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The President's 1978 Tax Program

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Detailed Descriptions and Supporting Analyses of the Proposals

DEPARTMENT OF THE TREASURY
Washington, D.C.

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The Need for a Tax Cut

To achieve the economic goals outlined in the President's Budget and Economic Messages, prompt, permanent tax reductions for both individuals and corporations are required. Such reductions are needed not because the U.S. economy is weak today, but rather to strengthen and maintain the current economic expansion, and to assure the future productivity of the economy. The unemployment rate has declined by more than two and a half points from its peak in 1975, but unemployment remains unacceptably high. To assure that it will continue to decline through 1979, the economy must continue to grow at a rate of 4-1/2 to 5 percent.

To maintain this growth rate will require a fiscal offset to the drain on consumer purchasing power from higher taxes and inflation. The outlook for future increases in consumption is dimmed by the recently legislated increases in social security taxes, which will reduce consumer take-home pay in 1978 and especially in 1979 and subsequent years. Furthermore, without personal tax reductions, inflation would operate to move individual taxpayers into higher marginal tax brackets, increasing their effective tax burden just as though higher rates had been enacted.

The tax cut is also designed to stimulate business investment. In recent years, the growth in the stock of productive capital in the United States has been inadequate. During the current recovery, the level of business investment has been particularly sluggish. Real business investment during the fourth quarter of 1977 was three percent below its previous peak (during the first quarter of 1974). This weakness was particularly noticeable in investment in non-residential structures which, during the fourth quarter of 1977 (corrected for inflation), remained 14 percent below its peak during the third quarter of 1973.

The sluggishness of business investment could become a major long-run problem. For the longer term, an increasing portion of GNP must be devoted to investment in order to facilitate the introduction of new technology and to expand and modernize the nation's stock of capital, thereby raising the overall productivity of the economy and reducing inflationary pressures. Additional capital is needed to equip a growing labor force, to meet the goals of the National Energy Plan, and to provide a cleaner environment and safer workplaces. In addition, the real income of workers can grow over the long run only if labor productivity is enhanced. Increased capital formation, which provides new and more efficient productive facilities, can help accelerate the growth of labor productivity, offsetting inflationary pressures and improving U.S. competitiveness in world markets.

Moreover, growth in the stock of capital must be accompanied by increased efficiency in its use. Much of the current capital stock is outmoded. It is energy intensive, predicated on the existence of cheap energy--something that will not occur again. Similarly, much of the existing capital was constructed when environmental standards were less stringent than they are today. The achievement of a more efficient capital stock will require high levels of new investment, which in turn requires a tax program that will assure adequate after-tax returns to capital.

Finally, the composition of the existing capital stock has been distorted by features of current tax law. For example, opportunities for tax-sheltered investments and more lightly-taxed investment abroad, as well as restrictions on the investment in industrial facilities eligible for the investment credit, all tend to discourage the most efficient allocation of capital resources. These tax impediments to an efficient overall stock of capital must be removed.

In a suitable fiscal environment, the private sector is capable of strong economic growth, but a tax cut is necessary at this time to ensure that the present expansion is not choked off by Federal taxes claiming a rising share of income. A balanced tax program is needed to strengthen and extend the current economic expansion in a non-inflationary way, to improve the capacity of the economy to supply goods and services, to increase real wages over time, and to insure that future growth is not aborted by capacity shortages. If the vigor of the current economic expansion is to be maintained and the unemployment rate is to be reduced below six percent, legislation must be enacted promptly.

The Proposals in General

The specific tax proposals will be discussed in detail below, but their general magnitude is presented in Table IA-1. Individual tax changes, reflecting primarily the $240 credit and the new individual rate schedules, will provide a gross tax cut for individuals of $23.5 billion in 1979 and,

Table IA-1

Summary of Tax Proposals
($ billions)

Proposal	Revenue Effect 1979
* Reduce Individual Tax Rates and Adopt $240 Personal Credit	-23.5
* Limit Itemized Deductions	+5.8
* Restrict Tax Shelters and Other Opportunities to Receive Tax-Preferred Income	+1.0
* Restrict Deductions for Entertainment and Travel Expenses . . .	+1.5
* Reduce Corporate Tax Rates	-6.0
* Liberalize Investment Tax Credit	-2.4
* Curtail Business Tax Preferences	+1.1
* Reduce Telephone Excise and Unemployment Taxes	-2.0
TOTAL	-24.5

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after allowing for revenue raising reforms, a net reduction in individual income tax liabilities of $16.8 billion. Corporate changes consist of rate reductions and liberalization of the investment credit. These cuts, together with business tax reforms, yield a net reduction of almost $6 billion in 1979. In addition, both businesses and individuals will derive benefits from the $2 billion reduction in telephone excise taxes and a reduction in the payroll tax for unemployment insurance.

While these measures will tend to increase the budget deficit during 1979, the stimulus to the economy, which will lead to higher levels of economic activity during 1979, should offset about 35 percent of the initial revenue loss by 1980. With the proposed tax cuts, the unemployment rate will continue to decline throughout the period.

The Personal Tax Proposals

The largest single aspect of the package, introduction of the $240 credit and reduction of the individual tax rates, will become effective October 1, 1978, while most of the reforms, which generally lead to revenue gains, become effective January 1, 1979. Thus, the net tax reduction for individuals during calendar 1978 will be slightly over $6 billion, increasing to almost to $17 billion by 1979. The phase-in of this stimulus is such that its impact will be felt primarily during late 1978 and 1979, when it will be most needed.

The Business Tax Proposals

The benefits to the economy from the individual tax cuts will be augmented by the business tax program. This program not only will provide the stimulus to regain full employment, but it will also correct the current imbalance between the growth of productive capacity and the growth of the labor force. In the long run, this program will operate to increase the share of national output devoted to expansion and modernization of the nation's capital stock. Thus, the business tax proposals are designed to achieve multiple objectives, while assuring the continued vigor of the national economy.

First, and of overriding importance, is the stimulation to capital formation both in the near future and over the longer term. A significant cause of the recent sluggishness in business investment has been the low after-tax rate of return on investment. There has been a downward trend in the rate of return on reproducible assets since the mid-1960's, a trend that must be reversed. To this end, corporate tax rates will be reduced as of October 1, 1978, and further reduced on January 1, 1980. The 10 percent investment tax credit will be made permanent, and will be extended to the construction or rehabilitation of industrial and utility structures. The full investment credit also will be extended to all pollution abatement facilities currently amortized over five years with a five percent credit. In addition, investors will be permitted to use these credits to offset 90 percent of tax liability in any year. Effective as of the first of January 1978, these liberalizations of the credit together with the corporate rate cuts will have a substantial impact on business investment beginning in 1978, an impact that will grow in 1979 and thereafter.

These tax reductions will stimulate capital formation in two ways. First, the lower taxes will have an immediate, favorable effect on corporate cash flow, facilitating the financing of capital expenditures. Second, the lower tax rates will increase after-tax profits on investment, creating incentives for corporations to increase capital spending. While there are substantial delays in the response of capital expenditures to stimulative measures, prompt enactment of this tax program should induce increased investment spending even during the current calendar year.

The degree of permanent investment stimulus in the program may be measured by the overall reduction in tax on returns from all investment, including the reductions in individual tax rates as they apply to dividends, interest, rents, royalties, capital gains, and profit of noncorporate enterprises. Even after allowances for revenue raising reforms, there will be a significant reduction in overall taxation of income from ownership of capital. 1/ As measured at 1979 levels of income, the entire tax program, when fully phased in, will reduce taxes on capital income by an estimated $7.3 billion. The elements of the program included in this estimate are set forth in Table IA-2. The table discloses that the combined amounts of individual and corporate rate reductions and liberalization of the investment credit will substantially outweigh selective tax increases from business reforms. This permanent, net reduction in taxes on investment income will provide a lasting incentive to capital formation.

It is equally important that the increase in aggregate capital spending be allocated in an efficient way. Efforts must therefore be made to reduce incentives in the tax system that give rise to inefficiencies in the allocation of capital. The restructuring of the investment credit and a number of the reforms in the business tax proposals are directed toward this goal.

Table IA-2

Change in Tax on Capital Income

($ millions)

Proposal	Full Year 1979
Individual rate reductions, $240 credit, and itemized deductions (capital income only) 1/	-1,832
Repeal alternate tax for individuals	140
Minimum tax change	284
Real estate shelters	666
Financial Institutions	224
Taxable bond option	257
Tax credits limited to 90 percent of individual liability	52
At risk limitation	13
Elimination of deferral of tax on foreign source income	660
Phase out of DISC	1,032
Corporate family farm accounting	35
Investment tax credit:	
Extend to structures	-1,443
Increase liability limit to 90 percent	- 84
Pollution abatement facilities	- 120
Corporate tax rate reductions	-7,203
Total for capital income	-7,319

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1/ Capital income items are: dividends, interest, rents, royalties, capital gains, proprietorship, and partnership income.

For example, the investment credit currently applies to industrial equipment, but not to the buildings needed to house that equipment. Thus, the tax system encourages businesses to build a capital stock that is "over-equipped" and "under-housed" relative to what it would be under a more neutral tax system. Extending the credit to industrial structures will eliminate this bias.

Other efficiency losses stem from variations in the tax rates paid by different industries. Such variations occur because of the very different way in which different forms of business income are taxed. The present tax proposals seek to encourage a more efficient allocation of capital resources by reducing the tax incentives that distort investment decisions. This would be accomplished by making effective business tax rates more equal through repeal of some special provisions for taxing business income. These include the phase-out of DISC, the elimination of tax deferral on foreign source income, changes in provisions for bad debt reserves by financial institutions, and increasing the taxation of tax shelters and other tax preference items.

Overall Impact of the Tax Program

In the absence of this tax program, the share of the nation's output going to the Federal government will continue to rise. The Social Security tax increases, the unemployment insurance tax increases, and the "inflation tax" increases would mean that in fiscal year 1979, Federal receipts would be equal to 20.4 percent of GNP. The Administration's tax program would reduce this share to 19.3 percent.

A similar pattern is reflected in individual income taxes as a percent of personal income. Under current law, this ratio would rise to 10.7 percent in calendar year 1978 and 11.4 percent in 1979--close to its historic high (11.6 percent in 1969). The Administration's tax program will reduce these ratios to 10.3 percent and 10.5 percent, respectively, thus working to offset the fiscal drag on the economy.

While the impact of the entire tax package on the performance of the economy will be modest in 1978, it will become significant in 1979. In the absence of the tax package, we would expect the unemployment rate to remain steady at 6.3 percent or move slightly upwards. The tax stimulus will increase output by $40 billion by the end of 1979, creating one million more jobs and reducing the rate of unemployment below six percent. Forecasting the performance of the economy beyond 1979 is hazardous, but it seems clear that, in the absence of the tax package, there would be further softening of the economy, while with the tax package the economy will continue to expand.

Such economic stimulus is not entirely without cost: while the rate of inflation will continue to decline each year, it would decline more rapidly in the absence of the stimulus. In proposing this package, the Administration has made the judgment that the production of an additional $40 billion of goods and services (in 1977 prices) and the creation of almost a million new jobs is worth the risk of an extra one-tenth of one percent in the inflation rate at the end of 1979.

The tax program is thus a key element in the Administration's overall economic plan, which relies principally upon growth in the private sector to create the jobs needed to achieve high employment. The tax program is designed to offset such fiscal changes as the "inflation tax" and increased social security taxes that would otherwise tend to limit economic growth. It will reform our present system in order to achieve greater equity and simplification. The tax program will also raise the rate of return on investment, to stimulate expansion and modernization of our capital stock, increasing employment in the short run and raising productivity and removing capacity bottlenecks in the future. At the same time, the tax program avoids excessive stimulation, for potential inflationary pressures are still present in the economy. The reductions in the telephone excise tax and the unemployment insurance tax work directly against such pressures by reducing the cost of output. Other aspects of the Administration's economic program will also help in restraining inflation, most notably the expenditure restraint contained in the fiscal year 1979 Budget and the program for voluntary wage and price restraint. Taken together, all these programs will enable the U.S. economy to enjoy steady, sustainable, non-inflationary economic growth.

Footnote

1/ Regardless of whether the tax on capital income is paid by corporations or individuals.

INCREASED EQUITY ACHIEVED BY THE TAX PROGRAM

One important goal of the Administration's tax proposals is to restructure the law to increase the extent to which it reflects the two basic principles of tax fairness. The first principle, generally referred to as horizontal equity, is that people with comparable incomes should pay a comparable amount of tax. The second principle, vertical equity, is that tax liabilities should increase with increasing ability to pay; that is, the tax system should be progressive. Although other objectives of the income tax system may at times come into conflict with the principles of equity, our income tax structure -- if it is to be maintained -- must rest on this foundation.

Effective administration of our income tax depends upon the perception by taxpayers that the system is basically equitable. If honest citizens begin to doubt the equity or fairness of the system, the level of voluntary compliance will be diminished. Therefore, when taxpayers with an equal ability to pay are taxed at vastly different rates, or when higher income taxpayers are taxed at lower rates than lower income taxpayers, the viability of our income tax system becomes threatened.

Vertical Equity

Progressivity. The income tax has always been designed to be progressive, so that higher income individuals are to pay a larger share of their incomes in tax than lower income individuals. The Administration's tax proposals would reinforce the current progressivity of the income tax. The proposals are structured to give the lowest income classes the greatest percentage reductions in tax liability, the next greatest reductions to the middle income classes, and the smallest reductions to the upper income classes. In fact, the average taxpayer with an expanded income 1/ of $100,000 or more will have a slight tax increase. As a result, as shown in Table IB - 1, taxpayers with expanded income of up to $30,000 will bear a smaller proportion of the total tax burden, while those with expanded income of $30,000 or more will bear a greater proportion.

This increase in progressivity will be accomplished through replacement of the personal exemption with a personal credit and a restructuring of the tax rates. In addition, the proposals to provide further limits on tax shelters, to treat interest income from annuities the same as other

Table IB-1

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

(1976 Levels of Income)

Expanded Income Class	Present Law		Administration Proposal		Tax Change	
	Tax Liability	Percentage Distribution	Tax Liability	Percentage Distribution	Tax Liability	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%

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Office of Tax Analysis

January 15, 1978

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

interest income, to repeal the alternative tax on capital gains and to tighten the minimum tax will enhance the equity of the tax system by restricting the extent to which individuals can lower their tax merely by the choice of their investments. The taxable bond option will reduce the extent to which high-bracket taxpayers can increase their after-tax income by holding tax-exempt bonds.

Chart IB-1 and Table IB-2 below, provide a comparison of effective tax rates under present law and the Administration's proposal.

Tax Reform and Poverty Levels. A major equity objective of reform of the individual income tax is the elimination of any income tax upon people whose incomes are at or near poverty levels. Since poverty level income is sufficient to purchase only minimum amounts of food, shelter, and other necessities, imposition of income tax on income below these levels is inappropriate.

The tax-free level of income is defined to be the maximum level of adjusted gross income at which no income tax is paid by a taxpayer who does not itemize deductions. The tax-free level is determined by the combination of personal exemptions, personal credits, and the zero bracket amount (or standard deduction) 2/.

In recent years, the tax-free level of income has been increased primarily through increases in the size of a minimum standard deduction. Under the tax proposals, the tax-free level will rise primarily from the change of the personal exemption to the personal credit.

Raising the tax-free levels of income also serves to limit the overlap of the income tax system with the welfare system. Under most welfare programs, there is a phase-out of benefits as income rises. If welfare benefits are reduced at the same level that income is taxed, a wage earner can face a situation where he can keep little if anything from an additional dollar of earned income. Therefore, to avoid strong disincentives to work at low income levels, it is desirable that tax-free levels of income be set high enough to prevent a dollar of increased earned income from causing both a reduction in welfare assistance and an increase in income tax liability.

A comparison of the tax-free levels of income and poverty levels is presented in Table IB - 3. Under the Administration's tax proposals the tax-free level of income would rise substantially above the poverty level for 1979.

It should be noted that the poverty level is defined in terms of total income, while the tax-free level of income is defined in terms of adjusted gross income for a taxpayer who

CHART I-B-1

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

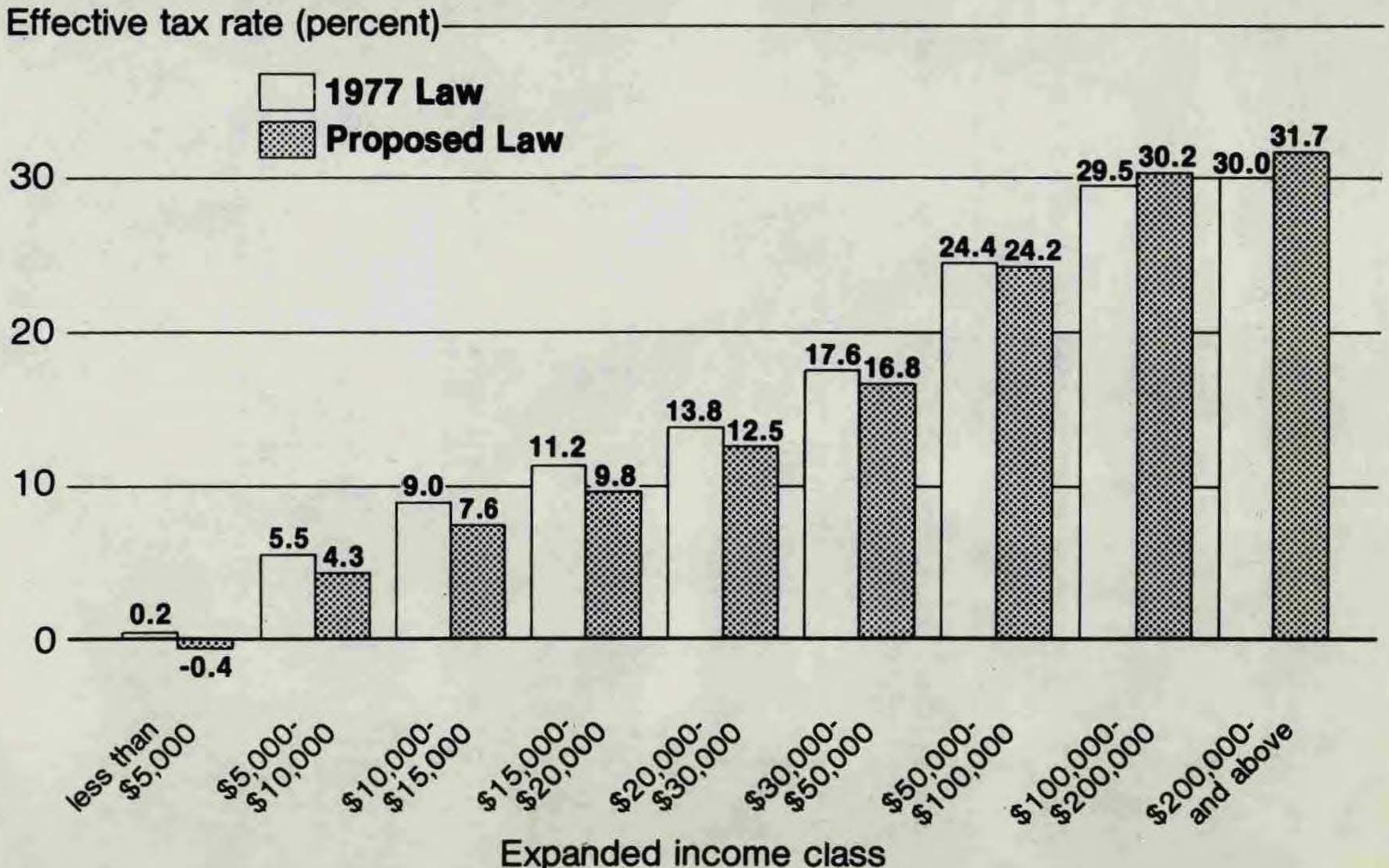

Table IB-2

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

(1976 Levels of Income)

($ millions)

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

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Office of Tax Analysis

January 12, 1978

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

TABLE IB-3

Tax-Exempt and Poverty Levels

Of Income

Family Size 1/	Tax-Exempt Levels of Income Under Current Law 2/	Tax-Exempt Levels of Income Under Proposal 2/	1979 Poverty Levels 3/
1	3,200	3,967	3,449
2	5,200	6,553	4,438
3	6,200	7,922	5,429
4	7,200	9,256	6,954
5	8,183	10,589	8,223
6	9,167	11,884	9,280

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Office of Tax Analysis

Jan. 26, 1978

1/ Family size assumed to equal number of exemptions. For family sizes greater than two, families are assumed to file joint returns and be two parent families.
2/ Excludes Earned Income Credit.
3/ Non-farm families.

does not itemize and does not receive additional credits because of age or blindness. Thus, for some taxpayers, the tax-free level of income may be higher than the numbers reported in the table. This higher level may be the result of nontaxable income such as social security payments, extra credits, additional exemptions for age and blindness, or itemized deducions in excess of the zero bracket amount.

Employee Benefits -- Employer programs designed to provide retirement income to employees or to provide protection in the event of illness, death or disability receive favorable tax treatment. The President's proposals relating to qualified retirement plans and Social Security and medical, disability and life insurance provided by the employer will assure that a greater portion of the benefits from these plans will inure to rank and file employees.

Horizontal Equity -- Equal Incomes, Equal Tax

The tax proposals are also designed to move in the direction of equalizing the tax treatment of taxpayers with an equal ability to pay. The tax reform proposals previously described will reduce the disparity in tax treatment arising from choice of investment. Also, the President's proposal relating to entertainment benefits will tend to equalize the tax burden between those who are able to arrange their business activities so as to enjoy entertainment which is deductible and those who must provide these amenities out of after-tax dollars.

Finally, for taxpayers with over $20,000 of income if single and over $25,000 of income if married, at least some portion of their unemployment benefits will be taxed. These taxpayers with unemployment benefits will, therefore, be taxed more like other taxpayers at a comparable income level whose income is from other sources.

Footnotes

1/ As used here, the term "expanded income" is generally a taxpayer's adjusted gross income plus items of tax preference (not otherwise included in adjusted gross income).

2/ Before the Tax Reduction and Simplification Act of 1977, there was no zero bracket amount but rather a minimum standard deduction (low income allowance).

SIMPLIFICATION ACHIEVED BY THE TAX PROGRAM

In our tax system, equity and public policy goals often conflict with the desire to achieve simplicity. Many deductions and credits are allowed in order to further public policies; however, government spending via the tax system invariably adds complexity to the tax laws. In many cases, factual situations are distinguishable and arguably ought to be taxed differently in the interest of equity. However, the more distinctions which the tax system recognizes, the more complicated it becomes and the more difficult it is to determine tax liability in even the most ordinary situations.

Some complexity in our tax laws cannot be avoided since the law must reflect the enormous complexity and vitality of the American economy. It is essential to our system of self-assessment, however, that the law be understandable to the people to whom it applies. At the present time even routine applications of the tax laws frequently are not understood. Our tax laws must be made simpler, especially for the average taxpayer who does not have access to high priced professional counsel.

The President's proposals include important steps toward simplification, without sacrificing equity. For both individual and business taxpayers, the proposals will reduce the amount of time and energy spent on recordkeeping and tax computation. They will also reduce the frequency of disputes between taxpayers and the Internal Revenue Service. For individuals the most significant gain in simplification is that about 6 million individual taxpayers will be able to determine their tax liability without itemizing deductions. Even those who continue to itemize will be required to keep fewer records and to make fewer and easier calculations.

These proposals continue the Administration's efforts toward simplification which began with the Tax Reduction and Simplification Act of 1977. That Act provided a flat standard deduction (now called the "zero bracket amount"). The Act also provided new tax tables that 95 percent of all taxpayers are able to use. These taxpayers no longer are required to make separate calculations for the standard deduction, personal exemptions, or the very complicated general tax credit.

The proposals which will simplify the tax laws are as follows:

Itemized Deductions

Under the proposals, certain itemized deductions will be reduced or eliminated. This will make it easier for individuals to prepare their own tax returns, eliminate much recordkeeping, and reduce audit and administrative burdens on both taxpayers and the Internal Revenue Service.

The itemized deductions for state and local general sales taxes, personal property taxes and gasoline taxes will be repealed. Also the deductions for medical expenses and casualty losses will be combined into one "extraordinary expense" deduction which will be available only to the extent that these expenses exceed 10 percent of adjusted gross income. This proposal will eliminate the need for taxpayers to compile and retain detailed records unless their medical expenses and casualty losses are unusually large and seriously impair their ability to pay taxes. It will also eliminate many disputes between taxpayers and the IRS over the nature of medical expenses and the extent of casualty losses.

Reductions in tax rates applicable to individuals will substantially offset increases in tax liabilities which would otherwise result from these changes in the treatment of itemized deductions. Since these expenses are incurred in a relatively uniform manner, they can be reflected in the structure of tax rates.

Capital Gains

Generally, the Internal Revenue Code permits an individual taxpayer to deduct 50 percent of any net long-term capital gain from adjusted gross income. However, a special rule applies to the first $50,000 of net long-term capital gain realized in any one year. Instead of paying regular tax on one-half the gain, the individual taxpayer may elect to pay a 25 percent "alternative tax" on the entire gain up to $50,000. A taxpayer who does so may not utilize the averaging provisions of the Code. Therefore, two sets of calculations are required by taxpayers to minimize tax liability -- one based on the alternative tax and no averaging and one based on averaging but no alternative tax. Repeal of the alternative tax will simplify treatment of capital gains and computation of tax.

Political Contributions

The Internal Revenue Code now permits an itemized deduction for up to $200 of political contributions by a married couple filing jointly. As an alternative, a credit against tax of half of the first $100 of political contributions is permitted. To treat political contributions more equitably and to eliminate the complexity which results from an alternative deduction or credit, the deduction for political contributions will be repealed. Also, this will permit the tax return form to be shortened.

Personal Credit

The replacement of both the personal exemption and the general tax credit by a $240 personal credit represents an important conceptual simplification.

Small Business

Complexities in the tax law are especially burdensome for small businesses. Computation of the depreciation deduction is a particular source of complexity. In computing the deduction for depreciation, small businesses are now required to estimate the useful life of property. These estimates often provoke disputes with the IRS. To prevent these disputes from arising, the IRS will prepare for use by small businesses a simple table to determine the useful life of property.

Salvage value is another source of unnecessary complexity. The burdensome calculations have little practical effect on the depreciation deductions allowed. The proposal will permit small businesses to disregard salvage value if the table lives are used.

Losses on the sale of stock of certain small corporations can offset ordinary income. Under present law this beneficial treatment is available only if the taxpayer complies with complicated procedures when the stock is offered. Many taxpayers fail to receive this beneficial treatment because they are unaware that these procedures exist. Under the proposal this special treatment will be made automatic.

The ADR System

The Asset Depreciation Range (ADR) system, an optional method for computing depreciation, is designed to minimize disputes between taxpayers and the IRS. However, many taxpayers have not been able to use the ADR system because it is complicated and imposes burdensome reporting requirements. Several technical changes are proposed to simplify the ADR system, including replacing the current reporting requirements with a survey of sample taxpayers.

Real Estate

The ADR system generally does not apply to real estate. As a substitute for the ADR system, a simple table for use in computing depreciation of real estate will be provided. This will eliminate disputes between taxpayers and the IRS over the useful life of buildings.

Investment Credit

The proposed extension of the investment credit to industrial and utility structures will reduce disputes between taxpayers and the IRS caused by the need under current law to distinguish between two categories of equipment since equipment which is a structural component of a building is not eligible for the credit. Although it will be necessary to distinguish between industrial and other structures, this should be a simpler line to draw. Also, the expansion from 50 percent to 90 percent of the amount of tax liability that may be offset by an investment credit will reduce the need for taxpayers to use complicated carryover provisions or to engage in lease arrangements.

Deferral and DISC

The proposed phase-out of the deferral of income of controlled foreign subsidiaries and the DISC provision will eliminate some of the most complex provisions of the Code and reduce the circumstances where other little-understood rules must be applied.

Travel and Entertainment Expenses

The elimination of deductions for entertainment expenses such as theater tickets, yachts, and hunting lodges will reduce recordkeeping requirements and eliminate a source of taxpayer disputes. The proposed rules regarding expenses of attending foreign conventions will eliminate burdensome recordkeeping resulting from the 1976 Act's partial solution to the problem of vacations disguised as business-related conventions.

Ordering of Credits

The proposal will simplify the treatment of tax credits. Under present law, some credits can be taken against certain special taxes such as the minimum tax, but others cannot. The proposal will provide a uniform base for all credits.