The President's 1978 Tax Program $

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Office of the White House Press Secretary

THE WHITE HOUSE

TO THE CONGRESS OF THE UNITED STATES:

I recommend that Congress enact a series of proposals that will reform our tax system and provide $25 billion in net tax reductions for individuals and businesses.

Fundamental reform of our tax laws is essential and should begin now. Tax relief and the maintenance of a strong economy are essential as well. The enactment of these proposals will constitute a major step towards sustaining our economic recovery and making our tax system fairer and simpler.

The Need for Tax Reduction

I propose net tax reductions consisting of:

-- $17 billion in net income tax cuts for individuals, through across-the-board rate reductions and a new personal credit, focused primarily on low and middle-income taxpayers.

-- $6 billion in net income tax cuts for small and large corporations, through reductions in the corporate tax rates and extensions of the investment tax credit.

-- $2 billion for elimination of the excise tax on telephone calls and a reduction in the payroll tax for unemployment insurance.

These tax reductions are a central part of the Administration's overall economic strategy, which will rely principally upon growth in the private sector to create the new jobs we need to achieve our high-employment objective. The tax reductions will more than offset the recent increase in social security taxes and will provide the consumer purchasing power and business investment strength we need to keep our economy growing strongly and unemployment moving down.

Together with the programs that I will outline in my Budget Message, these tax cuts should assure that our economy will grow at a 4-1/2 to 5 percent pace through 1979, with unemployment declining to between 5-1/2 and 6 percent by the end of 1979. Without the tax cuts, economic growth would slow markedly toward the end of 1978 and fall to about 3-1/2 percent in 1979. Unemployment would be unlikely to fall below 6 percent and, by the end of 1979, might be moving upward.

This tax program will mean up to one million additional jobs for American workers. It should lead to a pattern of economic growth which is steady, sustainable, and non-inflationary.

-- Ensure that the tax preferences available for fringe benefits assist rank-and-file workers as well as executive officers.

-- Eliminate the special bad debt deduction for commercial banks, reduce the bad debt deduction available to savings and loan associations, and remove the tax exemption for credit unions.

-- Phase out the tax subsidies for Domestic International Sales Corporations (DISCs) and the deferral of tax on foreign profits.

These reforms will make our tax system both fairer and simpler. Many of them are targeted at tax preferences and subsidies for activities that do not deserve special treatment and that largely benefit those who have no need for financial assistance. The average working man and woman pay for the loopholes and the special provisions in our tax laws -- because when some do not pay their fair share, the majority must pay higher taxes to make up the difference.

Low and middle-income workers, struggling to make ends meet, are discouraged by tax laws that permit a few individuals to live extravagantly at the expense of government tax revenues. The privileged few are being subsidized by the rest of the taxpaying public when they routinely deduct the cost of country club dues, hunting lodges, elegant meals, theater and sports tickets, and night club shows. But the average worker's rare "night on the town" is paid for out of his <u>own</u> pocket with <u>after-tax</u> dollars.

Likewise, individuals who pay taxes on nearly every penny of earnings are treated unfairly compared to the few who are able to "shelter" their high incomes from taxes. Some persons with incomes exceeding $200,000 have little or no tax liability, while other high-income individuals return to the Federal government nearly 60 cents of every dollar received. There is no good reason for next-door neighbors, in the same economic circumstances, to have vastly different tax bills because one has found tax shelters and loopholes.

In addition to the preferences for expense account items and tax shelter activities, there are a number of equally inappropriate and inefficient corporate tax subsidies. For example, there is no justification for the DISC export subsidy under which we pay over $1 billion a year in foregone tax revenue (mostly to our largest corporations) to encourage our firms to do what they would do anyway -- export to profitable foreign markets. Nor can we rationalize proposals to reduce business taxes to increase investment at home while the deferral subsidy encourages multinational corporations to invest overseas by letting them pay lower taxes on their foreign profits than they pay on money earned in the United States.

I ask Congress to join with me to end these unwarranted subsidies and return the revenue to the vast majority of our taxpayers who want no more or less than to pay their fair share.

Judged by this standard, the current tax structure is seriously defective. Millions of honest and intelligent Americans find themselves confused and frustrated by its complexity. The cost of this complexity is enormous in terms of hours and dollars spent.

Accordingly, tax simplification has been a goal of this Administration from the outset. The tax return individuals will file between now and April 15 has been simplified as a result of the Tax Reduction and Simplification Act which I proposed and Congress enacted last year. The short form 1040A has been reduced from 25 lines to 15 lines. Form 1040 has been restructured so that it can be completed more systematically. Tax tables have been revised to reduce arithmetic computations. The language of the tax forms and the instructions has been made more understandable.

The simplification efforts that were begun in 1977 will be continued and expanded in the tax program I am presenting today. The replacement of the existing personal exemption and general tax credits by the $240 personal credit will simplify return preparation for taxpayers and enable millions of individuals at or below the poverty level to file no tax return. Changes in itemized deductions (which will be more than offset by the rate cuts) will increase the number of nonitemizers to 84 percent of all taxpayers. Six million Americans will be able to switch to the standard deduction and avoid keeping detailed records for tax purposes. The preparation of returns by itemizers will be simplified, and the tax program will reduce recordkeeping burdens on small businesses.

Business and Anti-Inflation Tax Reductions

Our Nation's employment and anti-inflation goals cannot be met without a strengthening of private business investment. In recent years, capital spending in the United States has been inadequate. Capacity growth in manufacturing has declined from a growth rate of about 4.5 percent during the period 1948-1969, to 3.5 percent from 1969-1973, and to 3 percent from 1973-1976. Real business fixed investment in the third quarter of 1977 was 5 percent below its 1974 peak.

In order to encourage needed capital outlays in the period ahead, my tax program contains annual net business tax reductions of approximately $6 billion. The corporate tax rate will be reduced on October 1, 1978 from 20 percent to 18 percent on the first $25,000 of income and from 22 percent to 20 percent on the second $25,000 -- this will result in a 10 percent reduction in tax liability for most small corporations. The tax rate for large corporations will be cut from 48 percent to 45 percent on October 1, 1978 and to 44 percent on January 1, 1980.

I also recommend several important changes in the existing 10 percent investment tax credit: the 10 percent credit should be made permanent; liberalized to cover up to 90 percent of tax liability; made fully applicable to qualified pollution control facilities; and extended to investments in industrial and utility structures (including rehabilitation of existing structures). These changes should be particularly beneficial to developing businesses that are seeking to expand their productive facilities and should help to increase expenditures for the construction of new factories.

(1) Rate Cuts. The proposed rate schedule will range from a lowest bracket of 12 percent to a top bracket of 68 percent, compared with the current 14 to 70 percent range. As under current law, the top rate bracket will apply with respect to income in excess of $200,000 for joint returns and $100,000 for single returns. The entire schedules are set forth in Tables 11 and 12. This new rate structure will, in and of itself, increase the overall progressivity of the individual income tax because the cuts are proportionately larger in the low and middle-income brackets.

(2) Per Capita Tax Credit. The tax benefits for dependents currently favor the wealthy over persons with modest incomes. A taxpayer is now entitled to a $750 exemption for each family member in addition to a general tax credit, which is equal to the greater of $35 per family member or 2 percent of the first $9,000 of taxable income. The net effect of the complicated series of exemptions and credits is this: a family of four in the 50 percent tax bracket enjoys a tax savings of $1,680 for dependents while families earning $10,000 save about one-third of that amount.

I propose that the existing exemption and general credits be replaced with a single credit of $240 per family member. Unlike the current structure, the new credit will provide the same benefit at all income levels; for a family with four members, the per capita credit will be worth $960 whether that family is middle class or wealthy. The $240 credit will ensure that most families at or near the poverty level will pay no taxes. Also, a single tax credit will simplify tax return preparation by eliminating the confusion caused by the existing combination of exemptions and alternative credits.

Changes in Itemized Deductions

The primary source of complexity in the tax laws for many middle-income individuals is itemized deductions. Average taxpayers have to maintain burdensome records in order to substantiate the deductions and are required to decipher complex tax rules to complete their tax returns. Restructuring of itemized deductions is essential if the tax laws are to be simplified for typical, middle-class individuals and families.

I am recommending changes in itemized deductions that will enable approximately 6 million taxpayers to switch to the simple standard deduction. The number of taxpayers who use the standard deduction will be increased from 77 percent to 84 percent. And the calculation of the deductions for itemizers will be simplified greatly.

The deductions that will be curtailed are ones that add complexity and inequity to the tax system without advancing significant objectives of public policy. We will have a simpler, more efficient tax system if we eliminate

But, as a result of the changing relationship between medical costs and income, that standard is no longer satisfied. Substantial recordkeeping burdens and administrative problems can be eliminated through the proposed simplification of the deduction and the redefinition of "extraordinary" in the light of current experience among taxpayers.

PROPOSALS TO CURTAIL INAPPROPRIATE SUBSIDIES, SPECIAL PRIVILEGES, INEQUITIES AND ABUSES OF THE TAX SYSTEM

Entertainment and Other Expenditures for Personal Consumption

One feature of the current tax system that is most disheartening to average taxpayers is the favorable tax treatment accorded extravagant entertainment expenses that are claimed to be business-related. Some individuals are able to deduct expenditures that provide personal enjoyment with little or no business benefit. And, even where entertainment expenditures may have some relationship to the production of income, they provide untaxed personal benefits to the participants. More than $2 billion of tax revenue is lost every year through these tax preferences.

For example, one person claimed a deduction of $17,000 for the cost of entertaining other members of his profession at his home, at a country club, at sporting events, at restaurants, and at a rental cottage. Another individual wrote off the cost of business lunches 338 days of the year at an average cost far exceeding $20 for each lunch. But there is no deduction in the tax laws for the factory worker's ticket to a football game or the secretary's lunch with fellow workers.

These special tax advantages for the privileged few undermine confidence in our Nation's tax system. The disparity must be eliminated by denying a deduction for expenditures to the extent they provide the participants with such untaxed personal enjoyment and benefits.

(1) Theater and Sporting Events. No deduction will be permitted for purchases of tickets to theater and sporting events. Present law, by allowing a deduction for the purchase of such tickets, provides a "two for the price of one" bargain to some taxpayers. As long as an individual is in the 50 percent tax bracket or above, he may be able to invite a business friend at no cost to himself by having the Federal government pay for at least one-half of the total ticket costs. The overwhelming majority of our citizens pay for their theater and sports tickets out of their own after-tax dollars. No taxpayer should be asked to help subsidize someone else's personal entertainment.

(2) Other Entertainment Expenses. The tax reform program will also deny deductibility of any expenses of maintaining facilities such as yachts, hunting lodges and swimming pools and for fees paid to social, athletic, or sporting clubs. During a recent tax year, one small corporation deducted $67,000 for yacht expenses incurred in entertaining customers and potential customers on cruises and fishing trips. Another small company deducts over $100,000 a year to maintain hunting and fishing lodges to entertain employees of customers. Asking taxpayers to subsidize these kinds of activities for a tiny minority of our citizens strikes at the fairness and integrity of the tax system.

dollars away from profit-seeking businesses and into ventures designed only for tax write-offs; legitimate businesses suffer competitive disadvantages as a result.

In the Tax Reform Act of 1976, Congress enacted reforms intended to restrict tax shelter abuses. The principal methods used in that legislation were revisions of the minimum tax and the adoption of an "at risk" rule to limit the deductibility of certain tax shelter losses.

However, some promoters have now adapted their operations to provide shelters in forms that were not specifically covered by the 1976 Act. In fact, shelter activity in 1977 may have surpassed the level reached in 1976. Form letters, addressed to "All of Us Who Wish to Reduce Our Taxes," boldly promise tax write-offs several times larger than the amount invested, and persons are urged to pass the message along "to anyone you think may have interest in tax reduction." Tax shelter experts promote their services in large and expensive advertisements in the financial sections of our Sunday papers.

Such flagrant manipulation of the tax laws should not be tolerated. I recommend action that will build upon the 1976 reforms and further reduce tax shelter abuses.

(1) Strengthening of the Minimum Tax. The minimum tax has proved to be one of the most useful devices to limit the attractiveness of tax shelter schemes, and it should be made still more effective. In its current form, the minimum tax is imposed at a rate of 15 percent on the amount of certain tax preference items enjoyed by a taxpayer. But the total amount of tax preferences can be reduced by the greater of $10,000 or one-half of regular tax liability (in the case of individuals) before the minimum tax is applied.

I recommend that the minimum tax for individuals be strengthened by eliminating the offset of one-half of regular tax liability against preference income. This change will make the minimum tax more progressive and a more sharply focused deterrent to the use of tax shelters. Persons making excessive use of preferences will be taxed on their preference income without regard to regular tax liability. On the other hand, those individuals with modest preference income will still be totally exempted from the minimum tax by the $10,000 preference offset, and the minimum tax will not be applied to capital gain realized on the sale of a personal residence. Ninety-eight percent of the $284 million in revenue raised by this proposal will come from taxpayers with incomes exceeding $100,000 and more than 77 percent will come from the income class over $200,000.

(2) Extension of "at risk" Rule. One of the 1976 reforms that should be toughened is the "at risk" rule. That rule denies deductibility for a shelter investor's paper losses that exceed his cash investment and indebtedness for which he has personal liability. My tax reform plan will generally extend the "at risk" provisions to cover all activities (except real estate) carried on individually, through partnerships, or by corporations controlled by five or fewer persons.

(3) Changes in Real Estate Depreciation. Reform of real estate depreciation practices is needed to reduce much of the wasteful tax shelter investment that has led to over-building of commercial real estate in such forms as shopping

(6) Tax Audit of Partnerships. Tax shelter partnerships are not themselves subject to the tax assessment mechanism of the Internal Revenue Service; therefore, each individual partner must be audited separately even though the same substantive determinations may be involved. I recommend that legislation be enacted to permit a partnership to be treated as an entity for the purpose of determining tax issues. Tax shelters based on illegitimate deductions should not be permitted to succeed merely because of the difficulties involved in conducting an IRS examination of their activities.

Termination of Alternative Tax for Capital Gains

The wages of most workers are fully subject to tax at the rates contained in the published tax tables. But persons whose income arises from the sale of assets such as stock or land generally receive preferred treatment; a deduction for long-term capital gains has the effect of taxing these gains at a rate that is one-half of the rate for ordinary income. This preference results in an annual revenue loss to the Treasury of $8 billion.

Taxpayers in the highest income brackets are granted an additional tax preference over and above the special capital gains deduction. Individuals above the 50 percent tax bracket can take advantage of a 25 percent tax ceiling on the first $50,000 of capital gains, a provision known as the "alternative tax." The benefits of this provision go exclusively to persons with taxable incomes exceeding $52,000 (if filing a joint return) or $38,000 (if filing a single return) -- less than one percent of all taxpayers.

Through the alternative tax, a wealthy investor can shield nearly 65 percent of his capital gains from taxation -- a benefit that is grossly inequitable when middle-class investors are taxed on one-half of such gains, and most workers are taxed on every cent of their wages and salaries. The alternative tax costs the Treasury over $100 million every year, almost 90 percent of which goes to taxpayers in income classes above $100,000. I propose the repeal of this unfair and complicated tax benefit.

Fringe Benefits Unavailable to Rank-and-File Workers

Our tax system generally operates under the principle that employees should be taxed on their compensation no matter what form that compensation assumes. A worker who receives cash wages that he uses to provide benefits for his family should not ordinarily be taxed more heavily than the employee who receives those benefits directly from his employer. There are now exceptions to this general rule for certain types of employee benefits. I urge Congress to act so that these tax preferences benefit rank-and-file workers as well as the executive officers.

(1) Non-discrimination Requirement for Health and Group Life Plans. An example of a tax-preferred employee benefit is a health or group life insurance plan. If an individual purchases medical insurance, the premiums are deductible only within the limits applicable to the medical expense deduction. However, if an employer establishes a medical insurance program for its employees, the premium payments by the employer are deductible while neither the premiums nor the benefits are taxable to the employee.

Taxable Bond Option and Industrial Development Bonds

Present law exempts from Federal taxation the interest on certain bonds issued by state and local governments. There are now two general categories of tax-exempt bonds: obligations issued for the benefit of the state and local government itself, and industrial development bonds issued by the government to provide facilities such as pollution control equipment, sports facilities, waste disposal facilities, industrial parks, and facilities (including hospitals) of private, non-profit organizations. Also, there is a "small issue" exemption for certain industrial development bonds with face amounts that do not exceed $1 million, or $5 million where the total cost of capital expenditures on the financed facility does not exceed the $5 million amount.

My tax program preserves the freedom of state and local governments to issue tax-exempt bonds. I am recommending reforms that will restrict the tax avoidance opportunities available to the wealthy in the tax-exempt market while, at the same time, increasing the ability of state and local governments to obtain low-cost financing. In particular, I propose the following:

(1) Option for Bonds Benefitting Governmental Units. State and local governments will be given the option of continuing to issue tax-exempt bonds or issuing fully taxable bonds, accompanied by a direct Federal interest subsidy to the governmental units. For bonds issued in 1979 and 1980, the subsidy will be equal to 35 percent of the interest cost; the subsidy will rise to 40 percent for bonds issued after 1980. The Federal government will exercise no control over the purposes for which state and local governments use subsidized financing. State and local governments will benefit under the taxable bond option regardless of whether they decide to issue taxable or tax-exempt bonds: those issuing taxable bonds will benefit directly from the interest subsidy, and those continuing to issue tax-exempt bonds will benefit because the reduced supply of such bonds will allow governments to sell them at lower interest rates.

(2) Pollution Control Bonds, Bonds for the Development of Industrial Parks, and Private Hospital Bonds. The tax exemption will be removed for interest on pollution control bonds and bonds for the development of industrial parks. Also, the exemption will be removed for bonds issued to finance construction of hospital facilities for private, non-profit institutions unless there is a certification by the state that a new hospital is needed. These activities are essentially for the benefit of private users, and the tax exemption for the bonds has the effect of undermining the financing of governmental functions. Moreover, the general exemption for hospital bonds encourages excessive expansion of unneeded hospital facilities and runs counter to the Administration's Hospital Cost Containment proposal.

(3) Small Issue Exemption. The existing "small issue" exemptions will be retained only for economically distressed areas; and, with respect to those areas, the $5 million exemption will be raised to $10 million.

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deduction is scheduled for elimination after 1987. I propose that the effective date for repeal be accelerated so that beginning in 1979 banks, like other businesses, will base their bad debt reserves on their own experience in the current and 5 preceding years.

(2) Mutual Savings Banks and Savings and Loan Associations. Mutual savings banks and savings and loan associations are also permitted a special bad debt deduction that bears no relationship to actual experience. These thrift institutions are generally entitled to deduct 40 percent of their net income (this percentage is scheduled to apply in 1979) as a bad debt reserve as long as a significant portion of their deposits is invested in real estate loans. My tax program will reduce the percentage to 30 percent over a 5-year period.

(3) Credit Unions. Credit unions are tax-exempt. Yet, their powers and functions are defined so broadly that the term "credit union" can include financial institutions that are functionally identical to a savings and loan association. The tax exemption provides them with an unfair financial advantage over their competitors. I propose that the percentage of exempt income be phased out over a 4-year period, and that credit unions be taxed in the same manner as mutual savings banks and savings and loan associations after 1982.

Domestic International Sales Corporation (DISC)

Business incentives form an integral part of my tax program. I am recommending measures that will encourage American businesses to invest in productive facilities and to create jobs. However, adoption of those incentives must be accompanied by the elimination of tax preferences that have proved to be wasteful. The so-called "DISC" provision is a prime example.

In 1971, Congress enacted a special tax program for exports. This program permitted tax benefits for exports channeled through a company's specially created subsidiary, usually a paper organization, known as a domestic international sales corporation (DISC). Artificial pricing rules on transactions between the parent company and its DISC permit a favorable allocation of export profits to the DISC, and the taxation of one-half of eligible DISC income is deferred as long as these profits are invested in export related assets.

DISC has proved to be a very inefficient and wasteful export subsidy in the current international monetary system. A recent Treasury study indicates that DISC may have contributed only $1 to $3 billion to U.S. exports in 1974 -- an increase of less than 3 percent in total exports -- at a tax revenue cost of $1.2 billion. In the long run, even these increased exports are probably offset by rising imports that result from the operation of the flexible exchange rate system. DISC does nothing for, and may even disadvantage, our import sensitive industries and our exporters not using the DISC provision. Independent experts believe that DISC may have had no positive effect on our balance of payments.

Congress has recognized the wasteful nature of DISC and, in 1976, limited its applicability. However, DISC continues to cost U.S. taxpayers over $1 billion per year, with 65 percent of DISC benefits going to corporations with more than $250 million in assets.

I recommend complete repeal of this tax as of October 1, 1978. This action will reduce the cost of living directly. It will also lower consumer prices indirectly through a reduction of the business cost associated with telephone services.

Federal Unemployment Insurance Tax

I recommend a reduction in the Federal unemployment insurance tax to reduce the payroll costs of employers. On January 1, 1978, the unemployment insurance tax rate rose from 0.5 percent to 0.7 percent of an employer's taxable wage base. This tax increase was instituted in order to replenish general revenue funds that have been loaned to the unemployment insurance trust fund during recent periods of high unemployment. But the issue of unemployment compensation financing requires a thorough reexamination to determine the best means of providing future benefits. To this end, I will soon appoint the National Commission on Unemployment Insurance which the Congress established to make this study and to offer recommendations. In the meantime, I am guided by my concerns about inflation. I propose that the tax rate be reduced to the 0.5 percent level as of January 1, 1979.

RECOMMENDED BUSINESS INCENTIVES TO FOSTER GROWTH OF THE ECONOMY

Corporate Rate Cut

I recommend a corporate rate cut that will reduce business taxes by $6 billion. Tax relief in this form is sizable, easily understood by taxpayers, and applicable across the board.

The corporate tax rate is now 20 percent on the first $25,000 of income, 22 percent on the next $25,000, and 48 percent on corporate income exceeding $50,000. Effective October 1, 1978, this program will reduce the first two rate brackets to 18 and 20 percent, respectively, and the rate to 45 percent on taxable income in excess of $50,000. The top rate will be reduced an additional point, to 44 percent, on January 1, 1980. Small as well as large corporations will benefit from these rate cuts.

A corporate rate reduction of this magnitude will increase capital formation and help to assure a sustained economic recovery. In recent years, the level of business fixed investment has been unsatisfactory. One of the primary causes of this inadequate investment performance has been the low rate of return businesses receive on their investments -- after tax liability is taken into consideration. The lower tax rates I recommend will enhance the anticipated after-tax profits on corporate investment projects and increase cash flow immediately. Businesses will thereby be encouraged to increase capital spending and to create jobs for American workers. Corporate rate cuts this large are made possible by, and depend upon, passage of the revenue-raising business tax reforms I have described earlier.

Revision and Simplification of Regulations Under the Asset Depreciation Range System

The asset depreciation range (ADR) system provides substantial tax benefits to businesses. Under ADR, generous class lives are prescribed for categories of assets, and a taxpayer can select useful lives for depreciation purposes within a range that extends from 20 percent below to 20 percent above the designated class life. However, certain complexities in the ADR regulations discourage most businesses, especially small ones, from electing this depreciation system and impose administrative burdens on those businesses that do use ADR.

I recommend legislation expressly permitting the Treasury Department to issue regulations that will simplify the ADR system. Included among the changes will be a termination of the annual reporting requirement.

Proposals Focused on Small Business

The tax reductions I recommend will provide significant benefits for small businesses. For example, a small corporation with annual income of $50,000 will save $1,000 in taxes due to corporate rate reductions. For that corporation, tax liability will be reduced by nearly 10 percent. Moreover, those small businesses conducted in partnership or sole proprietorship form will benefit substantially from the rate cuts I have proposed for individuals.

But in addition to providing these general tax incentives, I recommend three proposals designed specifically to assist small businesses. First, my tax program will simplify and liberalize the rules (Subchapter S) that treat certain small corporations as partnerships; the number of permissible shareholders will generally be increased from 10 to 15, and the rules governing subchapter S elections will be made less stringent. Second, a simplified method of depreciation will be authorized for small businesses that will provide tax benefits similar to the current ADR system without complex recordkeeping requirements. And third, risk-taking will be encouraged by doubling the amount of a small corporation's stock (from $500,000 to $1 million) that can qualify for special ordinary loss treatment and by eliminating several technical requirements that needlessly restrict the ability of small businesses to use this provision.

CONCLUSION

Enactment of these recommendations will effect major reform of our tax laws, provide significant tax relief, and sustain our economic recovery.

This program will eliminate a number of the inequities that undermine the integrity of the tax system. It will make preparation of returns simpler and more understandable for millions of taxpayers. Prompt passage will strengthen the confidence of consumers and businesses in our growing economy and lead to the creation of up to one million new jobs for workers who need them.

I look forward to working in partnership with Congress to enact this program of tax reform and tax reduction.

JIMMY CARTER

THE WHITE HOUSE,

January 20, 1978.

Table 2

The Effect of Tax Proposals on Calendar Year Tax Liability

($ millions)

	Full year 1976	Calendar Years 1978	1979	1980	1981	1982	1983
$240 credit and reduced tax rates	-17,305	-6,067	-23,538	-26,583	-30,272	-34,732	-40,110
Itemized deduction changes:							
Repeal gasoline tax deductions	582		862	983	1,121	1,277	1,456
Repeal sales tax deductions	1,672		2,477	2,824	3,219	3,670	4,184
Repeal miscellaneous tax deductions	384		569	649	739	843	961
Deduction for medical and casualty expenses	1,396		1,909	2,119	2,352	2,611	2,898
Repeal political contributions deduction	2		2	4	2	3	3
Repeal capital gains alternate tax	113		140	151	162	174	187
Individual real estate tax shelters	320		61	181	296	407	514
Taxation of unemployment benefits	275		212	207	204	204	214
Tax interest element of annuity contracts	320		12	26	40	57	80
Minimum tax change	229		284	306	329	353	380
Taxable bond option (individual)	255		197	592	1,080	1,666	2,218
Extend 10 percent investment tax credit to structures (indiv.)	-36	-47	-54	-65	-73	-79	-86
Limit individual tax credits to 90 percent of tax before credits	38		52	58	64	71	79
Tax qualified retirement plans and employee death benefits	30		32	32	33	33	34
Corporate real estate shelters	180		40	118	194	265	335
Corporate family farm accounting	30		40	25	10	5	7
Bad debt reserves:							
Commercial banks	196		227	232	232	23	--
Mutual savings banks and savings and loans	82		37	85	145	221	316
Credit unions	82		22	50	83	123	171
Entertainment expenses	1,125		1,476	1,633	1,771	1,932	2,107
Taxable bond option (corporations)	-24		-15	-47	-79	-113	-150
Phase-out DISC over 3 years	852	193	664	1,228	1,513	1,613	1,751
Phase-out deferral of tax on foreign source income	523		88	280	768	830	897
Corporate tax rate reduction	-5,718	-1,349	-5,965	-8,516	-9,228	-10,010	-10,764
At risk limitation (corporations)	10		14	10	8	5	6
Increase investment tax credit limit to 90 percent	-71		-882	-576	-114	-194	-205
Extend 10 percent investment tax credit to structures (corporations)	-1,055	-1,100	-1,389	-1,649	-1,869	-2,074	-2,268
Nondiscrimination rule for health and group term life plans	29		32	33	34	35	36
Full investment tax credit for pollution abatement facilities	-90	-142	-93	-107	-127	-115	-144
Total individual	-11,725	-6,114	-16,783	-18,516	-20,704	-23,442	-26,988
Total corporate	-3,849	-2,398	-5,704	-7,201	-6,659	-7,454	-7,905
Subtotal tax reform	-15,574	-8,512	-22,487	-25,717	-27,363	-30,896	-34,893
Repeal telephone excise tax	--	-355	-1,200	-900	-500	--	--
Reduce unemployment payroll tax rate	--	--	-850	-900	-950	-1,000	-1,050
Total	-15,574	-8,867	-24,537	-27,517	-28,813	-31,896	-35,943

Office of the Secretary of the Treasury
Office of Tax Analysis

January 21, 1978

Table 4

Income Tax Liabilities: Present Law and Administration Proposal
(Personal Income Only)

(1976 Levels of Income)

Expanded Income Class	Present Law: Tax Liability	Present Law: Percentage Distribution	Administration Proposal: Tax Liability	Administration Proposal: Percentage Distribution	Tax Change: Tax Liability	Tax Change: Change as Percent of Present Law Tax
($000)	($ millions)	(percent)	($ millions)	(percent)	($ millions)	(percent)
Less than 5	141	0.1%	-251	-0.2%	-392	-278.0%
5 - 10	8,227	6.1	6,368	5.2	-1,859	-22.6
10 - 15	18,071	13.4	15,361	12.4	-2,710	-15.0
15 - 20	23,009	17.0	20,148	16.3	-2,861	-12.4
20 - 30	32,778	24.2	29,593	23.9	-3,185	-9.7
30 - 50	22,017	16.3	20,971	17.0	-1,046	-4.8
50 - 100	16,492	12.2	16,344	13.2	-148	-0.9
100 - 200	8,084	6.0	8,261	6.7	177	2.2
200 and over	6,476	4.8	6,838	5.5	362	5.6
Total	$135,293	100.0%	$123,633	100.0%	$-11,660	-8.6%

Office of the Secretary of the Treasury
Office of Tax Analysis

January 21, 1978

Note: Details may not add to totals due to rounding.

Table 6

Burden Table
Joint Returns
No Dependents

(1976 Levels of Income)

Expanded income class	Average tax present law	Average tax under proposal	Average tax change	Percentage change
($000)	(................. dollars		.................)	(.. percent ..)
Less than 10	168	95	-73	-43.6%
10 - 15	1,104	983	-121	-11.0
15 - 20	2,084	1,906	-178	-8.5
20 - 30	3,615	3,308	-307	-8.5
30 - 50	6,921	6,535	-386	-5.6
50 - 100	17,020	16,647	-373	-2.2
100 - 200	40,403	40,956	553	1.4
200 and over	132,121	137,140	5,020	3.8

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Office of Tax Analysis

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Table 8

Burden Table
Joint Returns
Two Dependents

(1976 Levels of Income)

Expanded income class	Average tax present law	Average tax under proposal	Average tax change	Percentage change
($000)	(.................	dollars	.................)	(.. percent ..)
Less than 10	9	-79	-88	-975.6%
10 - 15	867	589	-278	-32.1
15 - 20	1,739	1,461	-278	-16.0
20 - 30	3,117	2,780	-337	-10.8
30 - 50	6,287	5,979	-308	-4.9
50 - 100	16,336	16,088	-248	-1.5
100 - 200	40,885	41,087	202	0.5
200 and over	127,666	130,473	2,807	2.2

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Table 10

Income Tax and FICA Tax Changes Four Person, One-earner Families

Wage Income	Income Tax 1/	FICA Tax 2/	Total Tax
$ 5,000	0	14	14
10,000	-312	28	-284
15,000	-258	42	-216
20,000	-270	120	-150
25,000	-320	298	-22
30,000	-322	298	-24
40,000	-218	298	80
50,000	-80	298	218
100,000	590	298	888

1/ Assumes deductible expenses equal to 23 percent of income under present law and 20 percent under the proposal.

2/ Change in FICA tax calculated assuming present law rate and base for 1979 (6.13 percent and $22,900), employees' share only and assuming prior law rate for 1977 (5.85 percent) and prior law estimated base for 1979 ($18,900).

Table 12

Individual Tax Rate Schedules For
Single Returns

Taxable Income Bracket 1/	Present Law: Tax At Low End of Bracket	Present Law: Tax Rate on Income In Bracket	Tax Proposal: Tax At Low End of Bracket	Tax Proposal: Tax Rate on Income In Bracket
0 - 500	0	14	0	12
500 - 1,000	70	15	60	13
1,000 - 1,500	145	16	125	15
1,500 - 2,000	225	17	200	15
2,000 - 3,000	310	19	275	18
3,000 - 4,000	500	19	455	19
4,000 - 6,000	690	21	645	20
6,000 - 8,000	1,110	24	1,045	20
8,000 -10,000	1,590	25	1,445	22
10,000 -12,000	2,090	27	1,885	23
12,000 -14,000	2,630	29	2,345	25
14,000 -16,000	3,210	31	2,845	25
16,000 -18,000	3,830	34	3,345	29
18,000 -20,000	4,510	36	3,925	29
20,000 -22,000	5,230	38	4,505	33
22,000 -24,000	5,990	40	5,165	33
24,000 -26,000	6,790	40	5,825	38
26,000 -28,000	7,590	45	6,585	38
28,000 -32,000	8,490	45	7,345	41
32,000 -36,000	10,290	50	8,985	46
36,000 -38,000	12,290	50	10,825	50
38,000 -40,000	13,290	55	11,825	50
40,000 -44,000	14,390	55	12,825	51
44,000 -48,000	16,590	60	14,865	57
48,000 -50,000	18,990	60	17,145	58
50,000 -52,000	20,190	62	18,305	58
52,000 -54,000	21,430	62	19,465	60
54,000 -60,000	22,670	62	20,665	60
60,000 -62,000	26,390	64	24,265	60
62,000 -64,000	27,670	64	25,465	63
64,000 -70,000	28,950	64	26,725	63
70,000 -76,000	32,790	66	30,505	63
76,000 -80,000	36,750	66	34,285	66
80,000 -88,000	39,390	68	36,925	66
88,000 -90,000	44,830	68	42,205	66
90,000 -100,000	46,190	69	43,525	67
100,000 and over	53,090	70	50,225	68

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1/ The zero bracket is not shown in this table. To include the zero bracket, increase all taxable incomes shown by $2,200.

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Fact Sheet 1

January 21, 1978

FACT SHEET

Overview of The Tax Reduction and Reform Act of 1978

The President's Proposal: A major tax cut for individuals and business is combined with a major package of tax reforms.

Objectives The proposal will:

- reduce taxes for most Americans, even after the recently legislated increase in social security taxes;
- help sustain the economic expansion and move the economy toward full employment;
- provide incentives for increased investment in productive facilities and for increased efficiency in the American economy;
- increase tax fairness by making the taxes actually paid more progressive and by reducing differences in taxes levied on taxpayers with like incomes;
- make the tax system simpler for individuals and business by making it easier for the average person to complete his or her tax return, making tax rules more understandable and removing special provisions.

Tax Cuts For individuals, the President proposes cuts in individual tax rates and the adoption of a $240 per capita tax credit, in place of the existing $750 exemption and general tax credit, that will reduce taxes by $23.5 billion in calendar year 1979.

The investment credit changes will generally be effective as of January 1, 1978. The rate cuts will be effective beginning October 1, 1978. The tax reform proposals will generally take effect in 1979 and will not affect 1978 tax liabilities.

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The Effect of Tax Proposals on Calendar Year Tax Liability

($ millions)

	Full year 1976	Calendar Years 1978	1979	1980	1981	1982	1983
$240 credit and reduced tax rates	-17,305	-6,067	-23,538	-26,583	-30,272	-34,732	-40,110
Itemized deduction changes:							
Repeal gasoline tax deductions	582		862	983	1,121	1,277	1,456
Repeal sales tax deductions	1,672		2,477	2,824	3,219	3,670	4,184
Repeal miscellaneous tax deductions	384		569	649	739	843	961
Deduction for medical and casualty expenses	1,396		1,909	2,119	2,352	2,611	2,898
Repeal political contributions deduction	2		2	4	2	3	3
Repeal capital gains alternate tax	113		140	151	162	174	187
Individual real estate tax shelters	320		61	181	296	407	514
Taxation of unemployment benefits	275		212	207	204	204	214
Tax interest element of annuity contracts	320		12	26	40	57	80
Minimum tax change	229		284	306	329	353	380
Taxable bond option (individual)	255		197	592	1,080	1,666	2,218
Extend 10 percent investment tax credit to structures (indiv.).	-36	-47	-54	-65	-73	-79	-86
Limit individual tax credits to 90 percent of tax before credits	38		52	58	64	71	79
Tax qualified retirement plans and employee death benefits	30		32	32	33	33	34
Corporate real estate shelters	180		40	118	194	265	335
Corporate family farm accounting	30		40	25	10	5	7
Bad debt reserves:							
Commercial banks	196		227	232	232	23	--
Mutual savings banks and savings and loans	82		37	85	145	221	316
Credit unions	82		22	50	83	123	171
Entertainment expenses	1,125		1,476	1,633	1,771	1,932	2,107
Taxable bond option (corporations)	-24		-15	-47	-79	-113	-150
Phase-out DISC over 3 years	852	193	664	1,228	1,513	1,613	1,751
Phase-out deferral of tax on foreign source income	523		88	280	768	830	897
Corporate tax rate reduction	-5,718	-1,349	-5,965	-8,516	-9,228	-10,010	-10,764
At risk limitation (corporations)	10		14	10	8	5	6
Increase investment tax credit limit to 90 percent	-71		-882	-576	-114	-194	-205
Extend 10 percent investment tax credit to structures (corporations)	-1,055	-1,100	-1,389	-1,649	-1,869	-2,074	-2,268
Nondiscrimination rule for health and group term life plans	29		32	33	34	35	36
Full investment tax credit for pollution abatement facilities	-90	-142	-93	-107	-127	-115	-144
Total individual	-11,725	-6,114	-16,783	-18,516	-20,704	-23,442	-26,988
Total corporate	-3,849	-2,398	-5,704	-7,201	-6,659	-7,454	-7,905
Subtotal tax reform	-15,574	-8,512	-22,487	-25,717	-27,363	-30,896	-34,893
Repeal telephone excise tax	--	-355	-1,200	-900	-500	--	--
Reduce unemployment payroll tax rate	--	--	-850	-900	-950	-1,000	-1,050
Total	-15,574	-8,867	-24,537	-27,517	-28,813	-31,896	-35,943

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Fact Sheet 2

January 21, 1978

FACT SHEET

Effects of the Tax Program on the Economy

This has been summarized by the President's Tax Message of January 21, 1978:

"These tax reductions are a central part of the Administration's overall economic strategy, which will rely principally upon growth in the private sector to create the new jobs we need to achieve our high-employment objective. The tax reductions will more than offset the recent increase in social security taxes and will provide the consumer purchasing power and business investment strength we need to keep our economy growing strongly and unemployment moving down."

"Together with the programs that I will outline in my Budget Message, these tax cuts should assure that our economy will grow at a 4-1/2 to 5 percent pace through 1979, with unemployment declining to between 5-1/2 and 6 percent by the end of 1979. Without the tax cuts, economic growth would slow markedly toward the end of 1978 and fall to about 3-1/2 percent in 1979. Unemployment would be unlikely to fall below 6 percent and, by the end of 1979, might be moving upward."

"This tax program will mean up to 1,000,000 additional jobs for American workers. It should lead to a pattern of economic growth which is steady, sustainable, and noninflationary."

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Fact Sheet 3

January 21, 1978

FACT SHEET

Effect on Total Tax Burden

The President's Proposal: The percentage of total personal income that Americans now pay in Federal individual income taxes is 10.7 percent and rising. With the President's tax program, the burden will be 10.3 percent in 1978 and 10.5 in 1979. In contrast, without the program, the share of their personal income that Americans will pay in Federal individual income taxes will rise from its current level of 10.7 percent to 11.4 percent in 1979.

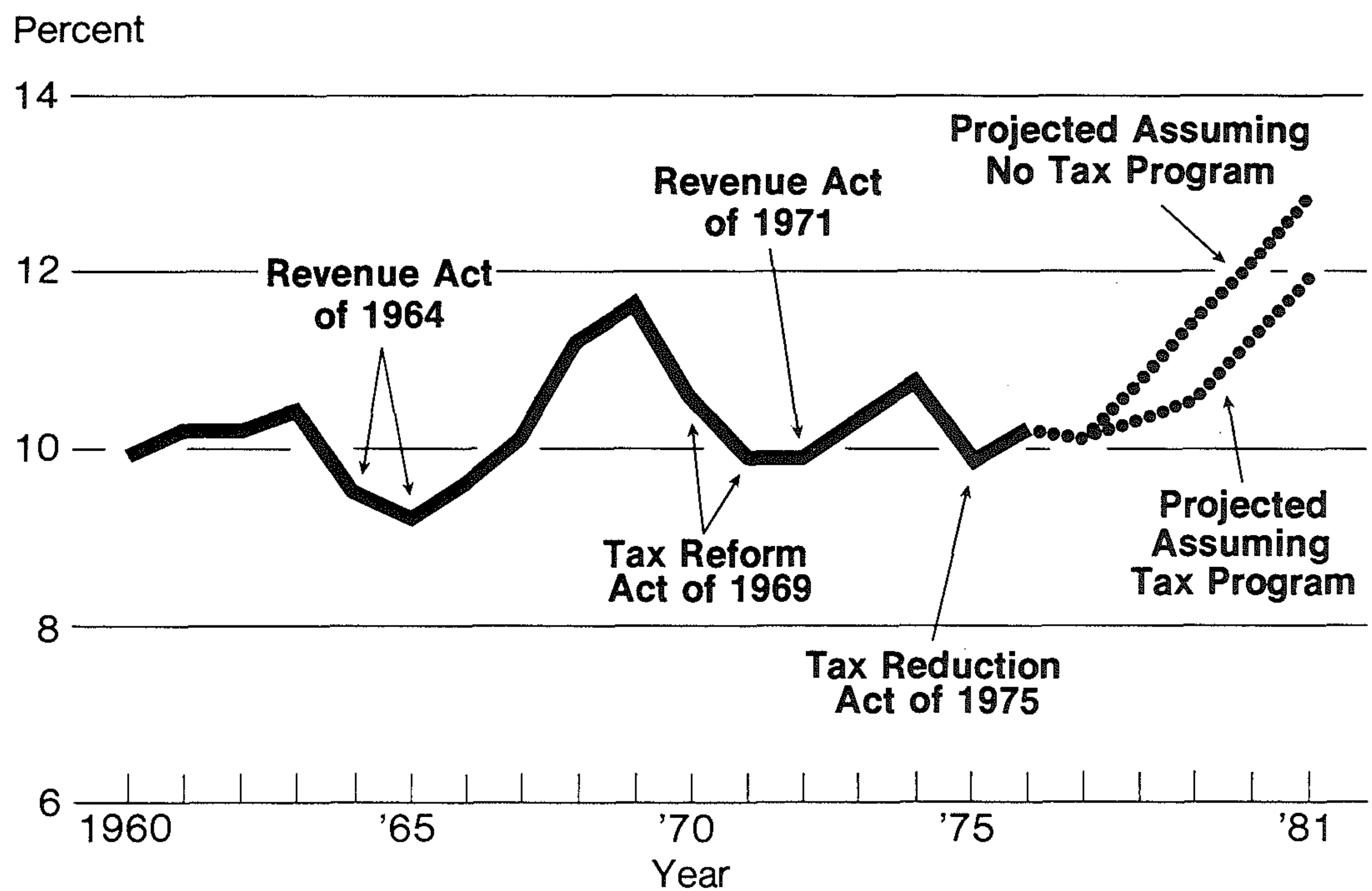
Effect of Inflation: As personal income rises because of inflation, the proportion of total income paid in income taxes also increases. This is due to the progressive tax rate structure which imposes higher tax rates as taxpayers move into successively higher tax brackets. This structure is based on the sound principle that taxation should be based on ability to pay. But when an increase in income reflects only inflation, a taxpayer's ability to pay is not actually increased. Tax increases in these circumstances reduce after-tax income adjusted for inflation.

Historically, when inflation has increased the income tax burden of Americans, taxes have been reduced. It is now time for another tax reduction to offset the tax effects of inflation.

Relation to Other Taxes: Social Security The need for increased financing for the nation's social security system will mean increased social security payroll taxes for most workers. A large part of the increased social security funding results from increasing the amount of wages and salary on which social security taxes are paid by workers. As a result, the largest increases in social security taxes, relative to income, will occur at incomes between $20,000 and $25,000.

Individual Income Taxes as a Percent of Personal Income, 1960-1982

(Arrows Identify Years of Major Effect of Significant Tax Legislation)



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Fact Sheet 4

January 21, 1978

FACT SHEET

Effect on the Distribution of Taxes

The President's Proposal: These tax reform proposals have been structured to give the greatest percentage tax cuts to the lowest income classes, the next greatest to middle income classes, and the smallest cuts to upper income classes. Also, several provisions of this program are designed to equalize the tax treatment of taxpayers with equal ability to pay.

The American tax system has always been designed so that higher income individuals pay a larger share of their income in tax than individuals with lower incomes. The specific proposals that would reinforce the progressive nature of the tax system are (1) replacement of the personal exemption with a per capita credit, (2) changes in the tax rates, and (3) limitations on deductions.

Tax Reductions by Income Level: The attached table shows by income classes the total taxes paid under present law, the total taxes under these reform proposals, and the net change. For example, taxpayers in the $5,000 to $10,000 income class paid $8.2 billion under present law. However, under these proposals they will pay $6.4 billion, a decrease of 23 percent. Taxpayers in the $30,000 to $50,000 income class receive a tax cut of only 5 percent. Thus, the tax reductions as a percent of tax liabilities under present law decline as income rises. In the $100,000 to $200,000 and $200,000 or more classes, there is a tax increase resulting from these proposals for those taxpayers who take advantage of various tax preferences being eliminated or curtailed.

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Expanded Income and Tax Liability Under Present Law
And Tax Proposals (Personal Only)

(1976 Levels of Income)

($ millions)

Expanded Income Class ($000)	Number of Returns (thousands)	Expanded Income	Present Law: Tax Liability	Present Law: Effective Tax Rate	Administration Proposal: Tax Liability	Administration Proposal: Effective Tax Rate
Less than 5	25,474	57,557	141	0.2%	-251	-0.4%
5 - 10	20,109	149,590	8,227	5.5%	6,368	4.3%
10 - 15	16,106	201,036	18,071	9.0%	15,361	7.6%
15 - 20	11,824	205,086	23,009	11.2%	20,148	9.8%
20 - 30	9,907	237,041	32,778	13.8%	29,593	12.5%
30 - 50	3,347	124,836	22,017	17.6%	20,971	16.8%
50 - 100	985	67,484	16,492	24.4%	16,344	24.2%
100 - 200	198	27,371	8,084	29.5%	8,261	30.2%
200 and over	49	21,573	6,476	30.0%	6,838	31.7%
Total	87,998	1,091,573	135,293	12.4%	123,633	11.3%

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Office of Tax Analysis

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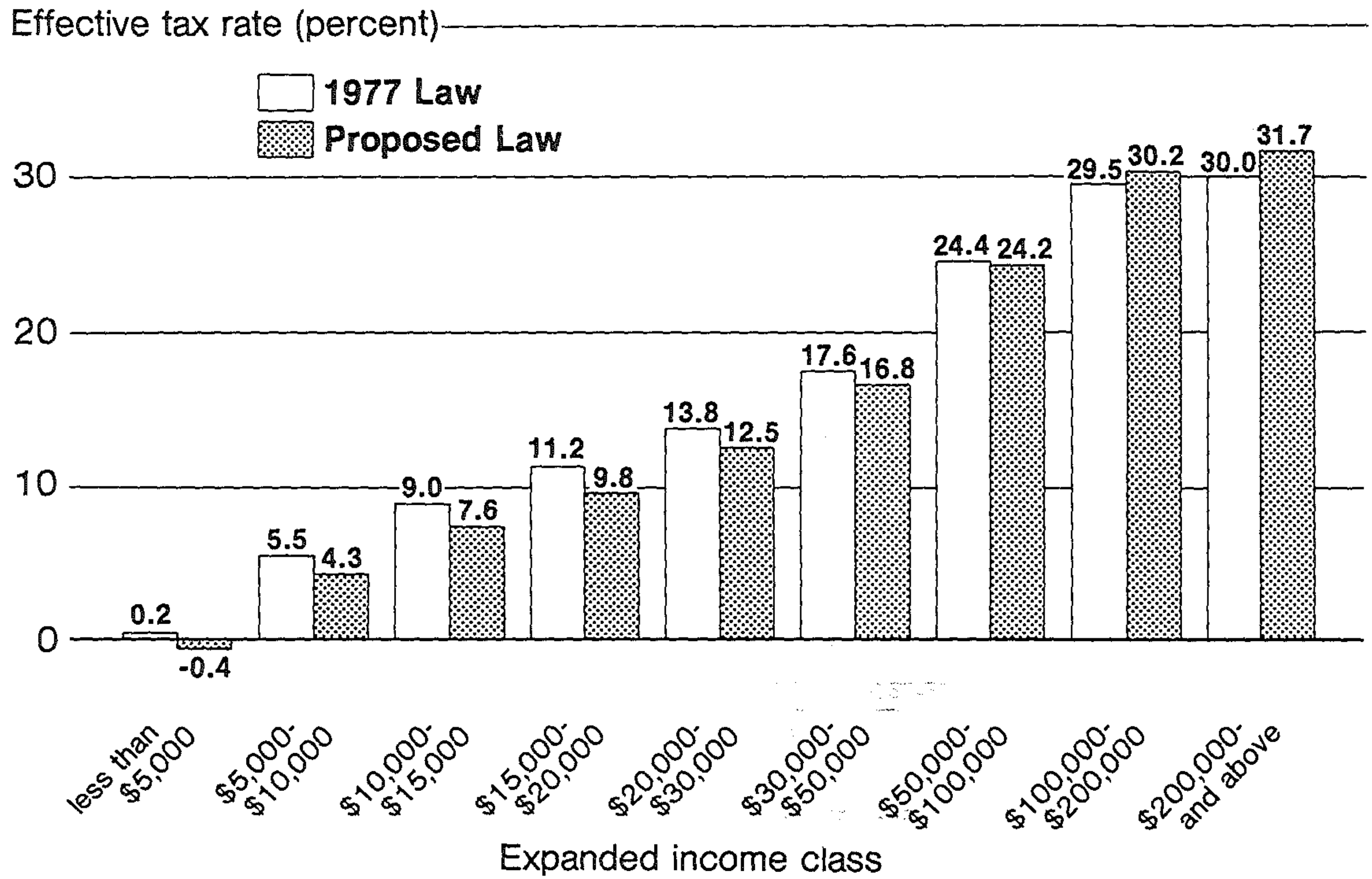
Note: Details may not add to totals due to rounding.

Tax Program:
Effective Individual Tax Rates -- Taxes as a Percent of Expanded Income. 1976 Level of Income.



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Fact Sheet 5

January 21, 1978

FACT SHEET

Effect on Individual Tax Burdens

Tables: Attached are 6 tables showing tax burdens for 8 income levels for single returns and joint returns with up to 4 dependents. The burdens shown are the average tax per return under present law, the average tax under the President's proposal, and the average change in tax liability in dollars and as a percent of present law liability.

Chart: The attached chart displays the data from the burden table for joint returns with 2 dependents.

Assumptions: The distribution of tax burdens under current and proposed law have been estimated on the Treasury Tax Model, which is based on a random sample of tax returns. The data base has been aged to the 1976 level of income. The estimates for each income class are, therefore, based on the average incomes, deductions, and credits for all taxpayers in that income class. Since the tables and chart are based on sampling techniques they should not be regarded as accurate in detail but rather as representing the general order of magnitude and relationships among the changes contained in the President's proposal.

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Burden Table
Joint Returns
No Dependents

(1976 Levels of Income)

Expanded income class	Average tax present law	Average tax under proposal	Average tax change	Percentage change
($000)	(.................	dollars	.................)	(.. percent ..)
Less than 10	168	95	-73	-43.6%
10 - 15	1,104	983	-121	-11.0
15 - 20	2,084	1,906	-178	-8.5
20 - 30	3,615	3,308	-307	-8.5
30 - 50	6,921	6,535	-386	-5.6
50 - 100	17,020	16,647	-373	-2.2
100 - 200	40,403	40,956	553	1.4
200 and over	132,121	137,140	5,020	3.8

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Office of Tax Analysis

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Burden Table
Joint Returns
Two Dependents

(1976 Levels of Income)

Expanded income class	Average tax present law	Average tax under proposal	Average tax change	Percentage change
($000)	(.................	dollars	.................)	(.. percent ..)
Less than 10	9	-79	-88	-975.6%
10 - 15	867	589	-278	-32.1
15 - 20	1,739	1,461	-278	-16.0
20 - 30	3,117	2,780	-337	-10.8
30 - 50	6,287	5,979	-308	-4.9
50 - 100	16,336	16,088	-248	-1.5
100 - 200	40,885	41,087	202	0.5
200 and over	127,666	130,473	2,807	2.2

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Office of Tax Analysis

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Burden Table
Joint Returns
Four Dependents

(1976 Levels of Income)

Expanded income class	Average tax present law	Average tax under proposal	Average tax change	Percentage change
($000)	(................. dollars		.................)	(.. percent ..)
Less than 10	-64	-70	-6	-9.9%
10 - 15	526	177	-349	-66.3
15 - 20	1,375	985	-390	-28.3
20 - 30	2,590	2,248	-342	-13.2
30 - 50	5,720	5,521	-199	-3.5
50 - 100	16,529	16,593	64	0.4
100 - 200	42,090	42,707	617	1.5
200 and over	127,755	131,298	3,543	2.8

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Fact Sheet 5A

January 21, 1978
Department of the Treasury

FACT SHEET

Effect on Individual Tax Burdens by Specific Income Level

Tables: Attached are 6 tables showing tax burdens for specific levels of income for single returns and joint returns with up to 4 dependents. In contrast, burden tables attached to Fact Sheet 5 show tax burdens for income classes based on expanded income. Expanded income is equal to adjusted gross income plus preference income included in the minimum tax less investment interest to the extent of investment income. It more nearly approximates total economic income.

Assumptions: The specific income burden tables assume that all income is fully taxable, as it would be if it were all derived from, say, wages and salaries. Itemized deductions are assumed to total 23 percent of income under present law and 20 percent under the President's proposal. Taxpayers are assumed to begin itemizing their deductions at the income level at which they benefit from doing so. At lower income levels taxes are calculated on the basis of the zero tax bracket amount -- usually called the standard deduction.

Not included in these tables are the effects of a number of the tax reform proposals which would affect income that currently is not fully taxed, such as the proposals restricting tax shelters and the elimination of the alternate tax on long-term capital gains. The examples are more representative of the tax burdens that would apply to lower and middle income taxpayers than of the taxes paid by those with large incomes. As income rises, taxpayers are more likely to have tax preferences that may be reduced by the President's proposal. The amounts of itemized deductions also tend to vary more widely at higher income levels.

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Burden Table
Joint Returns
No Dependents

Income	Present law tax 1/	Tax under proposal 2/	Tax change	Percentage change
(..........	.... dollars	....	..........)	(... percent ...)
5,000	0	0	0	0.0
10,000	761	614	-147	-19.3
15,000	1,651	1,552	-99	-6.0
20,000	2,555	2,390	-165	-6.5
25,000	3,570	3,310	-260	-7.3
30,000	4,712	4,390	-322	-6.8
40,000	7,427	7,110	-317	-4.3

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Office of Tax Analysis

January 20, 1978

1/ Assumes deductible expenses equal to 23 percent of income under present law.

2/ Assumes deductible expenses equal to 20 percent of income under proposed law.

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Burden Table
Joint Returns
Two Dependents

Income	Present law tax 1/	Tax under proposal 2/	Tax change	Percentage change
(..........................	dollars	....	)	(... percent ...)
5,000	-300	-300	0	0.0
10,000	446	134	-312	-70.0
15,000	1,330	1,072	-258	-19.4
20,000	2,180	1,910	-270	-12.4
25,000	3,150	2,830	-320	-10.2
30,000	4,232	3,910	-322	-7.6
40,000	6,848	6,630	-218	-3.2

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Office of Tax Analysis

January 20, 1978

1/ Assumes deductible expenses equal to 23 percent of income under present law.

2/ Assumes deductible expenses equal to 20 percent of income under proposed law.

Burden Table
Joint Returns
Four Dependents

Income	Present law tax 1/	Tax under proposal 2/	Tax change	Percentage change
(.....	..... dollars	.....	.....)	(... percent ...)
5,000	-300	-300	0	0.0
10,000	128	0	-128	-100.0
15,000	989	592	-397	-40.1
20,000	1,808	1,430	-378	-20.9
25,000	2,737	2,350	-387	-14.1
30,000	3,778	3,430	-348	-9.2
40,000	6,278	6,150	-128	-2.0

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January 20, 1978

1/ Assumes deductible expenses equal to 23 percent of income under present law.

2/ Assumes deductible expenses equal to 20 percent of income under proposed law.

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Fact Sheet 6

January 21, 1978

FACT SHEET

Individual Tax Rates

The President's Proposal: The marginal tax rates for all taxpayers will be reduced to a range of 12 percent to 68 percent for 1979 and later years.

A change in the rate schedules also will occur in 1978. This will allow a tax reduction for 1978 of approximately one-fourth the 1979 reduction. The 1978 reduction will be reflected in withholding beginning October 1.

Present Law: Marginal tax rates range from 14 percent to 70 percent.

Reasons for the Recommendation: The reduction of the tax rates represents the major reduction in taxes in the tax reform package. The lower tax rates in concert with the proposed $240 per capita tax credit assures the progressivity of the tax system by providing the largest percentage reduction in tax at the lowest income levels, and the least at upper income levels. The reduced amount of income taxes collected will help stimulate the economy, more than offsetting any dampening effect of the increase in social security taxes.

Other parts of the tax package propose changes designed to simplify the calculations of taxes for most taxpayers. These changes by themselves would increase taxes. The proposed rate reductions take these changes into account, and for almost all taxpayers will provide net decreases in taxes.

Individual Tax Rate Schedules For
Joint Returns

	Present Law		Tax Proposal	
Taxable Income Bracket 1/	Tax At Low End of Bracket	Tax Rate on Income In Bracket	Tax At Low End of Bracket	Tax Rate on Income In Bracket
0 - 500	0	14%	0	12%
500 - 1,000	70	14	60	12
1,000 - 2,000	140	15	120	14
2,000 - 3,000	290	16	260	16
3,000 - 4,000	450	17	420	17
4,000 - 8,000	620	19	590	18
8,000 - 12,000	1,380	22	1,310	19
12,000 - 16,000	2,260	25	2,070	20
16,000 - 20,000	3,260	28	2,870	23
20,000 - 24,000	4,380	32	3,790	27
24,000 - 28,000	5,660	36	4,870	32
28,000 - 32,000	7,100	39	6,150	36
32,000 - 36,000	8,660	42	7,590	39
36,000 - 40,000	10,340	45	9,150	42
40,000 - 44,000	12,140	48	10,830	44
44,000 - 48,000	14,060	50	12,590	48
48,000 - 52,000	16,060	50	14,510	48
52,000 - 54,000	18,060	53	16,430	51
54,000 - 62,000	19,120	53	17,450	51
62,000 - 64,000	23,360	53	21,530	51
64,000 - 76,000	24,420	55	22,550	54
76,000 - 88,000	31,020	58	29,030	57
88,000 - 90,000	37,980	60	35,870	57
90,000 -100,000	39,180	60	37,010	60
100,000 -110,000	45,180	62	43,010	60
110,000 -120,000	51,380	62	49,010	62
120,000 -130,000	57,580	64	55,210	62
130,000 -140,000	63,980	64	61,410	64
140,000 -150,000	70,380	66	67,810	64
150,000 -160,000	76,980	66	74,210	65
160,000 -175,000	83,580	68	80,710	65
175,000 -180,000	98,780	68	90,460	66
180,000 -200,000	97,180	69	93,760	66
200,000 and over	110,980	70	106,960	68

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1/ The zero bracket is not shown in this table. To include the zero bracket, increase all taxable incomes shown by $3,200.

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Fact Sheet 7

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FACT SHEET

Per Capita Tax Credit

The President's Proposal: A personal tax credit of $240 will be allowed for each taxpayer or dependent. An additional $240 credit will be allowed for taxpayers who are aged or blind.

Present Law: A personal exemption of $750 is allowed for the taxpayer and each dependent. An additional exemption is allowed for taxpayers who are aged or blind. Also, taxpayers are permitted a general tax credit of $35 per exemption, or 2 percent of taxable income up to a credit of $180, whichever is greater. (The personal exemption and general tax credit will be replaced by the proposed personal tax credit.)

Reasons for the Recommendation: A personal credit rather than a deduction for each exemption will reduce taxes by the same dollar amount for each family member regardless of a taxpayer's income.

The proposed credit and the rate schedule are designed to increase the progressivity of the tax system and to increase the level of income at which individuals first begin to pay taxes on their earnings.

The personal tax credit is an important step toward simplifying the tax system. Having both a credit which may be calculated in two different ways and an exemption is confusing and the source of many taxpayer errors. Assuming that either the existing exemption or the general credit should be eliminated, a credit is more consistent with other government programs. For example, per capita rebates of energy taxes can readily be added to the credit.

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Deductions for State and Local Taxes

The President's Proposal: The only state and local taxes that may be itemized as a personal deduction will be income and real property taxes.

Present Law: In addition to state and local income and real property taxes, deductions are currently allowed for sales, personal property and gasoline taxes, if a taxpayer itemizes personal deductions.

Reasons for the Recommendation: Eliminating sales, personal property and gasoline taxes as itemized deductions will simplify preparation of tax returns and reduce both record-keeping burdens and errors that result in costly and time-consuming audits of tax returns.

More taxpayers would take the standard deduction if there were fewer deductions to itemize. The proposal will not adversely affect the sales tax as a tool of state and local governments, since over three quarters of all taxpayers do not claim the deduction, and the tax benefit of the average deduction for those who do is not significant. The deduction for gasoline taxes runs counter to the country's energy goals. Both deductions complicate tax collection by generating substantial numbers of errors. There is no direct relationship between the amount of the deduction and the amount of taxes actually paid since most sales and gasoline tax deductions are determined from tables. Much the same result can be obtained by lowering tax rates and eliminating these deductions.

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Political Contributions

The President's Proposal:	The deduction for political contributions will be repealed, but the alternative credit will be retained.
Present Law:	Either an itemized deduction of up to \$200 or a credit of half of the first \$100 is allowable for political contributions on a joint return.
Reasons for the Recommendation:	These provisions provide a windfall for those who would contribute anyway. The deduction provides a larger benefit to high tax bracket contributors than to those in low tax brackets. The credit treats taxpayers at all income levels uniformly. Having the alternative of a credit or a deduction complicates tax returns and causes confusion.
Effect on Taxpayers:	Higher income taxpayers will obtain slightly less tax benefit from the first \$200 of their political contributions.
Effect on Revenue:	Tax liabilities will increase by less than \$5 million per year.

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Medical and Casualty Deductions

The President's Proposal:

Medical expenses and casualty losses will be deductible only to the extent that, when combined, they exceed 10 percent of adjusted gross income. Health insurance premiums and drug expenses will be treated like all other medical expenses. In addition, medical expenses will include only expenditures customarily made primarily for medical purposes.

Present Law:

If a taxpayer itemizes his or her personal deductions, 50 percent of the first $300 of health insurance premiums is fully deductible. Also deductible are medical expenses over 3 percent of adjusted gross income. Medicines and drugs over 1 percent of adjusted gross income and the remaining portion of health insurance premiums may be counted toward the 3 percent floor.

Uninsured casualty losses in excess of $100 are also deductible.

Reasons for the Recommendation:

This proposal will make the tax system simpler and fairer. Present law requires burdensome record-keeping, and complex regulations govern the specific items that are deductible. Both the medical and casualty loss deductions were originally intended to provide relief for extraordinary expenses which reduced the taxpayer's ability to pay.

The changing relationship between medical costs and income has resulted in many taxpayers deducting normal expenses. Similarly, many of the casualty losses under present law do not involve extraordinary losses which impair the taxpayer's ability to pay. Higher income taxpayers particularly are able to use the deductibility of casualty claims to self-insure through the tax system.

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FACT SHEET

Entertainment Expenses

The President's Proposal: Deductions will be totally disallowed for entertainment facilities such as yachts, hunting lodges, and club dues. Deductions for one-half the cost of meals now allowed as a business expense will be disallowed. Deductions for entertainment activities, such as the cost of tickets to theatre and sports events, will be disallowed.

Present Law: Relatively few restrictions are imposed by present law on the deductibility of entertainment expenses. Under present law, costs of country club memberships, lunches, dinners, world series or super bowl tickets, and vacation trips have all been claimed as deductions on the ground that such entertainment is ordinary and necessary in the taxpayer's business. While Congress in 1962 enacted some restrictions on entertainment deductions, the experience since then is that most of such entertainment is still being deducted. Thus, the cost of tickets to theatres and sports events is deductible under present law merely because the previous morning or the next day the parties talk business. The cost of meals eaten by people who happen to have business relationships are deductible even though no business is done or discussed.

Reasons for the Recommendation: As the tax law exists today, deductibility of entertainment expenses is an open invitation to charge personal expenses to Uncle Sam, to the detriment of the vast majority of taxpayers not able to

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Foreign Conventions

The President's Proposal: Expenses incurred to attend a convention, seminar, or other meeting held outside of the United States and possessions may not be claimed as a business expense deduction unless it is reasonable for the meeting to be held outside of the United States because of the composition of the membership or the specific purposes of the organization. For qualified foreign meetings the deductions allowed for subsistence may not exceed 125 percent of the government per diem for the area.

Present Law: In 1976, Congress provided that business expense deductions can be taken for no more than two foreign conventions per year. Deductions are not allowed unless the individual attends approximately two-thirds of the scheduled business activities of the convention and these activities must cover most of the time the individual is not in transit to or from the site. The time spent by the individual at the convention sessions must be verified (under oath) by a convention official. Also, the subsistence expenses for which deductions are taken cannot exceed the per diem rates which are available to Federal employees for government trips to the same locations. Finally, the deduction for transportation expenses outside of the United States cannot exceed the lowest coach, or economy, rate charged by a commercial airline.

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First Class Air Fare

The President's Proposal:	Deductions for first class air fare will be disallowed to the extent that they exceed coach fare for the same flight.
Present Law:	Except in the case of travel to foreign conventions, first class air fare is deductible if incurred in connection with the taxpayer's travel away from home on business.
Reasons for the Recommendation:	The proposal would make the tax system fairer. For most people, first class air fare is a luxury. Present law requires the many taxpayers who cannot afford first class fare for themselves to subsidize such travel by others. The additional personal comfort provided by first class accommodations is not necessary for the conduct of business. Both ends of the plane arrive at the same time.
Effect on Taxpayers:	Taxpayers who continue to use first class air fare will have to pay for the additional cost out of after-tax dollars.
Effect on Revenue:	This proposal will increase tax liabilities by $0.3 billion in calendar year 1979.

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FACT SHEET

Minimum Tax

The President's Proposal:

The provision that allows half of an individual taxpayer's regular tax liability to be deducted from preference income before the 15 percent minimum tax is imposed will be eliminated. Capital gain on the sale of a personal residence will not be subject to minimum tax. The minimum tax for corporations will not be changed.

Present Law:

A 15 percent minimum tax is imposed on certain preference income in excess of $10,000 or half of an individual's regular tax liability, whichever is greater. Preference income subject to the minimum tax includes income that would otherwise escape current taxation because of provisions which, for example, exclude from income one half of capital gains, permit accelerated depreciation on real estate, and allow deductions for depletion of minerals in excess of the amounts that would be allowed on the basis of cost.

Reasons for the Recommendation:

The proposal will make the tax system fairer, by raising the effective tax on those with substantial preference income. Tax preferences may serve a purpose in encouraging investment in some activity. However, they reflect adversely on the fairness of the tax system when they are used excessively by high income individuals to eliminate the tax on a substantial amount of their other income. The minimum tax serves to reduce this inequity. Under present law, however, two persons with equal amounts of tax preferences can pay vastly different amounts of

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Real Estate Depreciation

The President's Proposal:

Taxpayers generally will be required to base their depreciation deductions for buildings on the average depreciable lives now in use by all taxpayers as reported in surveys conducted by the Treasury. Deductions generally will be computed under the straight-line method. However, the 150 percent declining balance method will be permitted for new multi-family housing through 1982, when depreciation will be limited to the straight-line method. Low-income housing will be depreciated under the most accelerated methods through 1982 when it will be limited to the 150 percent declining balance method.

Present Law:

Each building owner claims depreciation based on his or her own estimate of the building's useful life under the facts and circumstances. Taxpayers are allowed depreciation deductions over these lives using the 200 percent declining balance method for new residential rental properties and the 150 percent declining balance method for new nonresidential properties. These accelerated methods permit taxpayers to recover their costs more rapidly than under the straight-line method.

Reasons for the Recommendation:

Depreciation claimed under existing methods is not uniform and clearly overstates the true decline in real estate value. The lack of uniformity favors sophisticated, high-income taxpayers.

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Tax Shelters

The President's Proposal:

The use of tax shelters to avoid or reduce income taxes will be restricted by:

-- extending to closely held corporations and to all activities except real estate the rule limiting losses that can be used to offset other taxable income to the amount the taxpayer actually has "at risk" in the activity;

-- treating as corporations for tax purposes limited partnerships with more than 15 limited partners, other than those primarily engaged in residential real estate;

-- authorizing the IRS to carry out tax audits of partnerships and to determine taxable income at the partnership level;

-- limiting the amount of tax liability which can be offset by the investment credit to 90 percent of tax liability;

-- imposing taxes currently on the earnings of most deferred annuities not purchased under qualified retirement plans.

Present Law:

Taxpayers continue to invest in tax shelters through loans for which they are not personally liable and deduct paper losses which exceed any actual losses that they might incur. A taxpayer is considered to be at risk to the extent of cash and other property the taxpayer contributes to the activity and also to the extent of any borrowings with respect to which the taxpayer has personal liability.

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Taxpayers seeking to avoid paying their fair share of the tax burden should not benefit from large limited partnerships that have the characteristics of corporations or from the difficulties in carrying out tax examinations of tax shelter activities. Allowing the IRS to audit partnerships as a distinct economic unit would result in more efficient and effective review of questionable tax shelters.

Taxpayers should not be able to use deferred annuities to avoid current taxation of regularly recurring investment income.

Effect on Taxpayers: Taxpayers, chiefly with high incomes, who are able to use tax shelters to avoid or reduce their tax payments, will pay higher taxes.

Effect on Revenue: These proposals will increase tax liabilities $0.1 billion in calendar year 1979, rising to $0.2 billion in 1983.

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FACT SHEET

<u>Capital Gains</u>

The President's Proposal:

Fifty percent of long-term capital gains will contine to be excluded from an individual taxpayer's taxable income, but the special 25 percent alternative tax on the first $50,000 of capital gains will be repealed.

Present Law:

One-half of a long-term capital gain is included in an individual's tax base (thus the effective rate of tax ranges from 7 to 35 percent). A special limit provides that $50,000 of these gains each year are not to be taxed at over 25 percent. A taxpayer in the 70 percent tax-bracket with $50,000 of capital gains can use the alternative tax to reduce his or her tax on the capital gains by nearly 30 percent of the capital gains tax otherwise due.

Reasons for the Recommendation:

The elimination of the 25 percent alternative tax on capital gains of up to $50,000 in any one year will end an unjustified benefit for taxpayers whose marginal tax rates exceed 50 percent -- single taxpayers with taxable incomes of more than $38,000 and married taxpayers filing a joint return with taxable incomes over $52,000. Thus, the proposal will make the tax treatment of capital gains more equitable without disturbing the favorable treatment of capital gains in general.

The alternative tax introduces significant additional complexity into an individual's tax planning and its repeal will simplify the tax laws.

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Medical, Disability, and Life Insurance

The President's Proposal:

The present tax exemption for premiums paid and benefits received under employer established health, accident and disability plans will continue to be given only for such plans which do not discriminate in favor of officers, shareholders, and higher paid employees. Tax-free status also will continue for employer-paid premiums on the first $50,000 of group life insurance coverage, but only if the plan which provides the coverage does not discriminate in favor of officers, shareholders, and higher paid employees.

Present Law:

Tax exemption is permitted for plans that discriminate against lower paid employees. Existing provisions of law, which will be retained for non-discriminatory plans, favor employer-paid coverage over insurance purchased by an individual. Premiums paid by an employer are deductible by the employer and are not recognized as income to the employee. The premiums paid by an individual for disability insurance and life insurance are not deductible by the individual and those for medical insurance are deductible only to a limited extent. Thus, individual premiums are generally paid out of taxable income, while employer-paid premiums are paid, in effect, with tax-free funds.

Reasons for the Recommendation:

The proposal will increase tax fairness by making tax incentives more effective in fostering the social objective of more comprehensive health, disability, and life insurance for Americans.

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FACT SHEET

Employee Death Benefits

The President's Proposal: The $5,000 employee death benefit exclusion will be repealed.

Present Law: The first $5,000 paid by an employer on account of the death of an employee is not included in taxable income.

Reasons for the Recommendation: Tax exemption is of greater benefit to those subject to tax at high marginal rates. Death benefit plans frequently discriminate in favor of officers, shareholders, and higher paid employees. The payments by employers that are covered by the current provision are typically deferred wages owed to high income taxpayers. There is no reason for favoring these high income employees and their heirs at the expense of other taxpayers.

Adequate tax relief for the heirs of employees at all income levels will continue to be provided through the tax exemption for insurance proceeds.

Effect on Taxpayers: The heirs of some taxpayers, chiefly people with high incomes, will pay higher taxes.

Effect on Revenue: This proposal will increase tax liabilities less than $50 million in calendar year 1979.

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FACT SHEET

Qualified Retirement Plans

The President's Proposal:

"Qualified" retirement plans will no longer be permitted to exclude entirely lower paid employees whose total wages are below the social security wage base. For every 1.8 percent in contributions or benefits provided under a retirement plan on compensation above the wage base, at least 1 percent in contributions or benefits will be required on compensation below the wage base.

Present Law:

"Qualified" retirement plans receive preferential tax treatment. Contributions for an employee and the earnings on them are not taxed until the employee receives these amounts, usually as pension benefits on retirement. Also, employer contributions to the plan are immediately tax deductible.

Qualified plans are not permitted to discriminate in favor of officers, shareholders or higher paid employees. But, under present law, the non-discrimination requirement can be met by a plan that is "integrated" with social security so that it provides no coverage for employees below the social security wage base. The wage base is the amount of wages or salary on which social security taxes are paid and benefits are calculated. It is set at $17,700 in 1978 and is scheduled to rise to $29,700 by 1981 with automatic inflation adjustments thereafter.

Reasons for the Recommendation:

Special tax treatment of qualified plans is justified because social security alone does not provide adequately for retirement. In view of this, lower paid employees should not be subject to exclusion from private pension plans on the ground that they are covered by social security.

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FACT SHEET

Unemployment Compensation Benefits

The President's Proposal:

Unemployment compensation benefits will be included in taxable income of taxpayers with income from all sources (including unemployment compensation) in excess of $20,000 if single or $25,000 if married. Fifty cents of unemployment compensation benefits will be included in taxable income for each dollar of total income in excess of $20,000 for single taxpayers and $25,000 for married taxpayers.

Present Law:

Unemployment compensation benefits paid under government programs are not now taxable.

Reasons for the Recommendation:

The exclusion of unemployment benefits is worth more to taxpayers in higher marginal tax brackets than to those in lower brackets. Thus, unemployment compensation is particularly attractive to those who work part of the year at high wages and pursue personal interests while drawing unemployment benefits in the remaining months. It is also attractive to those who have substantial property income, or have a spouse with earnings. Families and individuals with high income from all sources should be taxed on unemployment benefits. These benefits replace wages which are themselves taxable. Not taxing these benefits creates undesirable work disincentives.

Effect on Taxpayers:

Taxpayers receiving unemployment compensation benefits who have more than $20,000 of income (including unemployment compensation) if single, or $25,000 if married, will pay higher taxes.

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State and Local Taxable Bond Option

The President's Proposal: State and local governments will have the option of issuing either conventional tax-exempt bonds or taxable bonds which will receive a subsidy from the Treasury for a fixed percentage of their interest costs. The choice will be entirely a matter for the state or local government to decide. For 1979 and 1980, the Federal Government will pay 35 percent of the interest costs on taxable bonds issued by state and local governments. For bonds issued thereafter, the interest subsidy will be 40 percent of the interest costs.

Present Law: Interest payments received from debt obligations issued by state and local governments and their instrumentalities are exempt from Federal taxes. In contrast, all debt obligations issued by the Federal Government are subject to Federal income tax.

Reasons for the Recommendation: The proposal will make an important contribution to tax fairness and increased efficiency in the use of public resources.

The tax exemption of interest on state and local bonds is essential to local government and should not be interfered with in any way. At the same time the windfall to higher income persons who do not pay tax on such interest can be reduced.

The tax exemption on state and local bonds is also an inefficient means of aiding state and local governments, since less than three quarters of the tax loss to the Treasury actually accrues to state and local governments through

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FACT SHEET

Industrial Development Bonds

The President's Proposal:

Interest on industrial development bonds issued for pollution control and industrial parks will no longer be tax exempt. Also, bonds issued by state and local governments to finance hospital construction for private non-profit institutions will no longer be tax exempt unless there is a certification by the State that a new hospital is needed.

The size of projects which may be financed with tax exempt "small issues" of industrial development bonds will be increased from $5 million to $10 million, but the tax exemption will only be allowed for facilities constructed in economically distressed areas. Industrial development bonds that continue to qualify for tax exemption may be issued as taxable bonds with the Federal Government subsidizing 35 percent of the interest costs of taxable bonds issued in 1979 and 1980 and 40 percent of the interest costs of bonds issued thereafter.

Present Law:

Industrial development bonds are securities issued by state and local governments for the benefit of private borrowers. Under current law, interest on these bonds are tax exempt only in the following cases:

-- bonds issued to provide financing for certain facilities such as pollution control equipment, sports arenas and convention halls, airports and industrial parks;

-- small issues where the amount of the bonds sold does not exceed $1 million or the total capital expenses on the facility being financed do not exceed $5 million; and

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Effect on Taxpayers:	Restricting the use of tax exempt industrial development bonds will limit the amount of interest income which escapes taxation. It will also curtail the use of tax exempt financing by private borrowers.
Effect on Revenue:	This proposal will increase tax liabilities less than $50 million in calendar year 1979, rising to $0.3 billion in 1983.

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FACT SHEET

Accrual Accounting for Agricultural Corporations

The President's Proposal: All farm corporations will be required to use accrual accounting methods except those taxed like partnerships (Subchapter S Corporations) and those with less than $1 million of gross receipts. Noncorporate syndicates will also be required to use accrual accounting.

Present Law: The 1976 Tax Reform Act required accrual accounting methods for farm corporations except "family farms," regardless of size, which may use the cash method. A "family farm" is a corporation in which at least 50 percent of the stock is owned by members of the same family, including distant relatives. Farm syndicates were made subject to some, but not all, of the restrictions on use of the cash method. Prior to the 1976 Act, all farms generally could use the cash accounting method.

Reasons for the Recommendation: Apart from farming, the tax rules generally require taxpayers who sell products to report their income by the accrual method, and thereby accumulate their production costs in inventory until the product is sold. Cash accounting permits immediate deduction of expenses incurred whether or not the product is sold. Absentee, or non-active, farm owners have enjoyed unfair competitive advantages over the active farmer through this tax shelter, which permits them to claim artificial losses. This proposal will deal with the principal remaining tax shelters where "losses" from farm corporations or syndicates attributable to the treatment of capital costs and

Also, these provisions will lessen the incentives U.S. corporations now have to manipulate their international operations to avoid U.S. taxes.

The current tax laws and regulations relating to foreign corporations and international business transactions are so complicated that only the largest companies can afford the cost of sophisticated tax planning. This creates a definite competitive disadvantage for the smaller companies and those more oriented toward operations within the United States.

Effect on Taxpayers: The incentive for U.S. companies to invest in foreign countries simply because they provide special tax advantages will be greatly reduced. Generally, taxpayers will no longer be required to interpret the extremely difficult sections of the tax laws and regulations relating to foreign corporations.

Effect on Revenue: The proposed change will increase tax liabilities $0.1 billion in calendar year 1979, rising to $0.9 billion in calendar year 1983.

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FACT SHEET

Taxation of Financial Institutions

The President's Proposal:

Commercial banks will be required to base future additions to their bad debt reserves on their own actual experience in the current and 5 preceding years. In effect, this accelerates the transition rule enacted in 1969.

Mutual savings banks and savings and loan associations will be required to reduce their special bad debt deduction of 40 percent of net taxable income to 30 percent over a 5-year transition period.

Credit unions will be taxed on their income for the first time. After a 5-year transition period, they will be taxed on the same basis as savings and loan associations.

Present Law:

Commercial banks may claim a deduction for bad debts based on a fixed percentage of their eligible loans, regardless of their actual losses. The deduction is now at the level of 1.2 percent, and will drop to 0.6 percent in 1982. Not until 1988 will banks be required to base their bad debt deduction on actual loss experience.

Mutual savings banks and savings and loan associations which invest a significant portion of their deposits in real estate loans are entitled to a special deduction (known as an addition to a reserve for bad debts) equal to 41 percent of their taxable income in 1978. This deduction has been phased down from higher levels, and will phase down to a permanent level of 40 percent in 1979.

Credit unions are exempt from income tax.

that they are no longer truly mutual institutions with limited common bonds. Credit unions are most analogous to thrift institutions in the functions they perform and thus should be taxed on the same basis.

Effect on Taxpayers: The changes, by themselves, will increase the taxes paid by the affected financial institutions.

Effect on Revenue: These changes will increase tax liabilities $0.3 billion in calendar year 1979.

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FACT SHEET

Elimination of DISC

The President's Proposal: DISC tax benefits will be reduced by one-third in 1979, two-thirds in 1980, and 100 percent in 1981 and thereafter.

Present Law: U.S. corporations may defer tax on a portion of their export-related income by channeling it through a domestic subsidiary, usually a paper company, called a Domestic International Sales Corporation (DISC). Special pricing rules on transactions between the parent and its DISC permit a favorable allocation of profit to a DISC. Prior to 1976, the taxation of half of a DISC's income was deferred as long as these profits were invested in export-related assets. In 1976 the portion of the income eligible for deferral was further limited to income in excess of 67 percent of the company's average export income in a moving base period. The purpose was to limit the benefits to increased export activity and to deny them where the exports would clearly have occurred anyway.

Reasons for the Recommendation: DISC has turned out to be a far more costly and less effective program than originally claimed. There are more effective and evenhanded means of providing tax relief to business. A recent Treasury study indicates that DISC may have contributed only $1 billion to $3 billion to U.S. exports in 1974 (less than 3 percent of U.S. exports for that year) at a tax revenue cost of $1.2 billion. DISC was conceived as a means of reducing American export costs when exchange rates were fixed. Changes in flexible exchange rates now provide a far better means of adjusting to changes in the competitive position of U.S. exports.

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Terminating Deferral

The President's Proposal:

"Tax deferral" of earnings of U.S.-controlled foreign corporations will be phased out over a 3 year period by treating an appropriate fraction -- one-third in 1979, two-thirds in 1980, and the entire amount in 1981 and thereafter -- of a controlled foreign corporation's gross income, deductions, and taxes eligible for the foreign tax credit as having been earned or incurred directly by the U.S. shareholder. The earnings of a U.S.-controlled foreign corporation will be taxed currently whether or not those earnings are paid to the U.S. shareholders (usually parent companies) as dividends.

Foreign taxes in excess of the amounts that may be credited against U.S. taxes in any one year will be usable to offset U.S. taxes imposed for 3 years in the past. They may also be carried forward to offset U.S. taxes for 7 years in the future. (The carryback and carryforward periods are now 2 and 5 years respectively.)

U.S. shareholders will be allowed to claim losses incurred by their controlled foreign corporations.

Unrealized gains and losses, resulting from changes in the value of the U.S. dollar as compared to other currencies, will not be taken into account unless the U.S. shareholder elects. That election may be revoked 10 years after it is made with respect to future tax years only.

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FACT SHEET

Communication Taxes

The President's Proposal: The excise tax on communications -- chiefly telephone services -- will be repealed as of October 1, 1978.

Present Law: Amounts paid for telephone services and teletypewriter exchange services generally are subject to a communications excise tax. The rate for 1978 is 4 percent. Exemptions are provided for private communications services if they are charged for separately. The tax is being phased out by reducing the rate 1 percent a year through 1981.

Reasons for the Recommendation: Repeal of the tax will continue the comprehensive overhaul of the exicse tax system that began with the Excise Tax Reduction Act of 1965. It will reduce the cost of living both directly and by lowering business costs. The reduction of business costs, if passed through in the form of price cuts, will reduce inflation through lower consumer prices and through the effect of these lower prices on cost-of-living adjustments in wages. Repeal will be particularly beneficial to lower and middle income individuals who bear a disproportionate share of the present excise tax.

Effect on Taxpayers: Repeal will save individual telephone users about $650 million in 1979. Businesses will save about $550 million on their communication costs.

Effect on Revenue: This proposal will decrease tax liabilities $1.2 billion in calendar year 1979.

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FACT SHEET

Unemployment Tax Rate Reduction

The President's Proposal:

The Federal unemployment insurance tax will be reduced from 0.7 percent to 0.5 percent, effective January 1, 1979.

Present Law:

The unemployment compensation program is a Federal-state insurance system designed to provide temporary compensation for the loss of wages by unemployed workers. Funds accumulated from payroll taxes paid by the employer on the first $6,000 of earnings of each worker permit payment of benefits to unemployed insured workers.

To help defray the costs of Federal supplements to the regular unemployment compensation program, the net Federal tax was increased to 0.7 percent beginning January 1, 1977. That rate will continue until certain general revenue advances to the unemployment trust fund have been repaid. The tax rate would then revert to 0.5 percent.

Reasons for the Recommendation:

Reduction of the Federal employer payroll tax for unemployment insurance will assist in reducing inflation. The rate reduction will reduce employer wage costs, which, if passed through in the form of price cuts, will reduce inflation directly through lower consumer prices and, indirectly, as these lower prices work through cost-of-living-adjustment clauses to smaller wage increases.

The tax cut will be greatest, as a percent of wages for low-wage workers, thus partially offsetting the increased employer costs associated with recent minimum-wage legislation and increasing demand for low-skilled labor.

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FACT SHEET

Reduction of the Corporate Tax Rates

The President's Proposal:

The corporate tax rate on taxable income in excess of $50,000 will be reduced permanently by three percentage points to 45 percent effective October 1, 1978, with an additional reduction of one percentage point on January 1, 1980. The rate applied to the first $50,000 of taxable income will be reduced by two percentage points effective October 1, 1978.

Present Law:

The present corporate tax rates are 20 percent on the first $25,000 of taxable income, 22 percent on income in excess of $25,000 up to $50,000, and 48 percent on all income in excess of $50,000.

Reasons for the Recommendation:

These tax reductions, together with the extension of the investment credit, will assure the continuance and strengthening of the present economic recovery and will promote long-term capital formation. Increased capital formation can contribute both to economic demand needed for continued economic expansion and to increased productive capacity that will help avoid bottlenecks and inflationary pressures as the economy moves ahead.

The portion of GNP devoted to investment needs to be increased in the years ahead. Moreover, the efficient use of new capital needs to be assured. Additional jobs are needed for a growing labor force, to meet the goals of the National Energy Plan and to provide a cleaner environment and safer workplaces. The real income of workers can grow over the long run only if productivity is enhanced with new machinery and more efficient plants. Dependence on foreign oil can

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FACT SHEET

The Investment Credit

The President's Proposal:

The temporary 10 percent investment credit will be made permanent.

The investment credit will be extended to new industrial buildings and to investments made to rehabilitate existing industrial buildings. Generally only manufacturing and utility buildings will be eligible for the credit. Industrial structures placed in service after December 31, 1977 will be eligible for the credit to the extent of construction costs incurred after that date. Expenditures made after December 31, 1977 to rehabilitate existing industrial structures will be eligible for the credit.

Investment credits will be allowed to offset 90 percent of tax liability in any year. They will not be permitted to offset a taxpayer's complete tax liability.

The full 10 percent investment credit will be extended to pollution control equipment that now qualifies for the special 5-year amortization.

Present Law:

The 10 percent rate of the investment credit is scheduled to revert to 7 (4 for utilities) percent on January 1, 1981.

The investment credit is available for investment in business machinery and equipment but not for investment in buildings or their structural components.

Investment credits may be used to offset all of the first $25,000 of tax liability, but no more than 50 percent of the remainder.

caused by the need to distinguish between equipment, for which the credit is available, and buildings and their structural components, for which it is not.

New businesses and businesses facing temporary setbacks or the need to make major adjustments to economic changes cannot fully use the investment credit because of the 50 percent limit on offseting current tax liability.

Effect on Taxpayers:

The proposal will reduce the overall tax burden on business.

Increasing the percentage of tax liability that can be offset by investment credits to 90 percent will aid companies with large investment needs and relatively low taxable incomes.

Taxpayers with tax liabilities of less than $25,000 will no longer be able to use investment credits to offset their entire tax liability.

The increased investment credit for certain pollution control equipment will reduce the costs of compliance with environmental standards in the case of existing plants, many of which were constructed when pollution control standards were less stringent.

Effect on Revenue:

These proposals will reduce tax liabilities approximately $2.4 billion in calendar year 1979, the first full year of the proposed changes.

By 1983, it is estimated that the proposed changes will reduce tax liabilities $7.2 billion, of which $4.5 billion is attributable to permanent extension of the 10 percent credit.

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Fact Sheet 32

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FACT SHEET

Simplification of ADR

The President's Proposal:

The Asset Depreciation Range (ADR) system, which establishes procedures for taxpayers to depreciate their assets, will be simplified.

Salvage value will be disregarded under the revised system. Elaborate reporting requirements will be replaced by Treasury surveys which will require responses from only a small number of taxpayers each year. Only the straight-line and declining balance methods of depreciation will be allowed under ADR.

Present Law:

Under the ADR system, the IRS prescribes a range of guideline lives which taxpayers can use in setting the useful lives of their assets. Use of these lives by a taxpayer avoids disagreements between the taxpayer and IRS agents on audit as to what are the proper useful lives of the taxpayer's assets. Estimated salvage value in excess of 20 percent of cost limits the extent to which depreciation can be taken under ADR.

Taxpayers electing ADR are required each year to file detailed information about their assets.

Taxpayers electing ADR are permitted to use the sum of the years' digits, the 200 percent declining balance, and the straight-line methods of depreciation.

The ADR system, which was intended to simplify depreciation, occupies twenty pages in the printed regulations. Part of this length is due to the elections available to taxpayers in computing depreciation.

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Fact Sheet 33

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FACT SHEET

Small Business

The President's Proposal:

Taxes on small business will be reduced and the rules governing Subchapter S corporations, depreciation, and losses on investments in small businesses will be made simpler and more liberal.

Tax Cuts. Corporate tax rates will be reduced permanently to 18 percent on the first $25,000 of income, 20 percent on the next $25,000, and 44 percent (45 percent, from October 1978 through 1979) on any additional income. For example, if a small corporation makes $50,000 in 1979, it will pay only $9,500 in taxes, or almost 10 percent less than in 1977.

Subchapter S. A Subchapter S corporation will be allowed to have as many as 15 shareholders, and it will be easier for shareholders to deduct Subchapter S losses. Also some technical rules that now apply to Subchapter S corporations will be simplified.

Depreciation. A simple table of useful lives of equipment will be prepared for use by small business. The table will permit small businesses to take allowances for depreciation that are similar to those now available to larger businesses under the Asset Depreciation Range (ADR) system. These changes are in addition to a proposal that will simplify the ADR system for all businesses.

Stock in a Small Business. An exception in present law (section 1244 of the Internal Revenue Code) that treats a loss on certain stock in a small business

Stock in a Small Business. Generally, a loss on stock is a capital loss and is thus treated less favorably than an ordinary loss. However, an exception in present law (section 1244 of the Internal Revenue Code) treats a loss on certain stock in a small business as an ordinary loss.

Reasons for the Recommendation:

Economic Stimulus. Today, many small businesses badly need equity capital to modernize and expand. The largest source of equity capital for small businesses is retained earnings, or profits left over after taxes. Therefore, the proposal will allow small businesses to retain more earnings after taxes in order to assist them to modernize and expand.

In addition, the proposal will make it easier for small businesses to attract outside equity capital. An investor in a small business takes a great many risks. Change in technology and market conditions, larger competitors, and, in many cases, imports pose a continuing threat to the survival of a small business. These risks discourage potential investors and make it difficult for a small business to raise outside equity capital. The proposal will change the tax law so that if an investor loses money on stock in small business, it will be easier to deduct the loss. This change will reduce the risk of investment in a small business and therefore will make it easier for small businesses to attract outside equity capital. Small business will on balance benefit from the modifications of the investment credit.

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