Calendar No. 39

94TH CONGRESS } SENATE { REPORT
1st Session } { No. 94-36

Tax Reduction Act of 1975

REPORT

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

TOGETHER WITH SUPPLEMENTAL VIEWS

ON

H.R. 2166

MARCH 17, 1975 (legislative day MARCH 12, 1975).—Ordered to be printed
Filed under authority of the order of the Senate of March 17, 1975
(legislative day March 12, 1975)

U.S. GOVERNMENT PRINTING OFFICE

49-011 O WASHINGTON : 1975

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MARCH 17 (legislative day, MARCH 12), 1975.—Ordered to be printed
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Mr. LONG, from the Committee on Finance,
submitted the following

REPORT

together with

SUPPLEMENTAL VIEWS

[To accompany H.R. 2166]

The Committee on Finance, to which was referred the bill (H.R. 2166) to amend the Internal Revenue Code of 1954 to provide for a refund of 1974 individual income taxes, to increase the low income allowance and the percentage standard deduction, to provide a credit for certain earned income, to increase the investment credit and the surtax exemption, and for other purposes, having considered same, reports favorably with an amendment and recommends that the bill as amended do pass.

I. SUMMARY

The United States economy has experienced its sharpest decline since the 1930's. The unemployment rate in January was 8.2 percent, the highest since 1941, and the unemployment rate in February would have increased above that level but for the fact that many had despaired in looking for jobs and left the labor market. In addition, actual gross national output is over $200 billion below the potential output. The Finance Committee version of this bill deals with these problems by providing a $29.2 billion tax reduction in 1975.

In providing this reduction, the Finance Committee version of the bill—

Reduces taxes for individuals in the middle and lower income brackets, by providing a 4-percentage-point tax reduction and by providing a tax credit in lieu of exemptions for those in the low and middle income brackets.

Removes from the income tax rolls families with income below the poverty level.

Provides relief to earners with dependent children who pay little or no income taxes by providing a refundable tax credit based on earned income.

Stimulates the depressed housing industry by providing a 5-cent credit (up to a maximum of $2,000) for the purchase of personal residences during the remainder of 1975.

Encourages immediate increased investment in equipment by increasing the investment tax credit on a permanent basis to 10 percent. In addition, for a 2-year period the investment credit is increased to 12 percent, subject in certain cases to the condition that half of this 2-percentage-point increase is invested in employee stock ownership plans.

Aids public utilities by allowing them the same investment credit rate as other taxpayers and by increasing the fraction of their income tax liability which can be offset by the investment credit from 50 to 100 percent for a temporary period.

Helps small business by increasing the corporate surtax exemption from $25,000 to $50,000 and by reducing the rate of tax on the first $50,000 to 18 percent.

Provides tax relief to companies with large losses by allowing an extended net operating loss carryback in lieu of the regular carryback and carryforward period provided under present law.

Assists the hard-hit automobile industry by repealing the excise tax on trucks and buses and related parts.

The Finance Committee bill provides tax reductions of $9.5 billion above those available under comparable provisions of the House bill. Of this, $4 billion represents individual income tax decreases and $5.5 billion represents business tax decreases. The increase in the case of individual taxes is attributable to a special tax credit provided by the Finance Committee for home purchases, a 4-percentage-point rate reduction, and a tax credit in lieu of exemptions for those in the middle and lower-income brackets. In the case of businesses, the additional tax reduction under the Finance Committee bill is largely attributable to increases in the investment credit above the House provision (particularly the 2-year increase of the credit to 12 percent), the provision for an optional net operating loss carryback, lowering the corporate tax rate primarily for small businesses, and repealing the excise tax on new trucks.

More specifically, the Finance Committee version of the bill provides the following tax reductions:

Refund on 1974 tax liability.—The bill provides a refund on 1974 tax liability to be paid in one installment beginning in May 1975. It will generally equal 10 percent of tax liability up to a maximum of $200. However, each taxpayer is to receive a refund of at least $100 (or the full amount of his or her actual tax liability if less than $100). The refund is to be phased down from the maximum of $200 to $100 as the taxpayer's income rises from $20,000 to $30,000. The revenue loss from the 1974 refund is estimated to be $8.1 billion.

$200 personal exemption tax credit.—In lieu of raising the standard deduction, as would the House bill, the committee bill provides a $200 tax credit as an alternative to the $750 personal exemption deduction.

The tax credit is more generous than the personal exemption in all cases where individuals are subject to tax under present law below a 27-percent tax rate. This change involves a revenue loss of $6.3 billion, or approximately $1 billion more than the increase in the standard deduction which would have been provided by the House bill.

Rate reduction on the first $4,000 of income.—The committee bill lowers by one percentage point the tax rate applying to the first $4,000 of taxable income in the case of individuals. This reduction for those with higher incomes means a reduction of $40 in each case. This change will result in a revenue loss of $2.3 billion in 1975.

Refundable credit on earned income or work bonus.—The bill provides for a refundable credit of 10 percent of earned income up to a maximum of $400—closely matching the employee and employer social security tax on the first $4,000 of income. This credit is to be available only to those with dependent children. The credit is to be phased out from the maximum of $400 to zero as adjusted gross income rises from $4,000 to $8,000. This change involves a revenue loss of $1.5 billion, or about one-half of the provision in the House bill. Federal welfare costs will be reduced by an estimated $0.1 billion.

Credit for home purchases.—The committee bill provides a tax credit for the purchase of homes (both new and old homes) which are used as principal residences, where the settlement occurs after March 12, 1975. Generally, the house must be purchased in 1975, except that in limited types of situations purchases begun earlier may be eligible for the credit even if they were not completed until 1976. It is estimated that this provision will result in a revenue loss of $3.0 billion in 1975.

Capital loss carrybacks.—The bill provides a 3-year capital loss carryback for individuals where their capital losses on a cumulative basis amounts to $30,000 or more. This carryback may be offset in these prior 3 years only to the extent of capital gains realized in those years. This provision is expected to result in a loss of revenue of $110 million in 1975 and smaller amounts thereafter.

Increase in the investment credit.—The investment tax credit rate is increased for all taxpayers (including public utilities) to a permanent rate of 10 percent from the present rate of 7 percent (4 percent in the case of public utilities). In addition, for a 2-year period taxpayers may claim a 12-percent investment tax credit. However, if the taxpayer's qualified investment for a taxable year is more than $10 million, an employer must contribute one-half of the additional 2 percent to employee stock ownership plans. In addition, in the case of public utilities, the limitation on the amount of tax liability that may be offset by the investment credit in a year is increased from 50 percent to 100 percent for a 2-year period and then is gradually reduced back to the 50 percent level over a 5-year period. In the case of long lead-time property, the bill provides that the investment credit is to be available to the extent that progress payments are made during the construction period. Finally, the $50,000 limitation in present law on the amount of used property eligible for the investment credit is eliminated. The revenue loss from these changes in the investment credit is estimated at $4.3 billion with respect to 1975 liabilities, or $1.9 billion more than the House provision.

Net operating loss carryback.—The bill provides that businesses generally may elect to substitute for their present 3-year carryback and 5-year carryforward of net operating losses an 8-year carryback and no carryforward. This is to apply for loss years back to 1970. Once such a carryback is elected, a carryforward is not to be available unless the taxpayer revokes his election and in effect recomputes his tax for all of the years involved on the basis of the 3-year carryback and the 5-year carryforward. To be eligible for this treatment initially (except in cases where the tax benefit is small), 25 percent of the tax benefit realized from the first use of the extended loss carryback is to be placed in an employee stock ownership plan or in some cases to a limited extent, in a supplemental unemployment benefit plan. It is estimated that the initial revenue loss from this provision will be $1 billion.

Decrease in tax to help small business.—To aid small businesses, the surtax exemption (the amount to which the 22-percent corporate rate presently applies rather than the 48-percent rate) is increased from the present $25,000 to $50,000. In addition, the 22-percent rate applying to this first $50,000 of income is reduced to 18 percent, although no change is made in the 48-percent rate on income above $50,000. Finally, the accumulation credit under the accumulated earnings tax is increased from $100,000 to $150,000. It is estimated that these changes will result in a revenue loss of $1.9 billion, or $700 million more than under the House bill.

Repeal of truck excise tax.—The committee bill repeals the 10-percent manufacturers' excise tax on new trucks and buses and also the 8-percent manufacturers' excise tax on truck parts. It is estimated that this will result in a revenue loss of $700 million in 1975.

WIN tax credit.—The present tax credit of 20 percent of wages paid to employees hired under the Work Incentive Program is to be available with respect to the hiring of former welfare recipients, even though they have not been in the WIN program, by both business and non-business employers. This supplement to the WIN credit is to be available until July 1, 1976.

Effective date.—Most of the provisions included in the committee version of this bill apply only for 1975. However, the increase in the individual rates by 4 percentage points is to apply for 2 years, the investment credit is increased to 10 percent on a permanent basis and to 12 percent for 2 years, and the net operating loss provision for business and the capital loss carryback for individuals are permanent changes. The possibility of making the other changes permanent will be reviewed in subsequent legislation.

II. REASONS FOR THE BILL

The committee agrees with the House that it is imperative to provide a substantial tax reduction at this time to check the drastic downward slide in our economy and to restore a rate of economic growth that will move us closer to full employment. The Finance Committee version of the Tax Reduction Act of 1975 does this by providing appropriate tax reductions—substantially larger than those provided by the House bill—designed to increase purchasing power and investment incentives. There is widespread agreement among economists that such action is urgently needed at this time to avoid great hardship for large numbers of people and huge waste in unused human resources. Before adopting this bill, the committee held hearings in which it had the benefit of the views of Administration witnesses and eminent economists, businessmen, and labor experts, representing a broad spectrum of our political and economic institutions. Virtually all recommended quick action to cut taxes.

This is not surprising in view of the sharp decline in economic activity which has taken place recently. Although characterized by marked inflation, 1974 was clearly a recession year.

In 1974, real gross national product (that is, GNP in constant prices) registered the largest decline since 1946. (See table 1.) For the year as a whole, money GNP rose to $1,397 billion—7.9 percent over 1973—but this increase merely reflected higher prices. Real GNP fell 2.2 percent. The decine in output and the rise in prices was especially marked in the fourth quarter of 1974, when real GNP fell at an annual rate of 9.1 percent and prices rose at an annual rate of 14.4 percent.

TABLE 1.—GROSS NATIONAL PRODUCT 1929–74

[In billions of dollars]

Year	Gross national product in current dollars	Gross national product in 1958 dollars	Year	Gross national product in current dollars	Gross national product in 1958 dollars
1929	103.1	203.6	1956	419.2	446.1
1933	55.5	141.5	1957	441.1	452.5
1939	90.5	209.4	1958	447.3	447.3
1940	99.7	227.2	1959	483.7	475.9
1941	124.5	263.7	1960	503.7	487.7
1942	157.9	297.8	1961	520.1	497.2
1943	191.5	337.1	1962	560.3	529.8
1944	210.1	361.3	1963	590.5	551.0
1945	211.9	355.2	1964	632.4	581.1
1946	208.5	312.6	1965	684.9	617.8
1947	231.3	309.9	1966	749.9	658.1
1948	257.6	323.7	1967	793.9	675.2
1949	236.5	324.1	1968	864.2	706.6
1950	284.8	355.3	1969	930.3	725.6
1951	328.4	383.4	1970	977.1	722.5
1952	345.5	395.1	1971	1,054.9	746.3
1953	364.6	412.8	1972	1,158.0	792.5
1954	364.8	407.0	1973	1,294.9	839.2
1955	398.0	438.0	1974 [1]	1,397.3	821.1

[1] Preliminary.

Source: Department of Commerce.

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The falling GNP figures for 1974 reflect widespread declines in both consumption and investment. The decline in consumption was particularly sharp for durable goods expenditures, including new cars. The leading reasons for the weakness in consumer expenditures were falling disposable income, inflation, and lack of consumer confidence.

Real gross private investment fell 8.2 percent in 1974. The decline in housing starts was even sharper. Housing starts totaled only 1.4 million compared with 2.4 million in 1972 and 2.1 million in 1973. By January 1975, housing starts were running at an annual rate of well under 1 million.

As the economic situation deteriorated, unemployment rates rose—from 5.2 percent in January 1974 to 8.2 percent in February 1975. This compares with average unemployment rates of 4.9 percent in 1973, 5.6 percent in 1972, 5.9 percent in 1971, and rates averaging 3.8 percent or less from 1966 through 1969. The February unemployment rate was the highest since 1941.

In the absence of remedial action to cut taxes, the outlook is that the current recession will continue and deepen. Growth in business investment was one of the prime forces fueling the upward movement of our economy prior to the current downturn. However, after adjustment for price changes, capital expenditures for new plant and equipment are expected to fall significantly in 1975, according to the most recent survey of the Commerce Department.[1]

Economic forecasters are practically unanimous in predicting that in 1975 the economy will continue to operate far below its potential. While the precise figure varies with different forecasters, real GNP in 1975 is generally expected to be substantially lower than in 1974, although many forecasters anticipate a modest recovery beginning in mid-1975.

In view of these further expected sharp declines in economic activity, the committee concluded that appropriate tax reductions to stimulate the economy should be enacted promptly. In arriving at this conclusion, the committee gave careful consideration to the large budgetary deficits that are expected in the fiscal years 1975 and 1976 and the prevalence of a rapid rate of inflation despite the economic downturn.

Similarly, the committee does not view with equanimity the fact that in 1974 the consumer price index rose 12.2 percent and the wholesale price index rose 23.5 percent. Although in December 1974 and January 1975 the rate of growth of the consumer price index moderated and the wholesale price index dropped slightly in December 1974 and the early months of 1975, inflationary pressures are still very strong.

However, the committee believes that the present economic situation requires the adoption of an appropriate tax reduction measure now. Without such timely tax reduction, there is the grave risk that the present recession will be prolonged and intensified, resulting in huge waste of resources and human hardship.

The substantial budget deficits in prospect for fiscal years 1975 and 1976 are due in large measure to the economic downturn which has shrunk the tax base and cut tax receipts drastically. This is shown by the fact that if the economy were operating at its full potential, sufficient revenue would be collected with present law taxes to produce

[1] U.S. Department of Commerce News, March 7, 1975.

a budget surplus running at an annual rate of about $30 billion in the second quarter of 1975. The committee believes that the best way to reduce the anticipated large budget deficits would be to take action to restore economic growth and thereby increase tax receipts.

Moreover, without in any way seeking to diminish the vital importance of reducing the budget deficits, the committee believes that it is important to note that the projected budget deficits for fiscal years 1975 and 1976, though large in dollar amounts, are not unusually large in relation to the gross national product for a recession year. They are expected to amount to 2.4 percent and 3.2 percent of the gross national product, respectively. In other recession years the budget deficit amounted to 3.7 percent of gross national product in fiscal 1948, 2.7 percent in fiscal 1959 and 2.3 percent in fiscal 1971.

Furthermore, under present conditions, the adoption of an appropriate tax reduction program will help to revive the economy and increase employment without adding significantly to inflationary pressures. This is because there are now large amounts of available unused resources which can be gainfully employed to add to our output. As the tax reductions stimulate the economy, these at present idle resources will be brought back into use, thus adding more goods and services to match the added purchasing power made available by the tax cut. The size of these unused resources is shown in table 2 which sets forth estimates indicating that in 1975 the actual GNP may be as much as 14 percent below the potential GNP, assuming the present budgetary picture with no tax cut. This gap would amount to $250 billion, or over $1,000 per capita.

TABLE 2.—ACTUAL AND POTENTIAL GNP

[Billions of dollars, seasonally adjusted annual rates]

Year and quarter	Actual GNP	Potential GNP[1]	GNP gap (potential less actual)
1971-I	1,027.2	1,081.4	54.2
1971-II	1,046.9	1,105.2	58.3
1971-III	1,063.5	1,126.0	62.5
1971-IV	1,084.2	1,141.0	56.8
1972-I	1,112.5	1,164.3	51.8
1972-II	1,142.4	1,182.9	40.5
1972-III	1,166.5	1,202.6	36.1
1972-IV	1,199.2	1,223.8	24.6
1973-I	1,248.9	1,258.3	9.4
1973-II	1,277.9	1,293.0	15.1
1973-III	1,308.9	1,332.1	23.2
1973-IV	1,344.0	1,373.2	29.2
1974-I	1,358.8	1,427.7	68.9
1974-II	1,383.8	1,474.3	90.5
1974-III	1,416.3	1,532.0	115.7
1974-IV	1,430.2	1,599.1	168.9
1975-I	[2] 1,432.5	[3] 1,642.0	209.5
1975-II	[2] 1,454.0	[3] 1,686.9	232.9
1975-III	[2] 1,483.5	[3] 1,727.7	244.2
1975-IV	[2] 1,520.3	[3] 1,770.3	250.0

[1] The increase of potential GNP assumes a growth rate in real terms of 4 percent each year, composed of an increase in the labor force of 1.8 percent, a decline in hours worked of 0.3 percent and a rise of output per man-hour of 2.5 percent. These trends may not be an accurate reflection of conditions during the oil embargo of late 1973 and early 1974. Like all measures of capacity, these are subject to a wide margin of error.

[2] Forecasts of Chase Econometrics, Inc., assuming no tax reduction.

[3] Staff estimates using the methodology of the Council of Economic Advisers.

Source: Business Conditions Digest.

Appropriate tax reductions will also increase incomes, both directly and through the multiplier effect, and the increased saving from this additional income will provide the flow of funds needed to purchase

the government securities issued to finance the increase in the deficit resulting from the tax cut.

In view of these considerations, the committee provided tax reductions, totaling $29.2 billion in the calendar year 1975. Of this amount $21.2 billion, or 73 percent, is to go to individuals in their personal capacity. This reduction is designed to restore purchasing power and in this way to stimulate the economy. The remaining $8 billion of tax reductions, or 27 percent, is to go to businesses (both corporate and other) and is designed to stimulate investment.

The committee's bill is similar in a number of important respects to the House-passed bill, reflecting the basic similarity in objectives. However, the committee's bill also differs from the House bill in a number of important respects.

The $29.2 billion total tax reduction provided by the committee's bill for calendar year 1975 is $9.3 billion larger than the $19.9 billion tax reduction provided by the House bill for that year.

The committee increased the total tax reduction because it believes that a tax reduction in the neighborhood of $30 billion is required to bring the economy out of its present slump. While it would be helpful, the $19.9 billion tax cut provided in the House bill would not be adequate to do this job particularly in view of the fact that the economic situation has generally continued to deteriorate since the House action was taken. Moreover, because of the large amount of available unused resources which can be gainfully employed, the economy, at this time, is able to absorb a tax cut approaching $30 billion without creating undue inflationary pressures. Substantial tax reductions are also justified at the present time because individuals have incurred a tax increase of over $7 billion in 1974 alone as a result of increases in money incomes pushing them into higher tax brackets and the lack of adjustment of the tax brackets, the personal exemption and the minimum and maximum standard deduction for inflation.

The Finance Committee bill also provides reductions in 1975 liability both for individuals who itemize as well as those who take the standard deduction, instead of limiting these reductions only to those who take the standard deduction. While both version of the bill provide an earned income credit, the committee bill has redesigned the House credit both to double its size and also to direct it exclusively to families with children. The committee has also added a significant stimulant for the construction and sale of housing during the remainder of this year. On the business side, it has, for a limited period of time, increased the investment credit by two additional percentage points, and has also made provision for a longer net operating loss carryback. The major changes made by the committee bill which are described further below.

Individual Tax Reductions

The $21.2 billion of individual income tax reductions [2] consists of $8.1 billion from a refund of part of 1974 tax liability, $6.3 billion from a $200 tax credit in lieu of exemptions, $1.5 billion for a refundable credit on earned income, $3.0 billion from the 5-percent tax credit

[2] There also is a $800 million investment credit tax reduction in the business tax liabilities of individuals. This is included in the next discussion on business tax liabilities.

for home purchases, $2.3 billion from tax rate reductions, and approximately $100 million from the addition of a capital loss carryback provision.

While the committee's bill adopts the same $8.1 billion refund provision as is in the House bill, the committee believes that the individual income tax reduction should be weighted less in favor of a lump-sum payment and more toward tax cuts that are reflected in lower withholding. The lump-sum payment based on 1974 tax liability has the advantage of providing a quick increase in disposable income in a form that will encourage taxpayers to spend their refunds on consumer durable goods, a sector of the economy where much of the current decline in production has occurred. Many individuals, however, will save any lump-sum payment, or use it to repay debts, and to the extent this occurs, the tax cut will not increase income and employment. The tax reductions reflected in lower withholding will increase disposable income more slowly than a lump-sum payment, but individuals will be more likely to spend this additional income than the income they receive as a lump-sum payment. The committee believes that the best way to make sure that the tax reduction provides the desired stimulus is to supplement any refund by significant reductions in withheld taxes.

The committee believes that concentrating the tax reduction in the low- and middle-income brackets, as the committee bill does, is equitable in that these are the taxpayers who have been affected the most by inflation. Also, a tax cut concentrated in these brackets probably will be more effective since these people are more likely to spend the tax cut and in this way increase income and employment.

To an appreciable extent, this tax reduction reflected in withholding also compensates individuals for the increase in their real tax burden that results from inflation. Inflation erodes the value of the personal exemption and minimum and maximum standard deductions, and it pushes taxpayers into higher rate brackets even when they have not experienced an increase in their real income. The tax increase caused by inflation was approximately $7 billion in 1974 alone.

The withholding changes made by the bill are to take effect on May 1, 1975. The new withholding rates will reflect the personal exemption tax credit, the earned income credit, and individual tax rate reductions.

Refund on 1974 tax liability.—As in the House bill, the committee has provided individual income taxpayers a refund on 1974 tax liability amounting to 10 percent of tax liability (after credits) up to a maximum of $200. However, taxpayers with $1,000 of tax liability or less are to receive a refund of $100 or the amount of their actual tax if it is less than $100. (Married people who file separate returns are to receive $50 each unless a spouse's tax payment is less than $50, in which case that spouse is to receive a refund of the full amount of his or her tax liability.) For taxpayers whose adjusted gross income (AGI) exceeds $20,000, the refund is to be phased down from the maximum of $200 to $100 as AGI rises from $20,000 to $30,000. The $100 minimum refund is designed to provide some rebate for all taxpayers and especially to channel the greater portion of the total revenue to families in the income levels which are more likely to spend it. The committee considered phasing out the refund entirely for upper-income families, but decided it was more appropriate to give this group the same $100

minimum refund provided to other taxpayers. The revenue loss from the refund is estimated to be $8.1 billion.

Taxpayers should begin receiving these payments approximately six weeks after the date of enactment of this bill. There is no need for them to make any adjustments on their 1974 tax returns; the Internal Revenue Service will make the appropriate calculations and mail the refund checks without any action by taxpayers other than filing their 1974 tax returns.

$200 personal exemption tax credit.—In the present situation it is essential to extend relief generally to as broad a group of taxpayers as possible, both for equity and economic reasons. The House bill, however, provides only limited tax relief to a large group of individuals, namely, those who itemize their tax deductions. This is because all of the relief on 1975 liability provided by the House bill is granted in the form of a higher standard deduction which provides no benefits to individuals who continue to itemize their deductions. In order to remedy this situation, the Finance Committee bill substitutes for the larger standard deduction provided in the House bill a $200 tax credit that the taxpayer may take in place of the $750 personal exemption. This $200 personal exemption tax credit has the advantage of being available to taxpayers regardless of whether they itemize their deductions or take the standard deduction.

In addition, the tax credit provided by the committee is a more effective means of aiding low and middle-income taxpayers than the higher standard deduction provided in the House bill. As shown in table 3 the new credit raises the tax-free income level above poverty income levels. As is indicated in this table, in the case of families with more than one dependent, the tax credit is more successful in bringing the tax threshold above the poverty level than would be the changes in the minimum standard deduction provided by the House bill. Moreover, the credit has the effect of generously increasing the personal exemption for low and middle-income taxpayers, which is needed to take account of the increased cost of maintaining dependents in the face of rising prices. At the same time, taxpayers whose marginal tax rate exceeds 27 percent will continue to take the regular $750 personal exemption, thus conserving revenue.

TABLE 3.—1975 POVERTY LEVELS AND TAX THRESHOLDS UNDER PRESENT LAW, INCREASED MINIMUM STANDARD DEDUCTION [1] AND FINANCE COMMITTEE BILL [2]

	1975 poverty level	Present law tax thresholds	Tax threshold under increased minimum standard deduction in House bill	Tax threshold under $200 credit
Family size:				
1	$2,694	$2,050	$2,650	$2,733
2	3,470	2,800	4,000	4,167
3	4,253	3,550	4,750	5,405
4	5,442	4,300	5,500	6,458
5	6,423	5,050	6,250	7,511
6	7,226	5,800	7,000	8,563

[1] Minimum standard deduction of $1,900 for single persons and $2,500 for joint returns and $750 per personal exemption deduction.

[2] Including rate reductions in lower tax brackets, but excluding the refundable earned income credit.

The personal exemption tax credit involves a revenue loss of $6.3 billion for 1975. 5 percent of the reduction goes to taxpayers with incomes under $10,000, and 47 percent to taxpayers with incomes between $10,000 and $20,000. 57 million taxpayers will receive a tax reduction from this provision.

Earned income credit.—The Finance Committee's bill adopts the general concept of the earned income credit provided in the House bill, but significantly revises this provision in order to improve its impact on the low-income taxpayers with children.

The Finance Committee bill revises the House earned income credit generally to conform with the work-bonus concept reported by the committee previously. Under the committee's bill, the refundable credit is to be 10 percent of earned income up to a maximum credit of $400 (on $4,000 of earnings). The credit is set at 10 percent in order to correspond roughly to the added burdens placed on workers by both employee and employer social security contributions. The credit is to be phased out as adjusted gross income rises between $4,000 and $8,000. The credit is to be available only to taxpayers with dependent children—those who are most in need of the relief.

This new refundable credit will provide relief to families who currently pay little or no income tax. These people have been hurt the most by rising food and energy costs. Also, in almost all cases, they are subject to the social security payroll tax on their earnings. Because it will increase their after-tax earnings, the new credit, in effect, provides an added bonus or incentive for low-income people to work, and therefore, should be of importance in inducing individuals with families receiving Federal assistance to support themselves. Moreover, the refundable credit is expected to be effective in stimulating the economy because the low-income people are expected to spend a large fraction of their increased disposable incomes.

The new credit provided by the committee's bill involves an estimated revenue loss of $1.5 billion per year. It is estimated that Federal welfare costs will be reduced $0.1 billion.

Individual rate reduction.—The committee bill reduces individual income tax rates in the lowest tax brackets in order to provide additional relief to the low and middle-income taxpayers and to offset the tendency of the House bill to provide insufficient relief to individuals who itemize their deductions. More specifically, the bill reduces tax rates in the lower brackets—those applicable to taxable income under $4,000. For those at or above this income level the reduction is $40. These rate reductions result in a revenue loss of $2.3 billion. Of this amount, 35 percent goes to taxpayers with incomes under $10,000, and 46 percent to taxpayers with incomes between $10,000 and $20,000, although all taxpayers benefit from the reduction in the bottom rates.

Tax credit for home purchases.—The bill also provides a 5-percent tax credit (with a $2,000 maximum) for the purchase of a new or used home which is a taxpayer's principal residence. This credit is to be available only for the purchase of homes between March 13 and December 31, 1975. This includes condominiums and trailer homes. This new credit is designed to stimulate the housing industry, which has been operating at depression levels over the past year or so. In view of the fact that in January 1975, housing starts were running at an annual rate of well under one million, the committee believes that it

is imperative to provide additional tax incentives to the housing industry, both to increase the supply of housing to fulfill vital needs and help put the entire economy back on an economic growth path. While it is difficult to measure the exact impact, the committee expects that the new housing credit provision will increase home purchases by close to 100,000 units. This might raise residential construction by something like $3 billion for the year, and probably will also increase the purchases of furniture and major appliances by close to half a billion dollars. This, of course, (as also is true of other individual tax reductions provided in the bill) will increase the gross national product significantly for 1975. This, in turn, will result in an increase in revenues for the year, offsetting an important part of the revenue loss involved in this provision. The revenue loss from this provision is expected to be $3.0 billion in 1975 and $0.6 billion in 1976.

Capital loss carryback.—Under present law, individuals with capital losses exceeding capital gains are allowed to carry forward these losses to future years. There is no limitation on the number of future years to which these capital losses may be carried. However, such losses may not be carried back to past years. This imposes a hardship on individuals who have incurred substantial capital losses and who have little or no expectation of capital gains in future years against which they can offset such losses, but who in past years have paid tax on large capital gains. To give such individuals relief, the committee bill allows individuals whose cumulative capital losses in the current year exceed $30,000 to carry back the losses to offset capital gains in the previous 3 years. This provision is intended not only as a relief measure for those with substantial capital losses, but also to help sustain current investment in common stocks. The revenue loss from this provision is estimated to be $110 million in 1975 and to decrease in subsequent years.

Business Tax Reductions

Increase in the investment credit.—In view of the low and decreasing level of economic activity and the poor expected level of investment, the committee concluded that a balanced program which encourages both consumption and investment will be a more effective method of stimulating the economy than attempting to focus all of the tax stimulus on consumption. In addition to providing short-run stimulus to the economy, an increase in the amount of investment is desirable for other reasons. The investment not only creates jobs both directly and through the multiplier effect, but it also increases productivity. This is anti-inflationary because it increases the amount of output available to meet future consumer demands and because it results in lower production costs which means that money wage increases will not exert the same degree of upward pressure on product prices that they would in the absence of growing productivity. Increased productivity also has favorable implications for our balance of payments and the exchange rate of the dollar. Finally, unless in the future the stock of capital is increased significantly, there will be serious problems in providing enough jobs for those entering the labor force.

The House bill seeks to respond to these problems by increasing the investment credit for one year (with limited extensions beyond that year) from 7 to 10 percent generally (from 4 percent for public

utilities), and by adopting a number of other liberalizations in the credit designed to facilitate the use of the credit and increase the amount of relief provided by the credit. However, the Finance Committee believes that the current economic situation and the low level of investment now prevailing call for stronger remedies than those provided in the House bill. For this reason, the committee decided to increase the investment credit to 12 percent for 1975 and 1976, the 2 years in which most forecasts indicate the investment stimulus will be particularly needed. In addition it decided to make the 10-percent investment credit permanent for 1977 and later years. Thus under the Finance Committee action the investment credit rate will not return to the 4- or 7-percent rate provided by present law (as under the House bill).

In order to encourage the growth of employee stock ownership plans, the committee bill provides that a corporate taxpayer who elects the 12-percent credit (for 1975 and 1976) must agree to put an amount equal to one-half of the excess over 10 percent (or one percentage point of the credit) into an employee stock ownership plan if the corporation has more than $10 million of qualified investment property for the year.

Investment credit applicable for public utilities.—Under existing law, a 4-percent investment credit is provided for most public utilities, as compared to the 7-percent investment credit which applies generally. This lower investment credit for public utilities discriminates against investment in utilities and impedes such investment at a time when the public utilities need large amounts of capital to build up their capacity to meet the growth in demand for their services and to convert from oil and gas to other energy sources.

Public utilities have experienced very considerable difficulty in recent years in securing capital for essential expansion in view of the depressed state of the stock market, tight money, and the reluctance of regulatory commissions to grant rate increases to cover increased costs. The results have been especially severe for the electric utilities which have incurred sharp rises in costs as a result of substantially higher prices for their sources of energy.

As a result, the committee concluded that the investment credit for eligible investment in public utilities should be increased from 4 percent to the 12-percent rate provided in the bill for all other taxpayers for 1975 and 1976 and to the same 10-percent rate for 1977 and later years which was provided for corporations generally.

The committee believes that it also is not only appropriate to increase the investment credit from 4 percent to 12 percent and then to 10 percent for utilities, but also agrees with the House that it is necessary to focus the incentive effect of the investment credit on the less profitable utilities which are faced with increasing problems because of rising energy costs. The bill does this by increasing the limitation on the amount of income tax liability which can be offset by the investment credit in any one year from 50 percent of tax liability (above the first $25,000 of tax liability) to 100 percent. This 100-percent limit applies for 2 years and then the limitation is gradually phased back to 50 percent over a period of 5 years.

In addition, in order to increase the effectiveness of the credit as a means of granting relief to public utilities, the committee deleted

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from the bill a House provision limiting to $100 million the total amount of additional credit that would be provided to any utility or group of utilities.

Utilities also will be provided another opportunity to elect to normalize the investment credit as under the Revenue Act of 1971.

Investment credit for progress payments.—Under present law the investment tax credit is available only when property is placed in service. This has been considered an inequity in the case of property with a long construction period where payments are made during the course of construction but are not eligible for the credit until the property is completed and placed in service. The committee believes it is appropriate to make the credit available to the extent progress payments are made in the case of property which requires a long period of construction. As a result, the committee's bill accepts a House provision that in the case of long lead-time property, that is, property that requires at least 2 years to construct, the investment tax credit is to be available to the extent that progress payments are made during the construction period (rather than in the year when the property is ultimately placed in service). This provision has an initial 5-year transitional period to phase in the new system. The availability of the investment tax credit during the construction period of long lead-time property will also provide an additional financial incentive to encourage utilities and others to undertake longer term projects.

Investment credit for used property.—In order to encourage the acquisition of used property that will increase the productivity of small businesses, which are frequently unable to afford new equipment, the House bill increased the $50,000 limit of present law on the amount of used property eligible for the investment credit to $75,000. The Finance Committee concludued that even this limit was inappropriate for small businesses, and therefore eliminated the limitation on used property eligible for the investment credit. This is expected to cost $0.1 billion.

The estimated total revenue loss from the increased investment credit is $4.3 billion in 1975.

Net operating loss carryback.—The committee adopted a new provision designed to provide immediate tax relief to companies which are hard-pressed financially and which might otherwise fail. Under present law, taxpayers generally are allowed a 3-year carryback and 5-year carryforward as a period over which to average their net operating losses with their income. While an 8-year period generally grants adequate relief for losses, the relatively brief 3-year carryback period fails to grant sufficient relief in cases where taxpayers have incurred very substantial losses and anticipate little or only moderate profits in the period ahead.

In order to grant such taxpayers relief, the committee's bill generally extends the present 3-year loss carryback for 5 additional years for taxpayers who elect to forego the 5-year carryforward of present law.[3] This treatment, it should be noted, does not extend the overall period over which net operating losses can be deducted, since the period during which either a carryback or a carryforward may be utilized remains 8 years. However, it does provide substantial relief to businesses

[3] Where the carryforward period is more than 5 years (as in the case of the 7-year net operating loss carryforward for regulated transportation companies), the carryback is lengthened by this additional number of years.

which are hard-pressed in the current recession by giving them the opportunity to obtain refunds immediately through the use of carrybacks in exchange for an eventual recoupment through a carryforward. Companies with losses which elect to take the longer carryback period can thereby arrange to get immediate relief at a time when they need the cash, instead of waiting for profitable future years to take their loss carryforwards. Moreover, the provision is less likely to be subject to abuse than is a carryforward since, in many cases, companies are, in effect, "sold" largely to obtain the benefit of a carryforward. However, had a carryback been available instead, it would either have been used up or would not be available to offset the other company's past profits.

This provision involves an estimated $1 billion revenue loss. However, it is believed that much of this (over one-half) will be recouped by smaller loss offsets on carryforwards in future years. Approximately $150 million of this benefit will go to the Chrysler Corporation, $40 million to Pan American World Airways, Inc., and $65 million to Lockheed Aircraft Corporation. Under this provision, 1970 is the first loss year which may be taken into account for this purpose.

Those electing the new operating loss carryback rule (where the tax benefit is $10 million or more) in the initial application are required to devote an amount equivalent to 25 percent of the tax savings to employee stock ownership plans. In those cases where the company owner has a supplemental unemployment compensation benefits plan (SUB), however, in order to assist the unemployed, the company and any union plan subject to such a contract may elect to satisfy this obligation in part by putting an amount up to one-half of 25 percent of the tax savings into the SUB fund. No tax deduction is to be available for any amount so used.

Surtax exemption and rates applicable to small corporations.—The committee (like the House) was concerned that concentrating all the tax relief to business in the form of an increase in the rate of the investment tax credit alone would not provide sufficient financial relief to small corporations, particularly to those that are not capital intensive. The committee agreed with the House that the best way to provide financial relief for hard-pressed small corporations was through a rate reduction applicable primarily to them. This result was sought in the House bill by an increase in the surtax exemption from $25,000 to $50,000. This, in effect, increases from $25,000 to $50,000 the income of any corporation subject only to the 22-percent tax rate rather than the full 48-percent tax rate. The committee agreed with this House provision. However, it realized that while the relief provided by the House bill is of benefit to corporations with income of more than $25,000, it provided no tax relief for corporations with smaller incomes. To achieve this result, the committee, in addition to enlarging the surtax exemption, reduced from 22 percent to 18 percent the tax rate applicable under the House bill to the first $50,000 of taxable income. As a result, on the first $50,000 of taxable income, corporations will be taxed at a rate of 18 percent rather than at a rate of 22 percent on the first $25,000 of their income as under present law.

Increase in minimum accumulated earnings credit.—The bill also aids small business by increasing the minimum credit in the accumulated earnings tax from $100,000 to $150,000. This reflects the rise in

the price level that has occurred since 1958, when the credit was raised to $100,000.

The increase in the surtax exemption to $50,000 is estimated to cost $1.2 billion, and the reduction in the 22-percent tax rate to 18 percent is estimated to cost approximately $700 million more, for a total of approximately $1.9 billion.

Repeal of excise tax on trucks and buses and related parts.—The committee also repealed the 10-percent tax on trucks and buses and the 8-percent tax on truck parts effective for sales after March 13, 1975. This should aid in offsetting the badly lagging sales of trucks and truck trailers, the sales of which have dropped dramatically in recent months. At the same time it should reduce the price of trucks to businesses and consumers who have been faced with rapidly rising prices for trucks and truck parts. The tax revenues in these cases are devoted under present law to the Highway Trust Fund which, because of impoundments by the administration, presently is not spending all of its funds. As a result this lessening of revenue for the Highway Trust Fund is not likely to reduce highway construction. Moreover, since it does not affect the general fund it will not affect other programs. The revenue cost of this provision for 1975 is approximately $700 million.

Extension of work incentive program.—The bill also modifies the tax credit of 20 percent of the first year's wages paid to employees hired under the Work Incentive Program (WIN) in an attempt to make the tax incentive workable. The program has not been effective in moving welfare recipients into employment because of administrative complexities that have been added by the Labor Department. Consequently, the bill extends the credit to nonbusiness employees as well as the present business employees, and makes it available for welfare recipients whether or not in the WIN program if they have been on welfare for 90 days or more. In addition, after the eligible employee has worked the first 30 days, the employer would receive the credit for the wages paid or incurred by the employer for the first 30 days of employment plus the wages for all days the employee continued to work after the original 30-day period. This liberalization is provided as a supplement to the present WIN credit, and this supplement is to terminate on July 1, 1976.

III. REVENUE EFFECTS

The bill is estimated to result in a reduction in tax liability of $29.2 billion through calendar year 1975. Table 1 shows how the impact of this reduction is divided between individuals and business organizations. It shows that $21.2 billion of the reduction goes to individuals in their nonbusiness capacity and $8.0 billion to businesses. Thus, almost 73 percent of the tax reduction goes to individuals (in their nonbusiness capacity) and 27 percent to business.

The $21.2 billion of tax reduction for individuals (in their nonbusiness capacity) is made up of an $8.1 billion refund on 1974 income tax liability, a $6.3 billion increase relating to a $200 exemption tax credit, a $2.3 billion tax decrease relating to a 1-percentage point decrease in rates on the first $4,000 of taxable income, a $3.0 billion credit for the purchase of homes and a $1.5 billion earned income credit. Addition of a $794 million liberalization of the investment credit for individuals in their business capacity (plus the effect of a few other items) raises the total reduction for individuals through 1975 to $22.3 billion. The $8.0 billion reduction in corporate tax liability is made up almost entirely of $4.3 billion ascribable to liberalization of investment credit, $1.9 billion derived from increasing the corporate surtax exemption from $25,000 to $50,000 and from decreasing the starting rate for corporations, $1 billion from liberalizing the net operating loss carryback provisions, and $500 million from repeal of excise taxes on trucks.

Table 2, which presents the data from Table 1 on a quarterly and a fiscal year basis, shows the impact of the tax reduction on the economy so far as timing is concerned. As this table shows, almost 43 percent of the total tax reduction ($12.5 billion) is estimated to occur during the second quarter of calendar year 1975. Most of this will go to individuals ($1.8 billion will go to corporations). In the last two quarters of calendar year 1975 tax collections are estimated to decline, because of the reductions called for in the committee bill, by $13.9 billion with $11 billion of the decreased collections affecting individuals. Part of this latter sum reflects underwithholding which will be recouped in the first two quarters of calendar year 1976. The whole of fiscal year 1976 shows individuals benefiting from $13.4 billion of decreased receipts and corporations by $7.0 billion.

Table 3 shows, by adjusted gross income class, the distribution of the effect of the refund of part of 1974 tax liability which produces a tax reduction of $8.1 billion.

Table 4 shows the effect of the 1-percentage-point decrease in individual tax rates with respect to the first $4,000 of taxable income. As is indicated in this table, this represents a tax reduction of $2.2 billion, of which 35 percent is distributed to those with incomes under $10,000, and 47 percent to those with incomes between $10,000 and $20,000.

Table 5 shows the effect of allowing the $200 credit in lieu of the $750 personal exemption deduction. As indicated in this table, this provision will make 7.2 million returns nontaxable and provide tax reductions for 57.3 million returns. The tax reduction in this case is $6.1 billion, of which 51 percent goes to those with incomes below $10,000 and 47 percent to those with incomes between $10,000 and $20,000.

Table 6 shows the effect of the 10-percent refundable earned income credit provided by the bill. (The amounts shown in the body of this table do not include $200 million represented by credits for those who are not filers.) The total revenue cost of this provision is $1.5 billion and 100 percent of the amount of the tax decrease goes to those with incomes below $8,000.

Additional tables are provided in the Statistical Appendix of this report. These tables, numbered 1 through 5, give the tax burden under present law and (1) under the provision of the bill which grants a refund of 1974 tax liability; (2) under the provision of the bill which decreases tax rates by 1-percentage point on each of the brackets applicable to the first $4,000 of taxable income; (3) under the provision which grants a nonrefundable $200 tax credit in lieu of the $750 personal exemption deduction; (4) under the provision of the bill which grants an earned income credit; and (5) under the combined provisions of the bill which grant a 1-percentage point rate reduction to the first $4,000 of taxable income and a nonrefundable $200 tax credit in lieu of the $750 personal exemption. The tax burdens are given for single persons and married couples with differing numbers of dependents with selected levels of adjusted gross income under the assumption that deductible personal expenses are equal to 17 percent of adjusted gross income.

TABLE 1—ESTIMATED DECREASE IN INDIVIDUAL AND CORPORATE TAX LIABILITY UNDER THE BILL—CALENDAR YEARS 1974-77

[In millions]

Provision	Decrease in tax liability			
	1974	1975	1976	1977
Granting a 100-percent refund of 1974 individual income tax liability up to $100 with no phaseout and a 10-percent refund of tax above $1,000 with a maximum refund of $200 with the refund phased out between $20,000 and $30,000 of adjusted gross income but not below $100 [2]	$8,125			
Decreasing by 1 percentage point the tax rates applicable to the 1st $4,000 of taxable income		$2,289	$2,406	
Granting a nonrefundable optional $200 tax credit in lieu of the $750 personal exemption deduction		6,327		
Granting a nonrefundable tax credit equal to 5 percent of the purchase price of new and used homes (including mobile homes) to be used as the principal residence of the taxpayer		3,000	600	
Granting returns with dependent children a refundable credit of 10 percent of wage and salary and self-employment income with a $400 maximum credit with a phaseout of the credit between $4,000 and $8,000 of adjusted gross income [3]		1,455		
Total, individuals, nonbusiness [4]	8,125	13,071	3,006	
Granting individuals election of a 3-year carryback of capital losses		110	55	$30
Increasing the rate of investment credit to 12 percent for 1975 and 1976 and to 10 percent thereafter; repealing the $50,000 limitation on used property qualified for credit; and allowing the investment credit on progress payment:				
Individuals, business		794	892	572
Corporations		3,515	4,122	2,943
Total		4,309	5,014	3,515
Increasing the corporate surtax exemption from $25,000 to $50,000 on 1975 income subject to tax		1,200		
Lowering the rate of corporate normal tax from 22 percent to 18 percent and increasing the rate of corporate surtax from 26 percent to 30 percent on 1975 income subject to tax		700		
Repealing excise tax on trucks, buses and trailers:				
Individuals, business		162	173	165
Corporations		378	403	385
Total		540	576	550
Repealing excise tax on parts and accessories of trucks:				
Individuals, business		53	49	48
Corporations		123	115	
Total		176	164	159
Modifying tax credit to employers of public assistance recipients under the work incentive program (WIN):				
Individuals, business		1	1	
Corporations		2	1	
Total		3	2	
Liberalizing net operating loss carryback provisions: increase in refunds		1,000	500	200
Increasing the accumulated earnings credit allowance from $100,000 to $150,000		(5)	(5)	(5)
Total	8,125	21,109	9,317	4,454
Individuals	8,125	14,191	4,176	815
Corporations		6,918	5,141	3,639
Individuals, nonbusiness	8,125	13,071	3,006	
Business (individuals and corporations)		8,038	6,311	4,454

[1] The individual income tax liability figures in this table are based on income levels of the respective years and therefore may differ from those in the distributional tables which are based on 1974 income levels.

[2] Under the language of the bill this item is viewed as a refund of a payment deemed to have been made on 1974 individual income tax rather than a decrease in tax liability.

[3] Includes tax credits and/or payments, the latter going to tax returns where the tax liability before the credit is not big enough to absorb the credit and to specially designed returns where there is no tax liability and no tax return.

[4] Exclusive of the portion of the decreased tax liability under the loss carryback provision which may be ascribable to individuals in a nonbusiness capacity.

[5] An undeterminable amount deemed to be small.

TABLE 2.—ESTIMATED CHANGE IN INDIVIDUAL AND CORPORATE TAX COLLECTIONS UNDER THE BILL—FISCAL YEARS 1975 AND 1976

[In millions]

Provision	Collections				
	Calendar year 1975			Calendar year 1976	
	2d quarter	3d quarter	4th quarter	1st quarter	2d quarter
Granting a 100-percent refund of 1974 individual income tax liability up to $100 with no phaseout and a 10-percent refund of tax above $1,000 with a maximum refund of $200 with the refund phased out between $20,000 and $30,000 of adjusted gross income but not below $100 [1]	[2] −$8,125				
Decreasing by 1 percentage point the tax rates applicable to the first $4,000 of taxable income	−446	−$1,190	−$1,190	−$433	−$438
Granting a nonrefundable optional $200 tax credit in lieu of the $750 personal exemption deduction	−1,424	−3,796	−3,796	+1,107	+1,582
Granting a nonrefundable tax credit equal to 5 percent of the purchase price of new and used homes (including mobile homes) to be used as the principal residence of the taxpayer	−300	−150		−765	−1,845
Granting returns with dependent children a refundable credit of 10 percent of wage and salary and self-employment income with a $400 maximum credit with a phaseout of the credit between $4,000 and $8,000 of adjusted gross income.[3]	−140	−375	−375	+61	−626
Total, individuals, nonbusiness [4]	−10,435	−5,511	−5,361	−30	−1,327
Granting individuals election of a 3-year carryback of capital losses	−11	−6		−27	−72
Increasing the rate of investment credit to 12 percent for 1975 and 1976 and to 10 percent thereafter; repealing the $50,000 limitation on used property qualified for credit; and allowing the investment credit on progress payments:					
Individuals, business	−79	−40		−203	−562
Corporations	−1,055	−527	−527	−759	−1,884
Total	−1,134	−567	−527	−962	−2,446
Increasing the corporate surtax exemption from $25,000 to $50,000 on 1975 income subject to tax	−360	−180	−180	−240	−240
Lowering the rate of corporate normal tax from 22 percent to 18 percent and increasing the rate of corporate surtax from 26 percent to 30 percent on 1975 income subject to tax	−210	−105	−105	−140	−140
Repealing excise tax on trucks, buses and trailers:					
Individuals, business	−67	−42	−42	−42	−42
Corporations	−157	−98	−98	−98	−98
Total	−224	−140	−140	−140	−140
Repealing excise tax on parts and accessories of trucks:					
Individuals, business	−26	−12	−12	−12	−12
Corporations	−60	−28	−28	−28	−28
Total	−86	−40	−40	−40	−40
Modifying tax credit to employers of public assistance recipients under the work incentive program (WIN):					
Individuals, business					−1
Corporations			−1		−1
Total			−1		−2
Liberalizing net operating loss carryback provisions: increase in refunds		−800	−200	−400	−100
Increasing the accumulated earnings credit allowance from $100,000 to $150,000		(5)	(5)	(5)	(5)
Total	−12,460	−7,349	−6,554	−1,979	−4,507
Individuals	−10,618	−5,611	−5,415	−314	−2,016
Corporations	−1,842	−1,738	−1,139	−1,665	−2,491
Individuals, nonbusiness	−10,435	−5,511	−5,361	−30	−1,327
Business (individuals and corporations)	−2,025	−1,838	−1,193	−1,949	−3,180

See footnotes at end of table p. 21.

TABLE 2.—ESTIMATED CHANGE IN INDIVIDUAL AND CORPORATE TAX COLLECTIONS UNDER THE BILL—FISCAL YEARS 1975 AND 1976—Continued

[In millions]

FISCAL YEAR SUMMARIES

Provision		Collections				
		Calendar year 1975			Calendar year 1976	
		2d fiuarter	3d quarter	4th quarter	1st quarter	2d quarter
Fiscal year 1975:						
Individuals	−$10,618					
Corporations	−1,842					
Individuals and corporations	−12,460					
Individuals, nonbusiness	−10,435					
Business (individuals and corporations)	−2,025					
Fiscal year 1976:						
Individuals	−13,356					
Corporations	−7,033					
Individuals and corporations	−20,389					
Individuals, nonbusiness	−12,229					
Business (individuals and corporations)	−8,160					

[1] Under the language of the bill this item is viewed as a refund of a payment deemed to have been made on 1974 individual income tax rather than a decrease in tax liability.
[2] According to the Internal Revenue Service this refund will take place in fiscal year 1975 except for refunds to certain fiscal year taxpayers and late filers.
[3] Includes tax credit and/or payments, the latter going to tax returns where the tax liability before the credit is not big enough to absorb the credit and to specially designed returns where there is no tax liability and no tax return.
[4] Exclusive of the portion of the decreased tax liability under the loss carryback provision which may be ascribable to individuals in a nonbusiness capacity.
[5] An undeterminable amount deemed to be small.

TABLE 3.—EFFECT OF THE PROVISION IN THE BILL WHICH GRANTS A REFUND OF 1974 TAX LIABILITY [1]

[By adjusted gross income class—1974 income levels]

Adjusted gross income class (thousands)	Number of returns affected (thousands)		Decrease in tax liability			
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percentage distribution of total decrease		
				By income class	Cumulative	By segment
0 to $3	4,057	3,097	$230	2.8	2.8	
$3 to $5	7,579	1,280	685	8.4	11.2	35.7
$5 to $7	8,273	339	795	9.8	21.0	
$7 to $10	11,428	186	1,197	14.7	35.7	
$10 to $15	15,952	59	2,178	26.8	62.5	48.9
$15 to $20	9,856	16	1,796	22.1	84.6	
$20 to $50	9,006	3	1,162	14.3	98.9	
$50 to $100	655	(2)	65	0.8	99.7	15.3
$100 and over	160	(2)	16	0.2	99.9	
Total	66,966	4,980	8,125	100.0	100.0	100.0

[1] Granting a 100-percent refund of 1974 income tax liability up to $100 without a phaseout and a 10-percent refund of tax above $1,000 with a maximum refund of $200 with the refund phased out between $20,000 and $30,000 of adjusted gross income but not below $100
[2] Less than 500 returns

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

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TABLE 4.—EFFECT OF THE PROVISION IN THE BILL WHICH DECREASES BY ONE PERCENTAGE POINT THE TAX RATES APPLICABLE TO THE FIRST $4,000 OF TAXABLE INCOME[1]

[By adjusted gross income class—1974 income levels]

Adjusted gross income class (thousands)	Number of returns with tax decrease (thousands)	Decrease in tax liability			
		Amount (millions)	Percentage distribution of total decrease		
			By income class	Cumulative	By segment
0 to $3	4,057	$18	0.8	0.8	35.5
$3 to $5	7,579	115	5.3	6.1	
$5 to $7	8,273	236	10.8	17.0	
$7 to $10	11,428	403	18.5	35.5	
$10 to $15	15,952	621	28.5	64.0	46.6
$15 to $20	9,856	392	18.0	82.0	
$20 to $50	9,006	359	16.5	98.5	18.0
$50 to $100	655	26	1.2	99.7	
$100 and over	160	6	0.3	100.0	
Total	66,966	2,177	100.0	100.0	100.0

[1] The tax rates are as follows; for taxable income brackets not shown the tax rates are the same as under present law.

Taxable income bracket (thousands):	Tax rate (percent)
Joint returns:	
0 to $1	13
$1 to $2	14
$2 to $3	15
$3 to $4	16
Single person returns:	
0 to $0.5	13
$0.5 to $1	14
$1 to $1.5	15
$1.5 to $2	16
$2 to $4	18
Returns of heads of households:	
0 to $1	13
$1 to $2	15
$2 to $4	17

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

TABLE 5.—EFFECT OF THE PROVISION IN THE BILL WHICH GRANTS A $200 TAX CREDIT IN LIEU OF THE $750 PERSONAL EXEMPTION DEDUCTION

[By adjusted gross income class—1974 income levels]

Adjusted gross income class (thousands)	Number of returns affected (thousands)		Decrease in tax liability			
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percentage distribution of total decrease		
				By income class	Cumulative	By segmen
0 to $3	4,057	2,834	$217	3.6	3.6	51.0
$3 to $5	7,579	1,748	598	9.8	13.4	
$5 to $7	8,273	1,356	844	13.8	27.2	
$7 to $10	11,413	974	1,456	23.8	51.0	
$10 to $15	15,147	278	2,080	34.1	85.1	47.1
$15 to $20	8,834	31	801	13.1	98.2	
$20 to $50	2,011	3	109	1.8	100.0	1.8
$50 to $100	3	1	1	(1)	100.0	
$100 and over	1	(1)	(1)	(1)	100.0	
Total	57,317	7,225	6,106	100.0	100.0	100.0

[1] Less than 500 returns, $5C0,000, or 0.05 percent.

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

TABLE 6.—EFFECT OF THE PROVISION IN THE BILL WHICH GRANTS A REFUNDABLE EARNED INCOME CREDIT [1]

[By adjusted gross income class—1974 income levels]

Adjusted gross income class (thousands)	Number of returns affected (thousands): Total number with tax decrease [2]	Number of returns affected (thousands): Number made nontaxable	Decrease in tax liability: Amount [3] (millions)	Decrease in tax liability: Percentage distribution of total decrease: By income class	Percentage distribution of total decrease: Cumulative	Percentage distribution of total decrease: By segment
0 to $3	1,126	66	$238	18.5	18.5	100.0
$3 to $5	1,565	804	531	41.2	59.7	
$5 to $7	2,218	732	447	34.7	94.4	
$7 to $8	1,520	9	71	5.5	100.0	
$8 and over						
Total	6,429	1,611	1,288	100.0	100.0	100.0

[1] Granting returns with dependent children a refundable tax credit of 10 percent of wage and salary and self-employment income with a maximum credit of $400 and a phaseout of the credit between $4,000 and $8,000 of adjusted gross income.
[2] Does not include returns representing beneficiaries who are nonfilers under the 1970 filing requirements.
[3] Does not include an additional $200,000,000 to cover the credit on wage and salary and self-employment income of earners who are nonfilers under the 1970 filing requirements.

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

IV. GENERAL EXPLANATION

A. Individual Income Tax Reductions

1. Refund of 1974 Individual Income Taxes (Sec. 101 of the bill and secs. 6428 and 6611(e) of the code)

Under present law, individual taxpayers generally are required to file their 1974 tax returns by April 15, 1975. (This is true in the case of calendar year taxpayers who account for the great bulk of all individual taxpayers.)

In order to achieve the objective of infusing additional purchasing power into the economy as speedily as possible, and on a broad basis, your committee's bill and the House bill provide for refunds to be made to individual taxpayers of a portion of their Federal income tax liabilities for the year 1974. To achieve this objective, it is expected that the Internal Revenue Service will make every effort to pay out all refunds on returns filed by April 15 within 60 days of that date.

Under the provision adopted by the committee and the House, the general rule is that individuals are to receive a refund of 10 percent of their tax liability for 1974, but this refund is not to be less than $100 (except that the refund is not to exceed an individual's tax liability) or more than $200. In addition, for taxpayers with adjusted gross incomes of $20,000 or more, the size of this refund is to be phased down to $100 for those with adjusted gross incomes of $30,000 or more. These computations will not have to be made by the taxpayer but instead will be made by computers in the Internal Revenue Service.

The refund is to be $100 where the taxpayer's tax liability is at least $100 and not more than $1,000. For tax liabilities of less than $100 the refund is to be the full amount of the 1974 tax. Where the tax liability is over $1,000 but not over $2,000, the amount of the refund is to be 10 percent of the tax liability (subject to the adjusted gross income limitation described below). As a result, in this tax liability range the refund will vary from a low of $100 to a high of $200. Where tax liability exceeds $2,000, the refund remains at the maximum of $200 (also subject to the income limitation described below).

In cases where a taxpayer is entitled to a refund of more than $100 by reason of his tax liability for 1974 but has an adjusted gross income of over $20,000, the amount of refund over the $100 minimum is reduced. The amount of the reduction is computed by applying to the refund in excess of the $100 minimum the ratio of his adjusted gross income over $20,000 to $10,000 (the total difference of the phaseout between adjusted gross income of $20,000 and $30,000). For example, if a taxpayer whose adjusted gross income is $25,000 would otherwise be entitled to the maximum refund of $200 by reason of his tax liability, $100 of this maximum amount—that is, the amount over and above the minimum refund—must be reduced by 50 percent, reflecting the ratio between $5,000 (the amount of adjusted gross income over

$20,000) and $10,000 (the total difference between $20,000 and $30,000). As a result, this taxpayer's 1974 refund would be $150 ($100 minimum refund, plus $100 additional refund by reason of tax liability, less $50 reduction in the latter amount by reason of adjusted gross income).[1]

This phaseout on account of adjusted gross income in excess of $20,000 is to reduce the refund to $100 if the adjusted gross income is $30,000 or more—the phaseout is not to reduce the refund below $100 no matter how high the adjusted gross income. This minimum is $100 unless the taxpayer's 1974 tax liability apart from the refund is less than $100, in which case he is entitled to no more than a refund of the full amount of that tax liability.

In the case of married taxpayers who file separate returns for 1974, the minimum and maximum refunds and the income limitation referred to above are cut in half with respect to each spouse. Each spouse is entitled to a refund of all of his or her tax liability for 1974 if that liability is less than $50. If the spouse's tax liability is $50 or more, he or she will be entitled to a minimum refund of $50 and a maximum refund of $100, subject, however, to reduction by reason of his or her adjusted gross income. Where a spouse filing a separate return has adjusted gross income of more than $10,000 but not more than $15,000, the amount of refund to which the spouse would be entitled based on his or her tax liability for 1974 is reduced in proportion to the amount by which his or her adjusted gross income exceeds $10,000.[2]

Table 1 in the Statistical Appendix provides specific examples of the amount of refund which a single person or a married couple filing a joint return, assuming different family size and income levels, is to obtain under your committee's bill.

Eligibility for refunds.—The refund of all or part of 1974 taxes applies only to taxpayers who are individuals. This includes single persons, heads of households, surviving spouses (within the meaning of sec. 2(a)), and married persons, whether they file joint returns or separate returns. Where married taxpayers file a joint return for 1974, the amount of the refund is determined by reference to the joint income tax liability and adjusted gross income figures as if the spouses were one individual.

Refunds are not to be available under the bill in the case of nonresident aliens and trusts and estates.[3]

The refund is available, of course, in a situation where a decedent's executor or other representative files a final return of the decedent for 1974. In such a case, the refund is available for the decedent's final return, but not for the estate's return for the remainder of that year. The refund is also available in the case of a so-called grantor trust (secs. 671–678) where the person to whom the trust's income is

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[1] If the same taxpayer's tax liability apart from the refund were $1,500, so that he would be entitled to a $150 refund by reason of tax liability, the income limitation would reduce the refund by $25 (i.e., 50 percent of the excess of $150 over $100). As a result, this taxpayer's refund would be $125.

If the same taxpayer's tax liability apart from the refund were only $80, his refund would be $80. No reduction in that amount would occur under the income limitation since the taxpayer is not otherwise entitled to more than the $100 minimum refund.

[2] To illustrate the effect of the income limitation, a spouse filing a separate return who would be entitled to a maximum $100 refund based on tax liability, and whose adjusted gross income on his or her separate return is $13,000, is entitled to a refund of $70 by reason of the income limitation. The $100 refund amount is reduced by $30, i.e., $3,000/$5,000 of the $50 excess of the $100 refund based on tax liability over the minimum $50 refund.

[3] Where income in respect of a decedent is includible in the income of an estate under present law (sec. 691), no refund is available with respect to such income since the liability for tax on such income is that on the estate.

taxable is an individual, and to the extent that the trust's income is taxable to such person. There, too, the refund is available to the individual and not to the trust. In addition, the refund is available in fiduciary situations such as a guardianship where the tax liability reflected on the return is that of the individual beneficiary.

Taxable year affected.—The refund provisions of the bill generally apply to the year of a taxpayer which began during the 1974 calendar year. Thus, individuals who use the calendar year 1974 for tax reporting purposes, as well as those who report on a fiscal year which began in 1974 and ends during 1975, generally are entitled to refunds to the extent provided in the bill. However, if an individual has two taxable years which began during 1974 (where one taxable year was a short year), the refund provisions of the bill apply only to the first of the two taxable years.

Procedures for making refunds.—Under both the committee and the House bill a taxpayer computes his tax liability for 1974 as he has done in the past when no special refund was made. Therefore, in preparing his return for 1974, a taxpayer should not reduce his tax liability by the amount which he anticipates will be refunded to him under this bill. Instead, after the taxpayer's return has been filed, the Internal Revenue Service will initiate the refund based on the taxpayer's tax liability and adjusted gross income for the year.

In order to carry out this procedure, both versions of the bill provide that the taxpayer is to be treated as if he made an additional payment to the Treasury against his 1974 income tax liability. This constructive payment is to be treated as if made on the due date of the taxpayer's 1974 return (without taking into account any extension of time to file the return) or, if later, on the date on which he actually files his 1974 return.

This constructive payment is to be in most cases processed by the Service as an overpayment of tax by the taxpayer and, as such, is to be paid to him in the form of a refund of tax. In accord with the general rule that Federal income tax refunds do not constitute income, refunds received under the bill will likewise not constitute income (for Federal income tax purposes) to the taxpayers who receive them.[4]

Other aspects of the refunds.—The tax liability which determines the amount of the refund under the bill is the taxpayer's tax liability for 1974, reduced by the so-called "nonrefundable" credits against this liability to which he may be entitled. These credits are the foreign tax credit (sec. 33), the retirement income credit (sec. 37), the investment credit (sec. 38), the work incentive credit (sec. 40), and the credit for contributions to candidates for public office (sec. 41). The tax liability will also be computed with certain other adjustments necessary in order to assure speedy and efficient processing of the refunds through the Service's computer facilities.

Although under present law (sec. 6601(f)(1)), interest which a taxpayer owes on an underpayment of his tax liability is treated as part of his liability for "tax," your committee intends that interest not be treated as part of the tax liability for purposes of determining the refunds to be made under this bill.

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[4] By deeming the amount of 1974 tax which is to be refunded under the bill as a payment of 1974 Federal income tax by the taxpayer on the due date of his return, the committee expects that for State income tax purposes, States will treat the Federal refund of this deemed payment as a refund of an overpayment of Federal income tax. Such treatment would also reflect the committee's view that the refunds under the bill do not involve any reduction in the taxpayer's Federal income tax liability as such for 1974.

In determining marital status for purposes of the refund provisions of the bill, the provisions of section 143 of present law are to be utilized. As a result a married person living apart from his or her spouse will, under certain conditions, be treated the same as a single person, and have his or her 1974 refund determined accordingly.

The amount of the refund which a taxpayer may receive and retain is to be determined by reference to his tax liability as finally determined for Federal income tax purposes. Consequently, the refund is not finally determined by the amount of tax liability shown on the return as filed by the taxpayer, but (like refunds generally) may be subsequently increased or decreased depending on adjustments which may be made in the taxpayer's final tax liability for 1974.

Since a refund does not result from a reduction in tax liability for 1974 (but instead results from a constructive payment against a taxpayer's liability for tax), the two versions of the bill do not affect the definition of a "deficiency" in tax under present law (sec. 6211), or the computation of the negligence or civil fraud penalties (imposed by sec. 6653 of present law), which are based on the amount of the deficiency.

Interest on refunds.—Under present law, the Internal Revenue Service is not required to pay interest on an overpayment of income tax if it makes a refund within 45 days after the last date prescribed for filing the return (without regard to extensions) or, if the return is filed late, within 45 days after the date on which the return is actually filed (sec. 6611(e)). In order, however, to facilitate the speedy processing of the special 1974 refund by the Internal Revenue Service, a provision is included which is designed to give the Service up to 60 days to make 1974 refunds to individuals without incurring an obligation to pay interest on the refund. In the interest of administrative feasibility, the bill extends the 45-day interest-free period both for the special one-time refund under your committee's bill and for refunds of 1974 tax generally under present law. This special extension of the 45-day period under present law applies to refunds of any tax under Subtitle A of the code (secs. 1–1564) which are made to an individual for a taxable year which began during the calendar year 1974. As under present law, the 60-day period will run from the later of the due date of the return (disregarding extensions) or the date on which the return is actually filed.

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

This 60-day provision does not extend to refunds made to an estate or trust, to a nonresident alien individual or to a corporation. As to these taxpayers, the 45-day period of present law continues to apply. The 45-day period is also the governing rule for all other taxable years, i.e., those beginning before and after 1974.

Revenue effect.—The refunds for 1974 individual income tax liability are estimated to result in a revenue loss of $8.1 billion.

2. Disregard of Refunds with Respect to Federally Assisted Benefit Programs (Sec. 102 of the bill)

In some instances individuals who receive refunds of 1974 income tax payments under the bill will also be receiving benefits or assistance under one or more Federal or Federally assisted State social programs

based on individually determined needs. Such programs include those which provide supplemental security income benefits, aid to families with dependent children, medicaid, food stamps, educational and housing benefits, and veterans' pensions.

For example, an individual who is a member of a family receiving a payment under the program for aid to families with dependent children might receive, during some month in 1975, a tax refund for 1974 under the bill which, if considered to be income to the recipient during that month, might make him ineligible to continue receiving aid for that month. In some States the refund might also disqualify persons for medicaid or from eligibility to purchase food stamps, or, if treated as income, the refund might make the individual ineligible for a loan, or for a reduced rental, etc., under other aid programs.

Your committee does not believe that these refunds of 1974 tax should change an individual's eligibility for these assistance programs for the month in which the refund is received. In addition, the cost of identifying and making the adjustments might well exceed any savings in assistance funds were the refunds to be taken into account for these purposes.

Accordingly, both the House and your committee have included a provision in the bill which provides that 1974 income tax refunds under the bill are not to be considered income or resources for purposes of determining who is eligible to receive benefits or assistance, or the amount or extent of benefits or assistance, under any Federal or Federally assisted program. For this purpose the concept of benefits or assistance is intended to include all assistance benefits in which the Federal Government participates, including those made in a form other than cash, such as a reduced rental and eligibility for a loan. Your committee also intends that a refund which an individual receives pursuant to the bill should not be considered part of his resources or assets for that month for purposes of any resources test under the applicable social program.

The treatment of refunds of 1974 tax, were it not for this provision, would be a problem since these, in effect, are additional payments made by the Federal Government on behalf of the individuals involved.

3. $200 Personal Exemption Tax Credit (sec. 201 of the bill and secs. 2, 42, 63, 151, and 6201 of the code).

Present law provides a $750 personal exemption deduction for each taxpayer and each dependent with an additional exemption for taxpayers who are age 65 or over or who are blind. In addition, present law provides a low income allowance (also known as the minimum standard deduction) to determine the minimum amount of income an individual must have in order to pay Federal income taxes. Under present law, the low income allowance is $1,300 for both single individuals and for married couples filing joint returns ($650 for a married individual filing a seaparate return). This means that under present law a single individual does not pay tax unless income exceeds $2,050 (the $1,300 allowance plus $750 for one personal exemption), a married couple does not pay tax unless their income exceeds $2,800 (plus $750 for each dependent); and a married individual filing a separate return does not pay tax unless his income exceeds $1,400 (plus $750 for each dependent). Under present law, the percentage

standard deduction is 15 percent of adjusted gross income, with a maximum deduction of $2,000.

As indicated above in the reasons for the bill, your committee agrees with the House that persons whose income falls below the poverty levels should not pay income tax. The House bill met the poverty level thresholds for payment of tax by raising the minimum standard deduction from $1,300 to $1,900 for single persons and $2,500 for joint returns. In addition, the House bill increases the percentage standard deduction from 15 percent of adjusted gross income with a maximum of $2,000 to 16 percent with a maximum of $2,500 for single persons and $3,000 for joint returns.

The committee concluded, however, that it would be more appropriate to provide a $200 tax credit as an alternative to the $750 personal exemption deduction instead of increasing the minimum standard deduction and the percentage standard deduction.

The committee believes that an exemption credit of $200 is a more effective way to increase the tax-free income level above the poverty income levels than increasing the minimum standard deduction, as provided by the House (except for single persons and married couples with no dependents where the effect of the two approaches is virtually identical), as is shown in the table in the *Reasons For The Bill* section, above.

The committee was also concerned because the standard deduction changes provided by the House bill do not cover middle income taxpayers who itemize their deductions. Since the credit provides the same amount of tax reduction for taxpayers who itemize their deductions as for those who take the standard deduction, your committee believes that tax reductions provided in the form of a $200 exemption tax credit is more equitable in providing tax reductions to low and middle income taxpayers than increases in the standard deduction.

Moreover, a tax credit of $200 in lieu of the personal exemption deduction provides the same tax relief for low and middle income taxpayers as does an increase in the personal exemption deduction without giving excessive relief to high income taxpayers for whom an increase in the $750 exemption deduction is worth a great deal more.

The committee concluded that such tax relief to larger families is appropriate to compensate for the greater burden placed on families with more children by the recent inflation. This has been a severe problem for those lower and middle income taxpayers who itemize their deductions and would receive relatively little benefit from the House bill.

The committee bill provides that taxpayers are to compute their tax by using either the $750 exemption deduction of present law or the tax credit of $200 per exemption provided by the bill, depending on which alternative results in a lower tax liability. For taxpayers using the optional tax tables of section 3 (i.e., those with incomes of less than $10,000 who take the standard deduction), no additional computation is required by this provision since the tax tables will automatically reflect the credit when it is worth more than the exemption. A taxpayer not using the tax tables is to compute his tax either by subtracting $750

per exemption from adjusted gross income in arriving at taxable income as under present law, or by subtracting only his itemized deductions (or standard deduction), computing the tax on the resulting income, and then subtracting $200 per exemption from the resulting tentative tax to obtain his tax liability. Most of these taxpayers will not need to compute their tax both ways to determine which method to use, since the exemption deduction is worth more than the credit for taxpayers with a marginal tax rate at 27 percent or above. This is the case for taxable income (after the deduction of $750 per exemption as well as the standard or itemized deduction) above $10,000 for single persons and $16,000 for joint returns. Your committee expects that the Internal Revenue Service will provide guidelines to eliminate the need for taxpayers to compute their tax both ways. Of course, the personal exemption credit which may require a taxpayer to compute his tax in two ways is similar in principle to the choice between the standard deduction and itemized deductions.

The bill provides that any overstatement of tax liability resulting from incorrectly choosing the personal exemption deduction instead of the credit (or vice versa) will be treated by the IRS as a math error. Thus, the IRS will automatically check the computation made on each return and will refund (or credit) any excess amounts paid resulting from the overstatement of tax liability.

The overall tax reduction from the personal exemption tax credit is $6.1 billion in 1975. This is an increase of approximately $1 billion over the standard deduction changes in the House bill, which amount to $5.1 billion.

The personal exemption tax credit is to apply on a one-year basis for a taxable year beginning in 1975 only.

4. Tax Rate Reduction for Individuals (sec. 202 of the bill and sec. 1 of the Code)

Under present law, the individual income tax rates for joint returns begin with a 14 percent rate on the first $1,000 of taxable income and an increase to 15, 16, and 17 percent for each additional $1,000 of taxable income, as shown in the table below.[1] For single persons the first 4 rates are the same as for joint returns, but the brackets in each case relate to $500 of taxable income rather than $1,000. The fifth bracket which begins at $2,000, relates to the next $2,000 of income.

As indicated in the reasons for the bill, the committee concluded that a reduction in the lower tax rates is the best way of focusing tax relief on low and middle income bracket taxpayers without an excessive revenue cost. Moreover, a reduction in tax rates provides tax relief to tapayers whether they itemize their deductions or take the standard deduction, in contrast to changes in the standard deduction. The committee also believes that a reduction in the tax rates is appropriate as a partial offset to the effect of inflation in moving low and middle income taxpayers into higher tax brackets even though they have no increase in real income. The House did not include a provision for individual rate reductions.

The committee bill provides a one-percentage-point reduction in the four tax rates applicable to the first $4,000 of taxable income in

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[1] For heads of households the rates are 14 percent on the first $1,000 of taxable income, 16 percent on the second $1,000 of taxable income and 18 percent on the next $2,000 of taxable income.

the case of joint returns. In the case of single persons and married individuals filing separate returns, there are 5 brackets for the first $4,000 of taxable income (3 brackets in the case of heads-of-households). The bill also reduces each of these brackets by one percentage point. Thus, for all taxpayers (except heads-of-households), the 14-percent rate is cut to 13 percent, the 15-percent rate to 14 percent, the 16-percent rate to 15 percent, and the 17-percent rate to 16 percent. Since single persons have 5 brackets for the first $4,000 of taxable income, the 19-percent rate in the 5th bracket is also reduced one percentage point from 19 percent to 18 percent.[2] These rate reductions are shown in the table below. (The Internal Revenue Service will prepare new tax tables for the optional tax tables (under sec. 3 of the code) to reflect these changes for taxpayers with adjusted gross income under $10,000 who take the standard deduction.)

A one-percentage-point cut reduces the tax to be paid by $10 at the top of a $1,000 bracket and by $5 for a $500 bracket. These four-percentage point reductions provide tax savings of $40 for taxable income of $4,000 and above on joint returns; the five-percentage point reduction for single returns also saves $40 for taxable income of $4,000 and above in single persons' returns, as shown in the table below.

LOWER BRACKET TAX AND RATES UNDER PRESENT LAW AND UNDER THE COMMITTEE BILL

Taxable income brackets	Tax and rate	
	Present law	Committee bill
Joint returns:		
0 to $1,000	0 plus 14 percent	0 plus 13 percent.
$1,000 to $2,000	$140 plus 15 percent	$130 plus 14 percent.
$2,000 to $3,000	$290 plus 16 percent	$270 plus 15 percent.
$3,000 to $4,000	$450 plus 17 percent	$420 plus 16 percent.
$4,000 to $8,000[1]	$620 plus 19 percent	$580 plus 19 percent.
Single person returns:		
0 to $500	0 plus 14 percent	0 plus 13 percent.
$500 to $1,000	$70 plus 15 percent	$65 plus 14 percent.
$1,000 to $1,500	$145 plus 16 percent	$135 plus 15 percent.
$1,500 to $2,000	$225 plus 17 percent	$210 plus 16 percent.
$2,000 to $4,000	$310 plus 19 percent	$290 plus 18 percent.
$4,000 to $6,000[1]	$690 plus 21 percent	$650 plus 21 percent.

[1] Change in tax at the lower end of the bracket but no change in tax rate.

This rate reduction is to apply for tax years 1975 and 1976.

Approximately 62 million taxpayers will receive tax reductions from these rate reductions. The total amount of the tax reduction is estimated to be $2.3 billion. The tax savings for illustrative taxpayers is shown in table 2 of the Statistical Appendix.

5. Earned Income Credit (sec. 203 of the bill and secs. 43, 6201 and 6401 of the code, and sec. 402(a)(7) of the Social Security Act).

Under present law an individual is not required to pay income tax unless his income exceeds the amount of the minimum standard deduction plus the sum of available personal exemptions. Social security taxes, however, are paid on all covered earnings by workers and employers, regardless of how small the amount of earnings. For 1975,

[2] For heads of households the tax rate for the first bracket of $1,000 is reduced from 14 percent to 13 percent, for the second bracket of $1,000 the tax rate is reduced from 16 percent to 15 percent and for the next tax bracket of $2,000 the tax rate is reduced from 18 percent to 17 percent.

the social security tax rate on employees is 5.85 percent of employee wages up to $14,100. Self-employed individuals pay a tax at a 7.9 percent rate on net earnings from self-employment income up to $14,100 if that income exceeds $400.

As indicated in the section above on reasons for the bill, your committee agrees with the House that it is appropriate to use the income tax system to offset the impact of the social security taxes on low-income persons in 1975 by adopting a refundable income tax credit against earned income. Although the earned income credit may be viewed as a method to help compensate wage earners of low income families for the social security taxes they pay, your committee wishes to have it clearly understood that this provision of the bill is not intended to provide a way of reducing social security taxes paid by low income wage earners. The financing of the social security program is a matter which the committee will be required to review in depth in subsequent legislation.

The House bill provides a new refundable income tax credit for individuals, called the earned income credit, to compensate low income wage earners (and low income self-employed persons) for the social security taxes (or self-employment taxes) they pay. The amount of the credit provided by the House bill is 5 percent of earned income, up to a maximum of $200 per taxpayer. The credit is phased out at income levels between $4,000 and $6,000.

As indicated above, the committee agrees with the House that this tax reduction bill should provide some relief at this time from the social security tax and the self-employment tax for low income individuals. The committee believes, however, that the most significant objective of the provision should be to assist in encouraging people to obtain employment, reducing the unemployment rate and reducing the welfare rolls. Thus, the provision should be similar in structure and objective to the work bonus credit the committee has reported out previously.

As a result the committee does not agree with the House that the earned income credit should be available to all individuals who have earned income regardless of their marital status or family requirements. For example, the House bill grants the credit to students and retired individuals, who often have low amounts of earned income because they work part-time or for short periods of time and may receive most of their support from family relatives or through social security or private pension plans. More importantly, Federal welfare programs apply primarily to married couples with dependent children and it is in this area where this program can be most effective in reducing any tax disincentive to work.

In addition, the committee believes that the amount of the credit adopted in the House bill should be increased for those who are to be eligible for the credit. Here. also, the larger credit will largely remove the disincentive that the social security tax produces against seeking employment for low-income people. It will thus encourage low income individuals to seek part-time or full-time work.

As a result the committee bill provides an income tax credit of 10 percent of earned income up to a maximum of $400. The amount of the credit is to be reduced by the amount of adjusted gross income, or the amount of earned income, if greater, which exceeds $4,000 per

year on the basis of $1 of credit for each $10 of income in excess of $4,000. Thus, the credit is phased out for individuals with income levels of $8,000 and over.

An individual is eligible for the credit only if he maintains a household (within the meaning of sec. 214(b)(3)) in the United States for himself and for one or more children (of his own or legally adopted), who can be claimed as a dependent by the individual under the personal exemption provision (sec. 151(e)(1)(B)). A single individual is considered to be maintaining a household if the individual provides over half of the cost of maintaining the household (including costs attributable to children who are dependents). A married individual is considered to be maintaining a household if the individual and his spouse together furnish over one-half of the cost of maintaining the household.

Individuals otherwise eligible for the credit are not to receive the credit if they have amounts which are excluded from gross income under the exclusion for income earned abroad (sec. 911) or the exclusion of income from possessions of the United States (sec. 931).

Earned income eligible for the credit (up to the phaseout amount) includes all wages, salaries, tips, and other employee compensation, plus the amount of the taxpayer's net earnings from self-employment as that term is presently defined in the code (sec. 1402(a)). This broad definition of earned income can include some types of wages and other income not subject to social security tax (such as government employees' wages) but simplifies the process of determining what income is eligible for the credit. It is anticipated that a taxpayer will be able to calculate the amount of earned income eligible for the credit merely by adding together the amounts reported on form 1040 (the individual income tax return) as wages, salaries, tips and other employee compensation (line 9 of form 1040) with any amounts reported as net earnings from self-employment (line 13 of Schedule SE of form 1040).[1] Net earnings from self-employment are to be taken into account even though they are less than $400 (even though they are not subject to the self-employment tax).

Earned income generally is to be eligible for the credit only if it is includible in the gross income of the taxpayer during the taxable year in which the credit is claimed. Earned income of an individual is to be computed without regard to community property laws (so that a taxpayer is to take into account his or her own earnings for purposes of the earned income credit even though, under the community property laws, part of those earnings would be includible in the gross income of the spouse and not that of the earner). Amounts received as pension or annuity benefits are not to be taken into account for purposes of the credit.

Finally, the earned income credit is not to be available for income of nonresident alien individuals which is not connected with a U.S. trade or business (i.e., income not currently reported on a 1040NR form).

Because the credit as provided by the committee bill applies only to individuals who maintain a household and who are entitled to claim a child as a dependent, the bill omits the special rules for individuals under 18 years old and for individuals employed by a family relative,

[1] However, amounts included as net earnings from self-employment are not also to be included as wages, salaries, tips and other employee compensation.

both of which were provided in the House bill. These rules were aimed at preventing abuses in cases of young individuals and students; under the committee bill they would have no significant application.

The credit is to be calculated on a return-by-return basis. Individuals who are married and file joint returns are eligible for one credit on the combined income of the spouses. Married individuals filing separate returns are not to be eligible for the credit. A married individual who is treated as not being married (under sec. 143(b)) for return-filing purposes (i.e., a head of a household whose spouse has not been a member of the household for the entire year) is eligible for the credit in the same manner as a single individual who maintains a household and claims his child as a dependent (and any of the absent spouse's income attributed to him or her under State community property laws is to be disregarded).

The credit is generally available only for taxable years representing a full 12 months. However, in the case of a short year closed by reason of the death of the taxpayer, the credit is to be allowed.

Since the credit is refundable, eligible individuals with low incomes on which little or no income tax is due are to receive a cash payment equal to the amount of the credit reduced by any tax due. It is anticipated that low income individuals not required to file returns will be provided with a simple method of obtaining any payment due by filling out a brief form (such as the 1040A form) and attaching to it a copy of their W-2 withholding statements. It is hoped that through the simplicity of this form, plus efforts by the Internal Revenue Service to build public awareness of the availability of the credit, all eligible taxpayers will file for the credit available to them.

The amount of the credit received is to be taken into account as "other income" under the Social Security Act for purposes of determining eligibility for aid for dependent children payments (sec. 402 (a)(7) of the Social Security Act).

The earned income credit is to apply only to taxable years beginning in 1975.

It is estimated that this provision will decrease 1975 income tax liabilities by $1.5 billion, compared with $3.0 billion under the House version of the bill. Of this $1.5 billion amount, $0.1 billion will be offset by reduced AFDC payments resulting from the increase in income for those receiving the credit. The savings under this tax reduction for illustrative taxpayers is shown in — the Statistical Appendix.

6. Changes in Withholding Tables to Reflect the Exemption Tax Credit, the tax rate reduction, and the earned income credit (sec. 204 of the bill and sec. 3402(a) of the code).

Under present law, the amount of the personal exemption, the low income allowance and the percentage standard deduction are reflected in statutory withholding tables. The bill requires the Secretary of the Treasury to prescribe new withholding tables which reflect the $200 exemption tax credit, the rate reduction, and the earned income credit as well as the features of present law.

It is anticipated that the new withholding tables will be effective from May 1, 1975. Since income tax withholdings for the first one-third of the year will have been at current rates, which on an annual basis

would result in considerable over-withholding for lower income employees and employees who claim the standard deduction, the withholding rates for the last two-thirds of the year are to be additionally reduced so that amounts withheld by the end of the year would approximately equal 1975 tax liabilities after the reductions made by this bill. The changes in the withholding rates prescribed by the Secretary are therefore to reflect the changes listed above in such a way that the withholding change for the last 8 months of the year match as nearly as possible the change in tax liability for 1975. The committee expects the new withholding tables to be available for inclusion in the final legislation.

Another change in withholding rates will be required effective January 1, 1976, to put the withholding rates on a full year basis and to reflect the expiration of the earned income credit and personal exemption tax credit. A third change will be required on January 1, 1977, to reflect the fact that the rate reductions are effective only for 1975 and 1976.

The withholding changes made by the bill are to take effect on May 1, 1975. This will provide the Internal Revenue Service approximately 45 days to prepare and distribute new tables.

7. Housing Purchase Credit (Sec. 205 of the bill and sec. 44 of the code)

There is no tax credit under present law for the purchase of homes. However, homeowners (including ownership of condominiums and in certain cases tenant-stockholders in housing cooperatives) are able to deduct their mortgage interest and property taxes as itemized deductions. Although no similar provision applies to renters, owners of rental units can take deductions for accelerated depreciation and may expense their interest and tax charges during the construction period of the building.

The current weakness in the economy is centered disproportionately on the housing industry. Housing starts have declined from a level of approximately 2.4 million units in 1972 to a level of approximately 1.4 million units in 1974. This decline has created severe unemployment problems among the various construction trades and industries supplying construction materials. The average rate of unemployment in the construction industry is significantly higher than the average based on the overall labor force.

According to Department of Labor statistics, as of January 1974, the overall average unemployment rate was 5.2 percent (seasonally adjusted), while the average unemployment rate in the construction industry was 9.1 percent (seasonally adjusted). Similarly, as of January 1975, the overall unemployment rate was 8.2 percent (seasonally adjusted), while the unemployment rate for the construction industry was 15.0 percent (seasonally adjusted).

While general tax cuts stimulate the economy, the effect of the stimulation is diffused throughout all segments of the economy. The committee believes that it is necessary to direct a portion of the economic stimulus specifically toward the housing industry, which has suffered disproportionately from the current economic downturn.

To provide this needed stimulus, the committee has provided a tax credit in the case of the purchase by an individual taxpayer of a new or used home (but not rental apartment units) which is used by the

taxpayer as his principal place of residence. Under the bill, the definition of home includes, but is not limited to, a condominium, mobile home or cooperative housing unit. The rate of the credit is to be equal to 5 percent of the taxpayer's basis in the home. The amount of the credit is not to exceed the lesser of the taxpayer's tax liability or $2,000. In the case of a husband and wife who file a joint return, the $2,000 limitation applies to the joint return. In the case of married taxpayers who file separate returns, the amount of the credit is limited to $1,000 per return. Further, in the case of the joint purchase of a residence, the total credit allowable to the joint owners is not to exceed $2,000.

For purposes of computing the credit, the purchase price of a newly acquired residence must be reduced by any gain attributable to the sale of a former residence if such gain was not recognized for tax purposes by reason of a timely reinvestment in another residence (sec. 1034 of the code). However, no reduction will be made for any gain excluded from tax by reason of the special treatment provided under the tax laws in the case of a sale by a taxpayer who has attained age 65 (sec. 121 of the code). In any case where part of the property is to be used by the taxpayer as his principal residence and part is to be used for other purposes, an allocation of the purchase price of the property must be made. Only so much of the purchase price as is allocable to the residential portion is to be eligible for the credit.

Generally, to be eligible for the credit, the taxpayer must have acquired the home as his principal place of residence after March 12, 1975, and before January 1, 1976. However, a taxpayer will still be eligible for the credit even though the contract for purchase was entered into prior to March 13, 1975 (and even if equitable title passed prior to such date), if the settlement and occupancy occurred on or after that date (and before 1977). On the other hand, a taxpayer will be entitled to the credit if he has entered into a binding contract for the purchase of a home before January 1, 1976, even though he does not enter into settlement before that date, so long as the settlement occurs and the taxpayer occupies the home as his principal place of residence before 1977.[1]

The credit is also to apply in the case of a principal place of residence that is constructed, reconstructed, or erected by the taxpayer where he occupies the home as his principal place of residence before 1977, so long as the construction actually began before 1976. In this case, however, the credit is to be available only with respect to that part of the basis of the property attributable to construction, etc., after March 12, 1975. Construction is to be considered to begin only when physical work actually begins (i.e., not design, blueprints, planning, etc.).

A taxpayer will not be eligible for the credit if he purchases a residence from related persons whose relationship to the taxpayer would result in the disallowance of losses (sec. 267). Further, if a taxpayer acquires a residence by gift or inheritance he will not be eligible for the credit except to the extent of any reconstruction by him.

Under the committee's bill, there will be a recapture of the credit if the taxpayer disposes of the home within 3 years from the date of

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[1] Of course, if a calendar year taxpayer enters into settlement in 1976, he will be entitled to the credit in 1976, not in 1975.

purchase. However, to the extent that the taxpayer acquires or constructs another principal residence by reinvesting the proceeds from the disposition of his former principal residence within one year from the date of disposition, there is to be no recapture if the combined period of use satisfies the 3-year requirement. In addition, there would be no recapture if the taxpayer died before the 3-year period expired.

Thus, if the taxpayer received a credit of $2,000 for the purchase of a home and subsequently sold this home before the 3-year period expired, realizing $60,000 from the sale, there will be no recapture if the taxpayer purchases another home to be used as his principal residence within one year from the date of disposition, and the acquisition cost is at least $60,000 or more. However, if the taxpayer's acquisition cost is only $45,000, one-fourth of the credit, or $500, would be recaptured. In this latter case, the amount recaptured is the amount which bears the same ratio to the credit allowed as the amount realized from the sale of the first residence minus the cost of acquisition of the newly acquired residence bears to the amount realized from the sale of the first residence.

It is estimated that the credit described above would result in a revenue loss of approximately $3.0 billion for calendar year 1975, and a revenue loss of approximately $.6 billion for 1976. This estimate does not take into account the stimulative effect which such a provision might provide.

8. Capital Loss Carryback for Individuals (sec. 206 of the bill and sec. 1212 of the code)

Under present law individuals can deduct their capital losses to the extent of their capital gains in the taxable year. In addition, if an individual's capital losses exceed his capital gains, he can deduct capital losses against up to $1,000 of ordinary income each year ($500 for married individuals who file separate returns). If the excess capital losses are short-term these may be deducted on a dollar-for-dollar basis (up to the $1,000 limitation);[1] but only 50 percent of long-term capital losses incurred in taxable years beginning after December 31, 1969, in excess of short-term capital gains, can be deducted against ordinary income. (Thus, $2,000 of post-1969 long-term capital losses is required to offset $1,000 or ordinary income.) Individuals' capital losses in excess of the $1,000 limitation may not be carried back to prior years, but there is an unlimited carryover to future years. The same rules apply to estates and trusts.

As indicated above, if an individual sustains capital losses in one year and capital gains in the next year, he can carry over the capital losses and deduct them against the subsequent capital gains. However, if his capital gains precede his capital losses, he cannot carry the capital losses back and deduct them against prior capital gains. Your committee believes that a capital loss carryback should be permitted where a taxpayer has large capital losses. The House had no such provision in its bill.

The bill therefore provides that individuals with more than $30,000 of capital losses in a year (including carryforwards from prior years) may elect to carry them back for up to 3 years and deduct them against

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[1] Capital losses incurred in taxable years beginning before January 1, 1970, also are deducted on a dollar-for-dollar basis.

their capital gains in those prior years. Individuals who elect the capital loss carryback will have to recompute their regular income tax liability for the years to which the losses are being carried back. They will first carry their losses back to the third year prior to the year for which the carryback election is made and will carry back to the second prior year only those losses that cannot be deducted against capital gains in the third prior year. Similarly, the only losses that may be carried back to the year immediately preceding the year in which the carryback election is made will be those losses that are not usable as carrybacks to the third and second prior years. The amount of losses that may be carried back to a prior year will be limited to the capital gains in that year. In addition, a capital loss carryback may not create or increase a net operating loss in a prior year. All capital losses that are carried back (both short-term and long-term) will be treated as long-term capital losses and hence will be deductible first against long-term capital gains. They may be deducted against short-term capital gains in a year only after that year's long-term capital gains are exhausted.

Capital losses which are carried back but are in excess of the capital gains for the 3 prior years may be carried forward indefinitely, as under present law.

In order to determine whether a taxpayer has capital losses in excess of $30,000 for a year, the capital losses in that year may be aggregated with capital loss carryforwards from prior years in order to reach the $30,000 minimum. For example, if a taxpayer has a capital loss in a year of $25,000, this special capital loss carryback provision is not available. However, if the taxpayer also has capital losses from prior years of $10,000 which are carried forward, the taxpayer will thus qualify for the $30,000 level since the current capital loss of $25,000 plus the prior capital loss of $10,000 is in excess of the $30,000 level. Thus, the taxpayer in this case may carry back the $35,000 capital loss in the manner described above.

When a taxpayer carries a capital loss back, he will not recompute his minimum tax.

The capital loss carryback will result in a revenue loss of $110 million in 1975, $55 million in 1976, and $30 million in 1977.

The capital loss carryback applies to losses incurred in taxable years beginning after December 31, 1974, including carryforwards into those years.

B. Business Income Tax Reductions

1. Investment Credit

(Secs. 301, 302, and 304 of the bill and secs. 46, 47, and 48 of the code)

Present law provides a 7-percent investment credit (4 percent with respect to certain public utility property). The investment credit is available with respect to: (1) tangible personal property; (2) other tangible property (not including a building and structural components) which is an integral part of manufacturing, production, etc., or which constitutes a research or storage facility; and (3) elevators and escalators. Generally, the credit is not available with respect to property used outside the United States.

To be eligible for the credit, the property must be depreciable property with a useful life of at least 3 years. Property with a useful

life of 3 or 4 years qualifies for the credit to the extent of one-third of its cost; property with a useful life of 5 or 6 years qualifies with respect to two-thirds of its cost; and property with a useful life of 7 years or more qualifies for the credit to the full extent of the property's cost. (However, in the case of used property, not more than $50,000 of cost may be taken into account by a taxpayer as qualified investment for purposes of the credit for a taxable year.)

Property becomes eligible for the credit when it is placed in service. Property is considered to be placed in service in the earlier of (1) the taxable year in which depreciation on the property begins, or (2) the taxable year in which the property is placed in a condition or state of readiness and availability for a specifically assigned function.

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

Present law provides for a recapture of the investment credit to the extent property is disposed of before the end of the period (that is, 3–5, 5–7, or 7 or more years) which was used in determining the amount of the credit originally allowed. Thus, if property is disposed of, or otherwise ceases to be qualified, the tax for the current year is increased (or unused credit carryovers are reduced) by the reductions in investment credits which would have resulted if the credit were computed on the basis of the actual useful life of the property rather than its estimated useful life.

Public utility property to which the 4-percent investment tax credit applies is property used predominantly in the trade or business of furnishing or selling (1) electrical energy, water, or sewage disposal services, (2) gas through a local distribution system, or (3) telephone service, telegraph service through domestic telegraph operations, or other communications services (other than international telegraph services). In general, the reduced credit applies only if the rates for these services or items are established or approved by certain types of governmental regulatory bodies.

With respect to the treatment of the investment credit of regulated companies for ratemaking purposes, special limitations are imposed on the allowance of the credit to prevent the tax benefits of the credit from immediately being passed on to the consumers. These limitations are applicable to property used predominantly in the trade or business of furnishing or selling (1) the products or services described in the preceding paragraph and (2) steam through a local distribution system or the transportation of gas or steam by pipeline if the rates for those businesses are subject to government regulation.

The special limitations generally provide that the investment credit is not to be available to a company with respect to any of its public utility property if any part of the credit to which it would otherwise be entitled is flowed through to income (i.e., increases the utility's income for ratemaking purposes); however, in this case the tax benefits derived from the credits may (if the regulatory commission so requires) be used to reduce the rate base, if this reduction is restored over the useful life of the property.

If, within 90 days after enactment of the Revenue Act of 1971 the taxpayer has so elected, then the investment credit is to be available to the taxpayer with respect to any of its public utility property if the credit to which it would otherwise be entitled is flowed through to income ratably over the useful life of the property; however, in this case there must not be any adjustment to reduce the rate base. An additional elective rule was provided to permit certain types of utilities (primarily electric utilities) to immediately flow through benefits to consumers. Immediate flow through is permitted in situations where the tax benefits of accelerated depreciation rules enacted under the Tax Reform Act of 1969 are flowed through to consumers. This election was provided in recognition of the special competitive conditions under which a company subject to the accelerated depreciation flow-through rules was operating. A special election is provided with respect to local steam distribution systems and gas or steam pipelines where the regulatory body involved determined that the natural domestic supply of gas or steam was insufficient to meet the present and future requirements of the domestic economy. In this case, if the taxpayer elected (within 90 days after enactment of the Revenue Act of 1971) the investment credit is not to be available unless (1) no part of the credit is flowed through to income, and also (2) no part of the credit is used to reduce the rate base.

Increase in rate.—As indicated in the discussion of the reasons for the bill, the committee concluded as did the House, that the 7-percent investment credit (or 4 percent in the case of public utility property) should be increased in order to stimulate the economy.

Generally, under the House bill, the investment credit rate for 1975 would be increased for all taxpayers (including public utilities) to 10 percent from 7 percent, or from 4 percent in the case of certain public utility property. Generally, the House bill made the 10-percent investment credit available only for property placed in service in 1975, after January 21, although it also made the credit available for property placed in service in 1976 which was acquired under an order placed before that time. In addition, in the case of constructed property, the 10-percent credit would be available for the portion of the construction (that is, the basis) attributable to the construction which occurs after January 21, 1975, and before January 1, 1976.

The committee concluded that the 10-percent rate should be adopted without a termination date in order to provide a stimulus to investment in productive equipment on a long-run basis. Moreover, in light of the current economic situation, the committee concluded that the rate for all taxpayers should be further increased to 12 percent for a period of nearly two years. Thereafter, the 10-percent credit is to apply.

Thus, under these provisions if certain requirements are met, a 12-percent credit is to be available with respect to property acquired and placed in service after January 21, 1975, and before January 1, 1977. Similarly, in the case of property constructed, reconstructed, or erected by the taxpayer, the 12-percent credit is also to be available with respect to property completed by the taxpayer after January 21, 1975, to the extent of the part of the basis of the property properly attributable to construction, etc., after January 21, 1975, and before January 1, 1977. In addition, the 12-percent rate is to be available for qualified

progress expenditures (described below under *Progress payments*) for the period after January 21, 1975, and before January 1, 1977.

In cases where the property on which a taxpayer may claim an investment credit (qualified investment in property) for a year exceeds $10 million, the 12-percent rate is to be available only if the taxpayer establishes or maintains an employee stock ownership plan (described below under 3. *Employee stock ownership plan*).

To be eligible for the 12-percent rate in this case, a corporation will be required to contribute to the plan for the taxable year common stock, securities convertible into common stock (or cash for the acquisition of such stock or securities) of the employer in an amount equal to one of the additional 2-percentage-point increase above the 10-percent rate (i.e., one-twelfth of the total allowable investment credit in this case). If these requirements are not satisfied, only the 10-percent rate is to be available for the investment, and not the 12-percent rate. However, the 12-percent rate will be available without regard to the requirement for an employee stock ownership plan if the qualified investment property for the taxable year is less than $10 million.

Limitation on rate increase.—Under the House bill, a limit of $100 million is imposed on the increase in the investment credit that could be claimed by any one public utility by reason of the increase in the rate of the investment credit. This limit applies only to American Telephone and Telegraph Company.

The committee's bill deletes this limitation.

Increase in 50-percent limit for public utility property.—The committee agrees with the House that the 50-percent limitation on the amount of tax liability that may be offset by the investment credit should be temporarily increased in the case of public utility property. The committee adopted this provision of the House bill with a minor change. Under the House bill the temporary increase in the 50-percent limit applies for taxable years beginning in 1975. However, there are many public utilities on fiscal years ending in the latter half of the calendar year, which under the House bill would not benefit from the temporary increase in the 50-percent limit until 1976. To provide benefits for these companies sooner, the committee made the increase in the 50-percent limit available for taxable years *ending* in 1975 (and ending in each of the following years during the temporary period) rather than *beginning* in those years. This change will have no effect on calendar year taxpayers but will accelerate the increase in the 50-percent limit by one year for fiscal year taxpayers.

Under the bill the percentage limitation for public utility property is increased in 1975 and 1976 to 100 percent of the income tax liability (computed without regard to the investment credit, and in the manner provided under existing law). In each of the next succeeding taxable years the percentage limitation is reduced by 10 percentage points until, in taxable years ending in 1981 and thereafter, the 50-percent limitation goes back into effect. Thus, the percentage limitation is 90 percent in 1977, 80 percent in 1978, 70 percent in 1979, and 60 percent in 1980.

Public utility property for this purpose means property used predominantly in the trade or business of the furnishing or sale of (1) electrical energy, water, or sewage disposal services, (2) gas through

a local distribution system, or (3) telephone service, most domestic telegraph service, or other communications services—but only where the rates for the furnishing or sale are regulated by a utilities commission or similar agency. (This modification of the 50-percent limit does not apply to communication property even though used predominantly for communication purposes if the rates for furnishing of the services are not regulated.)

The computation of the percentage limitation for public utility property is to be made on a taxpayer-by-taxpayer basis. Thus, a group of corporations which file a consolidated return together are to be treated as one taxpayer.

Your committee intends that the benefit of the relaxation of the 50-percent limit go primarily to public utilities. However, it recognizes that many public utilities have varying amounts of nonpublic utility property. In addition, many public utilities are members of controlled groups that file consolidated returns. To achieve this objective in the most practical way administratively, the committee decided to prorate the increase in the credit limit in accordance with the extent to which the company (or the group filing the consolidated return) has qualified investment in public utility property, as compared to its qualified investment in other property.

Thus, if in 1975, 50 percent of the company's qualified investment is in public utility property, then the applicable limit is to be 75 percent of tax liability (the basic 50-percent limit plus one-half of the maximum additional limit allowable in 1975). If 70 percent of the company's qualified investment is in public utility property, then the applicable limit is to be 85 percent of the tax liability. In order to simplify such computations for most companies, if 75 percent or more of the qualified investment for a given year is in public utility property, then the full increase is to apply to that company for that year. Thus, the typical public utility, which has relatively little qualified investment in other property, is to get the full benefit of the increase in the percentage limitation.

If less than 25 percent of the qualified investment consists of public utility property, then no part of the additional limitation is to apply. In such a case, the company (or the group filing the consolidated return) is to be treated in its entirety as not being a public utility under this provision.

The percentage applicable to a taxpayer for a year is to apply to the aggregate of the credits arising from the taxpayer's public utility property and other property—it is not to apply separately to each category of property.

If a taxpayer has credit that remains unusable despite the higher limits, any such excess is to be allowed as a carryback (3 years) and carryover (7 years), as under present law. If there is a carryover or carryback to a year to which these higher limits apply, then the exact amount of the applicable limit is to be determined by the relative investments in the year to which the excess credit is carried. For example, assume that in 1975, 50 percent of company X's qualified investment is in public utility property. The maximum percentage limit in this case, as indicated above, is 75 percent of tax liability. Assume, further, that in 1976, 75 percent of company X's qualified investment consists of public utility property. The maximum credit for 1976 would then be (as indicated above) 100 percent of tax liability. If any of the

excess credit from 1975 would be carried over to 1976 (after having been first carried back to 1972, 1973, and 1974, as under present law), the 1976 limit would not be affected by whether the amount carried over to that year could be traced originally to public utility property or to other property.

Treatment of credit for ratemaking purposes.—The House bill did not contain any new provisions relating to the treatment of the increase in the investment credit for ratemaking purposes. The effect of this was to leave the rules applied as a result of the action taken in 1971 still in effect. The committee, however, was concerned that the stimulation for the acquisition of productive facilities intended by the increase in the investment tax credit allowable with respect to public utility property would be frustrated if any of the benefits were required to be flowed through immediately to consumers in the form of lower rates. Moreover, the committee believed that public utilities should have the opportunity to make new elections with respect to the treatment of the additional credit provided under the bill.

Under the committee's bill, the additional credit provided for a public utility by reason of the rate increase or the increase in the limitation based on tax liability is generally not to be available if the additional credit is used to reduce the rate base, unless the credit is then restored to the rate base at least as fast as ratably over the useful life of the property. Also, this additional credit is generally not to be allowed if it is flowed though to income as a reduction in cost faster than ratably over the useful life of the property to which the increased credit applies. This rule with respect to the additional credit is to apply with respect to property used predominantly in the trade or business of the furnishing or sale of electrical energy, water, or sewage disposal services, gas through a local distribution system, telephone service, domestic telegraph service, or other domestic communications service, if the rates for the furnishing or sale are regulated by a governmental body.

Under the bill, if the governmental regulatory agency requires ratable flow through to income, it cannot require any adjustment to the rate base; if the agency requires adjustments to the rate base, it cannot require flow through to income.[1]

A special election is provided to permit the immediate flow through of the additional credit without the consequence of disallowance in certain cases. This election is to be available only with respect to property where the benefits of accelerated depreciation are flowed through to customers. The election must be made by the taxpayer within 90 days after the date of enactment of the bill. In this case, the taxpayer must make the election at its own option and without regard to any requirement imposed by a regulatory body.

Under the bill, if a regulatory agency requires the flowing through of a company's additional investment credit at a rate faster than permitted, or insists upon a greater rate base adjustment than is permitted, the additional investment credit is to be disallowed, but only after a final determination (made after enactment of this bill) is put

[1] The bill also provides that the additional allowable credit may be taken into account ratably over the useful life of the utility property as a reduction in the cost of service for ratemaking purposes if the taxpayer elects this treatment within 90 days after the date of enactment of the bill. This treatment is also to be available if the taxpayer previously made such an election under the comparable provisions enacted under the Revenue Act of 1971.

into effect. The rules provided under present law with respect to determinations made by a regulatory body and the finality of its orders would apply to this provision.

Limitation on investment in used property.—Present law provides that in the case of used property, not more than $50,000 ($25,000 in the case of a husband and wife filing separate returns) of cost may be taken into account by a taxpayer as qualified investment for purposes of the credit for a taxable year. As an aid to small business, the House bill increases the limitation on used property to $75,000 ($37,500 in the case of a husband and wife filing separate returns).

The committee believes that in view of the special needs of small business the limitation on used property should be eliminated entirely. As a result, the committee's bill repeals the present limitation with respect to used property acquired by a taxpayer after January 21, 1975.

Progress payments.—Under present law, a tax credit may be taken for investment in qualified property at the time the property is placed in service and therefore is ready for use. The committee agrees with the House that in cases where taxpayers pay for long lead time property as it is being constructed and substantially before the property can be placed in service, to wait for the allowance of the investment credit until the property is placed in service represented too long a delay in the claiming of the credit. The bill overcomes this problem in present law by allowing an investment credit for what are called "progress payments."

The Committee adopted the provisions of the House bill without change. Under the bill, a taxpayer, at his election, is to be permitted to treat "qualified progress expenditures" made for new property as a part of the base for which he can claim an investment credit. In general, these qualified progress expenditures are amounts actually paid (or incurred in the case of self-construction property) for construction (or acquisition or reconstruction) of property which has a normal construction period of at least two years and which will have an estimated useful life in the hands of the taxpayer of at least seven years.

The normal construction period generally begins when physical work on the property commences (i.e., not design, blueprints, planning, etc.) and ends when the property is available to be "placed in service" by the taxpayer.

The commencement of physical work for this purpose is to include the physical work done by a subcontractor. For example, if a shipyard orders a turbine before it begins work on building a ship, the normal construction period is to be considered as beginning when the builder of the turbine commences physical work on it. Thus, the 2-year construction period is measured by the time it normally takes the subcontractor to complete its work (if it is normal for such work to precede the work of the main contractor) and the time it would normally take the prime contractor to complete the property once it receives the property from the subcontractor. Of course, for the work of any subcontractor to be included, the work must be specifically designated as part of the project. The normal construction period, in no case, includes a period of construction before January 22, 1975 (the general effective date of these provisions), and, where progress payment treatment is elected by the taxpayer for years beginning after

that date, no normal construction period will begin before the first day of the taxable year for which the election is in effect.

Where possible, the normal construction period is to be estimated by reference to normal industry practice in producing similar items. The estimate is to be based on the information available at the close of the taxable year in which physical work on the property is started (or, if later, the close of the first taxable year for which the taxpayer has elected to change to this "progress payments" method). Once the normal construction period has been reasonably estimated, the actual time that it takes to complete work on the property would generally be irrelevant for purposes of determining the property tax treatment of the taxpayer's progress payments.[2]

For purposes of the 2-year test, property which will be placed in service by the taxpayer separately is to be considered separately (for example, if two ships were contracted for at the same time, each ship would be considered separately). On the other hand, property which must be placed in service by the taxpayer as part of an integrated unit (for example, equipment which will all be placed in service at the same time as part of the same plant) is to be treated as a unit for purposes of the test.[3] Thus, if the taxpayer is constructing a pipeline which will not be operational for five years after construction begins, the fact that some equipment used in connection with the pipeline (such as pumps for the pumping stations) take less than five years to manufacture, is not to affect the status of the pipeline for progress payment purposes. Also, the taxpayer may treat all amounts expended in connection with the pipeline as progress payments (including amounts expended for the pumps). On the other hand, if some segments of the pipeline can be placed in service in less than two years, progess payment treatment is not to be available with respect to that segment.

In the case of self-constructed property (i.e., property where it is reasonable to believe that the taxpayer will bear more than half of the construction costs directly) "qualified progress expenditures" will generally equal the costs incurred by the taxpayer which are properly chargeable to capital account in connection with that property (for purposes of the investment credit). Thus, qualified progress expenditures would not include any depreciation sustained with respect to other property (machinery, equipment, etc.) used in the construction of new section 38 property (because such depreciation is not part of the basis for purposes of section 38 although it is capitalized for other purposes), nor generally would it include the adjusted basis of reconstructed property at the time the reconstruction is commenced.

Also, in the case of self-constructed property, qualified progress expenditures can include amounts expended for materials by the taxpayer to the extent that the taxpayer can establish, to the satisfaction of the Internal Revenue Service, that these materials have been irrevocably allocated to the construction of the property. For purposes of these rules, an item which is suitable only for use in connection with

[2] Of course, if there were a significant error in estimating the normal construction period, this could be evidence that the estimate had not been reasonable in the first place, particularly where the error could not be explained by a later change in circumstances.

[3] Of course, the construction period for property not qualifying for the investment credit, such as real estate, will not affect the "normal construction period" of any qualifying property which may be used on the premises. Thus, if a plant is being constructed, and qualifying equipment has a normal construction period of less than two years, the progress payments for the equipment are not to be treated as qualified investment, even if the building in which the equipment is to be housed will take more than two years to construct.

the property is to be regarded as irrevocably allocated, even though the item has not yet become a part of the property, and even though it has not yet been delivered to the site of the property. Other items may be treated as allocated when they have been delivered to the site under circumstances where it would be impractical to then remove the items to some other project (i.e., pumps delivered to locations on a tundra pipeline could be treated as allocated to that pipeline even though they (but for their location on the tundra) would be usable on other projects). In many cases, the items would not be treated as allocated until they were actually attached or consumed in the construction of the property. Mere bookkeeping notations are not to be sufficient to establish to the satisfaction of the Secretary or his delegate that the necessary allocation has occurred.

In the case of acquired property, qualified progress expenditures are to be the amounts paid by the taxpayer to the manufacturer, but only to the extent that there is actual progress made in the construction of the property. (This is further limited by the "pro rata" rule, discussed below.)

For this purpose, "progress" will generally be the percentage of completion, measured in terms of the manufacturer's incurred cost, as a fraction of his anticipated cost (as adjusted from year to year) based upon cost accounting records or in some cases on engineer or architect certificates.[4]

Where several manufacturers or contractors are used in connection with the same property, "progress" is to be measured on a manufacturer-by-manufacturer basis, so that the taxpayer may utilize payments made to a manufacturer who has made "progress" within the meaning of these rules, even if payments have also been made to another manufacturer who has made no progress. By the same token, payments to one manufacturer in excess of that manufacturer's progress are not to give rise to credits merely because another manufacturer's progress exceeds the payments made to that other manufacturer.

In the case of self-constructed property, "progress" will generally equal "progress expenditures," so no separate percentage-of-completion test is needed.

"Progress expenditures", as well as "progress" are not to be taken into account to the extent that they occur before the start of the "normal construction period" of the property nor to the extent allocable to nonqualified property. Thus, progress expenditures and progress which occur before January 22, 1975, cannot be utilized by the taxpayer to increase his qualified investment prior to the year in which the property is placed in service. Likewise, progress expenditures and

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[4] For example, assume that in 1980 a taxpayer makes a payment of $11,000 under a contract which provides for delivery of the property in 1985, with a fixed purchase price of $110,000 and an estimated cost to the manufacturer of $100,000. During 1980, the manufacturer incurs $10,000 of cost in connection with the property.

Under these circumstances the manufacturer will be considered to have made 10 percent progress in connection with the property ($10,000 of costs incurred divided by $100,000 of total estimated cost). The taxpayer will be permitted to treat his full $11,000 payment as qualified investment for 1980, since this payment does not exceed 10 percent of the total cost, to the taxpayer, of the section 38 property.

If, on the other hand, the manufacturer had incurred only $5,000 of costs in connection with the property in 1980, the taxpayer would be allowed to treat only 50 percent of his $11,000 payment as qualified investment in 1980 ($5,500) because there had been only 5 percent "progress" in that year. However, in that case, if the manufacturer incurred an additional $5,000 of cost in connection with the property in 1981, the taxpayer could treat the $5,500 of unused 1980 payment as qualified investments for 1981 (receiving, in effect, a carryover of his unused 1980 payment) even if no further payments were made to the manufacturer in 1981.

progress which occur before the year for which the taxpayer first elects to come under the progress payment rules cannot be so utilized. Similarly, progress expenditures and progress allocable to a building (or its structural components) would not be taken into account.

To prevent a possible abuse situation, where a manufacturer might certify unrealistic amounts of progress in connection with a project, the committee bill contains a "pro rata" rule. Under this rule, it will be presumed that generally progress will not occur with respect to a project more rapidly than ratably over the expected construction period for the property.[5] However, this presumption could be rebutted if the taxpayer shows by clear and convincing evidence that progress had, in fact, been more rapid.

Progress expenditures may be made in cash, or in the form of property furnished by the taxpayer to the manufacturer for use in the construction of the property. However, if the taxpayer furnishes property, that property is to be taken into account only to the extent that that property could be included in the basis of the completed section 38 property at the time that it is placed in service.

Progress payments may be made out of the taxpayer's capital, or from borrowed funds. However, to prevent an obvious abuse situation, the committee bill provides that progress expenditures made with funds borrowed, directly or indirectly, from the manufacturer of the property may not be treated as qualified investment.

Under the committee bill, the taxpayer is to be allowed to claim the full credit to which he is entitled with respect to property in the year in which it is placed in service. Of course, amounts which were treated as qualified investments with respect to the property in preceding years, due to the operation of the progress payment rules, are to be subtracted from the amount for which the taxpayer may obtain a credit.[6]

The provisions discussed above are to apply only if the taxpayer makes an election (in a time and manner to be prescribed in regulations) to come under these rules. Once made, the election would apply to all subsequent taxable years, and can only be revoked with the permission of the Commissioner. It is anticipated that taxpayers generally will exercise the election because this will accelerate their opportunity to use the investment credit. However, taxpayers who are currently in a loss situation may not wish to make the election, so that progress payments are not treated as qualified investments until the year in which the property is placed in service, in order to obtain a more favorable carryover period with respect to those payments.

If property is sold or otherwise disposed of by the taxpayer before he places it in service, or if (under Treasury regulations) it becomes apparent that the property will not be section 38 property when placed

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[5] For example, if physical work pursuant to a contract is begun by July 1, 1980, for the manufacture of a machine to be delivered on July 1, 1985 (5 years later) it will be presumed that there would not be more than 10 percent progress during calendar 1980, and not more than 20 percent progress during the fiscal year from July 1, 1980, through June 30, 1981. (The determination as to the normal construction period of the property will be made only once, at the close of the taxable year in which work on the property commences.)

[6] Otherwise, the taxpayer might obtain two credits with respect to the same property. For example, assume that section 38 property placed in service in 1985 has a basis of $100,000, and that of that amount $10,000 has been treated as qualified investment in each of the years 1982, 1983, and 1984 under the progress payment rules. The taxpayer's basis in the property, for purposes of determining his qualified investment in 1985 is to be $70,000. (Of course, the taxpayer's basis for purposes of determining depreciation, or his gain or loss from the sale of the property, would not be affected by this adjustment, which is made for investment credit purposes.)

in service, any amounts which were treated as qualified investments in prior years are, of course, to be subject to full recapture in a manner generally similar to present law.[7]

As discussed above, progress expenditure treatment is to be allowed only in the case of property which has an estimated useful life (measured from the time the property is placed in service by the taxpayer) of seven years or more. If the estimated useful life of the property is less than seven years at the time it is placed in service (even if previous estimates were for a longer useful life and were reasonable when made) any excess credits previously allowed under the progress payment rules are to be subject to recapture.[8]

Where the rate of the investment credit for the year in which qualified progress expenditure treatment was allowed with respect to the property is different from the rate in effect for the year of recapture, then recapture is to occur with respect to the rate in effect when qualified progress expenditure treatment was allowed. For example, recapture of 1975 progress expenditures would be 12 percent of those expenditures for taxpayers entitled to a 12-percent credit for that year.

Where the actual useful life of the property is less than the estimated life (estimated as of the time when the property is placed in service), any excess credits previously allowed under the progress payment rules will be subject to recapture on the same basis as other excess credits.

In the case where property is subject to a sale-leaseback transaction before the property is placed in service, the following rules are applicable. Where the seller-lessee makes progress payments, but the property is sold to a lessor before the property is placed in service, generally this will be treated as a recapture situation. For example, if a seller-lessee makes progress payments of $10,000 each in 1980, 1981, and 1982, but the section 38 property is sold to a lessor for $100,000 in 1984, before the property is placed in service, the lessor would be entitled to the investment credit on his $100,000 basis, but credits previously allowed to the seller-lessee based on his $30,000 of progress expenditures would be subject to recapture.

However, where the lessor and lessee enter into an agreement providing that the seller-lessee will be entitled to some or all of the credit, it is contemplated that there would be no recapture of the credits previously allowed with respect to the seller-lessee's progress expenditures since recapture would, in effect, permit the seller-lessee to revive

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[7] For example, sale of the property, or of the contract rights to the property before the property is placed in service, is to be treated as a disposition. A similar result is to follow if the contract for the property is cancelled, or if the project is abandoned by the taxpayer. Conveyance of the property by gift is also to be treated as a disposition. However, there would be no recapture in the event of a transfer by death, or pursuant to a sec. 381 transaction, but the decedent, or corporation (as the case may be) would be treated as a "predecessor" of the person receiving the sec. 38 property, and progress payments of the predecessor would have to be taken into account in reducing the qualified investment of the successor.

[8] For example, if a taxpayer made $10,000 of progress expenditures in 1980 with respect to a piece of section 38 property, reasonably believing at that time that the property would have a seven-year useful life in his hands (so that a full credit was allowable with respect to those payments) but reduces the estimated useful life to 5 years in 1983, when the property is placed in service, so that only a two-thirds credit is allowable, the one-third excess credit previously allowed in connection with the 1980 payment is subject to recapture at the time the property is placed in service.

otherwise unusable investment credits.[9] Accordingly, recapture is provided except to the extent that the lease agreement provides for the pass through of the credit to the seller-lessee.

To minimize the possible doubling up effect of these provisions, where taxpayers would be taking investment credits for all property placed in service this year (even though progress payments had been made with respect to that property in prior years) as well as progress payments made in the year, the committee bill provides that the progress payment provisions are to be phased in over a 5-year period.

Under these transition rules, 20 percent of a taxpayer's 1975 progress expenditures may be treated as part of his qualified investment for 1975. The remaining 80 percent of those payments may be taken into account ratably over the next 4 years (20 percent a year); 40 percent of the progress expenditures made in 1976 may be taken into account in 1976, with the remaining 60 percent of the payments to be taken into account in the remaining 3 years of the phase in period; 60 percent of the progress expenditures made in 1977 can be treated as qualified investments in 1977, with 40 percent of the payments to be phased in ratably in the succeeding two years; 80 percent of the taxpayer's progress expenditures in 1978 could be taken into account as qualified investments in 1978, while the remaining 20 percent of the payments would be taken into account in 1979. By 1979, the phase in period would be complete, and all progress expenditures made in that year and later years could be treated as qualified investments. Also, in 1979 the taxpayer would take into account the final 20-percent phase-in portions of the expenditures in fact made in the four preceding years.

For example, assume that a progress expenditure of $10,000 were made in 1975. Two thousand dollars of this amount would be treated as a qualified investment in that year, and $2,000 would be available to be treated as qualified investment in each of the next 4 years. On the other hand, if a $10,000 progress expenditure were to be made in 1977 then $6,000 of that payment would be treated as a qualified investment in that year, and the remaining $4,000 would be taken into account ratably in 1978 and 1979.

When a taxpayer places in service the property with respect to which the taxpayer has been making progress payments, the taxpayer is to be entitled to the full investment credit, reduced by the progress payments credits already taken. In the case of property placed in service by such a taxpayer during the 5-year transition period, this would also include the remaining portions of the credit that otherwise would have been phased in at the rate of 20 percent each year.

The progress payment rules will apply to progress expenditures made after January 21, 1975, in taxable years ending after December 31, 1974.

Revenue effect.—The changes in the investment credit under the House bill result in a revenue loss of $2.4 billion in 1975 and $1.5 billion is expected to occur in 1976.

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[9] For example, assume that the taxpayer (who has elected to use the progress payment rules) has been constructing a long-lead-time piece of property for a number of years and has had excess investment credits for those years (i.e., his investment credits have exceeded the amount that could be used because his taxable income was low for those years). Assume further that it becomes evident that some of these excess investment credits will not be able to be used in any of the years to which they could be carried under the carryover rules. The taxpayer is not to be permitted to "revive" those unused credits by entering into a sale-leaseback operation which would result in a recapture of the prior (unusable) credits and could result in the taxpayer and the new lessor agreeing to pass the new investment credit on to the taxpayer when the property is placed in service (when the taxpayer expects good profit years and therefore expects that the full credit could be utilized in those years).

The changes made by the committee increase the revenue loss to $4.3 billion. The revenue effect in 1975 of increasing the rate of the investment credit to 12 percent is $3.4 billion (or $1.4 billion above the $2 billion revenue loss of the 10-percent rate in the House bill). Eliminating the $100 million limitation on public utilities adds $400 million to the House bill. The elimination of the ceiling on used property results in a revenue loss of $175 million over the $85 million in the House bill (which increased the amount of used property eligible for the credit from $50,000 to $75,000). Allowing the investment credit on progress payments costs $90 million. (This was not changed from the provision in the House bill.)

Effective date.—In general, the rate increase provisions are to apply with respect to property acquired after January 21, 1975, the basis of property constructed, reconstructed, or erected after that date, and to qualified progress expenditures made after that date.

The 12-percent rate would terminate with respect to property acquired and placed in service after January 1, 1977. Property acquired or constructed during this period is to be subject to the 10-percent rate if the taxpayer does not satisfy the requirements for the 12-percent rate. Upon expiration of the temporary 12-percent rate, a 10-percent rate is to be generally in effect for all taxpayers.

The increase in the 50-percent-of-tax-limitation applicable with respect to public utility property is to apply to taxable years ending after 1974.

The provisions relating to the treatment of the additional credit allowable for public utility property for ratemaking purposes are to take effect on January 1, 1975.

The elimination of the limitation upon the amount of used property which is eligible for the investment tax credit is to apply with respect to used property acquired and placed in service after January 21, 1975.

The provisions relating to qualified progress expenditures are to apply to taxable years ending after December 31, 1974.

2. Election to increase net operating loss carryback (sec. 304 of the bill and sec. 172 of the code)

Present law, in general, provides that a taxpayer is allowed to carry a net operating loss back as a deduction against income for the 3 years preceding the year in which the loss occurred and to carry any remaining unused losses over to the 5 years following the loss year. This general rule enables taxpayers to balance out income and loss years over a moving 9 year cycle, to the extent of taxable income in the 3 years preceding and the 5 years following any loss year.[1]

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[1] Present law also provides exceptions to the general three year carryback-five year carryover rule in the case of certain industries or categories of taxpayers. One exception allows certain regulated transportation corporations to carry back and deduct net operating losses for the usual 3 years and to carry over such losses for 7 years Another exception prohibits the carryback of a net operating loss to the extent the net operating loss was attributable to a foreign expropriation loss. However, a 10-year carryover period is allowed for the foreign expropriation loss (15 years in the case of a Cuban expropriation loss). A third exception, applicable to financial institutions for taxable years beginning after December 31, 1975, will lengthen the carryback period for net operating losses to 10 years and allow the usual 5-year carryover period. Similarly, a bank for cooperatives is presently allowed to carry net operating losses back for 10 years and forward for 5 years. A fourth exception is provided for taxpayers which have incurred net operating losses resulting from increased imports of competing products under trade concessions made pursuant to the Trade Expansion Act of 1962. Where a taxpayer has elected to obtain certification as provided by this Act, it is allowed a 5-year carryback period and the usual 5-year carryover period. Finally, present law also contains a provision designed for American Motors Corporation permitting a 5-year carryback period and a carryover period of 3 years for losses incurred for taxable years ending after December 31, 1966, and prior to January 1, 1969.

Your committee's bill, as an aid to all sectors of the business community adversely affected by the current recession, provides for an election whereby taxpayers may obtain needed funds through additional refunds of income taxes which have been paid for prior years. Taxpayers presently covered by the general rule, which allows a 3-year carryback and a 5-year carryover for net operating losses incurred in a particular year, may, under the bill, elect to convert the 5-year carryover period into a carryback period and thereby obtain an 8-year carryback period and no carryover period. This provision applies to all business taxpayers, both individuals and corporations.[2]

The election does not apply to certain taxpayers allowed extended carryover or carryback periods under present law—those having foreign expropriation losses which qualify under section 172(b)(1)(D), certain financial institutions which qualify under section 172(b)(1)(F), and Banks for Cooperatives which qualify under section 172(b)(1)(G).

This election is applicable to net operating losses for taxable years ending after January 1, 1970.

If the taxpayer has more than one taxable year which has ended prior to the time the election is made and in which net operating losses were incurred, it may select the year for which the election is to be first applied. However, a net operating loss for any year subsequent to the first loss year to which the election is applied must also be carried back pursuant to the election. For example, if a taxpayer subject to the general 3-year carryover and 5-year carryback rule had net operating losses for each of calendar years 1972, 1973, and 1974 and the election is made during 1975 to convert carryover years to carryback years, effective with the 1973 loss, the election must also be applied to the net operating loss for 1974 and such loss may not be carried over so long as the taxpayer is governed by the election. However, the 1972 loss remains governed by the regular carryback and carryover rules, and to the extent it is not absorbed by income from 1969, 1970 and 1971, this loss may be carried over and applied against income for 1975, 1976 and 1977. Your committee intends, however, that the present rules of sec. 172(b)(2), pertaining to priorities in the application of net operating losses, shall continue to apply.[1]

Revocability of election; redetermination of tax liability.—Once a taxpayer has elected to obtain an extended net operating loss carryback, the election continues to apply (unless revoked on the conditions described below) to net operating losses incurred in taxable years subsequent to such loss year (or years).

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[2] Similarly, the bill allows elective 10-year carryback periods with no carryovers to taxpayers with net operating losses arising from increased imports of competing products and which, under present law, may carry a loss back 5 years and forward 5 years. The bill also allows certain regulated transportation corporations (of the type which are presently subject to the provisions of section 172(b)(1)(C) to elect to switch their present 7-year carryover period to an additional carryback period, which will result in a 10-year carryback and no carryover for these taxpayers.

[1] As a result, the 1972 loss in this example will be applied first against income for the years 1969 through 1971, and will have priority in this application as compared to the 1973 and 1974 losses. Similarly, the 1973 loss must be carried back to the eighth preceding taxable year and then to subsequent profit years prior to 1973 until it is absorbed, after which the 1974 loss may be carried back and applied. If the application of the 1973 and 1974 losses completely eliminates income for the years from 1965 through 1968 and some portion of these losses remain, the application of the 1972 loss to 1969 through 1971 continues to have priority. Also, the losses to which the election applies must be carried back in their entirety to the earliest year to which these losses may be carried under the election, even if these losses had previously been carried back for three years under the regular rule. In the example above, assuming that there was income rather than loss for 1972 and that the 1973 loss had, prior to the enactment of this provision, been carried back to 1970, 1971, and 1972 under the regular rules, the election to carry back the 1973 loss for 8 years under this provision will result in a recomputation of taxable income for 1970, 1971, and 1972.

The bill permits a taxpayer to revoke the election and to return to the carryback and carryover periods to which he would be entitled if he had not made the election. A taxpayer might want to revoke the election, for example, if, after having incurred a net operating loss for which he elected an extended carryback under the bill, he incurs another net operating loss in the following year and then, in the year after that, has an operating profit. In such a situation (or in comparable situations), the taxpayer should not be permitted, by reason of having obtained an extended carryback, to obtain a tax benefit which he would not have obtained if he had not made the election. In order to accomplish this objective, when a taxpayer revokes an election, so as to become entitled to carry over a subsequent net operating loss, the bill provides that the taxpayer must determine the tax benefit, if any, which he obtained from the additional carryback and in effect repay that benefit (without interest). He makes this determination by recalculating his tax liability for taxable years preceding the taxable year in which he revokes the election as if he had not obtained an extended carryback of one or more net operating losses. The taxpayer must recompute his tax liability for the earliest taxable year effected by the carryback of a net operating loss under the election, and for each succeeding taxable year up to (but not including) the taxable year in which the election is revoked. In such latter year (the taxable year in which the election is revoked), the taxpayer must increase his tax liability for that year by the amount of tax liability of which he was relieved by reason of carrying back a net operating loss for additional years under the election.

A special rule which affects the redetermination of tax liability in cases where a taxpayer was required to fund an employee stock ownership plan as a condition to obtaining an extended loss carryback is described below.

Special requirement for certain extended carrybacks.—Where a corporate taxpayer will obtain a large current refund as a result of making an election under the bill, your committee believes that the company should share with its employees the financial benefit which it receives from the extended loss carryback. Such benefit should be shared through an employee stock ownership plan in a manner analogous to the provision in sec. 301 of your committee's bill, which conditions a portion of the increase in the investment credit on the taxpayer's creating or funding such a plan for the benefit of its employees.

Under the net operating loss provision of the bill, an employee stock ownership plan is required where a company, as a result of electing the extended net operating loss carryback, becomes entitled to an aggregate credit or refund of more than $10 million. (This requirement is discussed in more detail below in *3. Employee Stock Ownership Plans.*)

However, once an employee stock ownership plan is created and funded by a taxpayer by reason of one or more carrybacks, the taxpayer is not again to be required to make payments for such a plan as a result of carrying subsequent losses back to a taxable year in an extended carryback period. Nevertheless, payments must be made into an employee stock ownership plan for all loss years ending prior to the time the first extended carryback election is made if the aggregate

amount of refunds or credits from these carrybacks amounted to more than $10 million.

Allowance for employee plan contribution in later redetermination of tax liability when election is revoked.—In cases where a taxpayer is required to create and fund an employee stock ownership plan as a condition to carrying back a net operating loss for an extended period, the bill provides a special rule which comes into play if and when the taxpayer revokes his election. In recomputing the company's tax liability for the additional carryback years obtained under the election (as if the election had not been made), the taxpayer can reduce his redetermined tax liability for these additional carryback years by the amount actually paid in to an employee plan up to the date of the redetermination. (This reduction for amounts paid in to an employee plan only applies if the taxpayer received an aggregate refund of more than $10 million.)

Other aspects of the election.—Under the bill, an election by the taxpayer applies with respect to the entire net operating loss of a given year and cannot be made with respect to only a portion of such a loss.

A taxpayer may revoke an election under the bill in such manner and at such time as the Service prescribes by regulations. The bill provides that a taxpayer may revoke a previous election without obtaining the consent of the Commissioner at any time within 60 months after the close of the taxable year in which he originally made the election. If the taxpayer desires to revoke his election at any later time than this 60-month period, he must obtain the consent of the Commissioner. (This latter requirement is imposed in order that the Commissioner can be satisfied that, if the election is revoked, sufficient records will be available from which the redetermination of tax liability for the extended carryback years can be made.)

Under the bill, an election which a taxpayer revokes on or before the due date for filing his return for a given taxable year (including extensions of time for filing the return) is effective with respect to such taxable year. An election which is revoked after the due date for filing a return for a given taxable year (including extensions of time to file the return) is effective with respect to the taxable year in which the revocation is actually made. Thus, for example, if a taxpayer incurs a net operating loss in 1975 which (under the bill) he elects to carry back for a total of 8 years, and then incurs another net operating loss in 1976 followed by a profit in 1977, he may want to revoke his election in order to be able to carry over his 1976 loss against his 1977 income. If the taxpayer makes his revocation during 1977 or early in 1978, before the due date for filing his return for 1977, the revocation is effective with respect to 1977, so that the taxpayer may benefit as to his income for that year by any carryover of his 1976 loss to which he may be entitled in light of the revocation of his carryback election.

A taxpayer is not limited to only one election under the bill. Thus, a taxpayer who makes an election to obtain an extended carryback and then later revokes his election may make another election in a later year to carry back a net operating loss for the extended period, as provided in the bill.[2]

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[2] However, the taxpayer may not make a second extended carryback election for a loss year which had previously been subject to an election. In addition, a loss from a year for which an election had previously been made and revoked may not be carried over to any years after a subsequent loss year for which the election is in effect. Such carryover losses in this situation become a part of the loss for the subsequent year and are carried back as with the loss for the subsequent loss year.

In the case of a net operating loss year which begins before the date of enactment of the bill, the taxpayer is allowed to elect under these provisions and to file for a tentative or "quickie" refund attributable to the election within 90 days following enactment of this provision or within the 12-month period prescribed by sec. 6411(a), whichever provides the taxpayer with the longer time in which to file the tentative refund application. For years for which the period for filing a tentative refund application has expired, the taxpayer may file a claim for refund during the time provided by sec. 6511(d)(2), which is generally by the end of the 15th day of the 40th month following the end of the net operating loss year, or by the end of the 39th month following the loss year in the case of corporations.

In the case of loss years beginning before the date this bill is enacted, a refund received pursuant to an election under the bill is considered to have been paid for the first taxable year ending after the date of enactment for the purposes of computing interest on the refund. Similarly, the statute of limitations, for purposes of determining a deficiency attributable to a loss year (or attributable to a year to which a loss is carried back) under this election beginning before the date this provision is enacted, will be considered to begin to run as if the loss year was the first taxable year ending after the date this provision is enacted.

The bill also provides for measures to prevent abuse of these provisions in corporate acquisition situations where different loss carryback and carryover periods are in effect for the acquiring corporation and the transferor corporation. The bill amends sec. 381(c) to delegate authority to the Secretary or his delegate to prescribe regulations for these situations. Your committee also contemplates the Secretary will similarly draft regulations to prevent abuse where corporations with differing loss carryback and carryover periods file consolidated income tax returns.

By substituting the elective carryback provisions of the bill for sec. 172(b)(1)(E) of present law, the bill in effect repeals the "American Motors rule," which has ceased by its own terms to be applicable and can be removed from the code as obsolete.

3. Employee stock ownership plans (secs. 301 and 304 of the bill)

The committee bill generally requires corporations to establish or maintain an employee stock ownership plan if they are to claim a 12 percent (instead of a 10 percent) investment credit and if they are to elect a long carryback (generally 8 years). A corporation electing a 12-percent credit must establish an employee stock ownership plan only if its qualified investment property is in excess of $10 million. If a corporation's qualified investment is above $10 million and it elects the 12-percent rate (instead of the 10-percent rate) the amount to be contributed is 1/12 of the investment credit.

The committee bill also provides that for certain corporations to be eligible for the optional long net operating loss carryback, they are to contribute to an employee stock ownership plan 25 percent of the tax benefit received from the additional years of the carryback in the first year in which this carryback is used. A corporation is to be subject to this requirement if the refund it receives on the first use of the long carryback exceeds $10 million.

The committee has conditioned these two tax benefits on the establishment and maintenance of an employee stock ownership plan because it believes that some of these tax benefits should flow directly to the employees and not just to the employer. Also, through their participation in an employee stock ownership plan, employees will be able to share in the ownership of corporate capital and in the growth and profitability of the employer. In addition, the employee stock ownership plan offers the companies involved a new technique of finance to meet their general financing requirements. The committee believes that through the employee stock ownership plan, many corporate employers will be introduced to a new technique of corporate finance that will enable the company to build its own investment capital while providing equity ownership for their employees, and in this way benefit society as a whole.

Since the assets which are to be contributed by the employer to the plan come from tax benefits (the investment credit or a refund based on net operating loss carrybacks), the contribution required by the bill is not to be deductible. Of course, any additional contribution over the required amounts is to be deductible under the rules of present law. Contributions may be in stock or in cash; however, if cash is contributed, it is to be used to buy common stock of the employer (or securities convertible into common stock).

An employee stock ownership plan is required under the committee bill only for corporations, since only in this case can the employees acquire ownership of stock of their employer.[1]

Investment credit and employee stock ownership plans.—Under the committee bill, for a corporation (subject to these provisions by reason of having qualified investment in excess of $10 million) to have an investment credit of 12 percent (instead of 10 percent) for the years 1975 and 1976, it is to contribute to an employee stock ownership plan an amount equal to one of the two additional percentage points above the 10-percent rate (that is, 1/12 of the available credit).

To meet the contribution requirement under the investment credit rules, amounts are to be contributed to the employee stock ownership plan not less rapidly than ratably over a ten year period from the date of claim for the credit. The amount of securities to be contributed over the 10 year period is to be determined by the value of the securities at the time the claim is made so the employees will receive the benefit of any appreciation in value over the 10 year period. If the employer fails to make the required contributions, it will not be eligible for the credit (or refund, in the case of the long carryback). In addition, the employer is to be subject to a nondeductible civil penalty equal to the amount involved in failing to make the required contributions. This penalty is to be not less than one-half of 1 percent of the total amount that (over 10 years) must be contributed to the plan under these provisions.

Your committee recognizes that in many cases the amount of investment credit would be too low to justify requiring the employer to establish and contribute to a plan. Therefore, the committee bill includes a "de minimis" rule, so that contributions to an employee

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[1] However, it is intended that an employee stock ownership plan is not to be required for those corporations which, by the very nature of their organization and operation, do not issue stock to shareholders. For example, an employee stock ownership plan would not be required for mutual insurance companies. However, this exclusion does not apply to corporations which have the option of issuing stock but choose not to do so.

stock ownership plan are to be required only if the amount of its qualified investment property is more than $10 million for the year. For example, if in 1975 the company has qualified investment of $12 million, then 1/12 of the applicable investment credit (or 1/12 of $1,144,000) is to be contributed to a plan if the employer is to qualify for the 12-percent credit (rather than the 10-percent credit). However, if in 1976 the company has qualified investment of $9 million, then no contributions would be required to the plan in 1976 for the employer to receive the full 12-percent rate in that year.

If the company prematurely disposes of the eligible property so there is a recapture of the investment credit, the recapture is to be computed without regard to the fact that a contribution to an employee stock ownership plan was attributable to the allowance of credit. For example, if the recapture would be $1 million had there been no employee stock ownership plan contribution, this same amount is to be recaptured even if a percentage of the credit with respect to the property in question had previously been contributed to a plan.

The committee recognizes that good faith errors may occur in following the employee stock ownership plan requirement. For example, since it may be difficult to value an employer's stock, if stock is contributed to the plan it may not be possible to know whether a sufficient amount of the stock has been contributed. The committee intends that if the employer makes a good faith effort to establish the fair market value of the stock and makes contributions to the plan on the basis of this good faith valuation, the employer will be entitled to the investment credit even if, on later audit, it is determined that more stock should have been contributed. In this case, however, the employer is to make up the deficiency by contributing additional shares of stock (based on the value at the time the contribution originally was to have been made) plus dividends paid between the time that the contributions should have been made and the actual time of contribution. The burden is to be on the employer to demonstrate a good faith effort in complying with the rules of this provision. To sustain this showing, it may be necessary for the employer to have his stock valued by an independent, reputable outside organization.

Net operating loss carryback and employee stock ownership plan.—Under the committee bill, for a corporation to use the optional long net operating loss carryback, it is to contribute to an employee stock ownership plan 25 percent of the tax benefit derived from the additional years of the carryback the first time it is used. For example, if the initial refund under this provision is $40 million, $10 million is to be contributed to an employee stock ownership plan. In later years, however, no contribution would be required.

In the case of net operating loss carrybacks, the committee bill also includes a "de minimis" rule. Under the bill, a contribution to an employee stock ownership plan is not required unless the tax benefit (that is, the refund received) from the first use of the optional carryback provision is more than $10 million.

Good faith errors may occur in the case of the net operating loss carryback as well as with the investment credit. As with the investment credit, the employer will be able to correct such good faith errors as long as any contributions plus dividends lost to the plan on account of such errors are contributed by the employer.

Following the rule with respect to the investment credit, the required amounts are to be contributed not less rapidly than ratably over a ten year period from the date of claim for the refund. The amount of securities to be contributed over the ten year period is to be determined by the value of the securities at the time the claim is made. In this way the employees will receive the benefit of any appreciation in the value of the securities over the ten year period.

If the claim for refund is denied (or, in the case of the investment credit, if the investment credit is not fully allowed), all or part of these amounts, as appropriate, (plus dividends earned on the contribution) may be returned to the employer.

The employee stock ownership plan will benefit persons who are currently employed by the employer. However, the committee recognizes that because of the current recession people who otherwise would be employed by corporations that will benefit from the net operating loss carryback may be out of work. The committee also understands that the basic financial support of such people may be a supplemental unemployment compensation benefit plan. Consequently, the committee bill provides that the employer may elect to contribute to a supplemental unemployment compensation benefit plan cash in an amount up to one-half of the amount that would otherwise go to the employee stock ownership plan. To be eligible for this election, the employer must currently participate in a supplemental unemployment compensation benefit plan, and the plan and trust must meet the requirements of sec. 501(c)(17). Following the basic provisions, the employer may choose to contribute to this plan ratably, over a 10-year period.

Employee stock ownership plan defined.—Generally, an employee stock ownership plan is a stock bonus plan designed to invest primarily in securities of the employer. Also, a money purchase pension plan may be coupled with the stock bonus plan. Additionally, in some cases a profit-sharing plan may be used. The committee understands that a key element of the employee stock ownership plan is that it provides a new technique of corporate finance. Therefore, an employee stock ownership plan is to provide that it may be used (i) to meet general financing requirements of the corporation, including capital growth and transfers in the ownership of corporate stock; (ii) to build into employees beneficial ownership of stock of their employer or its affiliated corporations, substantially in proportion to their relative incomes, without requiring any cash outlay, any reduction in pay or other employee benefits, or the surrender of any other rights on the part of such employees; and (iii) to receive loans or other forms of credit to acquire stock of the employer corporation or its affiliated corporations, with such loans and credit secured primarily by a legally binding commitment by the employer to make future payments to the trust in amounts sufficient to enable such loans to be repaid. Since the committee intends that this is to be an introduction to the employee stock ownership plan concept, the plan is to include these provisions, but there is to be no requirement that the plan engage in the activities authorized by these provisions.

The committee also understands that, through this technique of corporate finance, the employee stock ownership plan may be used to provide employees with the ownership of equity capital. In this regard, generally the plan will borrow money needed by the corporation for

expansion purposes, and will use this money to buy stock of the employer. The employer then will guarantee the debt obligation of the plan and will agree to make annual contributions to the plan sufficient to meet the plan's obligation of paying interest and principal on its debt. As the plan's debt is paid off, the employees share in the profitability of the employer and in any increase in the market value of the employer's securities. In this way, workers may share in the ownership of corporate capital without redistributing the property or profits from existing assets belonging to existing shareholders.

Under the committee bill, an employee stock ownership plan may be a tax-qualified plan or a nonqualified plan. While the committee recognizes that the full benefit of financing through an employee stock ownership plan may occur only under a qualified plan, nevertheless it also recognizes that a company may prefer to establish a nonqualified plan, in which case the provisions of title I of the Employee Retirement Income Security Act of 1974 generally are to apply. An employee stock ownership plan also is to meet such other requirements as may be prescribed by the Secretary of the Treasury.

Terms of employee stock ownership plan.—Under the committee bill, a plan established pursuant to the investment credit and net operating loss carryback provisions is not to be used as a tradeoff for other existing employee benefits or rights. Therefore, if the employer already has a pension, profit-sharing, etc. plan, the contribution required under the investment credit or net operating loss provisions is to be "added on" to the benefits of the existing plan. (Additionally, if an employer wishes to take advantage of both the operating loss carryback and the 12-percent investment credit provisions, a contribution is to be required under each of these provisions.) If the employer already has an existing plan which meets the requirements of an employee stock ownership plan or which is amended to meet these requirements, the benefits under that plan may be increased as required by the committee bill rather than a new plan being formally established.

The committee intends that plan benefits under the investment credit and net operating loss carryback provisions are not to be dependent upon contributions by the employees. Consequently, "matching" plans or other mandatory contribution plans are not to qualify under this provision. If a company has an existing matching plan, it may use this plan to meet the requirements of the bill, as long as no matching payment is required with respect to amounts contributed under the terms of the bill, and as long as participation in the plan with respect to these contributions is not dependent upon employee payments.

Generally, contributions to the plan are to be allocated to participants' accounts in proportion to their annual compensation. For this purpose, annual compensation which is greater than $100,000 is to be disregarded. Also, a qualified and nonqualified plan is to meet the requirements of sec. 415. Under the bill, if contributions in any one year to a participant's account would exceed the limits of section 415, the contribution is to be reallocated to the accounts of other participants (in proportion to annual compensation) until the additions to the account of each person participating in the plan reach the limits of sec. 415. If, even after such reallocation, contributions otherwise required under the investment credit and net operating loss carryback

provisions would be greater than otherwise allowed by the limits of sec. 415, it is intended that this amount may be held in escrow and may be allocated to participants' accounts in later years in proportion to annual compensation. The beneficiary of the escrow is to be the plan. The employer may establish the escrow and contribute stock or cash to the escrow, but there is to be no reversion of assets from the escrow to the employer unless the employer is not entitled to the full tax benefit on which the contribution is based. The escrow agent is to transfer assets to the plan each year to the maximum extent possible without violating the limitations of sec. 415.

If a plan is not tax-qualified, nevertheless the participation rules of the Internal Revenue Code are to apply. Since plan assets are to be allocated to participants in proportion to compensation (without regard to compensation in excess of $100.000 per year), the plan is not to be integrated directly or indirectly with social security.

To qualify, the employee stock ownership plan is to provide that the employees are to have the right to vote any stock allocated to their accounts.

Under the bill, cash or employer securities may be contributed to the employee stock ownership plan. If cash is contributed, it is to be used to purchase qualifying employer securities. Qualifying employer securities are to be common stock with voting and dividend rights that are the same as those of outstanding common stock. In addition, qualifying securities may be preferred stock that is convertible into common stock. Qualifying securities also may be stock of an affiliate of the employer. For this purpose, it is intended that an "affiliate" be defined by sec. 407(d)(7) of ERISA. Cash contributed to an employees' stock ownership plan may be used to buy new or existing shares.

The bill requires employee stock ownership plans to invest in securities of the employer (or its affiliates). Therefore, even if these securities earn no current income (and even if it appears that the company whose stock is held by the plan will have little if any earnings in the future), the plan trustees may acquire and hold these securities without being subject to any penalty or surcharge and without violating any law that may govern the prudence or quality of investment (including the Employee Retirement Income Security Act of 1974). The committee intends that no inference is to be drawn in this respect with regard to any other plans.

The committee intends that there is not to be a partial termination of an employee stock ownership plan because the rate of contribution to the plan is decreased after the employer has made his required contributions under the investment credit and net operating loss provisions.

In the case of amounts contributed to nonqualified plans under these provisions, beneficiaries generally are to be taxed on distribution to them (under sec. 72) and not at an earlier date (and therefore, not under sec. 83).

4. Increase in corporate surtax exemption and reduction in rates (sec. 303 of the bill and sec. 11(d), 12(7), 962(c), and 1561(a) of the code)

Under present law, corporate income is subject to a normal tax at a rate of 22 percent and a surtax at a rate of 26 percent (for a total tax rate of 48 percent). However, the first $25,000 of corporate income

is exempt from the surtax. In effect, then, the first $25,000 of corporate income is taxed at the rate of 22 percent and the income in excess of $25,000 is taxed at a 48 percent rate.

In order to provide tax relief to small businesses that are not particularly capital intensive and would not be able to benefit as much from the investment credit, the House bill increases the surtax exemption from $25,000 to $50,000. Your committee agrees with the House in providing tax relief to small businesses but believes that it is appropriate to provide rate reductions in addition to the increase in the surtax exemption in order to benefit small businesses with taxable incomes under $25,000. As a result, your committee's bill reduces the normal tax by 4 percentage points (from 22 percent to 18 percent) while at the same time increasing the surtax by 4 percentage points (from 26 percent to 30 percent). Thus, all corporations, including those with taxable incomes of $25,000 or less, are to receive a tax reduction.

Corporations with taxable incomes of $50,000 or less will save an amount equal to 4 percent of their taxable income. (This is because of the reduction of the normal tax from 22 percent to 18 percent.) Since the surtax exemption is increased from $25,000 to $50,000, the normal tax rate, as reduced by the committee to 18 percent, now applies up to the first $50,000 of a corporation's taxable income. As a result, a corporation having $50,000 or more of taxable income will have an annual tax savings of $8,500. (Under present law the tax on $50,000 of taxable income is $17,500—22 percent of the first $25,000, plus 48 percent of the remaining $25,000; under the committee bill, the tax is $9,000—18 percent of $50,000.) In effect, then, all corporations with taxable incomes of $50,000 or more will receive this amount of tax savings while being taxed at the rate of 48 percent on their taxable income above $50,000.

Corporations with taxable incomes between $25,000 and $50,000 will save $1,000 on the first $25,000 of taxable income (4 percent—the difference between the present 22 percent and the 18 percent rate provided in the committee bill—of $25,000) plus 30 percent of the corporations taxable income between $25,000 and $50,000 (that is, the difference between the present 48 percent tax rate and the provision in the committee's bill for the 18-percent rate up to $50,000).

The increase in the corporate surtax exemption and the reduction in the corporate rates are effective for taxable years ending after December 31, 1974. They are to apply, however, for only one year in this bill and are to cease to apply for taxable years ending after December 31, 1975.

In the case of a corporation which is not on a calendar year basis, the bill provides that the one year increase in the surtax exemption and the rate reductions are to be treated as an increase and decrease in rates (sec. 21 of the code). As a result, in the case of a fiscal year taxpayer, the increase in the surtax exemption and the rates for the year ending in 1975 will be prorated based on the number of days from January 1, 1975, to the end of that taxable year, and the decrease in the surtax exemption and the rates, for years ending after 1975, will be prorated based on the number of days from the beginning of that taxable year through December 31, 1975. Thus, the tax benefit resulting from the one year increase in the surtax exemption and the rate reductions will, in effect, be spread over two taxable years in the case of fiscal year taxpayers.

This increase in the corporate surtax exemption and the rate reductions are expected to result in a revenue loss of $1.9 billion, of which it is estimated about 60 percent, or $1.2 billion, will go to businesses with incomes under $100,000.

5. Increase in minimum accumulated earnings credit (sec. 305 of the bill and sec. 535(c) of the code).

In addition to the regular corporate income tax, present law imposes an accumulated earnings tax of 27½ percent to 38½ percent on improperly accumulated corporate earnings where the accumulation occurs in an attempt to avoid the individual income tax. In computing the base on which this tax is imposed, there is excluded an amount equal to the earnings and profits of the taxable year which are retained for the reasonable needs of the business. This is known as the accumulated earnings credit. Present law provides, however, that in any case, there is to be a minimum credit of $100,000 of earnings which may be accumulated before any income is subject to this tax. This is a cumulative credit, however, rather than an annual credit.

Since 1958, when the accumulated earnings credit was increased from $60,000 to its present level of $100,000, there have been substantial increases in costs which require additional capital to make an investment of the same type and scope. Increased borrowing costs cause small businesses to rely more heavily upon internal generation of capital for posible future needs. Quite often small businesses do not have the specific plans for expansion which are required, under the law, to justify accumulations of corporate earnings in excess of the minimum credit. An increase in the credit not only adjusts for the rise in costs. but also provides a wider margin for the retention of earnings for future contingencies, and thus reduces borrowing pressures on small businesses. As a result, your committee believes it is appropriate to increase the amount of the credit.

The committee's bill increases the amount of the accumulated earnings credit from $100,000 to $150,000. Thus, a corporation may accumulate as much as $150,000 of earnings before its retained earnings may be subject to the accumulated earnings tax. The House bill did not include any such provision.

The amendments related to the increase in the minimum accumulated earnings credit apply to taxable years beginning after December 31, 1974.

C. Changes Affecting Individuals and Businesses

1. Repeal of manufacturers excise tax on trucks, buses, tractors, etc. and related parts and accessories (sec. 402 of the bill and sections 4061–63 of the code)

Under existing law, there is imposed a 10-percent manufacturers excise tax (5 percent on or after October 1, 1977) on the sale of trucks and buses, truck trailers and semi-trailers, and highway tractors used in combination with trailers and semitrailers (sec. 4061(a)). The Revenue Act of 1971 exempted light-duty trucks, etc. (those having a gross vehicle weight of 10,000 pounds or less) at the time when the tax on the sale of passenger automobiles was repealed. There are currently the following exemptions (under sec. 4063) from the

excise tax on trucks, etc.: (1) camper coaches and bodies for self-propelled mobile homes; (2) feed, seed, and fertilizer equipment; (3) house trailers; (4) ambulances and hearses; (5) concrete mixer units placed or mounted on a truck or trailer chassis; (6) local transit buses used predominantly in mass transit service in urban areas; and (7) units designed as trash containers.

Present law also imposes an 8-percent manufacturers excise tax (5 percent as of October 1, 1977) on the sale of truck and bus-related parts and accessories (sec. 4061(b)).

As indicated under the discussion with respect to reasons for the bill, the excise tax on trucks and buses, etc. (and related parts) is repealed both to provide a stimulus for the purchase of trucks and buses and because of the additional employment this is expected to create. In recent years, costs of trucks and buses have risen significantly due to general inflation and added safety requirements. Sales of trucks have declined significantly in recent months as the price has risen and as the economy has slackened, thus adding to the unemployment rate. Factory production of the truck-trailer units has shown an even greater drop. The committee believes that the cost increases will be reduced by the repeal of the excise tax. The committee also intends that the repeal of the 10-percent excise tax on trucks and buses, etc. and the 8-percent excise tax on related parts and accessories should be fully passed on to the purchasers, as it intended in the repeal of the excise tax on passenger automobiles and light-duty trucks in the Revenue Act of 1971.

Under the bill, the repeal is effective the day after the enactment of the bill, with floor stocks refunds and consumer purchase refunds (as described below) available with respect to trucks and buses, etc. (and related parts) sold after March 13, 1975.

Floor stocks refunds.—Under present law (sec. 6412(a)(2)), floor stocks refunds would be made available in the case of rate reductions on trucks and buses, etc. (and related parts), scheduled for October 1, 1977.

To avoid creating competitive disadvantages because of the relative sizes of dealers' inventories and in conformity with prior practice, the bill makes provision for floor stocks refunds with respect to trucks and buses, etc. (and related parts), in dealers' inventories on the tax repeal date (the day after the date of the enactment of the bill). This floor stocks refund (or credit) is available with respect to trucks and buses, etc. (and related parts), sold by the manufacturer or importer before the tax repeal date, which are still held by the dealer on that date, and which have not been used but are intended for sale by him. The credit or refund for these floor stocks must be claimed by the manufacturer or importer before the first day of the 10th calendar month beginning after the tax repeal date, based upon reports submitted to him from the dealer before the first day of the 7th calendar month beginning after the tax repeal date. Also, before the first day of the 10th calendar month, the manufacturer or importer must have reimbursed the dealer for the tax or obtained his written consent to the allowance of the refund or credit. In addition, the manufacturer or importer must have in his possession evidence of the inventories on which the credit or refund is claimed (to the extent required by regulations prescribed by the Secretary of the Treasury or his delegate).

A truck, bus, etc. (or a part or accessory the tax on which is repealed by this provision), is not to be treated as having been sold before the tax repeal date (and, generally, is to be treated as being in the dealer's inventory on that date) unless possession or right to possession of the vehicle (or part) passes to the purchaser before that date.

It is expected that these floor stocks refund claims will be processed promptly. It is anticipated that the Internal Revenue Service will make refunds within 45 days of the receipts of the claims. There is no intention to have the Government unreasonably retain these excess taxes or to have the manufacturers be out-of-pocket the amounts of these taxes for an extended period of time. Indeed, any such unnecessary delays would tend to detract from the stimulative purposes of these provisions.

Refunds with respect to certain consumer purchases.—In connection with the repeal of the excise tax on trucks and buses, etc. (and related parts), the committee's bill also makes provision for refunds of the excise tax to consumers with respect to their purchases after March 14, 1975, and before the day after the date of enactment of this bill, when the tax is actually eliminated. Provision for these refunds is necessary to forestall the postponement of purchases of trucks and buses, etc. (and related parts), until the date of the repeal of the tax. (This provision is consistent with Congress' actions in 1965 and 1971 with regard to passenger automobiles, light-duty trucks, and related parts, such as air conditioners, etc.—articles where it was thought delays in purchases might adversely affect total sales.)

The bill provides that the government is to refund (or credit) to the manufacturer (or importer) of the tax-repealed truck, bus, etc. (or related part), the tax he paid on his sale of the article. However, to obtain this refund (or credit) the manufacturer (or importer) must file his claim with the Internal Revenue Service before the beginning of the 10th calendar month beginning after the day the tax is repealed. This claim is to be based on information submitted to him by the dealer (or other person) who sold the article to the ultimate purchaser. This information must be submitted to the manufacturer before the first day of the 7th month after the date of repeal. Also, before the beginning of the 10th calendar month after the date of repeal, the "ultimate purchaser" must be reimbursed for the tax paid on the article he purchased. The "ultimate purchaser" is the consumer or user of the new article.

A truck, bus, etc. (or related part), is not to be treated as having been sold before the date of enactment unless possession or right to possession of the vehicle has passed to the purchaser before that date.

It is expected that a consumer who purchases a truck, bus, etc. (or related part) during the post-March 13 period will be informed that, if these excise taxes are repealed, he will be refunded the amount of the tax. In these cases, the dealer is to notify the manufacturer as to the persons to whom he sold specific trucks, buses, etc. (or related parts), during the refund period. This notification must reach the manufacturer before the beginning of the 7th calendar month after the repeal of the tax. This gives the manufacturer time to process the claims, make reimbursements, and file his overall claim (or claims) with the Internal Revenue Service before the beginning of the 10th

calendar month after the date of repeal of the tax. The reimbursement may be made directly by the manufacturer to the consumer or may be made through the dealer who originally sold the article.

The committee intends and expects the Internal Revenue Service to allocate the necessary personnel to process consumer refund claims as soon as possible. The manufacturer is not to be permitted to claim a refund until he shows he has already reimbursed the ultimate purchaser. However, there is no intention that the Government delay refunding taxes or that the manufacturers be out-of-pocket for the taxes any longer than is necessary for administrative reasons. Indeed, any unnecessary delays would detract from the stimulative purposes of these repeal provisions.

Certain uses by a manufacturer, etc.—Under present law, if a manufacturer (or importer) of a truck, bus, etc. (or related part), uses the vehicle himself (other than in the manufacture of another taxable article), he is liable for tax in the same manner as if the article were sold by him (sec. 4218(a)). In this case, the tax is computed on the price at which he (or other manufacturers or importers) sells the same or similar articles in the ordinary course of trade.

The committee intends that where a manufacturer (or importer) pays a tax on account of his use of the article during the consumer refund period, he is as much entitled to reimbursement as would be any other consumer. Accordingly, the bill provides that where a truck, bus, etc. (or related part), is used by a manufacturer (or importer) and as a result of this use a tax was paid after March 13, 1975, the payment is to be treated as an overpayment.

Leases, installment sales, etc.—In the case of partial payments in connection with leases, certain types of installment sales, conditional sales, or certain types of chattel mortgage arrangements, present law (sec. 4216(c)) provides that the manufacturers excise tax is to be paid upon each partial payment and is to be based on the tax rate in effect on the date each partial payment is due. To avoid windfall benefits to a manufacturer where the lease, installment sale, etc., took into account the 10-percent tax (or 8-percent parts tax), the bill provides that no tax is due on partial payments after the tax repeal date if the lessor or vender establishes that the amount of the payments payable after that date has been reduced by the amount of tax that would otherwise have been due with each partial payment after that date. If the lessor or seller does not reduce the amount of the payments, however, the tax reduction provided by the bill will not apply to the article on which those partial payments are being made. In other words, for the tax reduction to be available in partial payment cases, the benefit of the repeal must be passed on to the lessee or purchaser.

Effective date.—The repeal of the manufacturers excise tax on trucks and buses, etc. (and related parts and accessories) applies to articles sold on or after the day after the date of the enactment of the bill. The bill also provides that an article is not to be considered as sold before the day after the date of enactment unless possession or right to possession passes to the purchaser before that day.

The bill also allows floor stock refunds for tax-paid articles held by a dealer on the day after the date of enactment, and consumer refunds for tax-paid articles sold to ultimate consumers after March 13, 1975, and on or before the date of enactment.

Revenue effect.—The revenue loss from the repeal of the excise tax on trucks and buses, etc. is estimated to be $224 million for the remainder of fiscal 1975 and $560 million for fiscal 1976. The repeal of the excise tax on truck and bus parts and accessories is expected to result in a revenue reduction of $86 million for fiscal 1975 and $160 million for fiscal 1976. Thus, the combined revenue loss for fiscal 1975 will be about $310 million and $720 million for fiscal 1976. The revenue loss will come out of the Highway Trust Fund.

2. The Federal Welfare Recipient Employment Incentive Tax Credit (sec. 401) of the bill and secs. 50A and 50B of the code)

The Committee adopted an amendment to the work incentive (WIN) tax credit to provide that an employer who hires a recipient of the aid to dependent children (AFDC) program under Title IVA of the Social Security Act would be eligible for a federal welfare recipient employment incentive tax credit equal to 20 percent of the gross wages paid to the recipient.

The WIN tax credit which was authorized under the 1971 Revenue Act applies only to AFDC recipients who are placed in employment through the Work Incentive program. The WIN tax credit amounts to 20 percent of the gross wages paid the employee for the first 12 months of employment during the period of 24 months from the first day of employment. The maximum amount of the WIN tax credit which may be claimed by an employer in any tax year is $25,000 plus 50 percent of any remaining tax liability in excess of $25,000. Excess credit may be carried forward for seven years or carried back for three previous years. There are restrictions on eligibility for the WIN tax credit which include (1) the individual must be retained by the employer for an additional 12 month period following completion of the first 12 month eligibility; and (2) an employer must certify that the position to be filled is not the result of (A) a layoff with other employees waiting to be recalled. (B) a strike or lock-out, and (C) a reduction in the wages, employment benefits, or regular hours of other workers currently in positions similar to the job vacancy being filled.

The federal welfare recipient employment incentive tax credit applies solely to the employment of an AFDC recipient who:

(A) has been certified by the State or local welfare department as being eligible for financial assistance for AFDC and as having continuously received such financial assistance during the 90 day period which immediately precedes the date on which such individual is hired by the taxpayer,

(B) has been employed by the taxpayer for a period in excess of 30 consecutive days on a substantially full-time basis,

(C) has not displaced any other individual for employment by the taxpayer, and

(D) is not a migrant worker (for purposes of this tax credit, a migrant worker means an individual who is employed for services for which the customary period of employment by one employer is less than 30 days if the nature of such services requires the employee to travel from place to place for a short period of time).

(E) bears any relationship to the taxpayer described in paragraphs (1) through (8) of Section 152(a) of the Internal Revenue code of 1954 as amended.

The tax credit amounts to 20% of the wages paid or incurred by the taxpayer for services rendered to the employer before July 1, 1976. Thus, after the eligible employee had worked the first 30 days, the taxpayer would receive the credit for the wages paid or incurred by the taxpayer for the first 30 days of employment plus the wages for all days the employee continued to work after the original 30 day period through June 30, 1976. The Federal welfare recipient incentive employment tax credit would be available to both business and non-business employers. The tax credit applies only to the wages paid or incurred by a taxpayer for an AFDC recipient whom such taxpayer hires after the date of enactment of this act.

The sum of the credits allowed under the WIN tax credit provisions for employment under a work incentive program established under Section 432(b)(1) of the Social Security Act and under the Federal welfare recipients employment incentive tax credit is subject to a limitation based on the tax liability of the taxpayer. The sum of such credit is 100 percent of the first $25,000 of tax liability for the taxable year plus 50 percent of so much of the tax liability for the taxable year as exceeds $25,000. A tax credit for wages paid to an individual may be allowable under either the WIN tax credit or under the Federal welfare recipients employment incentive tax credit, but is not allowable under both for the same wages paid to the same individual.

The Committee believes that any revenue loss under this program will be offset by the revenue saved under the AFDC Program.

V. STATISTICAL APPENDIX

TABLE 1.—INDIVIDUAL INCOME TAX BURDEN [1] UNDER PRESENT LAW AND UNDER THE PROVISION IN THE BILL WHICH GRANTS A REFUND OF 1974 INCOME TAX LIABILITY [2]

[Single person and married couple with no, 1, 2, and 4 dependents (assuming deductible personal expenses of 17 percent of income)]

Adjusted gross income	Tax liability														
	Single person			Married couple with no dependents			Married couple with 1 dependent			Married couple with 2 dependents			Married couple with 4 dependents		
	Under present law	Under the bill	Reduction	Under present law	Under the bill	Reduction	Under present law	Under the bill	Reduction	Under present law	Under the bill	Reduction	Under present law	Under the bill	Reduction
$3,000	$138	$38	$100	$28	0	$28	0	0	0	0	0	0	0	0	0
$5,000	491	391	100	322	$222	100	$208	$108	$100	$98	0	$98	0	0	0
$6,000	681	581	100	484	384	100	362	262	100	245	$145	100	$28	0	$28
$8,000	1,087	978	109	837	737	100	694	594	100	559	459	100	312	$212	100
$10,000	1,482	1,334	148	1,152	1,037	115	1,010	909	101	867	767	100	586	486	100
$12,500	1,996	1,797	200	1,573	1,415	157	1,408	1,267	141	1,261	1,135	126	976	876	100
$15,000	2,549	2,349	200	2,029	1,829	200	1,864	1,678	186	1,699	1,529	170	1,371	1,233	137
$17,500	3,145	2,945	200	2,516	2,316	200	2,329	2,129	200	2,156	1,956	200	1,826	1,643	183
$20,000	3,784	3,584	200	3,035	2,835	200	2,848	2,648	200	2,660	2,460	200	2,285	2,085	200
$25,000	5,230	5,080	150	4,170	4,020	150	3,960	3,810	150	3,750	3,600	150	3,330	3,180	150
$30,000	6,850	6,750	100	5,468	5,368	100	5,228	5,128	100	4,988	4,888	100	4,508	4,408	100
$35,000	8,625	8,525	100	6,938	6,838	100	6,668	6,568	100	6,398	6,298	100	5,858	5,758	100
$40,000	10,515	10,415	100	8,543	8,443	100	8,251	8,151	100	7,958	7,858	100	7,373	7,273	100

[1] Computed without reference to the tax tables for returns with adjusted gross income under $10,000.

[2] Granting a 100-percent refund of 1974 income tax liability up to $100 without a phaseout and a 10-percent refund of tax above $1,000 with a maximum refund of $200 with the refund phased out between $20,000 and $30,000 of adjusted gross income but not below $100.

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

TABLE 2.—INDIVIDUAL INCOME TAX BURDEN[1] UNDER PRESENT LAW AND UNDER THE PROVISION IN THE BILL WHICH DECREASES BY 1 PERCENTAGE POINT THE TAX RATES APPLICABLE TO THE FIRST $4,000 OF TAXABLE INCOME

[Single person and married couple with no, 1, 2, and 4 dependents (assuming deductible personal expenses of 17 percent of income)]

Adjusted gross income	Tax liability														
	Single person			Married couple with no dependents			Married couple with 1 dependent			Married couple with 2 dependents			Married couple with 4 dependents		
	Under present law	Under the bill	Reduction	Under present law	Under the bill	Reduction	Under present law	Under the bill	Reduction	Under present law	Under the bill	Reduction	Under present law	Under the bill	Reduction
$3,000	$138	$128	$9	$28	$26	$2	0	0	0	0	0	0	0	0	0
$5,000	491	461	29	322	300	22	$208	$193	$14	$98	$91	$7	0	0	0
$6,000	681	641	39	484	452	32	362	338	24	245	228	17	$28	$26	$2
$8,000	1,087	1,047	40	837	797	40	694	654	40	559	522	36	312	291	21
$10,000	1,482	1,442	40	1,152	1,112	40	1,010	970	40	867	827	40	586	548	38
$12,500	1,996	1,956	40	1,573	1,533	40	1,408	1,368	40	1,261	1,221	40	976	936	40
$15,000	2,549	2,509	40	2,029	1,989	40	1,864	1,824	40	1,699	1,659	40	1,371	1,331	40
$17,500	3,145	3,105	40	2,516	2,476	40	2,329	2,289	40	2,156	2,116	40	1,826	1,786	40
$20,000	3,784	3,744	40	3,035	2,995	40	2,848	2,808	40	2,660	2,620	40	2,285	2,245	40
$25,000	5,230	5,190	40	4,170	4,130	40	3,960	3,920	40	3,750	3,710	40	3,330	3,290	40
$30,000	6,850	6,610	40	5,468	5,428	40	5,228	5,188	40	4,988	4,948	40	4,508	4,468	40
$35,000	8,625	8,585	40	6,938	6,898	40	6,668	6,628	40	6,398	6,358	40	5,858	5,818	40
$40,000	10,515	10,475	40	8,543	8,503	40	8,251	8,211	40	7,958	7,918	40	7,373	7,333	40

[1] Computed without reference to the tax tables for returns with adjusted gross income under 10,000.

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

TABLE 3.—INDIVIDUAL INCOME TAX BURDEN[1] UNDER PRESENT LAW AND UNDER THE PROVISION IN THE BILL WHICH GRANTS A NONREFUNDABLE $200 TAX CREDIT IN LIEU OF THE $750 PERSONAL EXEMPTION DEDUCTION

[Single person and married couple with no, 1, 2, and 4 dependents (assuming deductible personal expenses of 17 percent of income)]

	Tax liability														
	Single person			Married couple with no dependents			Married couple with 1 dependent			Married couple with 2 dependents			Married couple with 4 dependents		
Adjusted gross income	Under present law	Under the bill	Reduction	Under present law	Under the bill	Reduction	Under present law	Under the bill	Reduction	Under present law	Under the bill	Reduction	Under present law	Under the bill	Reduction
$3,000	$138	$59	$79	$28	0	$28	0	0	0	0	0	0	0	0	0
$5,000	491	433	58	322	$169	153	$208	0	$208	$98	0	$98	0	0	0
$6,000	681	637	44	484	353	131	362	$153	209	245	0	245	$28	0	$28
$8,000	1,087	1,064	23	837	722	115	694	522	173	559	$322	237	312	0	312
$10,000	1,482	1,465	17	1,152	1,046	106	1,010	846	164	867	646	221	586	$246	340
$12,500	1,996	1,991	5	1,573	1,503	70	1,408	1,303	105	1,261	1,103	159	976	703	274
$15,000	2,549	2,549	0	2,029	1,973	57	1,864	1,773	92	1,699	1,573	127	1,371	1,173	198
$17,500	3,145	3,145	0	2,516	2,491	25	2,329	2,291	38	2,156	2,091	64	1,826	1,691	134
$20,000	3,784	3,784	0	3,035	3,028	7	2,848	2,828	20	2,660	2,628	32	2,285	2,228	57
$25,000	5,230	5,230	0	4,170	4,170	0	3,960	3,960	0	3,750	3,750	0	3,330	3,330	0
$30,000	6,850	6,850	0	5,468	5,468	0	5,228	5,228	0	4,988	4,988	0	4,508	4,508	0
$35,000	8,625	8,625	0	6,938	6,938	0	6,668	6,668	0	6,398	6,398	0	5,858	5,858	0
$40,000	10,515	10,515	0	8,543	8,543	0	8,251	8,251	0	7,958	7,958	0	7,373	7,373	0

[1] Computed without reference to the tax tables for returns with adjusted gross income under $10,000.

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

TABLE 4.—INDIVIDUAL INCOME TAX BURDEN[1] UNDER PRESENT LAW AND UNDER THE PROVISION IN THE BILL WHICH GRANTS AN EARNED INCOME CREDIT[2]

[Single person and married couple with no, 1, 2, and 4 dependents (assuming deductible personal expenses of 17 percent of income)]

Adjusted gross income	Tax liability														
	Single person			Married couple with no dependents			Married couple with 1 dependent			Married couple with 2 dependents			Married couple with 4 dependents		
	Under present law	Under the bill	Reduction	Under present law	Under the bill	Reduction	Under present law	Under the bill	Reduction	Under present law	Under the bill	Reduction	Under present law	Under the bill	Reduction
$3,000	$138	−$163	$300	$28	−$272	$300	0	−$300	$300	0	−$300	$300	0	−$300	$300
$5,000	491	191	300	322	22	300	$208	−93	300	$98	−202	300	0	−300	300
$6,000	681	481	200	484	284	200	362	162	200	245	45	200	$28	−173	200
$8,000	1,087	1,087	0	837	837	0	694	694	0	559	559	0	312	312	0
$10,000	1,482	1,482	0	1,152	1,152	0	1,010	1,010	0	867	867	0	586	586	0
$12,500	1,996	1,996	0	1,573	1,573	0	1,408	1,408	0	1,261	1,261	0	976	976	0
$15,000	2,549	2,549	0	2,029	2,029	0	1,864	1,864	0	1,699	1,699	0	1,371	1,371	0
$17,500	3,145	3,145	0	2,516	2,516	0	2,329	2,329	0	2,156	2,156	0	1,826	1,826	0
$20,000	3,784	3,784	0	3,035	3,035	0	2,848	2,848	0	2,660	2,660	0	2,285	2,285	0
$25,000	5,230	5,230	0	4,170	4,170	0	3,960	3,960	0	3,750	3,750	0	3,330	3,330	0
$30,000	6,850	6,850	0	5,468	5,468	0	5,228	5,228	0	4,988	4,988	0	4,508	4,508	0
$35,000	8,625	8,625	0	6,938	6,938	0	6,668	6,668	0	6,398	6,398	0	5,858	5,858	0
$40,000	10,515	10,515	0	8,543	8,543	0	8,251	8,251	0	7,958	7,958	0	7,373	7,373	0

[1] Computed without reference to the tax tables for returns with adjusted gross income under $10,000.

[2] Granting to returns with dependent children a refundable tax credit of 10 percent of wage and salary and self-employment income with a $400 maximum credit with a phaseout of the credit between $4,000 and $8,000 of adjusted gross income.

Note Details may not add to totals because of rounding.

TABLE 5.—INDIVIDUAL INCOME TAX BURDEN[1] UNDER PRESENT LAW AND UNDER THE PROVISIONS IN THE BILL WHICH DECREASE BY 1 PERCENTAGE POINT THE TAX RATES APPLICABLE TO THE FIRST $4,000 OF TAXABLE INCOME AND GRANT A NONREFUNDABLE $200 TAX CREDIT IN LIEU OF THE $750 PERSONAL EXEMPTION DEDUCTION

[Single person and married couple with no, 1, 2, and 4 dependents (assuming deductible personal expenses of 17 percent of income)]

Adjusted gross income	Tax liability														
	Single person			Married couple with no dependents			Married couple with 1 dependent			Married couple with 2 dependents			Married couple with 4 dependents		
	Under present law	Under the bill	Reduction	Under present law	Under the bill	Reduction	Under present law	Under the bill	Reduction	Under present law	Under the bill	Reduction	Under present law	Under the bill	Reduction
$3,000	$138	$42	$95	$28	0	$28	0	0	0	0	0	0	0	0	0
$5,000	491	396	94	322	$132	190	$208	0	$207	$98	0	$98	0	0	0
$6,000	681	597	83	484	313	171	362	$113	249	245	0	245	$28	0	$28
$8,000	1,087	1,024	63	837	682	155	694	482	212	559	$282	277	312	0	312
$10,000	1,482	1,425	57	1,152	1,006	146	1,010	806	203	867	606	261	586	$206	380
$12,500	1,996	1,951	45	1,573	1,463	110	1,408	1,263	145	1,261	1,063	199	976	663	314
$15,000	2,549	2,509	40	2,029	1,933	96	1,864	1,733	131	1,699	1,533	166	1,371	1,133	238
$17,500	3,145	3,105	40	2,516	2,451	65	2,329	2,251	77	2,156	2,051	104	1,826	1,651	174
$20,000	3,784	3,744	40	3,035	2,988	47	2,848	2,788	59	2,660	2,588	72	2,285	2,188	97
$25,000	5,230	5,190	40	4,170	4,130	40	3,960	3,920	40	3,750	3,710	40	3,330	3,290	40
$30,000	6,850	6,810	40	5,468	5,428	40	5,228	5,188	40	4,988	4,948	40	4,508	4,468	40
$35,000	8,625	8,585	40	6,938	6,898	40	6,668	6,628	40	6,398	6,358	40	5,858	5,818	40
$40,000	10,515	10,475	40	8,543	8,503	40	8,251	8,211	40	7,958	7,918	40	7,373	7,333	40

[1] Computed without reference to the tax tables for returns with adjusted gross income under $10,000.

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

VI. COSTS OF CARRYING OUT THE BILL AND VOTE OF THE COMMITTEE IN REPORTING THE BILL

In compliance with section 252(a) of the Legislative Reorganization Act of 1970, the following statement is made relative to the costs incurred in carrying out this bill. Your committee estimates that the bill will reduce tax liability by $29.2 billion in calendar year 1975, $9.3 billion in 1976, and $4.5 billion in 1977. The Treasury Department agrees with this statement. Part III of this report contains a more detailed statement of the revenue effect of the bill.

In compliance with section 133 of the Legislative Reorganization Act of 1946, the following statement is made relative to the record vote by the committee of the motion to report the bill.

The bill was ordered reported by a recorded vote of 16 ayes and 2 nays, as follows:

In favor—16 (Messrs. Long, Talmadge, Hartke, Ribicoff, Byrd of Virginia, Nelson, Mondale, Gravel, Bentsen, Hathaway, Haskell, Hansen, Dole, Packwood, Roth and Brock).

Opposed—2 (Messrs. Curtis and Fannin).

VII. CHANGES IN EXISTING LAW

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

VIII. SUPPLEMENTAL VIEWS OF SENATOR HARRY F. BYRD, JR.

"I believe this legislation should be reported to the Senate, but I reserve judgment as to how I shall vote when the bill comes before the Senate.

"I am deeply concerned that the $29 billion revenue loss will greatly increase the deficit. In the absence of a reduction in spending, this legislation could accelerate inflation, which itself is a cruel tax."

HARRY F. BYRD, Jr.

IX. SUPPLEMENTAL VIEWS OF SENATORS CURTIS AND FANNIN

We cannot support H.R. 2166. In its present form, it simply fails to meet the needs of our economy. Today, our economy is beset both by recession and by inflation. These two problems are interrelated. Inflation is a persistent and cancerous malady which can be overcome only by firm and courageous actions. Inflation cannot be ignored; it is a cause of recession. In his testimony before the Committee on Finance, Secretary of the Treasury Simon said:

> More than anything else it is inflation which has created our current recession. Inflation destroys consumer confidence, investor confidence, and public confidence in the ability of our government to perform its obligations.

We do not oppose the use of a reasonable tax cut to stimulate the economy, but if a tax cut is to be used to combat recession it must, in our view, meet several criteria. *First*, a tax cut must strike a balance in our economic policy. The recession is severe and we must seek to counteract it. Nevertheless, we cannot follow policies which will again overheat the economy and lead to additional period of double-digit inflation. *Second*, a tax cut should be temporary in nature, cast in the form of a rebate or refund, and coupled with modification of those provisions of the tax law (such as the investment tax credit) that are proven job-producers. Permanent reduction in taxes (whether accomplished by rate reductions or otherwise) have no place in a temporary anti-recession tax cut. Permanent changes tend to invite budgetary problems for future years. *Third*, special consideration should be given to those individuals with low incomes who, because of inflation, face severe hardship. Many of the problems of the poor cannot be met by reducing taxes, but where tax relief is effective, action should be taken. *Fourth*, we believe that to provide jobs the relief should go to business, but if it is to go to individuals, it should give particular consideration to middle income taxpayers who have been hit hardest by increased taxation due to the inflationary rise in incomes. Substantial rebates of tax reduction to middle income taxpayers could have the greatest impact on consumer purchase of durable goods which, in turn, would put more employees to work in the industrial sector.

Unfortunately, H.R. 2166 fails to meet these criteria. For calendar year 1975, the bill would reduce Federal revenues by $29.2 billion. This is $9.3 billion more than the House bill and $13 billion more than requested by the President. At this level, we risk both unacceptable budgetary deficits and a new round of inflation.

Moreover, although cast as a temporary tax cut, the bill contains provisions which are either expressly made permanent or likely to become permanent features of our tax structure. Of $29.2 billion in tax reductions provided for in the bill, $21.2 billion is for relief to

individuals. Of this amount, $9.9 billion is attributable to provisions we consider to be permanent in nature. These "permanent" provisions include a $200 optional tax credit in lieu of the $750 personal exemption ($6.1 billion), a reduction of one percentage point in the four lowest income tax brackets ($2.0 billion), a refundable 10 per cent credit against earned income for workers with families who earn $8,000 or less annually ($1.7 billion), and a provision permitting individuals to carryback capital losses for three years ($0.1 billion). The bill also makes permanent changes in the pattern of business taxation. The investment tax credit rate is increased to 12 per cent on a temporary basis and to 10 per cent on a permanent basis. A special loss carryback provision for corporations has been added and made permanent. The manufacturer's excise tax on trucks has been repealed. Additionally, the bill increases the corporate surtax exemption to $50,000 and reduces the rate at which corporations with less than $50,000 in earnings will be taxed. These last two provisions are technically temporary, but they may well become permanent. These provisions may well be desirable as a matter of tax policy, but they do not belong in an ostensibly temporary anti-recession tax cut. They can be, and should be considered in the context of general tax reform later in this session of the Congress.

The bill does grant tax relief of low income families, but we are concerned that, given the very special and particular purpose of this legislation, the bill may be tilted too far in this direction. While low income taxpayers are likely to spend a tax reduction, the recession is particularly pronounced in the case of durable goods. During 1974, personal consumption expenditures (measured in constant 1958 dollars) dropped almost 9 per cent. A broadly-based stimulus for the purchase of all durable goods (the so-called "big ticket" items) is needed. This the bill does not do. For example, the maximum rebate of 1974 taxes is $200 and no taxpayer with adjusted gross income in excess of $20,000 can receive even this "maximum" amount. The bill should provide relief to low income taxpayers, but its purpose as a stimulative device requires that the tax reductions be balanced.

For these reasons, we have reluctantly concluded that we cannot support H.R. 2166 in its present form.

We need to remember certain economic facts of life. The total public debt outstanding as of March 12, 1975, was $501,559,000,000. The estimated deficit for the year ending July 1, 1975, (Fiscal Year 1975) is $45 billion, and for the year ending July 1, 1976, (Fiscal Year 1976) is $80 billion. The interest on the national debt in Fiscal Year 1975 was $32.9 billion, and it is estimated it will climb to $36 billion in Fiscal Year 1976.

The greatest spur that we could give to our economy would be to put the Federal government's house in order. This would restore confidence throughout all segments of our economy.

CARL T. CURTIS,
U.S. Senator.
PAUL J. FANNIN,
U.S. Senator.

X. SUPPLEMENTAL VIEWS OF SENATOR BROCK

Although I have reservations about the size of the tax cut and various tax "reform" sections of the Tax Reduction Act of 1975, I am particularly concerned about the earned income credit section of this bill. My remarks will be addressed to the latter issue.

There are many serious problems related to the present inequities in Aid to Families with Dependent Children (AFDC), employed vs. unemployed assistance, and other long-standing weaknesses within welfare assistance programs, that lead me to conclude that if we adopt an earned income credit at the present time there will be little economic impact and no welfare reform.

This bill is not a welfare reform bill. Our attention should be concentrated on those measures which give us an immediate economic stimulus. The earned income credit is little more than an income maintenance proposal and should be discussed as such. In approving this measure we would be adding just another program to the proliferation of the presently inadequate public assistance statutes. Specifically the proposal could complicate the present coverage of employed AFDC recipients. In addition, consideration should be given to the way the earned income credit would relate to other programs to assist low-income families, such as the food stamp, housing, and health care programs, as well as AFDC.

In conclusion, the earned income credit should not be a part of this bill. This section is a welfare reform measure that attempts to build upon a weak welfare system. We should focus our attention on the measures that promote economic activity and employment.

BILL BROCK.

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