxpayer, gifts to private foundations (other than an operating foundation) unless the property is channeled to a publicly supported charity within one year, gifts of tangible personal property, and gifts of future interests of property.

Our recommendation (discussed below) to delete the appreciation element from the Limit on Tax Preferences and the Allocation of Deductions provisions makes most of these limitations appropriate even though they go beyond our recommendations on April 22, 1969. However, we recommend that this rule not be extended to all tangible personal property

as provided in the bill. Under other provisions of the bill collections of papers will produce ordinary income if sold, just as are paintings sold by the artist under existing law. As we recommended on April 22, 1969, the bill prohibits deduction of the value of ordinary income property unless the appreciation is included in ordinary income. But the extension of this rule to gifts of all works of art, even though not created by the donor, appears unduly severe. Our finest museums and art galleries are dependent on such gifts, and their contribution to the good of our society is universally acknowledged. We see no sufficient reason to distinguish such gifts from gifts of appreciated securities to other charities. The problems of valuation of tangible personal property have been substantially resolved by changes in the income tax form, by improved audit programs, and by the creation of a special advisory group to the Commissioner of Internal Revenue on valuation of art objects. Moreover, these valuation problems are not eliminated by the rule in the bill since the donor would still be entitled to deduct the value of the art work against ordinary income even though the appreciation were treated as capital gain.

The bill provides for repeal of the unlimited charitable deduction, the change to be phased in over five years. This differs somewhat from the Administration's original recommendation that the unlimited deduction be limited so that the charitable deduction, when taken together with other itemized deductions, could not result in reducing the taxpayer's adjusted gross income by more than 80 percent thereof. However, the provision in the bill is also a reasonable solution and we support it.

The bill restricts the availability of the charitable contribution deduction where, by the use of a trust, property interests are split between charitable and noncharitable beneficiaries. On reconsideration, we believe the bill is unduly stringent in permitting a deduction for the value of a charitable income interest only where the income is taxable to the grantor under other rules. The donor should be allowed a deduction for the value of any long-term income interest to charit which is in the form of a guaranteed annuity or a "unitrust". Under the bill a "unitrust" is a trust in which the income beneficiary is entitled to a return equal to a fixed percentage of the value of the assets of the trust each year, thus

assuring the income beneficiary a certain return irrespective of the investment policies of the trust.

We also recommend that the effective date of the new estate tax provisions governing charitable deductions be deferred so that the new rules will apply only to persons dying after December 31, 1970. This will provide time for amendments of wills. Moreover, the new estate tax rules should not apply to trusts created heretofore that cannot be amended.

6. Farm Losses (Secs. 211, 212, 213)

Our studies have demonstrated that large farm losses generally represent capital expenditures which have been deducted under the liberal cash method of accounting. The cash method has been allowed to farmers primarily to help small farmers, but taxpayers with large farm losses are generally not in this class but are wealthy investors who obtain a tax shelter. The bill requires that taxpayers maintain an excess deductions account (EDA) for large farm "losses." On the later sale of farming property, any gain--to the extent it would otherwise be taxed as a long-term

capital gain--will be treated as ordinary income to the extent of the balance in the excess deductions account. The provision would not apply if the taxpayer used inventories and capitalized items properly chargeable to a capital account as part of his method of accounting for the farming operation.

In its present form, this provision of the bill applies only to individuals with nonfarm adjusted gross income in excess of $50,000. Taxpayers with nonfarm income over $50,000 are permitted to exclude the first $25,000 of their farm losses each year from the operation of the EDA provisions. In practice, this exclusion renders the bill ineffective.

The Administration recommended this EDA treatment on April 22, 1969, but at that time proposed that only $5,000 of losses in any year be excluded. We believe the higher exclusions in the bill should be modified. We now recommend that the EDA rules apply to any taxpayer with nonfarm adjusted gross income in excess of $25,000 whose farm losses exceed $15,000. In such a case, all of the losses should be included in the excess deductions account. These changes will not affect the small farmer or the person with modest nonfarm income.

We estimate that as so modified the EOA rule would apply to only 9,300 individuals, whose farm losses would aggregate $418 million, an average farm loss per individual of $44,700. The effect of this particular provision would not be to disallow the loss, but only to require that future gains from the sale of cattle, race horses, orange groves, etc., raised on the farm could not be reported as capital gains until they had offset these losses previously deducted from ordinary income.

The bill also provides new rules to deal with the problem of hobby losses. Under the bill, losses will be disallowed if the activity is not carried on with a reasonable expectation of profit. The taxpayer will be presumed not to have a reasonable expectation of profit if the losses from the activity exceed $25,000 in three out of any five consecutive years. The Administration urges adoption of this proposal as an effective means of dealing with cases where the tax laws are being used to subsidize the hobbies of wealthy taxpayers. However, in order to make it clear that the provision is not intended to apply to legitimate business operations,

it is recommended that the term "profit" be specifically defined to include not only immediate economic profit but also any reasonably anticipated long-term increase in the value of property.

7. Interest (Sec. 221)

Under the bill, the deduction for interest in excess of $25,000 on indebtedness incurred to purchase or carry investment assets is allowed only to the extent that the interest is not in excess of investment income plus long-term capital gains. This provision is designed to deal with an abuse resulting from the opportunity to deduct an unlimited amount of interest expense, making it possible to acquire growth potential property with borrowed funds and deduct the interest against ordinary income with the anticipated gain on disposition being subject to the capital gains rate.

However, the bill in fact fails to correct many of the problems in this area. By permitting the interest deduction to the extent of investment income, it discriminates against the taxpayer who has only earned income out of which to pay

his interest expense. The abuse is the same in either case, though under the bill the individual with earned income, but not a person receiving dividends or other investment income, might lose his interest deduction.

We have been studying many alternatives to the approach of the bill. The only truly equitable solution would require tracing the interest expense to the particular investment for which the funds were borrowed. We are inclined to believe, however, that an attempt to trace investment interest to the related investment would be administratively unworkable. Other alternatives do not appear to correct any substantial number of the actual abuses and uniformly add extraordinary complexity.

In light of these considerations, the Administration recommends that the interest provision of the bill be deleted, although we shall continue to explore the problem in an effort to develop a workable solution. The Allocation of Deductions provision (referred to below) will prevent individuals from offsetting all of their interest deductions against ordinary income when they have tax preferences, such as capital gains, in the current year, and will serve as a major limitation on the use of interest expense as a tax shelter.

8. Moving Expenses (Sec. 231)

The bill extends the deduction of employee moving expenses to expenses of house hunting trips, temporary living quarters at the new location and the sale or purchase of a house. Reasonable limitations are provided. The bill adopts the Administration's recommendations in this regard, except that the distance requirement of existing law is increased from 20 miles to 50 miles. The Administration recommends that the 20-mile test be restored.

9. Limit on Tax Preferences and Allocation of Deductions (Secs. 301, 302)

Present law imposes no limit on the amount of economic income which an individual may exclude from tax through preferential treatment contained in various provisions of the Code. These preferences were intended as incentives to investment, but they contain no adequate limits on their use. In recent years, many high bracket individual taxpayers have used these preferences alone or in combination so as to pay little or no tax for the support of the Federal Government.

Neither does present law prevent a taxpayer from charging all personal deductions against taxable income even though the presence of substantial amounts of preferential income make it apparent that, from an economic standpoint, such nontaxable

income in fact bears its share of the burden of such personal expenditures.

The bill seeks to correct these inequities through the Limit on Tax Preferences and the Allocation of Deductions provisions. The Limit on Tax Preferences places an over-all limit on the combined use of preferences; the Allocation of Deductions rule requires that a proper portion of itemized deductions be charged against income sheltered by tax preferences.

The House bill goes beyond the Administration's recommendations and provides that tax exempt interest on state and local bonds is included as a preference item for the Limit on Tax Preferences provision. The Administration opposes this inclusion for the same reasons we gave on April 22 -- there are constitutional doubts as to the inclusion of tax exempt interest and its inclusion will adversely affect the ability of hard-pressed state and local governments to market their bonds. On the other hand, the House bill provides that tax exempt interest will be treated as a preference for the Allocation of Deductions rule only to the extent such interest is paid on future issues and even then only with a 10-year phase-in rule. In April, we recommended that all tax exempt interest be included without such a phase-in rule, and we renew that recommendation at this time.

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Under the bill, the excess of percentage depletion over cost and the intangible drilling cost deduction are not treated as preference items under the Limit on Tax Preferences (LTP) provision, although they are included as preferences under the Allocation of Deductions rule. Since making our original tax reform proposals in April, in which both percentage depletion and intangible drilling costs were included in the Limit on Tax Preferences as well as the Allocation of Deductions rule, we have studied carefully the operation of these provisions. We have concluded that some changes in our original proposals are warranted.

First, in view of the substantial reduction in percentage depletion contained in the bill, the inclusion of the intangible drilling cost deduction as a tax preference item could work an unintended hardship in the case of an individual whose principal business is exploration for oil and gas. Accordingly, the Administration proposes that the intangible drilling cost deduction be excluded from the Limit on Tax Preferences provision, but not the Allocation of Deductions provision, if at least 60 percent of the taxpayer's gross income is from the sale of oil and gas. We also recommend, however,

as a complement to this rule that a recapture rule be added to the Code treating as ordinary income any gain on sale or transfer of a well, including a transfer to a controlled corporation, to the extent of intangible drilling costs previously deducted.

For all other purposes, however, both percentage depletion and intangible drilling costs should be included in the Limit on Tax Preferences as well as the Allocation of Deductions provision. Thus, an investor who is not primarily engaged in the oil business will be subject to this broader LTP rule.

In our judgment the provisions in this form will apply more reasonably to persons whose principal business is the discovery of new oil and gas deposits and to whom intangible drilling costs are more in the nature of an annual expense. They should avoid creating any serious disincentive to drilling. However, even in this form the Limit on Tax Preferences should insure that substantially all taxpayers, including those in the oil business, will pay some reasonable amount of tax each year.

High bracket taxpayers will no longer be able to avoid any substantial Federal income tax liability each year by regularly investing their funds in successful wells. (Dry hole costs, of course, will not constitute preferences for any purpose.) The provisions as recommended are essential from the standpoint of fairness in view of the various other preferences which have been included in the LTP.

Second, it appears that the inclusion of gifts of appreciated property to charity as a tax preference item will reduce the benefit of the contribution and, thus, unduly restrict public support of worthwhile educational and other public charitable institutions. For this reason the Administration proposes that this item be deleted from the Limit on Tax Preferences and Allocation of Deductions provisions.

Third, further study of the excessive use of tax preferences by some taxpayers has led to the conclusion that three additional preferences should be added both to the Limit on Tax Preferences and Allocation of Deductions provisions. Accelerated depreciation in excess of straight-line depreciation taken on equipment and other personal property by a

lessor of the property under a net lease arrangement should be included. Accelerated depreciation on real property is already treated as a preference under the bill, and accelerated depreciation on leased personal property offers an equivalent shelter to reduce taxes on other income. In addition, the excess of interest, taxes and rent over receipts (if any) from unimproved real property during the period of construction of improvements should be included as a preference. These amounts are part of the economic cost of the improvement and when allowed as a deduction result in excessive tax benefits to some high-bracket investors. Finally, rapid amortization of rehabilitation expenditures for low cost housing (provided elsewhere in the bill) should be included as a preference. This new provision could easily be used to such an extent as to shelter all of the taxpayer's income unless some limit is placed on its use.

The bill in certain instances allows a basis adjustment in the amount of disallowed preferences with respect to property when the property is later sold. A similar adjustment should be allowed in connection with amounts disallowed under the Allocation of Deductions proposal to the extent ordinary income is realized on a later sale of the property.

10. Income Averaging (Sec. 311)

The bill substantially liberalizes the income averaging provisions. The eligibility requirement is reduced from 133-1/3 to 120 percent of base period income, and averaging is permitted for capital gains, income from gifts and bequests, and wagering income. Removal of these exceptions from present law aids simplification, while achieving greater equity. The Administration strongly supports this provision.

11. Restricted Property (Sec. 321)

During the past few years there has been a rapid growth in the number of so-called "restricted stock plans." Under these plans, an employee receives stock or other property subject to certain restrictions, such as a prohibition on sale for a specified period. Under existing Treasury regulations, a tax is not imposed until the restrictions expire. The compensation deemed to be realized at that time is based in most cases upon the lower value of the property at the time of its previous receipt. This combination of deferral and capital gain treatment of appreciation during the deferral period with respect to property received as compensation represents an unwarranted and unintended benefit.

The Administration's recommendation is adopted in the bill. In general, the bill provides for the imposition of

tax when the employee's rights to the property become non-forfeitable even if the property is subject to restrictions. The tax is imposed on the then current value of the property determined without regard to these restrictions. Similar treatment is proposed for property transferred in trust. The Administration urges adoption of this provision.

12. Deferred Compensation (Sec. 331)

This bill provides a minimum tax on deferred compensation payments exceeding $10,000. This minimum tax would be based, in effect, on the individual's rate of tax in the years in which such payments are deemed to have been earned.

From a conceptual standpoint, this provision modifies in certain respects both the cash method of accounting and the annual accounting period. The annual accounting concept underlies our entire tax system. While the cash method of accounting may not lead to perfect results in some cases, the imperfections extend to many areas other than deferred compensation. We believe that with further study of this problem in the context of the tax treatment of all deferred compensation, including amounts paid under both qualified pension and profit sharing plans and nonqualified plans, a better solution in principle can be developed.

of income in taxable years beginning before April 22, 1969, and that the unlimited throwback provided by the bill apply only to accumulations made in taxable years beginning after that date.

14. Multiple Corporations (Sec. 401)

The bill adopts the Administration's recommendation to limit a controlled group of corporations to a single $25,000 surtax exemption, one $100,000 accumulated earnings credit, and one $25,000 limitation on the small business deduction of life insurance companies. These limitations would be phased-in over an eight-year transition period beginning on January 1, 1969. This is a more liberal transition period than that recommended by the Administration.

The bill also contains two special eight-year transitional rules for corporations which are affected by this provision. There is a gradual increase of the dividends received deduction from 85 to 100 percent for transition period dividends. The second rule operates with respect to a controlled group filing a consolidated return and permits the deduction of a gradually increasing portion

of certain pre-consolidation net operating losses arising in the transition period. These special transition rules introduce extraordinary complexity, and we believe are not justified in view of the phase-in rules already provided for the change. Accordingly, we recommend that these additional special transitional rules be eliminated. Also, while we do not oppose the eight-year phase-in period, a five-year phase-in period as we originally recommended seems adequate to do equity and would reduce the administrative complexity of the lengthy transition involved.

15. Corporate Securities (Sec. 411)

The bill seeks to curb tax benefits obtained by conglomerates and other acquisition minded companies by the substitution of an interest deduction for nondeductible dividends. This may occur where, for example, convertible debentures or other debt instruments having equity characteristics are used to effect a merger or acquisition. Under the bill, interest in excess of $5 million incurred for acquisition purposes would be disallowed where (i) the indebtedness is convertible or has warrants attached, (ii) the indebtedness is subordinated,

and (iii) either the debt to equity ratio of the acquiring corporation (including affiliated corporations) exceeds 2:1, or the projected annual earnings of the acquiring corporation are less than three times the annual interest expense of the company.

Although the Treasury Department is presently seeking to develop regulations which will aid in distinguishing debt from equity in all contexts, the Administration supports these particular statutory rules designed to deal specifically with the merger situation.

In addition, the Administration supports those provisions of the bill which adopt the Administration's prior recommendations. These include some (but not all) of the provisions of the bill dealing with installment sale treatment under Section 453 and the provisions of the bill dealing with corporate securities issued at a discount and repurchase by a corporation of its convertible securities.

16. Stock Dividends (Sec. 421)

The distribution of common stock dividends on common stock does not normally represent a taxable event to the shareholder. The shareholder simply receives additional shares to represent the same unchanged equity interest in

the corporation. The Internal Revenue Code does, however, provide for taxing a distribution of stock dividends where the shareholder has an election to receive either cash or stock. Many new sophisticated types of stock have been developed in recent years to avoid the impact of this rule, such as increasing and decreasing conversion ratios.

Present law does not adequately distinguish between taxable and nontaxable stock dividends and other corporate adjustments which have the effect of a stock dividend. A general provision is necessary to tax all stock dividends which change the proportionate interest of the shareholder in the corporation where such change is related to a cash dividend on other outstanding shares. Without such a provision substantial revenue losses resulting from circumvention of existing law are anticipated.

The bill substantially adopts the recommendation of the Administration, and we continue to support its enactment. The bill makes it clear that an increase in a shareholder's interest in a corporation, when related to a taxable dividend paid to other shareholders, is to be taxed. In addition to setting out a clear standard for the application of the statute, the section provides needed flexibility for its administration by regulation.

17. Foreign Tax Credit (Secs. 431, 432)

The bill deals with two separate circumstances in which the foreign tax credit is extended under existing law beyond its basic purpose of preventing double taxation of the same income.

The first type of case involves taxpayers, particularly U.S. mineral companies with foreign operations, who choose the "per-country" limitation on the credit (as opposed to the "over-all" limitation) in order to deduct losses incurred in a particular foreign country, such as those arising from the favorable rules applicable with respect to oil drilling expenses, against U. S. source income. When operations in that country become profitable, they are able to credit foreign taxes on the income against the U.S. tax even though there has been no net income over the span of years from that country and there is no net U.S. tax against which the credit should be applied. The taxpayer obtains a double benefit: in the year of the loss, he deducts the loss against U.S. source income, and in a subsequent profitable year, he claims the full foreign tax credit for the income from that country.

The bill deals with this problem by requiring a carryover of the losses in applying the limitation on the credit in

subsequent years where the per-country limitation was used in the loss year. We support this provision and recommend that it be extended to apply also where there has been an over-all foreign loss under the over-all limitation.

The bill also deals with the problem of foreign taxes paid on mineral income excess of U. S. taxes paid on such income. The bill provides for the separate computation of the foreign tax credit limitation with respect to mineral income in those cases where the foreign country holds mineral rights to the property or other conditions suggest that the high excess foreign tax may constitute a disguised royalty payment. The separate computation prevents any excess credit with respect to such income from being applied to shelter other foreign income which may be subject to foreign tax at an effective rate less than the U.S. effective rate on such income.

The Administration supports, in part, the effect of this second provision. However, while we recognize the hidden royalty problem at which the House bill is directed, we do not feel that the bill provides an equitable solution to that problem. On further examination of the tax and royalty structure applicable to the international minerals industry, we do not feel that it

is proper to characterize all foreign taxes on mineral income in excess of U.S. taxes on such income as disguised royalties. It is impossible to ascertain the extent to which income taxes in any particular country are a substitute for royalties, and in many cases the foreign country receives royalty payments which are even greater than royalties customarily paid in the United States. Also, foreign countries frequently impose income tax on nonmineral income, as well as on mineral income, at a rate in excess of the U.S. rate.

If, then, this separate limitation in the bill regarding mineral income is not justified on the ground that any foreign tax in excess of the effective U.S. tax on mineral income is a royalty, it works unfairly for mineral companies as compared to all other U.S. taxpayers with foreign operations. It completely denies mineral companies the opportunity, available to other taxpayers, to average the excess of foreign tax over U.S. tax on mineral income against any excess of U.S. tax over foreign tax on their other foreign income. This result occurs even though the foreign tax on the mineral income is at a reasonable rate judged by world standards and even though such averaging is precisely the purpose of the over-all limitation.

In our view, the special problem connected with foreign mineral income which can and should be dealt with arises from the lower effective U.S. rate on mineral production resulting from our percentage depletion incentive. While the bill denies percentage depletion with respect to foreign oil and gas production, we are recommending (as hereinafter described) that this provision be deleted from the bill. While the over-all limitation normally allows high foreign tax rates to be averaged with low foreign tax rates, in our judgment this is inappropriate in the case of mineral production income where the excess credits arise because the foreign country does not match our percentage depletion allowance.

We therefore recommend that excess foreign tax credits which result from the allowance of percentage depletion by the United States should not be available against other foreign income. Thus, to the extent the foreign tax in a particular foreign country exceeds the U.S. tax on the same foreign mineral income, but is less than the U. S. tax on such income computed without percentage depletion being allowed, the excess credits could not be applied against other foreign income. We believe this rule will effectively deal with the problem of percentage depletion on foreign mineral production. A similar rule

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now applies in the Code to Western Hemisphere Trade Corporations, which are taxed at an effective rate approximately 14 percentage points less than the usual corporate rate.

We also recognize that, even aside from not allowing percentage depletion, foreign tax rates on mineral income sometimes exceed the top rates generally applicable by world tax standards to other income.* This also, of course, results in unusually high excess credits to be applied against other foreign income. This problem could be resolved on the basis that typically the top rate on distributed income by world standards does not exceed 60 percent. Thus, it could be provided that to the extent the foreign tax exceeded 60 percent of the foreign mineral income from a particular country determined by U.S. standards without a percentage depletion allowance (this allowance having been dealt with by the proposal previously described), excess credits could not be used against other income. This approach could be justified on the ground that taxes in exeess of 60 percent represent

*In some cases the foreign country achieves high effective tax rates by requiring the taxpayer to compute taxable income on the basis of "posted prices" which are substantially in excess of arm's length prices and thus artificially inflate taxable income for their tax purposes.

a substitute for royalties. However, as stated above, not all high foreign rates can be properly characterized as royalty substitutes, and it is impossible to establish to what extent such characterization is proper. Since aside from percentage depletion it is difficult to justify dealing with high foreign taxes in the case of foreign mineral production income but not high foreign taxes imposed on other types of income, we believe it preferable to deal with high foreign tax rates in a general context. We plan to present recommendations to Congress on this subject as a part of comprehensive proposals relating to the U.S. taxation of foreign source income which we are presently developing.

Consideration of the foreign tax credit as applied to mineral income points up the need for clarification of the tax status of the continental shelf. There is no general provision to this effect in the present bill. The continental shelf areas of the world are being developed at an accelerated pace, and existing uncertainties as to the tax consequences could discourage development of natural resources or result in unintended tax preferences to taxpayers with continental shelf operations. We recommend that the tax status of these areas be clarified by: (1) amending the definition of "United States" in the Code, consistent with

our rights and obligations under international law, to include the continental shelf of the United States with respect to the exploration for natural resources; and (2) defining the term "foreign country" as used in the Code to include the continental shelf which pertains to the foreign country concerned.

18. Financial Institutions (Secs. 441, 442, and 443)

Commercial banks will be required under the bill to compute their reserves for bad debts on the basis of actual bad debt experience; they will no longer be entitled to the special rule under existing law granting them an absolute reserve of 2.4 percent of outstanding uninsured loans. The special bad debt deduction now allowed mutual thrift institutions is to be substantially reduced under the bill over a 10-year transitional period; their special deduction based on 3 percent of increases in real estate loans would be repealed, and their alternative deduction of 60 percent of taxable income would be reduced to 30 percent. The allowance of this 30 percent deduction is tied to a sliding scale permitting the full deduction to a savings and loan institution only if at least 82 percent of its assets is invested in residential real estate loans and certain other qualifying items. In the case of mutual savings banks, the required level would be 72 percent.

To furnish protection against unusually large losses, all financial institutions would be permitted to carry back net operating losses for 10 years (instead of three years) and to carry forward net operating losses for five years.

The bill also provides that gain on disposition of debt securities of financial institutions will be treated as ordinary gain rather than capital gain. Net losses on such securities are now allowed as ordinary losses, and the bill seeks to provide parallel treatment for net gains.

The Administration endorses the concept that the bad debt deduction should be based on actual loss experience, but we also support the allowance of a special deduction to encourage investment by financial institutions in residential real estate mortgages. Investment by these institutions in residential mortgages is a vital policy goal of the Administration and traditionally has been encouraged through the use of tax incentives. We believe that this goal will be more effectively accomplished by extending the same incentive to all banking institutions, not just the mutual thrift institutions.

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The investment standards applied by existing law and the bill to savings and loan institutions and mutual savings banks serve this goal imperfectly and limit free and open competition between these institutions and commercial banks. Conversely, those commercial banks which have traditionally invested in home mortgage financing will be prejudiced by the provisions of the bill which deny their present special deduction but retain a special deduction for the other two types of institutions with which they compete.

Accordingly, the Administration recommends that a special deduction, not tied to bad debt reserves, be provided for banking institutions as an incentive for investment in residential real property loans, student loans, and certain other loans which are made pursuant to national policy objectives. This incentive would be provided by a special deduction equal to a specified percentage of gross interest income from such residential real property and other loans, except that the deduction could not serve in

any year to reduce taxable income to an amount less than 60 percent of taxable income, adjusted (for purpose of this calculation only) to include the full amount of dividend income and tax exempt interest. The latter limitation will insure that the incentive could not be used to reduce the effective rate of tax on these institutions below an equitable level. We suggest that the special deduction be 5 percent of gross interest income from such loans, subject to the limitation stated above.

To prevent undue hardship on mutual savings banks and savings and loan institutions and to minimize the possible adverse effect of these proposed changes on the housing market, a five-year transition rule should be provided to phase in gradually the increased tax burden on these institutions.

19. Foreign Bank Deposits (Sec. 444)

The bill extends from December 31, 1972, to December 31, 1975, the expiration date of the rule of existing law relieving from Federal income tax certain interest paid on deposits by U.S. banks to nonresident aliens and foreign corporations.

This rule applies where the interest constitutes income not effectively connected with the alien's or corporation's trade or business in the United States. This extension would also apply to the existing relief from Federal estate tax for such deposits by nonresident aliens with U.S. banks.

Because of balance of payments considerations, the Administration recommended in April that these relief provisions not be permitted to expire at the end of 1972 but be continued indefinitely. We would prefer complete removal of the expiration date so long as the balance of payments problem exists, but the provision of the House bill extending the provisions through 1975 seems adequate for the time being.

Under current law, interest paid by U.S. branches of foreign banks to nonresident aliens or foreign corporations ordinarily is not subject to U.S. income tax whether or not the deposit is effectively connected with the depositor's U.S. trade or business. In the case of U.S. banks, the interest income is free of tax only if the deposit is not so connected.

While the Foreign Investors Tax Act of 1966 recognized that U.S. business-connected deposits in U.S. branches of foreign banks should be subject to U.S. tax to the same extent as if the deposits were made in a U.S. bank, that Act provided that such deposits in U.S. branches of foreign banks would not become taxable until January 1, 1973. We see no reason for any delay in achieving parallel treatment, and therefore recommend that interest paid by U.S. branches of foreign banks be treated the same as interest paid by U.S. banks effective for the calendar year following enactment of the bill. A similar problem arises with respect to deposits in U.S. branches of foreign banks by nonresident aliens for purposes of the estate tax liability, and we recommend similar action.

20. Regulated Utilities (Sec. 451)

Regulated public utility companies in general account for depreciation on a straight-line basis for purposes of the rate-making process. Where accelerated depreciation is taken for tax purposes, the actual Federal tax paid is lower than

the tax liability which would result from the straight-line depreciation taken for rate-making purposes. Some regulatory commissions permit taxpayers to "normalize" their tax for rate-making purposes; that is, they treat as a cost the tax which would have been imposed if straight-line depreciation had been used and treat the difference between this amount and the actual tax as a reserve for future taxes. In other situations the regulatory commissions require companies to take into account in determining the current cost of their operations only the actual tax paid, with the result that the tax reduction due to accelerated depreciation is "flowed through" to the customer as a reduction in price, thus further reducing profits and income tax revenues.

Many commissions are presently switching from normalization to flow-through, and others are even imputing the use of accelerated depreciation where the utility in fact is using straight-line depreciation for tax purposes. This trend will force utilities to switch to accelerated depreciation for tax purposes, and the "flow through" consequences will have a double effect in reducing tax revenues, since it results in a reduction in utility gross revenues as well.

Under the bill gas and oil pipeline, telephone, gas and electric utility companies, and water and sewage disposal companies would be allowed accelerated depreciation only if they "normalize" the tax saving for rate-making purposes. Thus they could not be required by regulatory agencies to "flow through" their tax savings to their consumers at the expense of Federal revenues. An exception would be provided for utilities which are presently using "flow through." Where straight-line depreciation is being taken with respect to property constructed or placed in service before December 31, 1969, no accelerated method will be permitted.

We support this provision of the bill. It would generally "freeze" the present situation, and prevent a major revenue loss estimated as high as $1.5 billion annually, which would result if the present trend by regulatory commissions toward "flow through" were allowed to continue.

There is one transitional problem which should be corrected. In determining whether a utility will be allowed to use accelerated depreciation and "flow through," the bill looks to the taxpayer's latest return filed prior to July 22, 1969. We recommend that a utility be granted this right if, as of July 22, 1969, the utility had established by book entries or certain other means that it was adopting accelerated depreciation and "flow through".

21. Effect of Accelerated Depreciation on Corporate Dividends (Sec. 452)

Under present law, a dividend is a distribution out of earnings and profits. A distribution exceeding the amount of earnings and profits is not taxed as a dividend but treated as a return of capital. Through the use of accelerated depreciation many companies, particularly in the utility and real estate fields, have been able to distribute substantial amounts to shareholders without current tax to the shareholders.

The bill adopts our recommendation made in April to require companies to compute earnings and profits by using

only the amount of depreciation allowable under the straight-line method. The Administration supports this provision.

22. Natural Resources (Sec. 501)

The bill puts an end to the tax benefits arising from carved out production payments and ABC transactions by treating these as loan transactions, a result which is in accord with their true nature. The bill also provides recapture rules for all hard mineral exploration costs. The Administration endorses these provisions.

The bill reduces the percentage depletion allowance for oil and gas from 27-1/2 percent to 20 percent and makes similar reductions for other minerals except copper, gold, silver, iron ore, and oil shale. While the Administration did not recommend these reductions, we do not oppose the decision of the House to increase the share of the national tax burden of the mineral industry.

However, the bill also extends the cut-off point for determining percentage depletion on oil shale to include certain non-mining processes. We oppose this provision because it would approximately double the effective depletion allowance on oil shale and would constitute an important breach in the principle that percentage depletion is to be computed on

gross income from mining, not manufacturing to any extent. As stated, the bill makes no reduction in the depletion rate for oil shale while reducing nearly all other rates. This would seem to provide a special incentive. If any additional incentive is to be provided, it should be granted in terms of the research and development objective, or at most in terms of the rate, not the cut-off point, or by some other means.

Finally, the bill eliminates percentage depletion with respect to foreign oil and gas production. Our analysis of this provision indicates, in the light of our foreign tax credit provisions, that after a brief period it will probably result in foreign countries increasing their effective tax rates on income from oil and gas production to "sponge up" any additional tax revenue otherwise accruing to the United States. Thus the denial of foreign depletion will increase the effective U.S. rate of tax on such income, which tax the foreign governments will then offset by increasing their rates. The end result will be that the U. S. taxpayer will pay additional tax to those countries, but no additional tax to the United States.

For these reasons, the elimination of percentage depletion on foreign deposits of oil and gas is unlikely to increase

U. S. revenues significantly, and will merely increase the burden of foreign taxes on U. S. businesses. We recommend, therefore, that this provision be deleted from the bill. Our proposal with respect to the foreign tax credit, previously described, adequately deals with percentage depletion on foreign deposits by preventing the depletion allowance on foreign mineral production from being used to reduce U. S. tax on other income and will not induce the foreign country to raise its tax on the American company.

23. Capital Gains and Losses of Individuals (Secs. 511-516)

The bill repeals the alternative capital gains tax rate of 25 percent and increases the holding period for long-term capital gains from 6 to 12 months. It also provides that net long-term capital losses are reduced by 50 percent before being available as an offset against ordinary income. The bill narrows the definition of a capital asset so that the sale of letters, papers, or memoranda by a person whose efforts created them, or by a person for whom they were produced, will give rise to ordinary income. The bill provides that an employer's contribution to a pension plan, when paid to the employee as part of a lump sum distribution, is taxed as ordinary income.

Additional changes made by the bill include a provision that life interests received by gift, bequest or inheritance, are not accorded a tax basis when sold. Under the bill, all casualty gains and losses on capital assets and section 1231 property are consolidated for the purposes of determining whether they give rise to an ordinary loss or to a gain which is consolidated with other section 1231 gains and losses. Finally, the bill provides that transfers of franchises will not give rise to capital gain treatment if the transferor retains any significant rights in connection with the transfer.

We are opposed to the complete elimination of the alternative tax and to the extension of the holding period. These changes in our judgment impose too great a burden on capital investment. The effect of the bill would be to remove a large measure of the incentive for private capital to engage in new and expanded business ventures. Present capital investments would tend to be frozen and the economy as a whole would suffer. We believe that the six months' holding period should be maintained and that, in general, the alternative tax should be retained.

However, the 25 percent ceiling rate on long-term capital gains has been used regularly by some wealthy persons who at the same time have minimized their ordinary income. By this means they have reduced their over-all effective income tax rate well below that of other persons of comparable or lesser ability to pay. We recommend that a maximum limit be placed on the extent to which the 25 percent ceiling rate can be used in relation to the amount of ordinary income.

The inclusion of the omitted one-half of long-term capital gains in the list of preferences contained in the Limit on Tax Preferences (LTP) generally has no operative effect because the purpose of that provision is only to insure that preferences do not exceed one-half of a person's income determined without the preferences. Thus, for example, when a long-term capital gain of $50,000 is realized, 50 percent or $25,000 is included as a preference in the LTP calculation, but it has no effect on that calculation since LTP operates only to limit tax preferences to 50 percent of income. However, if a taxpayer has $1 million of capital gains which are taxed at 25 percent instead of the

65 percent top rate applicable to ordinary income under the bill, his actual preference is 40/65 of this amount, or about 61.5 percent, instead of the 50 percent preference permitted by LTP. Thus, the actual preference due to the 25 percent alternative capital gains tax rate, which may be well above the 50 percent nominally excluded, should appropriately be reflected in LTP.

As a means of simplifying the calculation that would be required under LTP but at the same time achieving a comparable result, the Administration proposes that the 25 percent alternative capital gain tax be limited in its use by any taxpayer to long-term capital gains which do not exceed the higher of the two following amounts:

1. $140,000 in the case of a married person and $85,000 in the case of a single person if their other tax preferences do not exceed $10,000; or

2. Four times the taxpayer's taxable income (other than long-term capital gains) if his other preferences do not exceed $10,000. (If his other preferences do exceed $10,000, the allowable amount would be four times his taxable income adjusted under the LTP and Allocation of Deductions rules, less the amount of those other preferences.)

As an illustration, a married person with tax preferences of less than $10,000 could always realize at least $140,000 of long-term capital gains in any year and be assured of availability of the 25 percent alternative rate. Moreover, if he has $60,000 of taxable ordinary income from salary, dividends, etc., he could have $240,000 of capital gains at the 25 percent rate. However, beyond that amount he would lose the benefit of the alternative tax computation; in effect, to the extent his long-term capital gains exceed such amount, 50 percent of such amount would be added to his ordinary income and taxed at effective rates ranging from 25 percent up to 32.5 percent (one-half of the regular rates).

To prevent undue hardship arising from occasional realization of a large capital gain, the taxpayer would be permitted to carry over the unused portion of his limit on the alternative tax computation for any taxable year to each of the five succeeding years. This will achieve a fair averaging result.

The result of this rule will be to insure that a taxpayer who consistently realizes large capital gains in relation to his ordinary income will not be able to use the 25 percent ceiling tax to excess so as constantly to reduce his total effective tax rate.

In all other respects, we support the capital gain and loss provisions of the bill.

24. Capital Gains Rates for Corporations (Sec. 461)

The alternative capital gains tax on corporations is in creased from 25 to 30 percent. The Administration supports this provision. Consistent with the rule we recommend for individuals, an amount up to $50,000 of capital gains could continue to be subject to the 25% rate, subject to the multiple corporation provisions.

25. Real Estate (Sec. 521)

The bill would limit accelerated depreciation on new real estate construction (other than housing) to 150 percent declining balance depreciation. Two hundred percent declining balance and sum-of-the-years digits depreciation methods would continue to be available for new housing starts only. The bill would deny accelerated depreciation to real estate purchased from prior owners, but it provides for a five-year write-off of capital costs incurred in the rehabilitation of housing made available for persons of low and moderate income. The bill would amend the present recapture provisions of the Code to deny long-term capital gain treatment on the sale of real estate to the extent of all depreciation claimed in excess of straight line, eliminating the 10-year phase-out of the recapture provisions under present law.

We believe these provisions represent a major advance in the tax treatment of real estate and are consistent with the national housing objectives. We urge their approval. We recommend, however, that the special incentive for housing should be restricted to that constructed in the United States and its possessions. Moreover, we are concerned with the continued heavy reliance upon tax incentives as a means of achieving our national housing goals, and believe that consideration should be given in the near future to other additional methods of doing so.

26. Cooperatives (Sec. 531)

Under present law, cooperative organizations are permitted to reduce their taxable income by the amount of patronage dividends distributed to members if 20 percent of the patronage allocation is paid to the patron in cash. There is no requirement for redemption of the remaining amount in cash. The bill requires patronage dividends to be paid in cash over a period of no more than 15 years. It also requires that an additional 30 percent of the amount of current dividends be paid to patrons either with respect to the current allocation or in redemption of prior allocations. This additional 30 percent requirement is phased in over a 10-year period.

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The additional 30 percent requirement is complex and creates serious administrative problems. Since the 15-year requirement assures that cooperatives will make significant current payments, we recommend that the additional 30 percent pay-out rule be eliminated.

27. Small Business Corporations--Subchapter S (Sec. 541)

The bill provides limitations similar to those applicable to partnerships with respect to contributions to retirement plans for individuals who are significant shareholders of Subchapter S small business corporations. The bill adopts only this one element of our comprehensive recommendations in April dealing with the tax treatment of small business corporations. Our recommendations would have made the tax rules applicable to Subchapter S corporations simpler and easier to satisfy by conforming them more closely to the partnership rules. These changes, worked out through extended discussions with the members of a committee of the American Bar Association, would also have eliminated several unintended abuses in the Subchapter S provisions.

We recognize that the constraints of time made it impossible for the House to deal with the entire Subchapter S proposal, but we do not feel that additional limitations should be placed on the use of Subchapter S without making the liberalizing changes proposed. It is also clear, as I noted earlier, that treatment of deferred compensation and qualified pension and profit-sharing plans needs over-all revision. Accordingly, we recommend that this provision be deleted from the present bill and be dealt with when the other aspects of Subchapter S and compensation plans are dealt with in legislation.

28. Taxation of State and Local Bonds (Secs. 601 and 602)

The bill grants states and localities the option of issuing obligations the interest on which would be taxable, in which case the higher interest cost would be offset by the Federal Government paying a percentage of the total interest cost of the issue. The amount of the subsidy is to be set by the Secretary of the Treasury, in advance, for each calendar quarter, and may range between 30 and 40 percent of the interest yield of the issue of obligations until 1974, and thereafter between 25 and 40 percent. The provisions of the bill are entirely elective with the issuer: if the issuer chooses to issue taxable obligations, the Federal subsidy follows automatically, but the state or municipality may always issue tax exempt bonds if it prefers. These provisions of the bill were not contained in the Treasury's April 22 proposals.

The Administration has been quite concerned over the problems facing the states and localities as their demands for funds increase, driving the interest cost of tax exempt obligations closer to the interest cost of taxable obligations.

The Administration has studied this provision in the bill as well as alternate means for alleviation of these problems and has concluded that it will not recommend enactment of this provision. The Administration plans to recommend to the Congress a different proposal at an early date.

The bill would also deny tax exempt status to so-called "arbitrage bonds," the specific definition of which is left to the regulations. We believe that this is in general a proper method of handling that abuse, but we believe the scope of the term "arbitrage obligation" should be described with some further particularity in the bill.

29. Income Tax Surcharge (Sec. 701)

The bill would impose the income tax surcharge at a 5 percent rate for the first six months of calendar year 1970. This temporary extension of the surcharge is essential to control the inflationary forces now present in our economy, and to provide a firm basis for future economic growth. The Administration strongly urges the adoption of this proposal.

30. <u>Automobile and Communications Services Excise Taxes</u> (Sec. 702)

This bill would extend the existing rates of the excise taxes on automobiles (7 percent) and on communications services (10 percent) for one year until December 31, 1970, and would postpone scheduled reductions in future years. These measures would contribute substantially to our efforts to control the inflationary forces now present in our economy. We support their adoption.

31. <u>Termination of the Investment Credit</u> (Sec. 703)

The bill provides for repeal of the investment credit effective as of April 18, 1969. It also provides for transitional rules similar to the rules employed when the credit was suspended in 1966. The Administration recommends no change in these provisions.

32. <u>Rapid Depreciation for Pollution Control Facilities and Railroad Cars</u> (Secs. 704 and 705)

The bill contains a provision for rapid 5-year amortization of expenditures for certain facilities for the control or abatement of air and water pollution. The bill also gives railroads an option to depreciate rolling stock other than

locomotives on a 7-year straight-line basis. These provisions of the bill are designed as a substitute for the investment credit.

Our national concern as to problems of pollution and environmental control should not obscure the heavy revenue costs ($400 million annually in long-run operation) of the pollution proposal. The necessity for, and effectiveness of, any such provision is doubtful. The overwhelming incentive for industrial pollution control will continue to be governmental anti-pollution enforcement action, or the threat thereof. A tax relief provision in this setting is not an incentive so much as it is a type of cost sharing, or more accurately, an interest-free loan, to reduce the industrial cost of compliance with enforcement action.

As recommended by Secretary Kennedy in his previous appearance before this Committee in connection with the surcharge extension legislation in July, we urge that as a minimum certain corrective amendments be made to this provision. It should be amended to--

(1) limit the fast write-off to the portion of cost that would otherwise be depreciated over the first 15 years of the life of the facility (as now drawn the provision would confer a benefit roughly equivalent to a 20 percent investment credit in the case of facilities with a 50-year life--almost three times as liberal as the 7 percent investment credit the write-off is designed to replace);

(2) restrict the write-off to facilities installed as anti-pollution facilities in existing plants.

The fast write-off for railroad cars will provide a substantial tax advantage, involving some $100 million annual revenue loss in full operation, to a relatively small number of profitable railroads which already have adequate buying power to acquire new cars. It will be of no financial assistance to the more depressed railroads. Further it will not be an effective instrument for dealing with the specialized problem of seasonal shortages of general purpose freight cars. We are opposed to this provision.

Conclusion

With the changes we have recommended, we believe that the Tax Reform Act of 1969 will provide a much more equitable division of the tax burden and will materially strengthen the structure of our tax system. We shall continue to study the provisions of the bill and present any further recommendations to the Committee as they are developed. Our objective now and in the future will be to improve the equity and effectiveness of our tax laws.

Table 3

Tax Under Present Law and Tax Change Under H.R. 13270 and the Treasury Proposals Before the Senate Finance Committee

Adjusted gross income class	Present law tax	Change in H.R. 13270 tax	Treasury change before Senate Finance	Percent change: H.R. 13270 from present law	Percent change: Treasury from present law
($ 000)	(........... $ millions	....	..........)		
0 - 3	1,169	- 765	- 661	-65.4%	-56.5%
3 - 5	3,320	-1,025	- 448	-30.9	-13.5
5 - 7	5,[illegible]91	- 960	- 423	-17.2	- 7.6
7 - 10	11,792	-1,276	- 794	-10.8	- 6.7
10 - 15	18,494	-1,798	-1,155	- 9.7	- 6.2
15 - 20	9,184	- 699	- 511	- 7.6	- 5.6
20 - 50	13,938	- 827	- 781	- 5.9	- 5.6
50 - 100	6,659	- 306	- 308	- 4.6	- 4.6
100 and over	7,656	+ 363	+ 246	+ 4.7	+ 3.2
Total	77,884	-7,293	-4,835	- 9.4	- 6.2

Office of the Secretary of the Treasury
Office of Tax Analysis

September 2, 1969

Table 4

Present Law Tax, Tax Under H. R. 13270,
Tax Under Treasury Proposals
Before Senate Finance Committee, and Percent Tax Change

Married Couple with Two Dependents

Deductible Non-business Expenses of 10 Percent of Income

AGI	Present law tax	H. R. 13270 tax	Treasury proposals before Senate Finance	Percent tax change	
				P. L. to H. R. 13270	P. L. to Treasury proposals
$ 3,000	0	0	0	0	0
3,500	$ 70	0	0	-100.0%	-100.0%
4,000	140	$ 65	$ 81	-53.6	-42.1
5,000	290	200	253	-31.0	-12.8
7,500	687	576	616	-16.2	-10.3
10,000	1,114	958	1,012	-14.0	-9.2
12,500	1,567	1,347	1,447	-14.0	-7.6
15,000	2,062	1,846	1,951	-10.5	-5.4
17,500	2,598	2,393	2,451	-7.9	-5.6
20,000	3,160	2,968	2,968	-6.1	-6.1
25,000	4,412	4,170	4,170	-5.5	-5.5

Office of the Secretary of the Treasury
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September 4, 1969

Table 5

Present Law Tax, Tax Under H. R. 13270,
Tax Under Treasury Proposals
Before Senate Finance Committee and Percent Tax Change

Married Couple with Two Dependents

Deductible Non-business Expenses of 20 Percent of Income

AGI	Present law tax	H. R. 13270 tax	Treasury proposal before Senate Finance	Percent tax change: P. L. to H. R. 13270	Percent tax change: P.L. to Treasury proposals
$ 3,000	0	0	0	0	0
3,500	$ 56	0	0	-100.0%	-100.0%
4,000	112	$ 65	$ 81	-42.0	-27.7
5,000	230	200	214	-13.0	-7.0
7,500	552	516	516	-6.5	-6.5
10,000	924	868	868	-6.1	-6.1
12,500	1,304	1,228	1,228	-5.8	-5.8
15,000	1,732	1,636	1,636	-5.5	-5.5
17,500	2,172	2,056	2,056	-5.3	-5.3
20,000	2,660	2.508	2,508	-5.7	-5.7
25,000	3,708	3,492	3,492	-5.8	-5.8

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Table 6.

Long Run Revenue Effects of H.R. 13270 as Passed by the House and Proposed Treasury Changes by Major Provisions

	Long Run Revenue Effects: House Bill	Long Run Revenue Effects: Current Treasury Proposal
	(...... $ millions	......)
Reform provisions		
Individuals		
Contributions	20	20
Farm losses	20	50
Accumulation trusts	70	70
Deferred compensation	25	--
Capital gains	635	425
Natural resources	70	70
Interest deductions	20	--
LTP	85	60
Allocation	460	400
Real estate	330	330
Tax-free dividends	80	80
Gasoline tax deduction	--	310
Total	1,815	1,975
Corporations		
Foundations	100	25
Unrelated business income	20	20
Multiple corporations	235	235
Financial institutions	460	410
Natural resources	530	530
Foreign income	65	50
Regulated utilities	310	310
Real estate	1,005	1,005
Disallowed interest	70	70
Capital gains rate	175	175
Total	2,970	2,830
Tax relief provisions		
Individuals		
Low income allowance	-625	-920 (combined)
Eliminate phaseout	-2,027	
Increase standard deduction	-1,373	-770
Maximum tax on earned income	-100	-100
Head of household treatment	-650	-445
Reduce tax rates	-4,498	-4,705
Moving expenses	-100	-100
Income averaging	-300	-300
Total	-9,673	-7,340
Corporations		
Rate reduction		-1,600
Total		-8,940
Tax incentive provisions		
Pollution control amortization (Corporation)	-400	-180
Rail freight car amortization (Corporation)	-100	--
Real estate rehabilitation (Individual)	-70	-70
Real estate rehabilitation (Corporation)	-260	-260
Total	-830	-510
Other provisions		
Repeal investment credit		
Individuals	600	600
Corporations	2,700	2,700
Total	3,300	3,300
Grand total	-2,418	-1,345
Individuals	-7,328	-4,835
Corporations	4,910	3,490
[illegible]	--	

Office of the Secretary of the Treasury, Office of Tax Analysis September 2, 1969