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ANALYSIS OF THE HOUSE VERSION OF THE TAX REDUCTION ACT OF 1975 (H.R. 2166) AND POSSIBLE ALTERNATIVES

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE

BY THE STAFF OF THE

JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

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CONTENTS

		Page
I.	The current economic situation	1
	Some factors contributing to the current recession	5
	The outlook without a tax cut	6
II.	Summary of administration proposal and House bill	8
III.	Economic effect of an individual income tax reduction	10
IV.	Duration of the tax reduction	12
V.	Size of the tax reduction	14
VI.	Distribution of the tax reduction	18
VII.	Alternative ways to reduce individual income taxes	20
	A. Tax refunds for 1974 tax liability	20
	B. Changes in the standard deduction	30
	C. Earned income credits	32
	D. Optional tax credit in place of the personal exemption	34
	E. Rate reduction	36
	F. Increases in the personal exemption	40
	G. Tax credits for purchases of durable goods	41
VIII.	Alternative ways to reduce corporate taxes	44
	A. Increase in investment tax credit	44
	B. Corporate tax rate reductions	49
	C. Net operating loss carrybacks and carryovers	51
IX.	Repeal of percentage depletion for oil and gas	54

I. THE CURRENT ECONOMIC SITUATION

The year 1974 was marked by both inflation and recession. After moving ahead vigorously since the close of 1970, output and employment moved downward during the year while prices continued to rise sharply.

In 1974, real gross national product (that is, GNP in constant prices) registered the largest annual decline since 1946. (See table 1.) For the year as a whole, money GNP rose to $1,397 billion—7.9 percent over 1973, but this increase merely reflected higher prices. After taking into consideration a 10.3-percent increase in prices (as measured by the GNP implicit price deflator which is the broadest measure of inflation), real GNP fell 2.2 percent. The decline in output and the rise in prices was especially marked in the fourth quarter of 1974 when real GNP fell at an annual rate of 9.1 percent and prices rose at a rate of 14.4 percent.

TABLE 1.—GROSS NATIONAL PRODUCT 1929–74

[In billions of dollars]

Year	Gross national product in current dollars	Gross national product in 1958 dollars	Year	Gross national product in current dollars	Gross national product in 1958 dollars
1929	103.1	203.6	1956	419.2	446.1
1933	55.6	141.5	1957	441.1	452.5
1939	90.5	209.4	1958	447.3	447.3
1940	99.7	227.2	1959	483.7	475.9
1941	124.5	263.7	1960	503.7	487.7
1942	157.9	297.8	1961	520.1	497.2
1943	191.6	337.1	1962	560.3	529.8
1944	210.1	361.3	1963	590.5	551.0
1945	211.9	355.2	1964	632.4	581.1
1946	208.5	312.6	1965	684.9	617.8
1947	231.3	309.9	1966	749.9	658.1
1948	257.6	323.7	1967	793.9	675.2
1949	256.5	324.1	1968	864.2	706.6
1950	284.8	355.3	1969	930.3	725.6
1951	328.4	383.4	1970	977.1	722.5
1952	345.5	395.1	1971	1,054.9	746.3
1953	364.6	412.8	1972	1,158.0	792.5
1954	364.8	407.0	1973	1,294.9	839.2
1955	398.0	438.0	1974 p	1,397.3	821.1

p=preliminary.

Source: Department of Commerce.

The falling GNP figures for 1974 reflect widespread declines in both consumption and investment. Instead of registering their customary gains, personal consumption expenditures (measured in constant 1958 dollars) for both durable and nondurable goods fell. The decline was particularly sharp for durable goods expenditures which dropped almost 9 percent for the year. About 8.9 million new cars were sold during the year—22 percent less than in 1973. The leading reasons for the weakness in consumer expenditures were falling disposable income, inflation, and lack of consumer confidence.

In contrast with 1973, when it rose 10 percent, real gross private investment fell 8.2 percent in 1974. Housing starts totaled only 1.4

million compared with 2.4 million in 1972 and 2.1 million in 1973. By January 1975, housing starts were running at an annual rate of well under 1 million.

As the economic situation deteriorated, unemployment rates rose—from 5.2 percent in January 1974 to 8.2 percent in February 1975. This compared with average unemployment rates of 4.9 percent in 1973, 5.6 percent in 1972, 5.9 percent in 1971, and rates averaging 3.8 percent or less from 1966 through 1969. The February unemployment rate was the highest since 1941. In addition, discouraged workers have withdrawn from the labor force (and are not counted as unemployed in the statistics) and employed workers have been forced to reduce their hours.

Despite the recession during the year, the consumer price index was 12.2 percent higher at the end of 1974 than at the start of the year. This was the highest rate of increase since 1946 when the index shot up 18.2 percent, reflecting the removal of wartime price controls. (However, for December 1974, the increase in the consumer price index declined to an annual rate of 8.4 percent.) Although the wholesale price index dropped slightly in December, for the year as a whole it rose even faster than the consumer price index, shooting up 23.5 percent.

Interest rates rose during most of the year, but declined toward the latter part of the year. Short-term rates have fallen considerably, but long-term rates are now still at high levels, reflecting anticipations of continuing inflation. In March 1975, the prime rate fell to 7¾ percent after having reached 12 percent in 1974. As of the end of January, the Treasury bill rate (91 days—new issues) was 5.61 percent, long-term government bonds yielded 6.67 percent and AAA corporate bonds 8.74 percent. (See tables 2 and 3.)

Corporate profits for 1974 were high in money terms, totaling $141.0 billion before taxes. However, $35.6 billion of these profits were due to the effect of higher prices in raising inventory values. After the inventory valuation adjustment, profits amounted to $105.4 billion, about the same as profits in 1973 but higher than profits of $78.7 billion in 1971 and $92.2 billion in 1972. Most analysts anticipate a substantial decline in corporate profits in 1975.

TABLE 2.—MONEY MARKET RATES

[Percent per annum]

Period	Prime commercial paper [1]		Finance company paper placed directly, 3 to 6 months [2]	Prime bankers acceptances, 90 days [1]	Federal funds rate [3]	U.S. Government securities [4]						
						3-month bills [5]		6-month bills [5]		9- to 12-month issues		
	90 to 119 days	4 to 6 months				Rate on new issue	Market yield	Rate on new issue	Market yield	1-year bill (market yield) [5]	Other [6]	3- to 5-year issues [6]
1967		5.10	4.89	4.75	4.22	4.321	4.29	4.630	4.61	4.71	4.84	5.07
1968		5.90	5.69	5.75	5.66	5.339	5.34	5.470	5.47	5.46	5.62	5.59
1969		7.83	7.16	7.61	8.21	6.677	6.67	6.853	6.86	6.79	7.06	6.85
1970		7.72	7.23	7.31	7.17	6.458	6.39	6.562	6.51	6.49	6.90	7.37
1971		5.11	4.91	4.85	4.66	4.348	4.33	4.511	4.52	4.67	4.75	5.77
1972	4.66	4.69	4.52	4.47	4.44	4.071	4.07	4.466	4.49	4.77	4.86	5.85
1973	8.20	8.15	7.40	8.08	8.74	7.041	7.03	7.178	7.20	7.01	7.30	6.92
1974:												
Jan	8.86	8.66	7.92	8.72	9.65	7.755	7.77	7.627	7.65	7.01	7.46	6.94
Feb	8.00	7.82	7.40	7.83	8.97	7.060	7.12	6.874	6.96	6.51	6.93	6.77
Mar	8.64	8.42	7.76	8.43	9.35	7.986	7.96	7.829	7.83	7.34	7.86	7.33
Apr	9.92	9.79	8.43	9.61	10.51	8.229	8.33	8.171	8.32	8.08	8.66	7.99
May	10.82	10.62	8.94	10.68	11.31	8.430	8.23	8.496	8.40	8.21	8.78	8.24
June	11.18	10.96	9.00	10.79	11.93	8.145	7.90	8.232	8.12	8.16	8.71	8.14
July	11.93	11.72	9.00	11.88	12.92	7.752	7.55	8.028	7.94	8.04	8.89	8.39
Aug	11.79	11.65	9.31	12.08	12.01	8.744	8.96	8.853	9.11	8.88	9.54	8.64
Sept	11.36	11.23	9.41	11.06	11.34	8.363	8.06	8.599	8.53	8.52	8.95	8.38
Oct	9.55	9.36	9.03	9.34	10.06	7.244	7.46	7.559	7.74	7.59	8.04	7.98
Nov	8.95	8.81	8.50	9.03	9.45	7.585	7.47	7.551	7.52	7.29	7.67	7.65
Dec	9.18	8.98	8.50	9.19	8.53	7.179	7.15	7.091	7.11	6.79	7.33	7.22
1975:												
Jan	7.39	7.30	7.31	7.54	7.13	6.493	6.26	6.525	6.36	6.27	6.74	7.29

[1] Beginning Aug. 14, 1974, the rate is the average of the midpoint of the range of daily dealer closing rates offered for domestic issues; prior data are averages of the most representative daily offering rate quoted by dealers.

[2] Averages of the most representative daily offering rate published by finance companies, for varying maturities in the 90- to 179-day range.

[3] 7-day averages for week ending Wednesday. Beginning with statement week ending July 25, 1973, weekly averages are based on the daily average of the range of rates on a given day weighted by the volume of transactions at these rates. For earlier statement weeks, the averages were based on the daily effective rate—the rate considered most representative of the day's transactions, usually the one at which most transactions occurred.

[4] Except for new bill issues, yields are averages computed from daily closing bid prices.

[5] Bills quoted on bank-discount-rate basis.

[6] Selected note and bond issues.

Note: Figures for Treasury bills are the revised series described on p. A–35 of the October 1972 Bulletin.

Source: "Federal Reserve Bulletin," February 1974.

TABLE 3.—BOND YIELDS

[Percent per annum]

Period	Government bonds				Corporate bonds							
							Seasoned issues					
		State and local			Aaa utility			By selected rating		By group		
	United States (long term)	Total [1]	Aaa	Baa	New issue	Recently offered	Total [1]	Aaa	Baa	Industrial	Railroad	Public utility
1970	6.59	6.42	6.12	6.75	8.68	8.71	8.51	8.04	9.11	8.26	8.77	8.68
1971	5.74	5.62	5.22	5.89	7.62	7.66	7.94	7.39	8.56	7.57	8.38	8.13
1972	5.63	5.30	5.04	5.60	7.31	7.34	7.63	7.21	8.16	7.35	7.99	7.74
1973	6.30	5.22	4.99	5.49	7.74	7.75	7.80	7.44	8.24	7.60	8.12	7.83
1974:												
January	6.56	5.23	5.03	5.49	8.21	8.21	8.15	7.83	8.58	7.97	8.34	8.27
February	6.54	5.25	5.05	5.49	8.12	8.23	8.17	7.85	8.59	8.01	8.27	8.33
March	6.81	5.44	5.20	5.71	8.46	8.44	8.27	8.01	8.65	8.12	8.35	8.44
April	7.04	5.76	5.45	6.06	8.99	8.95	8.50	8.25	8.88	8.39	8.51	8.68
May	7.07	6.06	5.89	6.30	9.24	9.13	8.68	8.37	9.10	8.55	8.73	8.86
June	7.03	6.17	5.95	6.41	9.38	9.40	8.85	8.47	9.34	8.69	8.89	9.08
July	7.18	6.70	6.34	7.10	10.20	10.04	9.10	8.72	9.55	8.95	9.08	9.35
August	7.33	6.70	6.38	7.10	10.07	10.19	9.36	9.00	9.77	9.16	9.30	9.70
September	7.30	6.77	6.49	7.18	10.38	10.30	9.67	9.24	10.12	9.44	9.46	10.11
October	7.22	6.56	6.21	6.99	10.16	10.23	9.80	9.27	10.41	9.53	9.64	10.31
November	6.93	6.54	6.06	7.01	9.21	9.34	9.60	8.89	10.50	9.30	9.59	10.14
December	6.78	7.04	6.65	7.50	9.53	9.56	9.56	8.89	10.55	9.23	9.59	10.02
1975:												
January	6.68	6.89	6.39	7.45	9.36	9.45	9.55	8.83	10.02	9.19	9.52	10.10

[1] Includes bonds rated Aa and A, data for which are not shown separately. Because of a limited number of suitable issues, the number of corporate bonds in some groups has varied somewhat. As of Dec. 23, 1967, there is no longer an Aaa-rated railroad bond series.

Note: Annual yields are averages of monthly or quarterly data.

Bonds: Monthly and weekly yields are computed as follows: (1) U.S. Government: Averages of daily figures for bonds maturing or callable in 10 years or more; from Federal Reserve Bank of New York. (2) State and local government: General obligations only, based on Thursday figures; from Moody's Investor Service. (3) Corporate: Rates for "New issue" and "Recently offered" Aaa utility bonds are weekly averages compiled by the Board of Governors of the Federal Reserve System. Rates for seasoned issues are averages of daily figures from Moody's Investors Service.

Source: "Federal Reserve Bulletin," February 1975.

Some Factors Contributing to the Current Recession

No attempt is made here to enumerate all the causes of the current economic downturn. However, the factors outlined below appear worthy of note.

The money supply.—The Federal Reserve Board slowed down the rate of increase in the money supply in 1974 in an attempt to keep strong inflationary pressures under control. In 1974, the money stock (currency plus demand deposits) increased 4.4 percent compared with an average of 6.7 percent over the previous 5 years. Since the implicit GNP deflator rose 10 percent for the year, the money supply in real terms declined by over 5 percent during the year. Nonborrowed reserves, an indicator of the direction of monetary policy, failed to grow at all between November 1973 and August 1974. This undoubtedly has had an important influence in slowing down the economy.

Fiscal situation.—As noted in table 4, the administration estimates deficits in the unified budget of $35 billion for fiscal 1975 and approximately $52 billion for fiscal 1976. These figures assume that the Congress will adopt the tax cut proposed by the administration and $17 billion of spending cuts proposed by the administration, including a 5-percent ceiling on Federal pay and social security benefit increases. These anticipated deficits amount to a 1975 deficit of 2.48 percent of GNP in 1974 and a 1976 deficit of 3.5 percent of estimated GNP in 1975.

TABLE 4.—UNIFIED BUDGET TOTALS

[Fiscal years; in billions of dollars]

Description	1974 actual	1975 current estimate	1976 current estimate
Budget receipts	264.9	278.8	297.5
Budget outlays	268.4	313.4	349.4
Deficit (—)	—3.5	—34.7	—51.9

Source: The Budget of the U.S. Government for Fiscal Year 1976.

Despite the large actual deficits that are anticipated, many economists maintain that the Federal budget will be contractionary in 1975 unless offsetting action is taken. This is because the Federal budget when measured on a full employment basis (which assumes that potential real GNP grows 4 percent per year) is expected to have a much larger surplus this year than in the past. (The full employment budget differs from the actual budget because when the economy is at full employment, tax receipts are larger because the tax base is larger and certain expenditures, such as expenditures for unemployment insurance and food stamps, are smaller.) In recent years, the administration has used the full-employment surplus rather than the actual surplus or deficit as the measure of the effect of fiscal policy on the economy.

In the first quarter of 1973, the Federal budget deficit on a full employment basis ran at an annual rate of $5.1 billion. In the third quarter of 1973, the full employment budget swung from a deficit to a surplus which continued through 1974. By the third quarter of 1974,

the full-employment surplus was $30.4 billion. During 1975, the surpluses on a full employment basis are expected to increase further unless taxes are reduced or spending is increased. In addition, the full employment surpluses of State and local governments are increasing.

Oil.—The sharp increase in the price of imported oil which has resulted from the actions of the OPEC cartel now involves an annual cost to the United States of approximately $25 billion, or about $18 billion more than in 1973. This has not only added to our balance-of-payments problem; it has also acted to dampen our economy since the outflow of such large funds siphons off purchasing power from the domestic economy. Some part of this resulting deflationary effect is (or will in the future) be offset by increased U.S. exploration for oil and gas, but the net dampening effect is still very large.

Inventories.—In 1973 and early 1974, the fear of shortages encouraged firms to accumulate more inventories than they normally hold in relation to their sales. Now, firms are trying to liquidate their excess inventories, so that production is declining by more than the decline in final sales.

Automobiles.—Sales of new U.S. autos have fallen from a rate of 10.5 million in the first quarter of 1973 to a rate of 5.8 million in the last quarter of 1974. They have picked up recently as a result of price reductions. While some of this decline in autos resulted from the tight monetary and fiscal policies pursued in 1974, the depressed state of the auto market is also a result of uncertainties about the price and availability of gasoline and the sharp auto price increases that occurred in 1974.

The Outlook Without a Tax Cut

Economic forecasters are practically unanimous in predicting that in 1975 and 1976 the economy will continue to operate far below its potential. Real GNP in 1975 is likely to be 3 or 4 percent below 1974, which will mean a 5 or 6 percent decline from its 1973 level. Even if there is no tax reduction, the economy should reach bottom sometime in 1975, although forecasters disagree over whether this would be in the middle or at the end of the year. The recovery should occur because some, but not all, of the economic forces that caused the recession have reversed themselves. Firms are now liquidating their excess inventories, and the completion of this process later in the year will strengthen the economy. Most important, there has been a significant easing of monetary policy in the past several months, which will increase housing starts and business investment. (Nonborrowed reserves grew at a rate approaching 7 percent in the past six months.) This recovery, however, is not likely to be strong enough to reduce unemployment below 8 percent by the end of 1976 unless there is additional fiscal stimulus.

With this pattern of forecasts for 1975 and 1976, the actual GNP for this year will fall considerably short of the potential GNP. Table 5 presents data on actual and potential GNP and staff projections which suggest that actual GNP during 1975 may be as much as 14 percent under the potential GNP assuming the present budgetary picture with no tax cut. This gap will be over $200 billion, or $1,000 per capita. This is significant for two reasons: first, it indicates that in the absence of remedial action, there will be a large loss of economic goods and services; and second, it suggest that tax reductions could be employed

to stimulate the economy without creating substantial additional inflation in view of the large amount of available unused resources.

TABLE 5.—ACTUAL AND POTENTIAL GNP

[Billions of dollars, seasonally adjusted annual rates]

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

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

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

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

Source: Business Conditions Digest.

II. SUMMARY OF ADMINISTRATION PROPOSAL AND HOUSE BILL

Administration proposal.—In his State of the Union message, the President announced his economic, tax, and energy programs designed to deal with the problems of recession, inflation, and energy dependence. The tax proposals, which have been reaffirmed by the administration in its testimony before the committee, include a temporary tax cut for individuals based on 1974 tax liabilities and a temporary increase in the investment credit for businesses. The proposals also include permanent tax reductions for individuals and corporations, and payments to nontaxpayers, which are to be financed by "energy conservation" taxes and fees.

The temporary tax cuts in the administration's anti-recession package amount to $16 billion. This consists of a $12 billion refund to individuals of their 1974 income taxes and a $4 billion increase in the investment tax credit for businesses. These two proposals for the temporary tax cut are as follows:

(1) A cash refund for individuals of 12 percent of a taxpayer's 1974 income tax liability, up to a maximum refund of $1,000.

(2) A temporary increase in the investment credit (from 7 percent to 12 percent generally, and from 4 percent to 12 percent for most utilities) for businesses, effective for property placed in service in 1975 (with an additional 2-year period for certain utility property) and covering binding contracts in effect at the end of 1975 if the property is placed in service before the end of 1976. In addition, with respect to utilities, the limitation on the amount of investment credit which may be claimed in a year would be temporarily increased.

The permanent tax reductions and payments to nontaxpayers proposed by the administration are to be financed by the energy conservation taxes and fees as part of the administration's overall energy program. In the case of individuals, these permanent tax reductions are as follows:

(1) An increase in the low income allowance from the present $1,300 to $2,600 for joint returns ($2,000 for single persons).

(2) A cut in the schedule of tax rates.

(3) A 15-percent tax credit on the first $1,000 of expenditures for thermal efficiency improvements in residences, effective January 1, 1975.

(4) An $80-per-adult payment to nontaxpayers and a lesser amount for certain low income taxpayers who receive less than $80 in tax reductions, so their refund and tax reduction together equal $80.

The administration also proposed permanent tax cuts for corporations by a reduction in the corporate surtax rate of 6 percentage points (reducing from 48 percent to 42 percent the total tax on income over $25,000), effective for 1975.

House bill.—The Committee on Ways and Means decided to deal with the temporary anti-recession tax reduction package first and then

take up the administration's energy program and permanent tax reductions. In the House tax reduction bill, the size of the tax cut proposed by the administration was increased from $16 billion to $20 billion. (Both the administration proposals and the House bill would involve some additional revenue losses for 1976.) The tax reduction for individuals was increased from the proposed $12 billion to $16 billion while the business tax reduction was decreased slightly. (The administration proposals would reduce 1975 business taxes by $4.1 billion; the House bill would reduce them by $3.6 billion.)

The 1974 refund was reduced in the House bill from $12.2 billion in the administration proposal to $8.1 billion, and its structure was changed to concentrate more of the reduction on low- and middle-income taxpayers. In addition, the House bill includes $8.1 billion of tax cuts for 1975 that are to be reflected in lower withholding. These are a $5.1-billion increase in the standard deduction (including the low-income allowance) and a $3.0-billion refundable credit for low-income people based on earned income.

The House bill raises the investment credit to 10 percent, instead of the 12 percent proposed by the administration. The House bill also liberalizes the extent to which most utilities may use the investment credit to offset their tax liabilities. In addition, the House bill provides in the case of long lead time property (that is, property that requires at least 2 years to construct) that the investment credit is to be available to the extent that progress payments are made during the construction period, rather than the year when the property ultimately is placed in service. This new feature of the investment credit, which is permanent under the House bill, is to be phased in over a 5-year transitional period.

The House bill reduces taxes for small business by increasing the limit on the amount of used equipment that can qualify for the investment credit from $50,000 to $75,000 and by raising the corporate surtax exemption from $25,000 to $50,000.

The investment credit provisions provide for $2.4 billion reduction for businesses in 1975 and $1.5 billion in 1976; the increase in the surtax exemption is expected to reduce revenue by $1.2 billion for 1975, of which $730 million (or about 60 percent) is expected to go to businesses with incomes under $100,000.

The House bill also repeals percentage depletion for oil and gas, effective January 1, 1975, except for regulated gas (which retains percentage depletion for 18 months) and gas sold under a pre-existing fixed price contract. This provision (sponsored by Congressman Green) was added to the bill on the House floor and is expected to raise $2.2 billion in 1975 and $2.7 billion in 1976.

III. ECONOMIC EFFECT OF AN INDIVIDUAL INCOME TAX REDUCTION

Most economists believe that an individual income tax reduction at a time when there is excess capacity in the economy will increase the level of real income and employment. People will spend a fraction of their tax cut on consumer goods, which will create jobs and increase incomes. The individuals who receive these increases in income (as wages and profits) will spend some fraction of the increase, thus creating more jobs and still further increases in income. Businesses will respond to higher demand for their products by increasing their investments which will also expand the economy. There is some dispute about the precise magnitude of the "multiplier"—the increase in income that results for each dollar of tax reduction—but most estimates are between 1 and 2. The multiplier, in any event, will vary depending on what type of tax reduction is enacted, what income groups receive the cuts, whether monetary policy is accommodating or offsetting, and whether there are offsetting spending cuts. Chase Econometrics, Inc., has estimated that the $20 billion tax cut in the House bill will raise GNP by $25 billion in 1976.

There are two principal arguments against a tax cut at the present time. Some argue that by stimulating the economy, a tax cut will increase the rate of inflation. There is probably some truth to this view; the recession can be expected to slow down the rate of inflation, and a shorter or milder recession will cause less of a reduction. With substantial slack in the economy, however, as there will be for the next several years, it does not appear probable that a tax cut of reasonable size will have much of an inflationary impact. The Chase Econometrics forecast is that the tax cut in the House bill would raise the rate of inflation by less than 0.1 percent in 1975 and 1976.

A second argument against a tax cut at this time is that it will not stimulate the economy because the higher deficit caused by the tax cut will drive up interest rates, crowd out private borrowing, and thereby reduce business investment. It is contended that this will offset the increased consumer spending caused by the tax cut, so that there will be no net stimulus to the economy.

The "crowding out" theory no longer has much support today among professional economists. It is true, of course, that a tax reduction does entail additional government borrowing. The increased deficit will be somewhat less than the initial tax reduction, however, because the tax cut will increase incomes which will lead to an increase in tax receipts. (A $20 billion tax cut, for example, will result in an increase in the deficit of less than $14 billion because $6 billion in taxes will be paid out of the higher incomes caused by the tax cut, and spending on unemployment compensation and food stamps will decline.) More important, the higher incomes resulting frcm the tax reduction (both directly and through the multiplier effect) will lead to increased saving by individuals and corporations, and this additional saving will

supply a flow of funds sufficient to finance the increase in the government deficit caused by the tax cut without a rise in interest rates.

The only problem that may arise in financing the additional deficit will be to the extent the public wants to hold some of its increased saving in the form of money. Unless the Federal Reserve increases the money supply by an amount equal to this increase in the demand for money, there will be some upward pressure on interest rates. It is reasonable to expect, however, that the Federal Reserve will be accommodative in this way as long as unemployment remains high.

A tax cut, then, should stimulate the economy, and the large gap between actual and potential output that probably will exist in the next several years should ensure that this stimulus will not seriously increase inflation.

IV. DURATION OF THE TAX REDUCTION

The administration has proposed a tax cut for one year. The House bill reduction also is technically only for one year, but half of it is of the type which is likely to be made permanent (the increase in the standard deduction and the addition of the earned income credit). An issue related to the duration of the tax cut is the extent to which a tax cut should be received in lump-sum refunds or reflected in lower withholding. Under the administration proposal, the entire tax reduction would be received in two payments during calendar year 1975, since it applies to 1974 tax liability. Under the House bill, the tax cut for individuals is evenly divided between a lump-sum refund in 1974 taxes and tax cuts for 1975 that are to be reflected in lower withholding.

There is likely to be a sizable gap between actual and potential output for the next several years if no tax cut is enacted. Even if the economy grows in real terms at 6 percent annually, which would be a vigorous recovery by historical standards, the economy will not reach full employment until 1980. Thus, the committee might want to consider some fiscal stimulus for at least the next two or three years.

Another consideration on the issue of the duration of a tax cut is the fact that inflation has the effect of raising individual income taxes, not only nominally but also in real terms. This occurs because inflation erodes the real value of the personal exemption and the minimum and maximum standard deductions and because it pushes people into higher rate brackets even when their real income is staying the same or declining. A disproportionate amount of this real tax increase in 1974 applied to low-income taxpayers. Using the Treasury computer tax model, the staff has estimated the distribution of this tax increase by income class, and this appears in table 6. The percentage increase in tax is greatest for the lower income classes. For people with AGI under $3,000, inflation raised taxes by 45.0 percent, while the increase was 2.6 percent for people with AGI over $100,000.

TABLE 6.—REAL INCOME TAX INCREASE IN 1974 CAUSED BY INFLATION

AGI class	Present law tax (millions)	Inflation-induced tax increase [1] (millions)	Inflation-induced increase as percent of present law tax
0 to $3,000	$289	$130	45.0
$3,000 to $5,000	1,779	295	16.6
$5,000 to $7,000	4,093	398	9.7
$7,000 to $10,000	9,251	637	6.9
$10,000 to $15,000	21,239	1,249	5.9
$15,000 to $20,000	20,910	1,210	5.8
$20,000 to $50,000	38,419	2,279	5.9
$50,000 to $100,000	11,883	637	5.4
$100,000 and over	10,992	289	2.6
Total	118,855	7,122	6.0

[1] Staff estimate of the excess of actual taxes in 1974 over what taxes would have been had tax brackets, the personal exemption, and the minimum and maximum standard deductions been adjusted upward for inflation.

The duration of a tax cut also may have a bearing on its effectiveness in causing people to spend it. This may depend, in part, on whether it is reflected in withholding or received in lump-sum payments. Economic theory suggests that people are more likely to spend tax cuts if they believe them to be permanent, which usually occurs when they are reflected in withholding. A lump sum is more likely to be saved, so that it will be less effective in stimulating the economy. Surveys conducted by Albert Sindlinger and the Survey Research Center at the University of Michigan suggest that as many as two-thirds of the population would save or invest an unexpected refund, or use it to pay off debts, although a recent Harris poll made shortly after the President made his proposal, shows that only 53 percent would save or invest any extra money they might receive. These results are consistent with previous surveys of how taxpayers would treat a large, unexpected refund. If these surveys are correct, to get the same fiscal stimulus a lump-sum payment has to be much larger than a tax cut that is reflected in withholdings. To the extent that the tax cut is saved, it does nothing to stimulate the economy (although it also does not do any harm). To the extent it is used to repay debts, it probably stimulates the economy only in cases where the creditor did not expect to get repaid, in which case he might consider the repayment to be income and go out and spend the income.[1]

On the other hand, there are some advantages of a lump-sum payment in the current situation. To the extent that it is spent, a lump-sum payment is more likely to be spent on durable goods, where the economy is particularly weak at present. Also, a cut in 1974 taxes will help people who were employed in 1974 but who are now out of work. Finally, a lump-sum payment can be paid out faster than any cut reflected in withholding.

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[1] The Harris poll asked what people would do with a little extra money. With the refund on 1974 taxes, 41 percent said they would save extra money or use it to pay off debts, and 12 percent said they would invest it. The poll also indicated that lower income people would be more likely to spend their refund than those with higher incomes. The poll by the Survey Research Center was taken in 1973 and asked people what they did with their income tax refunds on their 1972 taxes. Fifty-nine percent said they used their refund for savings or paying off debts. Only 15 percent said they used their refund for spending on consumer durables.

V. SIZE OF THE TAX REDUCTION

In determining the appropriate size for a tax cut, the committee will want to consider the gap between actual and potential output (estimated at over $200 billion in 1975). One econometric forecast is that the $20-billion tax reduction in the House bill will raise GNP by $25 billion in 1976, so that the tax cut by itself would close approximately one-tenth of the gap between actual and potential output. Other economic forces, especially expansionary monetary policy, increased spending, and the normal business cycle, can be expected to close some more of the gap; however, it is likely that a substantially larger tax cut could be enacted without excessively stimulating the economy in the next two years.

A tax reduction of $30 billion would be 2.0 percent of GNP. This is smaller relative to GNP than the tax reduction of the Revenue Act of 1964. Table 7 shows the revenue effects of the major tax changes since 1962. The 1964 income tax cut and the excise tax reductions of 1965 totaled $18.0 billion. This was about 2.6 percent of GNP over the years 1965 and 1966. An $18 billion tax cut in 1964 and 1965 would be $29 billion in current prices, and a tax cut equal to 2.6 percent of GNP would be $39 billion. A tax cut of $12 billion today would be the same fraction of GNP as was the $8 billion tax cut in the Revenue Act of 1971.

TABLE 7.—MAJOR TAX CHANGES SINCE 1962 AS A PERCENT OF GNP IN THE SAME YEAR

[Dollar amounts in billions]

Year	Act	GNP	Tax change	Tax reduction as a percent of GNP
1965	Revenue Act of 1964 fully effective	$685	−$15.2	2.2
1966	Excise Tax Reduction Act of 1965	750	−2.8	.4
1970	Tax Reform Act of 1969	977	−6.5	.7
1972	Revenue Act of 1971	1,158	−8.0	.7

Similarly, as the size of the economy grows, the deficits caused by tax cuts and by the recession itself will tend to be larger than in the past. Table 8 shows the unified budget receipts and outlays of the Federal Government and the Federal deficit both in absolute terms and as a fraction of GNP. In fiscal year 1959, as a result of the 1958 recession, the deficit was $12.9 billion, or 2.7 percent of GNP. A deficit equal to 2.7 percent of GNP in 1975 would be $41 billion. The deficit in the relatively mild 1970 recession was 2.3 percent of GNP, which is equivalent to a $35 billion deficit in 1975. The deficit in fiscal 1976 will be large, both absolutely and relative to GNP, but this only reflects the severity of the current recession.

TABLE 8.—UNIFIED BUDGET RECEIPTS, OUTLAYS, AND SURPLUS OR DEFICIT AS A PERCENT OF GROSS NATIONAL PRODUCT, FISCAL YEARS 1946-74

[In billions of dollars]

Fiscal year	GNP	Unified budget			As percent of GNP		
		Outlays	Receipts	Surplus (+) or deficit (−)	Outlays	Receipts	Surplus or deficit
1946	201.6	61.7	43.5	−18.2	30.6	30.6	9.0
1947	219.8	36.9	43.5	+6.6	16.8	19.8	3.0
1948	243.5	36.5	45.4	+8.9	15.0	18.6	3.7
1949	260.0	40.6	41.6	+1.0	15.6	16.0	.4
1950	263.3	43.1	40.9	−2.2	16.4	15.5	.8
1951	310.5	45.8	53.4	+7.6	14.8	17.2	2.4
1952	337.2	68.0	68.0	(1)	20.2	20.2	----------
1953	358.9	76.8	71.5	−5.3	21.4	19.9	1.5
1954	362.1	70.9	69.7	−1.2	19.6	19.2	.3
1955	378.1	68.5	65.5	−3.0	18.1	17.3	.8
1956	409.4	70.5	74.5	+4.1	17.2	18.2	1.0
1957	431.3	76.7	80.0	+3.2	17.8	18.5	.7
1958	440.3	82.6	79.6	−2.9	18.8	18.1	.7
1959	469.1	92.1	79.2	−12.9	19.6	16.9	2.7
1960	495.2	92.2	92.5	+.3	18.6	18.7	.1
1961	506.5	97.8	94.4	−3.4	19.3	18.6	.7
1962	542.1	106.8	99.7	−7.1	19.7	18.4	1.3
1963	573.4	111.3	106.6	−4.8	19.4	18.6	.8
1964	612.2	118.6	112.7	−5.9	19.4	18.4	1.0
1965	654.2	118.4	116.8	−1.6	18.1	17.9	.2
1966	721.2	134.7	130.9	−3.8	18.7	18.2	.5
1967	769.8	158.3	149.6	−8.7	20.6	19.4	1.1
1968	826.0	178.8	153.7	−25.2	21.6	18.6	3.1
1969	898.3	184.5	187.8	+3.2	20.5	20.9	.4
1970	954.6	196.6	193.7	−22.8	20.6	20.3	.3
1971	1,013.6	211.4	188.4	−23.0	20.9	18.6	2.3
1972	1,100.6	231.9	208.6	−23.2	21.1	19.0	2.1
1973	1,225.2	246.5	232.2	−14.3	20.1	19.0	1.2
1974	1,348.9	268.3	264.8	−3.5	19.9	19.6	.3

[1] Surplus of $49,000,000.

Note: Details may not add due to rounding.

Table 9 shows the public debt as a fraction of GNP. While the debt has been rising in absolute terms, it has been declining steadily as a fraction of GNP. At the end of World War II, the debt was 134.4 percent of GNP. By 1960, this fraction had declined to 58.7 percent, and in 1974, it was 35.2 percent.

TABLE 9.—GROSS PUBLIC DEBT AND GROSS NATIONAL PRODUCT, FISCAL YEARS 1946–74

[In billions of dollars]

Fiscal year	GNP	Gross public debt[1]	Gross public debt as percent of GNP
1946	201.6	271.0	134.4
1947	219.8	257.1	117.0
1948	243.5	252.0	103.5
1949	260.0	252.6	97.2
1950	263.3	256.9	97.6
1951	310.5	255.3	82.2
1952	337.2	259.1	76.8
1953	358.9	266.0	74.1
1954	362.1	270.8	74.8
1955	378.1	274.4	72.6
1956	409.4	272.8	66.6
1957	431.3	272.4	63.1
1958	440.3	279.7	63.5
1959	469.1	287.8	61.3
1960	495.2	290.9	58.7
1961	506.5	292.9	57.8
1962	542.1	303.3	55.9
1963	573.4	310.8	54.2
1964	612.2	316.8	51.7
1965	654.2	323.2	49.4
1966	721.2	329.5	45.7
1967	769.8	341.3	44.3
1968	826.0	369.8	44.8
1969	898.3	367.1	40.9
1970	954.6	382.6	40.1
1971	1,013.6	409.5	40.4
1972	1,100.6	437.3	39.7
1973	1,225.2	468.4	38.2
1974	1,348.9	464.2	35.2

[1] On June 30 each fiscal year.

At the same time, it should be noted that permanent tax cuts. if they are large, can erode Federal Government revenues so that it will be difficult to finance future increases in government expenditures. Table 10 shows the effects in calendar year 1974 of the major income tax changes made since 1962. The aggregate revenue loss is $54 billion, of which $30 billion resulted from the 1964 tax reduction. Much of this tax reduction was recouped as inflation and real economic growth raised individual income tax rates, so that despite the tax cuts individual income taxes were 10.3 percent of personal income in both 1962 and 1974. Thus, the amount of tax reduction that is desirable from the standpoint of fiscal stimulus alone probably exceeds the amount of permanent tax reduction that is desirable from the standpoint of the effect on the erosion of revenues.

TABLE 10.—REVENUE EFFECTS IN 1974 OF MAJOR TAX ACTIONS SINCE 1962 OTHER THAN TRUST FUNDS AND USER CHARGES

[In billions of dollars]

Tax action	1st year fully effective revenue effect	1974 revenue effect
Revenue Act of 1962:		
Investment credit:		
Individual	−0.3	−0.8
Corporation	−1.1	−3.6
Other provisions:		
Individual	+.3	+.3
Corporation	+.5	+.5
Total	−.6	−3.6
Depreciation guidelines of 1962:		
Individual	−.2	−.1
Corporation	−1.0	−1.0
Total	−1.2	−1.1
Revenue Act of 1964:		
Individual	−12.2	−25.3
Corporation	−3.0	−4.9
Total	−15.2	−30.2
Excise Tax Reduction Act of 1965 [1]	−2.8	−3.7
Other excise tax legislation [2]	([3])	−.3
Tax Reform Act of 1969:		
Reform and relief:		
Individual	−8.1	−11.4
Corporation	+1.2	+1.6
Total	−6.9	−9.8
Termination of investment credit:		
Individual	+.6	+.8
Corporation	+1.9	+3.3
Total	+2.5	+4.1
Total for Tax Reform Act of 1969	−4.5	−5.7
Asset depreciation range:		
Individual	([3])	([3])
Corporation	−1.0	−1.6
Total	−1.0	−1.6
Revenue Act of 1971:		
Individual	−4.1	−2.2
Corporation	−2.0	−3.6
Excise	−2.2	−1.8
Total	−9.2	−7.6
Grand total		−53.8
Individual		−38.7
Corporation		−9.3
Excise		−5.8

[1] Excluding reductions later rescinded.
[2] Includes interest equalization tax, tax on foundations, and reductions in telephone tax.
[3] Less than $50,000,000.

VI. DISTRIBUTION OF THE TAX REDUCTION

The $12 billion individual income tax reduction proposed by the administration is concentrated among the middle- and upper-income groups. Because the income tax is progressive, a tax cut that is a flat percent of the tax will be a larger fraction of income for high-income people than for low-income people. An argument favoring such a tax cut is that the weakness in the economy is disproportionately in the consumer durables sector, especially autos, and that only fairly large lump-sum payments will induce people to buy these "big ticket" items. However, it is also true that spending on any goods and services stimulates the economy, not just spending on "big ticket" items.

For several reasons the House decided to concentrate the tax cut in the lower- and middle-income groups. While upper-income people may be more likely to spend their tax refunds on large purchases than low-income people, they are also more likely to save or invest it. While saving is usually helpful to the economy from the long run point of view of aiding capital formation, spending is more helpful during a recession.

A second reason the House provided a cut directed more toward low-income families is that they tend to spend a larger fraction of their income on food and energy than do higher income people. Therefore, they have been most seriously affected by the sharp rises in food and energy prices that have occurred in the past two years. Some preference for the low-income group, it was concluded, was needed to restore the real income distribution to what it was two years ago.

Because of inflation, especially higher food and energy costs, the poverty level is now significantly higher than the income level at which people must start to pay income taxes. The poverty level and tax thresholds for recent years are compared in table 11. The tax threshold for a single person is $2,050 (the $750 personal exemption plus the $1,300 minimum standard deduction). This was approximately the poverty level in 1972; but in 1975 the poverty level for a single person is estimated at $2,694, so that a poor single individual can pay as much as $80 in income tax. For a family of four, the tax threshold is $4,300 (four exemptions of $750 each, plus the standard deduction). This also approximated the 1972 poverty level. Today, however, the poverty level for a four-person family is estimated at $5,442, so that it can have an income tax liability of $160. If the principle that poor people should be exempted from income tax is to be continued, the committee may want to provide substantial permanent tax cuts for low-income families. The table also shows the tax thresholds under the increases in the standard deduction in the House bill.

TABLE 11.—COMPARISON OF THE LOW-INCOME THRESHOLD FOR NONFARM FAMILIES WITH THE FEDERAL INDIVIDUAL INCOME TAX THRESHOLD UNDER THE MINIMUM STANDARD DEDUCTION PROVISION OF PRESENT LAW AND UNDER THE MINIMUM STANDARD DEDUCTION PROVISION IN THE HOUSE BILL

Family size (persons)	Low-income threshold for nonfarm families				Income tax threshold	
					Present law	House bill
	1972 [1]	1973 [1]	1974 [2]	1975 [3]	$1,300 plus $750 per exemption	$1,900 for single taxpayers, $2,500 for joint returns, plus $750 per exemption
1	$2,109	$2,247	$2,494	$2,694	$2,050	$2,650
2	2,724	2,895	3,213	3,470	2,800	4,000
3	3,339	3,548	3,938	4,253	3,550	4,750
4	4,275	4,540	5,039	5,442	4,300	5,500
5	5,044	5,358	5,947	6,423	5,050	6,250
6	5,673	6,028	6,691	7,226	5,800	7,000

[1] Source: Bureau of the Census, Social and Economic Statistics Administration, U.S. Department of Commerce.
[2] Estimated from the 1973 thresholds by assuming an 11-percent increase in the Consumer Price Index for 1974 over 1973.
[3] Estimated by assuming an 8-percent increase in the Consumer Price Index for 1975 over 1974.

VII. ALTERNATIVE WAYS TO REDUCE INDIVIDUAL INCOME TAXES

A. Tax Refunds for 1974 Tax Liability

Present law.—Individual taxpayers who report their income on the basis of the calendar year (which is the case for almost all individuals) are required to file their 1974 tax returns by April 15, 1975. Individual income tax liabilities for calendar year 1974 currently are estimated at approximately $119 billion.

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

Revenue effect of House bill.—The refund of 1974 tax liability in the House bill is estimated to result in a revenue loss of $8.1 billion.

Administration proposal.—The administration has recommended that individual taxpayers receive a cash refund of 12 percent of their tax liabilities reported on their 1974 tax returns, up to a maximum refund of $1,000. Married couples filing separate returns would receive a maximum refund of $500 each. The refund would be paid in two equal installments—the first payment being made beginning in May and the second payment being made beginning in September.

This proposal would not affect income tax liabilities for 1975 and later years.

Revenue effect of administration proposal.—The 12-percent refund would involve a revenue loss of $12.2 billion.

Staff analysis.—The main advantage of reducing taxes by allowing a refund on 1974 tax liability is that the tax reduction is clearly a temporary one, so that there is no permanent erosion of Federal revenues that will require tax increases or spending cuts sometime in the future. Also, the proposed refund pumps money into the economy quickly and directs some of the reduction to people who are unemployed now but who had income in 1974.

The disadvantage of a 1974 tax refund is that it is likely to induce less of an increase in consumer spending than would a tax cut that is reflected in withholding. This tendency to save or invest a large part of a lump-sum refund is supported by household survey data, which suggest that two-thirds of the recipients of a refund will save or invest it or use it to repay debts.

The specific tax refund proposed by the administration (12 percent of 1974 tax up to $1,000) has been criticized on the grounds that very little of the relief goes to those in the lower-income groups. The distribution of the reduction is shown in table 12. Fifteen percent of the reduction is received by taxpayers with adjusted gross income under $10,000. The concentration of a proportional tax refund in the middle- and upper-income groups, of course, is simply a reflection of the progressivity of the individual income tax. The $1,000 limit on the refund limits the concentration among the upper income groups of the proportional tax refund to some extent, but the limit is a factor only when

adjusted gross income exceeds $41,000 for the typical married couple and $34,000 for a single individual. (The limit applies at a lower income level for single people because their tax rates are higher.)

TABLE 12.—EFFECT OF THE ADMINISTRATION PROPOSAL FOR A REFUND OF 1974 INCOME TAX [1]

[1974 income levels]

Adjusted gross income class	Number of returns with tax decrease (in thousands)	Decrease in tax liability			
		Amount (in millions)	Percentage distribution of total decrease		
			By income class	Cumulative	By segment
0 to $3,000	4,057	$30	0.2	0.2	15.0
$3,000 to $5,000	7,579	213	1.7	1.9	
$5,000 to $7,000	8,273	491	4.0	5.9	
$7,000 to $10,000	11,428	1,110	9.1	15.0	
$10,000 to $15,000	15,952	2,549	20.9	35.9	41.5
$15,000 to $20,000	9,856	2,509	20.6	56.5	
$20,000 to $50,000	9,006	4,498	36.9	93.4	
$50,000 to $100,000	655	647	5.3	98.7	43.5
$100,000 and over	160	157	1.3	100.0	
Total	66,966	12,205	100.0	100.0	100.0

[1] Granting a 12-percent refund of 1974 income tax liability with a maximum refund of $1,000.

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

The 1974 refund in the House bill is directed more towards lower- and middle-income taxpayers because of the $100 minimum refund, the much lower maximum refund ($200 instead of $1,000), and the phase-down of the refund from $200 to $100 as adjusted gross income rises from $20,000 to $30,000. The distribution of the House refund is shown in table 13. In the House bill, 35.7 percent of the refund goes to taxpayers with adjusted gross incomes below $10,000, compared to 15.0 percent under the administration's proposal. For every adjusted gross income class up to $20,000, the House bill provides a greater proportion of the refund than the administration proposal—the administration proposal is proportionately more generous only to those with adjusted gross incomes above $20,000.

TABLE 13.—EFFECT OF THE REFUND OF 1974 INCOME TAX IN THE HOUSE BILL [1]

[1974 income levels]

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

[1] Granting a 100-percent refund of 1974 income tax liability up to $100 without a phaseout and a 10-percent refund of tax above $1,000 with a maximum refund of $200 with the refund phased down to $100 between $20,000 and $30,000 of adjusted gross income.

[2] Less than 500 returns.

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

Alternative proposals.—There are many different ways to design a tax refund similar to that proposed by the administration other than the method used in the House bill. One way to concentrate the effect of the refund more in the lower income groups than is done in the administration proposal would be to reduce the limit on the refund to a level lower than $1,000. A $300 limit, for example, would apply for a married couple with two children if their AGI exceeded $19,000 and for a single individual above $15,000. The revenue impact of refunds by percentage of tax refunded and maximum allowable refund is shown in table 14. Another way to make the credit more progressive would be to phase it out as income exceeded the level at which the limit applies, so that taxpayers with incomes above a certain level would get no tax credit at all or reduced credit.

TABLE 14.—REVENUE EFFECT OF A PERCENTAGE REFUND OF 1974 INCOME TAX LIABILITY WITH A MAXIMUM ALLOWABLE REFUND

[By percentage of tax refunded and maximum allowable refund]

Maximum allowable refund	Percentage of tax rebated																			
	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25
	Decrease in tax liability (billions of dollars)																			
$50	2.58	2.67	2.74	2.80	2.84	2.88	2.91	2.94	2.96	2.98	3.00	3.02	3.04	3.05	3.07	3.08	3.09	3.10	3.10	3.11
$100	4.06	4.35	4.58	4.77	4.92	5.05	5.16	5.26	5.35	5.42	5.48	5.54	5.59	5.64	5.68	5.72	5.76	5.79	5.82	5.84
$150	4.84	5.32	5.74	6.09	6.39	6.65	6.88	7.07	7.24	7.38	7.52	7.64	7.75	7.84	7.94	8.01	8.09	8.16	8.22	8.27
$200	5.28	5.90	6.45	6.94	7.38	7.78	8.12	8.43	8.70	8.95	9.17	9.36	9.54	9.70	9.84	9.98	10.10	10.22	10.33	10.42
$250	5.54	6.26	6.92	7.52	8.06	8.56	9.02	9.44	9.81	10.15	10.46	10.75	11.00	11.24	11.46	11.66	11.84	12.01	12.17	12.30
$300	5.72	6.50	7.23	7.92	8.55	9.14	9.68	10.18	10.65	11.08	11.48	11.85	12.18	12.50	12.78	13.05	13.31	13.53	13.75	13.95
$350	5.85	6.67	7.46	8.20	8.90	9.56	10.18	10.75	11.29	11.79	12.27	12.71	13.13	13.52	13.88	14.21	14.53	14.82	15.10	15.35
$400	5.95	6.81	7.63	8.41	9.17	9.88	10.56	11.20	11.80	12.37	12.90	13.41	13.89	14.34	14.77	15.17	15.55	15.91	16.24	16.56
$450	6.03	6.91	7.76	8.58	9.37	10.13	10.85	11.54	12.20	12.82	13.42	13.98	14.51	15.02	15.51	15.97	16.41	16.82	17.22	17.59
$500	6.10	7.00	7.87	8.72	9.54	10.33	11.09	11.82	12.52	13.19	13.81	14.45	15.04	15.60	16.13	16.64	17.13	17.59	18.04	18.46
$550	6.16	7.08	7.96	8.83	9.67	10.49	11.28	12.05	12.79	13.50	14.18	14.81	15.47	16.07	16.66	17.21	17.74	18.25	18.74	19.21
$600	6.22	7.14	8.04	8.93	9.79	10.63	11.44	12.23	13.00	13.75	14.47	15.16	15.83	16.48	17.10	17.70	18.27	18.82	19.35	19.86
$650	6.28	7.20	8.12	9.01	9.89	10.74	11.58	12.40	13.19	13.96	14.71	15.44	16.14	16.82	17.48	18.11	18.73	19.32	19.89	20.43
$700	6.33	7.25	8.18	9.09	9.98	10.85	11.70	12.53	13.35	14.14	14.92	15.67	16.40	17.11	17.80	18.47	19.12	19.75	20.35	20.94
$750	6.38	7.31	8.24	9.16	10.06	10.94	11.81	12.66	13.49	14.30	15.10	15.87	16.63	17.37	18.09	18.78	19.46	20.12	20.76	21.37
$800	6.43	7.37	8.29	9.22	10.13	11.02	11.90	12.77	13.61	14.44	15.26	16.05	16.83	17.59	18.33	19.05	19.76	20.44	21.11	21.76
$850	6.48	7.42	8.35	9.27	10.19	11.10	11.99	12.86	13.72	14.57	15.40	16.21	17.01	17.79	18.55	19.29	20.02	20.73	21.43	22.10
$900	6.52	7.47	8.41	9.32	10.25	11.17	12.07	12.95	13.82	14.68	15.52	16.35	17.16	17.96	18.74	19.51	20.25	20.99	21.70	22.40
$950	6.55	7.52	8.46	9.39	10.31	11.23	12.14	13.03	13.92	14.78	15.64	16.48	17.31	18.12	18.91	19.70	20.46	21.21	21.95	22.67
$1,000	6.58	7.56	8.51	9.44	10.36	11.29	12.21	13.11	14.00	14.88	15.74	16.59	17.43	18.26	19.07	19.87	20.65	21.42	22.17	22.91

For example, there could be a 10-percent refund against 1974 tax liability up to a maximum of $300 ($150 for a married individual who files a separate return), with the refund phased out between adjusted gross income levels of $20,000 and $30,000. This would involve a revenue loss of $6.9 billion. The distribution by income class is shown in table 15. Twenty-two percent of the reduction would go to people with income below $10,000.

TABLE 15.—EFFECT OF A REFUND OF 10 PERCENT OF 1974 TAX LIABILITY WITH A MAXIMUM REFUND OF $300 AND PHASEOUT OF THE REFUND BETWEEN $20,000 AND $30,000 OF ADJUSTED GROSS INCOME

[1974 income levels

Adjusted gross income class	Number of returns with tax decrease (thousands)	Decrease in tax liability			
		Amount (millions)	Percentage distribution of total decrease		
			By income class	Cumulative	By segment
0 to $3,000	4,057	$25	0.4	0.4	
$3,000 to $5,000	7,579	178	2.6	3.0	22.3
$5,000 to $7,000	8,273	409	5.9	8.9	
$7,000 to $10,000	11,428	925	13.4	22.3	
$10,000 to $15,000	15,952	2,115	30.7	53.0	60.6
$15,000 to $20,000	9,856	2,059	29.9	82.9	
$20,000 to $50,000	6,849	1,184	17.2	100.0	
$50,000 to $100,000	0	0			17.2
$100,000 and over	0	0			
Total	63,994	6,896	100.0	100.0	100.0

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

The House in its bill accepts the ideas of a relatively low maximum refund ($200) and a phase-down of the refund between income levels of $20,000 and $30,000. It also includes a minimum refund of $100 (or the actual tax liability, whichever is smaller). This $100 minimum applies both to taxpayers whose 1974 tax liability is less than $1,000 (for whom a 10-percent refund would be less than $100) and to taxpayers whose income exceeds $30,000 (whose refunds would otherwise be phased out).

Numerous variations on the House formula are possible. The maximum refund could be raised to $300 and the refund could be phased down from $300 to $100 between incomes of $20,000 and $30,000. This would cost $8.7 billion ($0.6 billion more than in the House bill), and its distribution is shown in table 16. A phasedown between $30,000 and $40,000 would increase the revenue loss to $9.6 billion.

TABLE 16.—EFFECT OF INCREASING THE MAXIMUM REFUND IN THE HOUSE BILL TO $300[1]

[1974 income levels]

Adjusted gross income class (thousands)	Number of returns with tax decrease (thousands)	Decrease in tax liability			
		Amount (millions)	Percentage distribution of total decrease		
			By income class	Cumulative	By segment
0 to $3	4,057	$230	2.6	2.6	33.2
$3 to $5	7,579	685	7.8	10.4	
$5 to $7	8,273	795	9.1	19.5	
$7 to $10	11,428	1,202	13.7	33.2	
$10 to $15	15,952	2,210	25.3	58.5	48.9
$15 to $20	9,856	2,065	23.6	82.1	
$20 to $50	9,006	1,473	16.9	99.0	17.8
$50 to $100	655	65	.7	99.7	
$100 and over	160	16	.2	99.9	
Total	66,966	8,742	100.0	100.0	100.0

[1] A 100-percent refund of 1974 tax liability up to $100 and a 10-percent refund of tax above $1,000 with a maximum refund of $300 and a phasedown of the refund from $300 to $100 between $20,000 and $30,000 of adjusted gross income.

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

A 10-percent refund with a $100 minimum (or 100 percent of liability if it is less than $100), a $300 maximum, and no phase-down would mean a revenue loss of $10.0 billion, and its distribution is shown in table 17. One with a $400 maximum refund would cost $10.6 billion, and its distribution is shown in table 18. A $500 maximum refund is shown in table 19 and would cost $11.0 billion.

The refund could also be increased by increasing the percentage. The distributions of a 12-percent refund with a $100 minimum (or 100 percent of liability if it is less than $100) and $300, $400, and $500 maximums are shown in tables 20, 21, and 22, respectively. The respective revenue losses are $10.9 billion, $11.8 billion, and $12.3 billion.

TABLE 17.—EFFECT OF INCREASING THE MAXIMUM REFUND IN THE HOUSE BILL TO $300 AND ELIMINATING THE PHASEDOWN [1]

[1974 income levels]

Adjusted gross income class (thousands)	Number of returns affected (thousands)		Decrease in tax liability			
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percentage distribution of total decrease		
				By income class	Cumulative	By segment
0 to $3	4,057	3,097	$230	2.3	2.3	29.0
$3 to $5	7,579	1,280	685	6.8	9.1	
$5 to $7	8,273	339	795	7.9	17.0	
$7 to $10	11,428	186	1,202	12.0	29.0	
$10 to $15	15,952	59	2,210	22.1	51.1	42.7
$15 to $20	9,856	16	2,065	20.6	71.7	
$20 to $50	9,006	3	2,571	25.7	97.4	28.2
$50 to $100	655	(2)	196	2.0	99.4	
$100 and over	160	(2)	48	.5	100.0	
Total	66,966	4,980	10,003	100.0	100.0	100.0

[1] The refund would be 100 percent of 1974 tax liability up to $100 and 10 percent of tax above $1,000 up to a maximum of $300.

[2] Less than 500 returns.

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

TABLE 18.—EFFECT OF INCREASING THE MAXIMUM REFUND IN THE HOUSE BILL TO $400 AND ELIMINATING THE PHASEDOWN [1]

[1974 income levels]

Adjusted gross income class (thousands)	Number of returns affected (thousands)		Decrease in tax liability			
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percentage distribution of total decrease: By income class	Percentage distribution of total decrease: Cumulative	Percentage distribution of total decrease: By segment
0 to $3	4,057	3,097	$230	2.2	2.2	
$3 to $5	7,579	1,280	685	6.4	8.6	27.4
$5 to $7	8,273	339	795	7.5	16.1	
$7 to $10	11,428	186	1,202	11.3	27.4	
$10 to $15	15,952	59	2,216	20.9	48.3	40.6
$15 to $20	9,856	16	2,089	19.7	68.0	
$20 to $50	9,006	3	3,082	29.0	27.0	
$50 to $100	655	(2)	261	2.5	99.5	32.1
$100 and over	160	(2)	64	.6	100.0	
Total	66,966	4,980	10,624	100.0	100.0	100.0

[1] The refund would be 100 percent of tax liability up to $1,000 and 10 percent of tax above $1,000 up to a maximum refund of $400.
[2] Less than 500 returns.

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

TABLE 19.—EFFECT OF INCREASING THE MAXIMUM REFUND IN THE HOUSE BILL TO $500 AND ELIMINATING THE PHASEDOWN [1]

[1974 income levels]

Adjusted gross income class (thousands)	Number of returns affected (thousands)		Decrease in tax liability			
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percentage distribution of total decrease: By income class	Percentage distribution of total decrease: Cumulative	Percentage distribution of total decrease: By segment
0 to $3	4,057	3,097	$230	2.1	2.1	
$3 to $5	7,579	1,280	685	6.2	8.3	26.4
$5 to $7	8,273	339	795	7.2	15.5	
$7 to $10	11,428	186	1,202	10.9	26.4	
$10 to $15	15,952	59	2,219	20.2	46.6	
$15 to $20	9,856	16	2,092	19.0	65.6	39.2
$20 to $50	9,006	3	3,370	30.6	96.2	
$50 to $100	655	(2)	325	3.0	99.2	34.3
$100 and over	160	(2)	79	.7	100.0	
Total	66,966	4,980	10,998	100.0	100.0	100.0

[1] The refund would be 100 percent of 1974 tax liability up to $100 and 10 percent of tax above $1,000 up to a maximum refund of $500.
[2] Less than 500 returns.

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

TABLE 20.—EFFECT OF INCREASING THE REFUND IN THE HOUSE BILL TO 12 PERCENT OF TAX UP TO $300 AND ELIMINATING THE PHASEDOWN [1]

[1974 income levels]

Adjusted gross income class (thousands)	Number of returns affected (thousands)		Decrease in tax liability			
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percentage distribution of total decrease: By income class	Percentage distribution of total decrease: Cumulative	Percentage distribution of total decrease: By segment
0 to $3	4,057	3,097	$230	2.1	2.1	
$3 to $5	7,579	1,280	686	6.3	8.4	27.7
$5 to $7	8,273	339	800	7.3	15.7	
$7 to $10	11,428	186	1,310	12.0	27.7	
$10 to $15	15,952	59	2,589,	23.8	51.5	45.7
$15 to $20	9,856	16	2,386	21.9	73.4	
$20 to $50	9,006	3	2,642	24.3	97.7	
$50 to $100	655	(2)	196	1.8	99.5	26.5
100 and over	160	(2)	48	.4	100.0	
Total	66,966	4,980	10,887	100.0	100.0	100.0

[1] The refund would be 100 percent of 1974 tax liability up to $100 and 12 percent of tax over $833 with a maximum refund of $300.
[2] Less than 500 returns.

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

TABLE 21.—EFFECT OF INCREASING THE REFUND IN THE HOUSE BILL TO 12 PERCENT OF TAX UP TO $400 AND ELIMINATING THE PHASEDOWN [1]

[1974 Income levels]

Adjusted gross income class (thousands)	Number of returns affected (thousands)		Decrease in tax liability			
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percentage distribution of total decrease: By income class	Percentage distribution of total decrease: Cumulative	Percentage distribution of total decrease: By segment
0 to $3	4,057	3,097	$230	2.0	2.0	
$3 to $5	7,579	1,280	686	5.8	7.8	25.7
$5 to $7	8,273	339	800	6.8	14.6	
$7 to $10	11,428	186	1,311	11.1	25.7	
$10 to $15	15,952	59	2,599	22.1	47.8	43.3
$15 to $20	9,856	16	2,493	21.2	69.0	
$20 to $50	9,006	3	3,330	28.3	97.3	
$50 to $100	655	(2)	261	2.2	99.5	31.0
$100 and over	160	(2)	64	.5	100.0	
Total	66,966	4,980	11,774	100.0	100.0	100.0

[1] The refund would be 100 percent of 1974 tax liability up to $100 and 12 percent of tax liability over $833 with a maximum refund of $400.
[2] Less than 500 returns.

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

TABLE 22.—EFFECT OF INCREASING THE REFUND IN THE HOUSE BILL TO 12 PERCENT UP TO A MAXIMUM OF $500 AND ELIMINATING THE PHASEDOWN [1]

[1974 income levels]

Adjusted gross income class (thousands)	Number of returns affected (thousands)		Decrease in tax liability			
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percentage distribution of total decrease: By income class	Cumulative	By segment
0 to $3	4,057	3,097	$230	1.9	1.9	
$3 to $5	7,579	1,280	686	5.6	7.5	
$5 to $7	8,273	339	800	6.5	14.0	24.6
$7 to $10	11,428	186	1,311	10.6	24.6	
$10 to $15	15,952	59	2,604	21.2	45.8	
$15 to $20	9,856	16	2,504	20.3	66.1	41.5
$20 to $50	9,006	3	3,770	30.6	96.7	
$50 to $100	655	(2)	326	2.6	99.3	33.8
$100 and over	160	(2)	79	.6	100.0	
Total	66,966	4,980	12,311	100.0	100.0	100.0

[1] The refund would be 100 percent of 1974 tax liability up to $100 and 12 percent of tax liability over $833 with a maximum refund of $500.
[2] Less than 500 returns.

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

The Republican Members of the House Committee on Ways and Means proposed, as an alternative to the individual income tax reductions provided in the House bill, a graduated refund of 1974 taxes (and no changes for 1975 taxes). The payment of the refund would be the same as in the House bill; that is, payments made by the Internal Revenue Service beginning in May.

The tax refund is based on a graduated schedule of rates applied to the tax liability of the taxpayer. The beginning rate is 18 percent of the first $500 of tax liability. The amount of the refund is based on a sliding scale of rates which reaches a maximum refund of $430 for a taxpayer with a tax liability of $4,500. Refunds for taxpayers who have tax liabilities in excess of $4,500 are phased down to a minimum of $200 for taxpayers with tax liabilities in excess of $8,000. In general, the maximum refund would be available on a typical joint return (two additional dependents and itemized deductions equal to 17 percent of AGI) with adjusted gross income slightly over $28,000; those taxpayers with adjusted gross incomes in excess of that level would be subject to the phasedown of the amount of the refund.

A table of the graduated schedule of tax refund rates under this proposal is set forth below:

If the amount of tax is between	The tax refund is:
$0 to $500	18 percent of the tax.
$500 to $1,000	$90 plus 15 percent of the excess over $500.
$1,000 to $1,500	$165 plus 14 percent of the excess over $1,000.
$1,500 to $2,000	$235 plus 11 percent of the excess over $1,500.
$2,000 to $2,500	$290 plus 10 percent of the excess over $2,000.
$2,500 to $3,000	$340 plus 7 percent of the excess over $2,500.
$3,000 to $3,500	$375 plus 6 percent of the excess over $3,000.
$3,500 to $4,000	$405 plus 3 percent of the excess over $3,500.
$4,000 to $4,500	$420 plus 2 percent of the excess over $4,000.
$4,500 to $5,000	$430 less 1 percent of the excess over $4,500.
$5,000 to $5,500	$425 less 2 percent of the excess over $5,000.
$5,500 to $6,000	$415 less 5 percent of the excess over $5,500.
$6,000 to $6,500	$390 less 6 percent of the excess over $6,000.
$6,500 to $7,000	$360 less 9 percent of the excess over $6,500.
$7,000 to $7,500	$315 less 10 percent of the excess over $7,000.
$7,500 to $8,000	$265 less 13 percent of the excess over $7,500.
$8,000 and over	$200.

Revenue effect of House Republican alternative.—This proposal would involve a revenue loss of $12.2 billion, which is the same total amount as the administration's proposal. Its distribution is shown in table 23.

TABLE 23.—EFFECT OF THE REPUBLICAN WAYS AND MEANS COMMITTEE MEMBERS' ALTERNATIVE [1]

[1974 income levels]

Adjusted gross income class	Number of returns with tax decrease (in thousands)	Decrease in tax liability			
		Amount (in millions)	Percentage distribution of total decrease		
			By income class	Cumulative	By segment
0 to $3,000	4,057	$44	0.4	0.4	20.9
$3,000 to $5,000	7,579	308	2.5	2.9	
$5,000 to $7,000	8,273	694	5.7	8.6	
$7,000 to $10,000	11,428	1,504	12.3	20.9	
$10,000 to $15,000	15,952	3,270	26.8	47.7	50.6
$15,000 to $20,000	9,856	2,901	23.8	71.5	
$20,000 to $50,000	9,006	3,310	27.1	98.6	28.5
$50,000 to $100,000	655	133	1.1	99.9	
$100,000 and over	160	32	.3	100.0	
Total	66,966	12,196	100.0	100.0	100.0

[1] Graduated percentage refund, with a maximum refund of $430 (at tax liability of $4,500) and with the refund declinin to $200 (on tax liability over $8,000).

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

There could also be a flat credit either per taxpayer, per exemption, or per return. This would have the greatest impact in concentrating the reduction among low-income families. The revenue cost of a nonrefundable $75 credit per taxpayer would be $7.8 billion. A nonrefundable $75 credit per exemption would cost $13.1 billion, and a nonrefundable $75 credit per tax return would cost $4.9 billion. The distribution of these alternatives is shown in table 24, 25 and 26.

TABLE 24.—EFFECT OF A NONREFUNDABLE $75 TAX CREDIT PER TAXPAYER [1]

[1974 income levels]

Adjusted gross income class	Number of returns affected (thousands)		Decrease in tax liability			
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percentage distribution of total decrease		
				By income class	Cumulative	By segment
0 to $3,000	4,057	2,525	$206	2.6	2.6	37.0
$3,000 to $5,000	7,579	1,298	588	7.5	10.1	
$5,000 to $7,000	8,273	585	796	10.2	20.3	
$7,000 to $10,000	11,428	288	1,308	16.7	37.0	
$10,000 to $15,000	15,952	83	2,101	26.8	63.8	44.8
$15,000 to $20,000	9,856	16	1,406	18.0	81.8	
$20,000 to $50,000	9,006	3	1,308	16.7	98.5	18.2
$50,000 to $100,000	655	(2)	95	1.2	99.7	
$100,000 and over	160	(2)	23	.3	100.0	
Total	66,966	4,798	7,830	100.0	100.0	100.0

[1] Joint return counted as 2 taxpayers.
[2] Less than 500 returns.

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

TABLE 25.—EFFECT OF A NONREFUNDABLE $75 TAX CREDIT PER PERSONAL EXEMPTION

[1974 income levels]

Adjusted gross income class	Number of returns affected (thousands)		Decrease in tax liability			
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percentage distribution of total decrease		
				By income class	Cumulative	By segment
0 to $3,000	4,057	2,558	$207	1.6	1.6	30.0
$3,000 to $5,000	7,579	1,728	659	5.0	6.6	
$5,000 to $7,000	8,273	1,427	1,031	7.9	14.5	
$7,000 to $10,000	11,428	1,144	2,030	15.5	30.0	
$10,000 to $15,000	15,952	466	3,750	28.7	58.7	49.0
$15,000 to $20,000	9,856	46	2,649	20.3	79.0	
$20,000 to $50,000	9,006	7	2,515	19.2	98.2	
$50,000 to $100,000	655	1	193	1.5	99.7	21.1
$100,000 and over	160	(1)	47	.4	100.0	
Total	66,966	7,376	13,081	100.0	100.0	100.0

[1] Less than 500 returns.

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

TABLE 26.—EFFECT OF A NONREFUNDABLE $75 TAX CREDIT PER RETURN

[1974 income levels]

Adjusted gross income class	Number of returns affected (thousands)		Decrease in tax liability			
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percentage distribution of total decrease		
				By income class	Cumulative	By segment
0 to $3,000	4,057	2,525	$206	4.2	4.2	45.3
$3,000 to $5,000	7,579	940	540	11.1	15.3	
$5,000 to $7,000	8,273	242	612	12.5	27.8	
$7,000 to $10,000	11,428	108	854	17.5	45.3	
$10,000 to $15,000	15,952	55	1,195	24.5	69.8	39.6
$15,000 to $20,000	9,856	10	739	15.1	84.9	
$20,000 to $50,000	9,006	3	675	13.8	98.7	
$50,000 to $100,000	655	(1)	49	1.0	99.7	15.0
$100,000 and over	160	(1)	12	.2	100.0	
Total	66,966	3,883	4,883	100.0	100.0	100.0

[1] Less than 500 returns.

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

B. Changes in the Standard Deduction

Present law.—Taxpayers who choose not to itemize their deductions can elect a standard deduction equal to 15 percent of adjusted gross income (AGI) or $1,300 (the minimum standard deduction or low-income allowance), whichever is greater. The percentage standard deduction is limited, however, to no more than $2,000. The standard deduction is the same for married couples filing joint returns as it is for single people. Taxpayers who do not itemize use the minimum standard deduction when their income is less than $8,667 and are limited by the maximum standard deduction when income exceeds $13,333.

House bill.—The House bill increases the minimum standard deduction from $1,300 to $1,900 for single persons and $2,500 for joint returns. It raises the percentage standard deduction from 15 percent of adjusted gross income up to a maximum of $2,000 to 16 percent of AGI up to a maximum of $2,500 for single persons and $3,000 for joint returns. The new minimum standard deduction would apply for incomes below $11,875 for single returns and $15,625 for joint returns. The new maximum standard deduction would apply for incomes above $15,625 for single returns and $18,750 for joint returns.

Revenue effect of House bill.—The increases in the standard deduction in the House bill involve a revenue loss of $5.1 billion. The distribution by income class is shown in table 27. Virtually all of the reduction goes to taxpayers with incomes below $20,000.

TABLE 27.—EFFECT OF INCREASING THE STANDARD DEDUCTION IN THE HOUSE BILL (INCLUDING THE LOW INCOME ALLOWANCE) [1]

[1974 income levels]

Adjusted gross income class (thousands)	Number of returns affected (thousands)			Decrease in tax liability			
	Total number with tax decrease	Number made non-taxable	Number shifting to the standard deduction	Amount (millions)	Percentage distribution of total decrease		
					By income class	Cumulative	By segment
0 to $3	4,039	2,837	99	$221	4.4	4.4	62.2
$3 to $5	7,347	1,278	546	707	13.9	18.3	
$5 to $7	7,671	445	1,287	931	18.3	36.6	
$7 to $10	9,194	88	2,674	1,297	25.6	62.2	
$10 to $15	9,821	(2)	2,663	958	18.9	81.1	29.6
$15 to $20	4,053	(2)	1,546	541	10.7	91.8	
$20 to $50	1,998	(2)	1,016	404	8.0	99.8	8.3
$50 to $100	38	(2)	18	13	.3	100.0	
$100 and over	4	(2)	2	2	(2)	100.0	
Total	44,164	4,649	9,851	5,074	100.0	100.0	100.0

[1] Increasing the minimum standard deduction to $1,900 for single person returns and $2,500 for joint returns; the percentage standard deduction to 16 percent; and the maximum standard deduction to $2,500 for single person returns and $3,000 for joint returns.

[2] Less than 500 returns or 0.05 percent.

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

Administration proposal.—The administration, as part of its energy tax package, proposes to increase the minimum standard deduction from $1,300 to $2,000 for single taxpayers and $2,600 for married couples. This would, in effect, abolish the existing percentage and maximum standard deductions and put every taxpayer who does not itemize deductions on the new, higher minimum standard deduction.

Revenue effect of administration proposal.—The administration proposal would involve a revenue loss of $5.2 billion at 1974 income levels. Table 28 shows the distribution of the reduction by income class. The distribution is slightly more skewed towards low-income groups than in the formula adopted in the House bill.

TABLE 28.—EFFECT OF INCREASING THE MINIMUM STANDARD DEDUCTION TO $2,000 FOR SINGLE PERSON RETURNS AND $2,600 FOR JOINT RETURNS

[1974 income levels]

Adjusted gross income class	Number of returns affected (thousands)			Decrease in tax liability			
	Total number with tax decrease	Number made non-taxable	Number shifting to the standard deduction	Amount (millions)	Percentage distribution of total decrease		
					By income class	Cumulative	By segment
0 to $3,000	4,039	3,125	99	$236	4.5	4.5	68.0
$3,000 to $5,000	7,379	1,425	580	800	15.3	19.8	
$5,000 to $7,000	7,746	490	1,371	1,055	20.2	40.0	
$7,000 to $10,000	9,292	112	2,772	1,464	28.0	68.0	
$10,000 to $15,000	9,756	(1)	2,948	1,112	21.3	89.3	28.2
$15,000 to $20,000	3,202	(1)	1,168	363	6.9	96.2	
$20,000 to $50,000	1,331	(1)	482	190	3.6	99.8	3.7
$50,000 to $100,000	24	(1)	8	6	.1	99.9	
$100,000 and over	3	(1)	1	1	(1)	100.0	
Total	42,770	5,153	9,429	5,226	100.0	100.0	100.0

[1] Less than 500 returns or 0.05 percent.

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

Staff analysis.—The standard deduction serves two purposes: it provides tax relief to low-income families and it simplifies the income tax by giving taxpayers an alternative to itemizing their deductions.

In the past, Congress has used the personal exemption and the low-income allowance to make sure that people with incomes below official government poverty levels do not pay Federal income taxes. Inflation, however, especially higher food and energy costs, has raised the poverty level substantially in the past two years, but there has been no corresponding increase in the level at which people pay income taxes, the tax threshold. Table 11 shows projected poverty levels for 1975 and what the tax threshold would be under the House bill. The House bill raises the tax threshold above the poverty level for two-, three-, and four-person families and near the estimated poverty level in the other cases.

The House bill and the administration proposal both distinguish between single taxpayers and joint returns, which now have the same standard deduction, by giving joint returns approximately twice the increase given to single returns. The argument for making such a distinction is that married couples have higher living costs than single people and that there should not be a substantial tax penalty for marriage.

Any change in the standard deduction would be more understandable to taxpayers if it were permanent, which probably is why the administration proposes it as part of its energy package instead of its tax reduction package.

Increasing the standard deduction also effects a major simplification of the tax system by encouraging taxpayers to shift from itemizing deductions to the standard deduction. The change in the standard deduction in the House bill would induce taxpayers accounting for 9.9 million returns to shift to the standard deduction.

Of course, increasing the standard deduction would not reduce the tax liabilities of those who itemize (except, to varying extents, for the 9.9 million itemizers who would shift to the standard deduction).

C. Earned Income Credits

Present law.—None.

House bill.—The House bill introduces a refundable tax credit equal to 5 percent of earned income up to a maximum credit of $200 (on $4,000 of earnings). The credit is phased out between adjusted gross incomes (or earned incomes, if greater) of $4,000 and $6,000.

Revenue effect of the House bill.—The earned income credit in the House bill involves a revenue loss of $3.0 billion, all of which goes to people with incomes below $6,000.

Administration proposal.—In connection with its energy tax package, the administration has proposed to make an annual payment of $160 to married couples who file joint returns if their prior year's adjusted gross income is less than $4,500 and an annual payment of $80 to single people whose prior year's income is less than $2,250. For joint returns, the payment is reduced by $4 for every $25 of income above $4,500, so that it would phase out at an income of $5,500. For single people, the phaseout would occur at an income of $2,750. The purpose of this credit is to offset the effect of higher energy prices resulting from the administration's energy proposals.

Revenue effect of the administration proposal.—The revenue loss from these payments is estimated at $2 billion annually.

Staff analysis.—It has been argued that there should be some relief for people who do not now pay income tax. This could be provided through some type of refundable tax credit or payment to nontaxpayers. Even if the administration's energy program is not enacted, a refundable credit may be desirable to offset the impact of the social security payroll tax on the poor.

A problem with the administration proposal for payments to nontaxpayers is that the Internal Revenue Service will have trouble locating many of the eligible people. Because there are no records of many nontaxpayers, there is considerable potential for abuse. This could be dealt with by linking the refundable credit to the receipt of earned income, since the Service deals with almost all earners through either income or social security tax withholding or the self-employment tax.

Alternative proposal.—The earned income credit in the House bill is a modification of the "work bonus" proposal sponsored by Senator Long, a provision which has passed the Senate on several occasions, but previously was not acceptable to the House. The work bonus plan as previously presented was a 10-percent refundable tax credit on wages and salaries up to a maximum credit of $400. The $400 credit was then phased out at income levels between $4,000 and $5,600. The work bonus was available only to families with children and was phased out on the basis of income from all sources, including tax-exempt income. Limiting the credit in this case to families with children, and basing the phaseout on total income, reduces the cost of this proposal to approximately $700 million.

The House designed its earned income credit after the work bonus plan, but took into account administrative problems which the administration has raised with respect to the earlier work bonus provision. Thus, for example, it does not attempt to base the phaseout on income other than that included in adjusted gross income shown on the tax return. In addition, to a large extent it integrates the credit into the regular withholding system rather than making provision for separate quarterly refunds. Making the credit available whether or not children are in the family is an important factor in increasing the cost under the House bill, but this is mitigated in part by providing that the rate of the credit is to be 5 percent (approximately the employee's social security rate) rather than 10 percent, which includes most of both the employee's and the employer's social security tax.

The work bonus plan was thought of both as a way of decreasing work disincentives in the case of persons on welfare who were provided an opportunity to work, and also as a way of removing much of the regressivity of the social security taxes. The earned income credit of the House bill appears to accomplish much the same objectives, but probably with fewer administrative problems.

The House bill could be modified by lengthening the phaseout to between $4,000 and $8,000. This would cost an additional $0.7 billion. The rate of the credit could also be increased to 10 percent as provided in the earlier work bonus provision. With a phaseout between $4,000 and $6,000, the 10-percent rate would cost an additional $3 billion

above the $3 billion revenue loss in the House bill. With a phaseout between $4,000 and $8,000, it would cost approximately an additional $4.5 billion above the $3 billion revenue loss in the House bill.

If the committee decides to increase the credit, it could make the increase available only for joint returns. For example, increasing the rate of the credit from 5 percent to 10 percent with a phaseout between $4,000 and $8,000 for joint returns (leaving the credit at 5 percent with a phaseout between $4,000 and $6,000 for single people) would involve a revenue loss of $1.6 billion above the $3 billion revenue loss in the House bill.

D. Optional Tax Credit in Place of the Personal Exemption

Present law.—Taxpayers receive a $750 personal exemption for each taxpayer and each dependent with an additional exemption for taxpayers who are age 65 or over or blind.

House bill.—None.

Administration proposal.—None.

Alternative proposals.—The personal exemption has been criticized for being worth more to high-bracket taxpayers than to low-bracket ones. A $750 exemption is worth $525 to a taxpayer whose marginal tax rate is 70 percent, but only $105 to someone in the 14-percent bracket. To remedy this situation, it has been proposed that taxpayers be given the option of claiming a tax credit in place of their personal exemptions. A $200 optional credit would mean a revenue loss of $5.8 billion, and a $225 optional credit would involve a loss of $9.1 billion. The distribution of these reductions is shown in tables 29 and 30. These estimates assume that the increases in the standard deduction in the House bill are enacted.

TABLE 29.—EFFECT OF ADDING TO THE PROVISIONS IN TITLE II [1] OF THE HOUSE BILL A $200 OPTIONAL TAX CREDIT IN LIEU OF THE $750 PERSONAL EXEMPTION DEDUCTION

[1974 income levels]

Adjusted gross income class (thousands)	Number of returns affected (thousands)		Decrease in tax liability			
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percentage distribution of total decrease: By income class	Percentage distribution of total decrease: Cumulative	Percentage distribution of total decrease: By segment
0 to $3	1,219	57	$33	0.6	0.6	
$3 to $5	6,301	1,037	457	7.9	8.5	
$5 to $7	7,828	1,523	713	12.4	20.9	45.9
$7 to $10	11,340	1,260	1,438	25.0	45.9	
$10 to $15	15,198	343	2,164	37.6	83.5	
$15 to $20	9,045	31	840	14.6	98.1	52.2
$20 to $50	2,125	3	111	1.9	100.0	
$50 to $100	3	1	1	(2)	100.0	1.9
$100 and over	1	(2)	(2)	(2)	100.0	
Total	53,061	4,255	5,757	100.0	100.0	100.0

[1] Increasing the minimum standard deduction to $1,900 for single person returns and $2,500 for joint returns, the percentage standard deduction to 16 percent, and the maximum standard deduction to $2,500 for single person returns and $3,000 for joint returns and granting a refundable tax credit of 5 percent of wage and salary and self-employment income with a maximum credit of $200 and a phaseout of the credit between $4,000 and $6,000 of adjusted gross income.

[2] Less than 500 returns, $500,000, or 0,05 percent.

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

TABLE 30.—EFFECT OF ADDING TO THE PROVISIONS IN TITLE II[1] OF THE HOUSE BILL A $225 OPTIONAL TAX CREDIT IN LIEU OF THE $750 PERSONAL EXEMPTION DEDUCTION

[1974 income levels]

Adjusted gross income class (thousands)	Number of returns affected (thousands)		Decrease in tax liability			
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percentage distribution of total decrease		
				By income class	Cumulative	By segment
0 to $3	1,219	57	$33	0.4	0.4	38.5
$3 to $5	6,301	1,437	567	6.2	6.6	
$5 to $7	7,828	1,893	924	10.2	16.8	
$7 to $10	11,340	1,816	1,972	21.7	38.5	
$10 to $15	15,857	588	3,360	37.0	75.5	55.7
$15 to $20	9,524	58	1,699	18.7	94.2	
$20 to $50	5,242	4	518	5.7	99.9	5.7
$50 to $100	5	1	1	(2)	99.9	
$100 and over	1	(2)	(2)	(2)	100.0	
Total	57,318	5,854	9,073	100.0	100.0	100.0

[1] Increasing the minimum standard deduction to $1,900 for single person returns and $2,500 for joint returns, the percentage standard deduction to 16 percent, and the maximum standard deduction to $2,500 for single person returns and $3,000 for joint returns and granting a refundable tax credit of 5 percent of wage and salary and self-employment income with a maximum credit of $200 and a phaseout of the credit between $4,000 and $6,000 of adjusted gross income.

[2] Less than 500 returns, $500,000, or 0.05 percent.

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

The optional credit would concentrate a large tax reduction in the low- and middle-income groups. For a $225 optional credit, the credit option would be used only by taxpayers below the 30-percent bracket, who are generally families with income below $25,000 or single people with income below $16,000.

There are, however, several problems with the optional credit. Unlike increases in the standard deduction, an alternative way to reduce taxes for low- and middle-income taxpayers, the optional credit does not simplify the tax system; rather, the optional feature adds a significant complication. Also, the optional credit creates wide disparities in income tax for families with different numbers of dependents. Under present law, a three-person family with income of $10,000, which uses the standard deduction, pays a tax of $1,048, while a four-person family in the same position pays $905, a difference of $143. With the optional credit, the three-person family would pay $815 while the four-person family would pay $590, so that the difference in their taxes would widen from $143 to $225.

Some of the benefits of the optional tax credit could be obtained if a tax credit for the taxpayer and his spouse were allowed in addition to the existing personal exemption. A $75 credit would involve a revenue cost of $7.8 billion, and its distribution (not taking into account the interaction with the standard deduction changes) is shown in table 24. A $75 credit per taxpayer with an additional $25 credit per other dependent would cost $8.6 billion and is shown in table 31.

TABLE 31.—EFFECT OF ADDING TO THE PROVISIONS IN TITLE II [1] OF THE HOUSE BILL A NONREFUNDABLE TAX CREDIT AMOUNTING TO $75 PER TAXPAYER AND $25 PER DEPENDENT

[1974 income levels]

Adjusted gross income class (thousands)	Number of returns affected (thousands)		Decrease in tax liability			
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percentage distribution of total decrease: By income class	Cumulative	By segment
0 to $3	57	57	$1	(2)	(2)	
$3 to $5	2,869	1,006	183	2.1	2.1	27.3
$5 to $7	7,575	1,115	703	8.1	10.2	
$7 to $10	11,340	824	1,475	17.1	27.3	
$10 to $15	15,952	178	2,634	30.5	57.8	51.4
$15 to $20	3,855	17	1,807	20.9	78.7	
$20 to $50	9,005	4	1,689	19.5	98.2	
$50 to $100	655	(2)	124	1.4	99.6	21.2
$100 and over	160	(2)	29	.3	100.0	
Total	57,469	3,201	8,648	100.0	100.0	100.0

[1] Increasing the minimum standard deduction to $1,900 for single person returns and $2,500 for joint returns, the percentage standard deduction to 16 percent, and the maximum standard deduction to $2,500 for single person returns and $3,000 for joint returns and granting a refundable tax credit of 5 percent of wage and salary and self-employment income with a maximum credit of $200 and a phaseout of the credit between $4,000 and $6,000 of adjusted gross income.

[2] Less than 500 returns or 0.05 percent.

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

E. Rate Reduction

Present law.—Under present law, there are separate rate schedules for married couples who file joint returns, single people, married people who file separate returns, and heads of households. The rates for joint returns and single people are shown in tables 32 and 33.

House bill.—None.

Administration proposal.—As part of its energy package, the administration has proposed rate reductions in the low-income brackets, offset by increases in the middle brackets that have the effect of almost phasing out the reductions. The administration's proposed reductions are also shown in tables 32 and 33. For joint returns, the administration proposed to reduce the beginning rate from 14 percent to 7 percent, and there are other reductions in the brackets below $6,000. (The administration proposes splitting the current $4,000-to-$8,000 bracket into two separate brackets.) There are rate increases in the brackets between $16,000 and $24,000, so that families with taxable incomes above $24,000 receive only a $130 tax reduction regardless of their income. For single people, the administration proposed to reduce rates in brackets below $8,000 and to raise them in brackets between $20,000 and $26,000 so that single people with taxable income over $26,000 also receive $130 tax reductions.

TABLE 32.—PRESENT LAW AND PROPOSED RATE TABLE FOR MARRIED INDIVIDUALS FILING JOINT RETURNS AND CERTAIN SURVIVING SPOUSES [1]

Taxable income		Present law		Administration proposal	
Over—	Not over—	Pay	Plus tax rate (percent)	Pay	Plus tax rate (percent)
	$1,000		14		7
$1,000	$2,000	$140	15	$70	10
$2,000	$3,000	290	16	170	13
$3,000	$4,000	450	17	300	15
$4,000	$8,000	620	19		
($4,000)	($6,000) [2]			450	17
($6,000)	($8,000) [2]			790	19
$8,000	$12,000	1,380	22	1,170	22
$12,000	$16,000	2,260	25	2,050	25
$16,000	$20,000	3,260	28	3,050	29
$20,000	$24,000	4,380	32	4,210	33
$24,000	$28,000	5,660	36	5,530	36
$28,000	$32,000	7,100	39	6,970	39
$32,000	$36,000	8,660	42	8,530	42
$36,000	$40,000	10,340	45	10,210	45
$40,000	$44,000	12,140	48	12,010	48
$44,000	$52,000	14,060	50	13,930	50
$52,000	$64,000	18,060	53	17,930	53
$64,000	$76,000	24,420	55	24,290	55
$76,000	$88,000	31,020	58	30,890	58
$88,000	$100,000	37,980	60	37,850	60
$100,000	$120,000	45,180	62	45,050	62
$120,000	$140,000	57,580	64	57,450	64
$140,000	$160,000	70,380	66	70,250	66
$160,000	$180,000	83,580	68	83,450	68
$180,000	$200,000	97,180	69	97,050	69
$200,000	$300,000	110,980	70	110,850	70

[1] Applies for a qualified surviving widow or widower in the first 2 years after the year in which the spouse died.
[2] Proposed new brackets; split of present law $4,000 to $8,000 bracket.

TABLE 33.—PRESENT LAW AND PROPOSED RATE TABLE FOR UNMARRIED INDIVDUALS (OTHER THAN CERTAIN SURVIVING SPOUSES AND HEADS OF HOUSEHOLDS)

Taxable income		Present law		Administration proposal	
Over—	Not over—	Pay	Plus Tax rate (percent)	Pay	Plus Tax rate (percent)
	$500		14		7
$500	$1,000	$70	15	$35	9
$1,000	$1,500	145	16	80	11
$1,500	$2,000	225	17	135	13
$2,000	$4,000	310	19		
($2,000)	($3,000) [1]			200	16
($3,000)	($4,000) [1]			360	18
$4,000	$6,000	690	21	540	20
$6,000	$8,000	1,110	24	940	23
$8,000	$10,000	1,590	25	1,400	25
$10,000	$12,000	2,090	27	1,900	27
$12,000	$14,000	2,630	29	2,440	29
$14,000	$16,000	3,210	31	3,020	31
$16,000	$18,000	3,830	34	3,640	34
$18,000	$20,000	4,510	36	4,320	36
$20,000	$22,000	5,230	38	5,040	39
$22,000	$26,000	5,990	40	5,820	41
$26,000	$32,000	7,590	45	7,460	45
$32,000	$38,000	10,290	50	10,160	50
$38,000	$44,000	13,290	55	13,160	55
$44,000	$50,000	16,590	60	16,460	60
$50,000	$60,000	20,190	62	20,060	62
$60,000	$70,000	26,390	64	26,260	64
$70,000	$80,000	32,790	66	32,660	66
$80,000	$90,000	39,390	68	39,260	68
$90,000	$100,000	46,190	69	46,060	69
$100,000		53,090	70	52,960	70

[1] Proposed new brackets, split of present law $2,000 to $4,000 bracket.

Revenue effect.—These rate reductions would mean a revenue loss of $10.6 billion. The distribution of the reduction is shown in table 34.

TABLE 34.—EFFECT OF SUBSTITUTING NEW TAX RATE SCHEDULES [1] FOR THOSE UNDER PRESENT LAW

Adjusted gross income class	Number of returns affected (thousands)		Decrease in tax liability			
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percentage distribution of total decrease		
				By income class	Cumulative	By segment
0 to $3,000	4,057	16	$121	1.1	1.1	34.8
$3,000 to $5,000	7,579	31	647	6.1	7.2	
$5,000 to $7,000	8,273	14	1,071	10.1	17.3	
$7,000 to $10,000	11,428	21	1,859	17.5	34.8	48.7
$10,000 to $15,000	15,952	6	3,129	29.5	64.3	
$20,000 to $50,000	9,006	2	1,631	15.4	98.9	
$50,000 to $100,000	655	(2)	85	8	99.7	16.2
$100,000 and over	160	(2)	21	(2)	100.0	
Total	66,966	96	10,597	100.0	100.0	100.0

[1] The new rate schedules are those proposed by the administration. See tables 32 and 33.
[2] Less than 500 returns, or 0.05 percent.
Note: Details may not add to totals because of rounding.

Alternative proposals.—The House bill has been criticized because it does not give any tax reduction for the taxpayers who will continue to itemize their deductions even with the increase in standard deduction. These taxpayers would receive the rebate on 1974 taxes, but they would receive nothing for 1975 and future years. Rate reductions would be one way of providing a reduction for these taxpayers.

A rate reduction such as the one proposed by the administration implies a degree of permanence. The committee, however, could pass a rate reduction that is more clearly labeled as temporary. For example, there could be a temporary rate reduction of one percentage point in each tax bracket. The revenue loss would be $5.5 billion. This would

be a proportional reduction with respect to taxable income and, therefore, would give a larger reduction to lower- and middle-income people than a proportional tax credit, as proposed by the administration for 1974.

Another possibility would be a reduction of one percentage point in each of the initial four rate brackets (which apply to the first $4,000 of taxable income for joint returns). This would involve a revenue loss of $2.0 billion, and its distribution is shown in table 35. There could also be a one-point reduction in the brackets below $4,000 and a two-point reduction in the $4,000 to $8,000 bracket. This would involve a loss of $4.7 billion, and its distribution is shown in table 36.

TABLE 35—EFFECT OF ADDING TO THE PROVISIONS IN TITLE II [1] OF THE HOUSE BILL CERTAIN TAX RATE CHANGES [2]

[1974 income levels]

Adjusted gross income class (thousands)	Number of returns with tax decrease (thousands)	Decrease in tax liability			
		Amount (millions)	Percentage distribution of total decrease		
			By income class	Cumulative	By segment
0 to $3	1,219	$2	0.1	0.1	31.4
$3 to $5	6,301	71	3.5	3.6	
$5 to $7	7,828	190	9.3	12.9	
$7 to $10	11,340	378	18.5	31.4	
$10 to $15	15,952	620	30.3	61.7	49.5
$15 to $20	9,855	392	19.2	80.9	
$20 to $50	9,005	359	17.6	98.5	19.2
$50 to $100	655	26	1.3	99.8	
$100 and over	160	6	.3	100.0	
Total	62,317	2,045	100.0	100.0	100.0

[1] Increasing the minimum standard deduction to $1,900 for single person returns and $2,500 for joint returns, the percentage standard deduction to 16 percent, and the maximum standard deduction to $2,500 for single person returns and $3,000 for joint returns and granting a refundable tax credit of 5 percent of wage and salary and self-employment income with a maximum credit of $200 and a phaseout of the credit between $4,000 and $6,000 of adjusted gross income.

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

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

TABLE 36.—EFFECT OF ADDING TO THE PROVISIONS IN TITLE II [1] OF THE HOUSE BILL CERTAIN TAX RATE CHANGES[2]

[1974 income levels]

Adjusted gross income class (thousands)	Number of returns with tax decrease (thousands)	Decrease in tax liability			
		Amount (millions)	Percentage distribution of total decrease		
			By income class	Cumulative	By segment
0 to $3	1,219	$2	(3)	(3)	17.7
$3 to $5	6,301	73	1.5	1.6	
$5 to $7	7,828	201	4.2	5.8	
$7 to $10	11,340	561	11.9	17.7	
$10 to $15	15,952	1,549	32.7	50.4	57.3
$15 to $20	9,855	1,164	24.6	75.0	
$20 to $50	9,005	1,084	22.9	97.9	
$50 to $100	655	79	1.7	99.6	25.0
$100 and over	160	19	.4	100.0	
Total	62,317	4,732	100.0	100.0	100.0

[1] Increasing the minimum standard deduction to $1,900 for single person returns and $2,500 for joint returns, the percentage standard deduction to 16 percent, and the maximum standard deduction to $2,500 for single person returns and $3,000 for joint returns and granting a refundable tax credit of 5 percent of wage and salary and self-employment income with a maximum credit of $200 and a phaseout of the credit between $4,000 and $6,000 of adjusted gross income.

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

Taxable income bracket (thousands)	Tax rate (percent)
Joint returns:	
0 to $1	13
$1 to $2	14
$2 to $3	15
$3 to $4	16
$4 to $8	17
Single person returns:	
0 to $0.5	13
$0.5 to $1	14
$1 to $1.5	15
$1.5 to $2	16
$2 to $4	18
$4 to $6	19
$6 to $8	21
Returns of heads of households:	
0 to $1	13
$1 to $2	15
$2 to $4	17
$4 to $6	17
$6 to $8	20

[3] Less than 0.05 percent.

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

F. Increases in the Personal Exemption

Present law.—Taxpayers receive a personal exemption of $750 for each taxpayer and each dependent. In addition, taxpayers age 65 or over or blind receive an extra exemption. The exemption was last increased in 1972.

House bill.—None.

Administration proposal.—None.

Alternative proposals.—Large tax reductions could be achieved by increasing the personal exemption. The extent of inflation since 1972 would suggest a $150 increase (to $900) in order to maintain the 1972 value of the exemption in real terms. The distribution of this reduction is shown in table 37. The distribution of an increase to $850 is shown in table 38.

TABLE 37.—EFFECT OF INCREASING THE PERSONAL EXEMPTION FROM $750 TO $900

[1974 income levels]

Adjusted gross income class	Number of returns affected (thousands)		Decrease in tax liability			
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percentage distribution of total decrease		
				By income class	Cumulative	By segment
0 to $3,000	4,057	918	$81	1.4	1.4	
$3,000 to $5,000	7,579	608	255	4.3	5.7	26.0
$5,000 to $7,000	8,273	265	403	6.8	12.5	
$7,000 to $10,000	11,428	212	795	13.5	26.0	
$10,000 to $15,000	15,952	60	1,509	25.5	51.5	45.5
$15,000 to $20,000	9,586	11	1,182	20.0	71.5	
$20,000 to $50,000	9,006	4	1,436	24.3	95.8	
$50,000 to $100,000	655	(1)	192	3.3	99.1	28.5
$100,000 and over	160	(1)	54	.9	100.0	
Total	66,966	2,077	5,906	100.0	100.0	100.0

[1] Less than 500 returns.

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

TABLE 38.—EFFECT OF INCREASING THE PERSONAL EXEMPTION DEDUCTION FROM $750 TO $850

[1974 income levels]

Adjusted gross income class	Number of returns affected (thousands)		Decrease in tax liability			
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percentage distribution of total decrease		
				By income class	Cumulative	By segment
0 to $3,000	4,057	625	$57	1.4	1.4	
$3,000 to $5,000	7,579	274	175	4.4	5.8	26.3
$5,000 to $7,000	8,273	195	272	6.9	12.7	
$7,000 to $10,000	11,428	152	537	13.5	26.3	
$10,000 to $15,000	15,952	50	1,011	25.5	51.8	45.4
$15,000 to $20,000	9,856	8	791	19.9	71.7	
$20,000 to $50,000	9,006	2	960	24.2	95.9	
$50,000 to $100,000	655	(1)	128	3.2	99.1	28.3
$100,000 and over	160	(1)	36	.9	100.0	
Total	66,966	1,307	3,967	100.0	100.0	100.0

[1] Less than 500 returns.

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

The problem with lowering taxes in this way is that less of the reduction would be concentrated in the low- and middle-income brackets than is the case with increases in the standard deduction or rate reductions, such as those proposed by the administration. Also, increases in the exemption would probably have to be permanent.

G. Tax Credits for Purchases of Durable Goods

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

Since the repeal of the auto excise tax in 1971, there has been no special tax or credit relating to automobiles.

House bill.—None.

Administration proposal.—None.

Possible alternatives.—One possibility is to allow a tax credit in the case of purchase of new homes (but not rental apartment units). Under this proposal a credit equal to 10 percent of the first $10,000 of purchase price, and 5 percent of the next $20,000 of purchase price, could be allowed. This would provide a maximum credit of $2,000 and could be allowed only for houses sold in the period from April 1, 1975, through December 31, 1975.

Such a credit might be accompanied by a lesser credit for the purchase of used homes. A credit for used homes would be provided equal to one-half the credit allowable in the case of new homes. Thus, the starting credit might be 5 percent on the first $10,000 of purchase price, and 2½ percent on the next $20,000 of purchase price. This would provide a maximum credit in the case of used homes of $1,000. Such a credit might also be allowed only for the period from April 1, 1975, through December 31, 1975.

S. 453, introduced by Senators Hartke and Hatfield, would provide a refundable credit for the acquisition of a new principal residence. The credit in this case would be 5 percent of the first $25,000 of the purchase price (providing a maximum credit of $1,250) for homes purchased in 1975. For homes purchased in 1976, the credit would be 2.5 percent of the first $25,000 of purchase price, for a maximum credit of $625.

Revenue effect.—It is estimated that the credit described above which provides a maximum credit of $2,000 for the last 3 quarters of this year, would result in a revenue loss of approximately $1 billion assuming the selling of 650,000 new homes in the remainder of 1975. This estimate does not take into account the stimulative effect which such a provision might provide (but see staff analysis below). If a credit of up to $1,000 were also provided for the sale of used homes during the last 3 quarters of 1975, it is estimated that the $1 billion revenue loss might be increased to $2.4 billion. This assumes the sale of 1,600,000 used homes in the last 3 quarters of 1975. Again, this does not take into account any stimulative effect of this provision.

It is estimated that the Hartke/Hatfield credit would result in a revenue loss of $800 million in 1975, and $520 million in 1976. This also does not take into account any stimulative effect that such a provision might have.

Staff analysis.—The current weakness in the economy has centered disproportionately on housing and automobiles, and a temporary tax credit for the purchase of new homes (and possibly used homes) or for new autos could be expected to have an appreciable impact on sales during this year in much the same way as the rebates provided by the automobile manufacturers apparently stimulated their sales during February.

It is difficult to measure the extent to which the $2,000 credit might increase housing starts in the remainder of 1975, but it might be by something like 100,000 units at an annual rate. This might raise residential construction by $3 billion for the year and probably would also increase the purchases of furniture and major appliances by close to a half billion dollars. The ripple or multiplier effect of such additional purchases might increase the GNP for the rest of 1975 by close

to $4 billion. In terms of Federal tax receipts, this could give rise to perhaps $750 million of increased income for the year. Taking into account the fact that the provision is effective for only part of a year suggests revenue increases of perhaps $750 million for the year. However, just as it is suspected that the auto rebates which the companies have recently allowed may in part at least be "borrowing" from future periods, so this may also be borrowing housing starts from the year 1976. Perhaps as much as half of the housing starts might fall in this category, which suggests that the provision's induced revenue effect might be in the order of magnitude of half of the amount initially estimated above. There would of course also be a reduction in unemployment which, in turn, would mean decreased unemployment compensation payments of something like $100 million for the rest of the year 1975.

A tax credit for the purchases of new autos would appear to pose special problems. With the energy problem presently before the country, the Congress might not want to provide tax credits for autos providing low gas mileage. Some of the energy proposals presently being considered by the Congress provide tax credits for fuel-efficient cars, and in view of this the Congress might want to consider this problem in connection with that legislation rather than at this time. In any event, there are also problems with tax credits limited to fuel-efficient cars, since these currently tend to be imported cars to a much larger extent than American cars. Because of this, some of the proposals which have been put forth have suggested the postponement of measures of this type to give the U.S. auto industry time to shift their production over to a higher ratio of fuel-efficient automobiles.

VIII. ALTERNATIVE WAYS TO REDUCE CORPORATE TAXES

A. Increase in Investment Tax Credit

Present Law

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

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

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

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

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

House Bill

Increase in rate.—The investment credit rate is to be increased for all taxpayers (including public utilities) to 10 percent from 7 percent, or from 4 percent in the case of certain public utility property. (The

additional credit for public utilities is not to exceed $100 million for any one taxpayer.)

Increase in 50-percent limit for public utility property.—The bill modifies the limitation on the amount of tax liability that may be offset by the investment tax credit for a year in the case of most public utility property (which under present law is entitled to only a 4-percent investment credit). The percentage limit for public utility property is to be increased from the general 50-percent limit to 100 percent of the income tax liability for 1975 and 1976. In each of the next 5 taxable years, the increase for public utilities is to be reduced by 10 percentage points until 1981 and thereafter, at which time the 50-percent limitation again is effective. Thus, the percentage limitation is to be 90 percent in 1977, 80 percent in 1978, 70 percent in 1979, and 60 percent in 1980.[1]

Progress payments.—In the case of long-lead-time property, that is, property that requires at least 2 years to construct, the bill provides that the investment tax credit is to be available to the extent that progress payments are made during the construction period (rather than being allowed in the later year when the property is ultimately placed in service). During the first 5 years this provision is in effect, a transitional rule provides for a phase in to the new system at the rate of 20 percent a year.

Increase in limitation for used property.—As an aid to small business, the bill increases from $50,000 to $75,000 the amount of used property which can qualify for the investment credit for any one year.

Revenue Effect of House Bill

These changes in the investment credit are estimated to result in a revenue loss of $3.9 billion (of which $1.5 billion is expected to occur in 1976). The revenue effect in 1975 of increasing the rate of the investment credit to 10 percent is $2.0 billion. The increase in the amount of tax that utilities can offset with the investment credit involves a further revenue loss of $244 million. Allowing the investment credit on progress payments costs $75 million, and the increase in the amount of used property eligible for the credit to $75,000 costs $85 million.

Effective Date

The 10-percent credit is to be available for property acquired and placed in service after January 21, 1975, and before January 1, 1976; it is also to be available for property placed in service in 1976, if the property was acquired pursuant to an order placed before January 1, 1976.

In addition, in the case of property constructed, reconstructed, or erected by the taxpayer, the 10-percent credit is to be available for property completed by the taxpayer after January 21, 1975, but only to the extent of the portion of the value actually attributable to construction, etc., by the taxpayer after January 21, 1975, and before January 1, 1976. On this same basis, the 10-percent rate is to be available for qualified progress expenditures made in the period after January 21, 1975, and before January 1, 1976.

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[1] In the case of companies that have substantial amounts of investment in public utility property and also substantial amounts of investment in other property eligible for the credit in the same year, the increase in the 50-percent limit is to be proportional to the amount of the eligible public utility property as compared to the total eligible property.

The provisions increasing the amount of used property which can qualify for the investment credit apply to taxable years beginning in 1975. The provisions with respect to progress payments apply to payments made after January 21, 1975, in taxable years ending after December 31, 1974.

Administration proposal

The administration has proposed that the investment tax credit be increased for one year to 12 percent for all taxpayers, including public utilities. The temporary higher credit would apply to property placed in service in 1975 and to property ordered during 1975, if placed in service before the end of 1976. In addition, the credit would also be available to the extent of construction, reconstruction or erection of eligible property by or for a taxpayer during 1975, without regard to the date when the completed property is placed in service.

In the case of utilities the 12-percent credit would continue to apply for two additional years after 1975 with respect to qualified investment in electrical power plants other than oil- or gas-fired facilities.

Also, with respect to utilities, the 50-percent limitation on the amount of credit which may be claimed in a year above the first $25,000 of a taxpayer's income tax liability would be temporarily increased. Utilities would be permitted to use the credit against up to 75 percent of their tax liability above the first $25,000 of liability for 1975. Thereafter, the limitation would decrease by five percentage points for each year after 1975 (that is, 70 percent in 1976, 65 percent in 1977, 60 percent in 1978, 55 percent in 1979) until the limitation is decreased to the 50 percent limitation, generally applicable to other taxpayers, in 1980 and later years.

The temporary increase in the credit would be effective retroactively to January 1, 1975.

Revenue effect of administration proposal.—The administration estimates that tax liabilities would be reduced by $4.1 billion for 1975 as a result of the increases in the investment tax credit. (The cost would be $3.9 billion if a January 22 effective date were used, as in the House bill, instead of a January 1 date.)

Staff Analysis.

As indicated in the section on individual tax reductions above, the economic situation is bad and likely to get worse without significant fiscal stimulus. A balanced program which encourages both consumption and investment may well be a more effective method of stimulating the economy than attempting to focus all the tax stimulus on consumption. In addition to providing short-run stimulus to the economy, an increase in the amount of investment is desirable for other reasons.

First, additional investment which increases productivity is itself anti-inflationary in that it increases the amount of output available to meet consumer demands in the future (although this obviously is not a problem at the present time). Second, increased productivity results in lower production costs which means that money wage increases will not have the same degree of upward pressure on product prices that they would in the absence of growing productivity.

Third, it appears that unless in the future the stock of capital is increased significantly there will be serious problems in providing enough jobs for those entering the labor force. Over the past few

years, the rate of investment has not been sufficient to provide the necessary increase in productivity or to provide the capital necessary to employ the labor force.

The short-term lack of investment is indicated by the fact that the amount of investment for new plant and equipment in fact is expected to increase by only $5 billion from 1974 to 1975, an increase from $112 billion to an expected $117 billion. Given the expected increase in prices for plant and equipment, this represents a decline in the real level of investment. For manufacturing the decline in the rate of growth is even more pronounced. As shown in Table 39, investment for manufacturing increased 20.5 percent from 1973 to 1974 but is expected to increase only 9 percent between 1974 and 1975. Part of the shortfall in investment is because of the tight financial position in which many corporations find themselves. This is a result not only of declining sales but of tight monetary policy and the impact of the recession on corporate profits and cash flow.

TABLE 39.—EXPENDITURES FOR NEW PLANT AND EQUIPMENT BY U.S. BUSINESS,[1] 1973–75

[Dollar amounts in billions]

	1973	1974 [2]	1975 [3]	Percent change 1973–74	Percent change 1974–75
All industries	$99.74	$111.92	$117.09	12.2	4.6
Manufacturing	38.01	45.80	49.92	20.5	9.0
Durable goods	19.25	22.67	23.08	17.7	1.8
Primary metals [1]	3.43	4.80	5.50	40.4	14.4
Blast furnace, steel works	1.38	2.03	2.55	46.6	25.8
Nonferrous	1.67	2.29	2.41	37.2	5.3
Electrical machinery	2.84	3.06	2.88	7.7	−6.0
Machinery, except electrical	3.42	4.26	4.62	24.8	8.4
Transportation equipment [1]	3.12	3.83	3.51	22.8	−8.3
Motor vehicles	2.28	2.81	2.57	23.1	−8.5
Aircraft	.53	.77	.69	43.4	−10.3
Stone, clay, and glass	1.49	1.48	1.36	−.3	−8.1
Other durables	4.96	5.23	5.22	5.5	−.3
Nondurable goods	18.76	23.13	26.83	23.3	16.0
Food including beverage	3.11	3.21	3.20	3.1	−.3
Textile	.77	.85	.70	10.8	−17.1
Paper	1.86	2.55	2.90	37.0	14.1
Chemical	4.46	5.63	7.16	26.3	27.2
Petroleum	5.45	7.87	10.07	44.3	28.0
Rubber	1.56	1.48	1.38	−5.4	−6.6
Other nondurables	1.56	1.55	1.43	−.4	−8.2
Nonmanufacturing	61.73	66.12	67.17	7.1	1.6
Mining	2.74	3.10	3.67	13.2	18.6
Railroad	1.96	2.48	3.17	26.5	27.7
Air transportation	2.41	1.97	1.78	−18.2	−9.6
Other transportation	1.66	2.03	2.34	22.5	14.9
Public utilities	18.71	20.60	21.46	10.1	4.2
Electric	15.94	17.65	17.87	10.7	1.2
Gas and other	2.76	2.95	3.60	6.6	21.9
Communication, commercial and other [5]	34.26	35.94	34.75	4.9	−3.3

[1] Data exclude expenditures of agricultural business; real estate operators; medical, legal, educational, and cultural services; and nonprofit organizations.
[2] Preliminary.
[3] Estimates are based on expected capital expenditures reported by business in late November and December 1974. The estimates for 1975 have been adjusted when necessary for systematic biases in expectations data.
[4] Includes data not shown separately.
[5] Includes trade, service, construction, finance, and insurance.

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

Source: U.S. Department of Commerce, Bureau of Economic Analysis.

Public utilities.—The lower investment credit was originally given for public utilities because regulatory agencies presumably consider capital requirements when deciding on changes in rate levels. Moreover, it was believed that the volume of investments made by regulated public utilitities would be determined in large part by the growth

of other industries, rather than their own. In addition, much of the benefit to regulated utilities was viewed as likely to be passed on in lower rates to consumers, thus offsetting much of the stimulus to investment.

In the past several years, a number of changes in the economic environment have in combination seriously reduced the ability of regulated public utilities to obtain capital. Some utility regulatory commissions have been slow to increase rates to cover increased fuel costs and inflation-induced increases in other operating costs. These factors taken together have reduced the internal cash flow available to utilities to self-finance expansion in productive capacity.

External financing also has been restricted recently. The aggregate book value of public utility common stock presently exceeds by a substantial margin its aggregate market value because of the severely depressed level of stock market prices. Debt financing is a limited alternative because many utilities have reached as high a debt-equity ratio as is practicable in view of the level of fixed obligations reached. In addition, long-term interest rates applicable to public utility bonds are so high that few public utilities dare to commit themselves to elevated fixed debt charges for long periods of time.

The nation's energy program will require large investments by utilities to convert from oil to other fuels. Thus, there are several reasons to give utilities the investment credit on at least as favorable a basis as industry generally.

Furthermore, many public utilities currently have below-normal net taxable earnings and, thus, do not receive the full benefit of the investment credits because of the applicable limitations. As a result, the House bill includes an increase in the 50-percent net income limitation (which applies to tax liability in excess of $25,000) for a temporary period to allow these utilities to use more of their investment tax credit against taxes during this period.

The estimated revenue going to public utilities under the House bill is about $500 million out of the $3.6 billion total cost of the business tax reductions for 1975.

Alternative proposals.—If the committee should decide to make an increase in the tax reduction proposed in the House bill, it might want to provide part of the additional reduction for business. Based on the division now in the bill, slightly over 20 percent of the total is for business. While problems are presented by a temporary increase in the investment credit, most analysts would agree that this would have more of a stimulative effect on the economy than either a temporary corporate rate reduction or an increase in the surtax exemption.

A further increase in the investment credit to 12 percent, the rate proposed by the administration, would reduce tax liabilities by $1.2 billion in addition to the House bill. If this were viewed as desirable, this further increase to 12 percent could be viewed as temporary even though it might be intended to maintain the increase to 10 percent permanently.

Also, the committee will want to review the $100-million "cap" in the House bill on the increase in the investment credit that can be claimed by any one utility by reason of the increase in the rate of the investment credit. This limit applies only to American Telephone and Telegraph Co., and it has been criticized for being discriminatory.

Removing the limit involves a revenue loss of $372 million (if no other changes are made as to the credit). Of course, further increases in rates, for example, would increase this figure.

Under the House bill, the temporary increase in the 50-percent limitation on the amount of tax liability that may be offset by the investment credit for public utility property applies for taxable years beginning in 1975. There are a number of public utilities who are on a fiscal year which ends in the latter half of the calendar year. As a result, these companies would not benefit from the temporary increase in the 50-percent limit until 1976. In order to provide the benefit to these companies sooner, the committee may want to make the increase in the 50-percent limit available for taxable years *ending* in 1975 (and ending in each of the following years during the temporary period) rather than *beginning* in those years. This change would have no effect on calendar year taxpayers but would accelerate the increase in the 50-percent limit by one year for fiscal year taxpayers.

S. 1119, introduced by Senator Nelson, is designed to modify the investment credit in a manner which is especially beneficial to small business. It increases the investment credit to 12 percent on the first $20,000 of investment in a year, 10 percent on the next $30,000 of investment, and 8 percent on the excess over $50,000 (public utilities would continue, under that bill, to receive 4/7 of the amount available to others); the $50,000 maximum on used property eligible for the credit would be eliminated; and a $1,000,000 annual investment credit "cap" would be imposed on all taxpayers. Under this proposal, each taxpayer who would otherwise be affected by the $1,000,000 "cap" would be permitted to elect to use the present investment credit rates, in which case the "cap" would not apply to that taxpayer. The total revenue loss from the investment credit, if this provision were the only change made in the law, would be $1 billion.

B. Corporate Tax Rate Reductions

Present law.—Under present law, corporate income is subject to a normal tax at a rate of 22 percent and a surtax at a rate of 26 percent (for a total tax rate of 48 percent). However, the first $25,000 of corporate income is exempt from the surtax. In effect, then, the first $25,000 of corporate income is taxed at the rate of 22 percent and the income in excess of $25,000 is taxed at a 48-percent rate.

House bill.—The House bill increases the surtax exemption from $25,000 to $50,000. This means that the first $50,000 of corporate taxable income is to be taxed at the 22 percent rate, while any additional corporate income is to be taxed at the 48 percent rate. This is to result in an annual tax savings of $6,500 for a corporation having $50,000 or more of taxable income. (Under present law the tax on $50,000 of taxable income in $17,500—22 percent of the first $25,000 of income, plus 48 percent of the remaining $25,000; under the bill the tax is to be $11,000—22 percent of $50,000.)

The increase in the corporate surtax exemption is to be effective for taxable years ending after December 31, 1971. It is to apply, however, for only one year in this bill and is to cease to apply for taxable years ending after December 31, 1975.

Revenue effect of the House bill.—The increase in the corporate surtax exemption is expected to result in a revenue loss of $1.2 billion,

of which 60 percent, or $730 million, will go to corporations with incomes under $100,000.

Administration proposal.—The administration in connection with its energy package (but not its temporary anti-recession package) has proposed to reduce the corporate tax rate from 48 percent to 42 percent effective for 1975 and thereafter. It would accomplish this by reducing the surtax rate from 26 percent to 20 percent. Under the proposal, the first $25,000 of corporate income would continue to be taxed at the rate of 22 percent, but the income in excess of $25,000 would be taxed at the reduced rate of 42 percent.

Revenue effect of the administration proposal.—The administration estimates that this rate reduction represents an annual revenue loss of $6 billion.

Other proposals.—S. 1119 (Sen. Nelson) would increase the corporate surtax exemption from $25,000 to $100,000 and would provide, for 1975 only, that $5,000 of income is exempt from the normal tax. This would eliminate the tax for corporations whose taxable income was up to $5,000; reduce taxes by $1,100 for corporations with taxable incomes between $5,000 and $25,000; reduce taxes by varying amounts up to $19,500 for corporations with taxable incomes between $25,000 and $100,000; and reduce taxes by $19,500 for all larger corportions. The revenue loss of a further increase in the surtax exemption to $100,000 would be $1.3 billion in addition to the $1.2 billion under the House bill. The exemption of the first $5,000 of increase from corporate tax would involve a revenue loss of $500 million.

Staff analysis.—It has been argued that business needs a permanent form of tax relief to offset the rising cost of energy and to increase the amount of capital available to business for reinvestment. Such investment, in turn, may increase productivity and reduce unemployment. It has also been argued that real corporate profits have been declining in recent years, and that the inflated value of inventories on corporate books and the use of historical cost depreciation have produced paper profits which are taxed to corporations without increasing the actual profits which are available for investment or distribution to shareholders. On the other hand, the fact that corporations are net debtors means that the real value, and hence the real burden, of their outstanding debt decreases during a period of inflation. This reduction of the real burden of coporate debt for corporations substantially offsets the "overstatement" of corporate profits resulting from historical cost depreciation and the taxation of inventory profits.

If funds are available to reduce corporate taxes, it might well be that a better use of these funds would be to begin the integration of the individual and corporate rate structures. This could be done by allowing a deduction for dividends paid, or by giving the shareholder a credit for the tax paid on the dividend he receives by the corporation (increasing the amount treated as a dividend for this purpose by the amount of this tax), or by extending the use of the partnership method which presently is available in the case of subchapter S corporations with 10 or fewer shareholders to corporations more widely held. Any of these techniques could be implemented to a limited degree depending upon the revenue available for this purpose. European countries have developed integration plans along this line to reduce the impact

of the tax at the corporate level and have used them much more extensively than has the United States. Such changes, however, probably would require considerably more time for consideration by the committee than is available for this bill.

Another problem with the administration proposal is that much of the value of the tax reduction, which would cost an estimated $6 billion annually, would be concentrated in the hands of large corporations. For example, the administration proposal in this area would afford no relief at all to small businesses, especially those which have taxable income of $25,000 or less. Moreover, under the administration proposal, the corporations which have the largest profits would receive the most relief. Many would argue that the need of small business for tax relief is even more critical, since small businesses have little control over the marketplace and are hit even harder by such factors as inflation and a reduction in consumer confidence than are large businesses. Increasing the surtax exemption concentrates much of the tax reduction on these small businesses. However, because there is no change in the marginal tax rate for corporations with taxable incomes in excess of the surtax exemption, increasing the surtax exemption provides no incentive to increase investment for these firms.

Alternative proposals.—As an alternative to increasing the surtax exemption, the committee may want to consider reducing the normal corporate tax and making an offsetting increase in the corporate surtax. Thus, the normal tax could be reduced from 22 percent to 18 percent, and the surtax raised from 26 percent to 30 percent. This would keep the tax rate at 48 percent for all income above the surtax exemption but would reduce the tax on income below the surtax exemption level by four percentage points. This would reduce taxes by $1,000 to each corporation with taxable income of $25,000 or more. The revenue loss would be $520 million. While increasing the surtax exemption does not help small corporations whose taxable incomes are below the surtax exemption level, moving points from the normal tax to the surtax in this way helps corporations generally, the small proportionately more than the large.

C. Net Operating Loss Carrybacks and Carryovers

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

Present law also provides exceptions to the general three year carryback-five year carryover rule in the case of certain industries or categories of taxpayers, as indicated in chart 1. One exception allows certain regulated transportation corporations to carry back and deduct net operating losses for the usual 3 years and to carry over such losses for 7 years. Another exception prohibits the carryback of a net operating loss to the extent the net operating loss was attributable to a foreign expropriation loss. However, a 10-year carryover period is allowed for the foreign expropriation loss (15 years in the case of a Cuban expropriation loss). A third exception, applicable to financial

institutions for taxable years beginning after December 31, 1975, will lengthen the carryback period for net operating losses to 10 years and allow the usual 5-year carryover period. Similarly, a bank for cooperatives is presently allowed to carry net operating losses back for 10 years and forward for 5 years. A fourth exception is provided for taxpayers which have incurred net operating losses resulting from increased imports of competing products under trade concessions made pursuant to the Trade Expansion Act of 1962. Where a taxpayer has elected to obtain certification as provided by this Act, it is allowed a 5-year carryback period and the usual 5-year carryover period. Finally, present law also contains a provision designed for American Motors Corporation permitting a 5-year carryback period and a carryover period of 3 years for losses incurred for taxable years ending after December 31, 1966, and prior to January 1, 1969.

Administration proposal.—None.

House bill.—None.

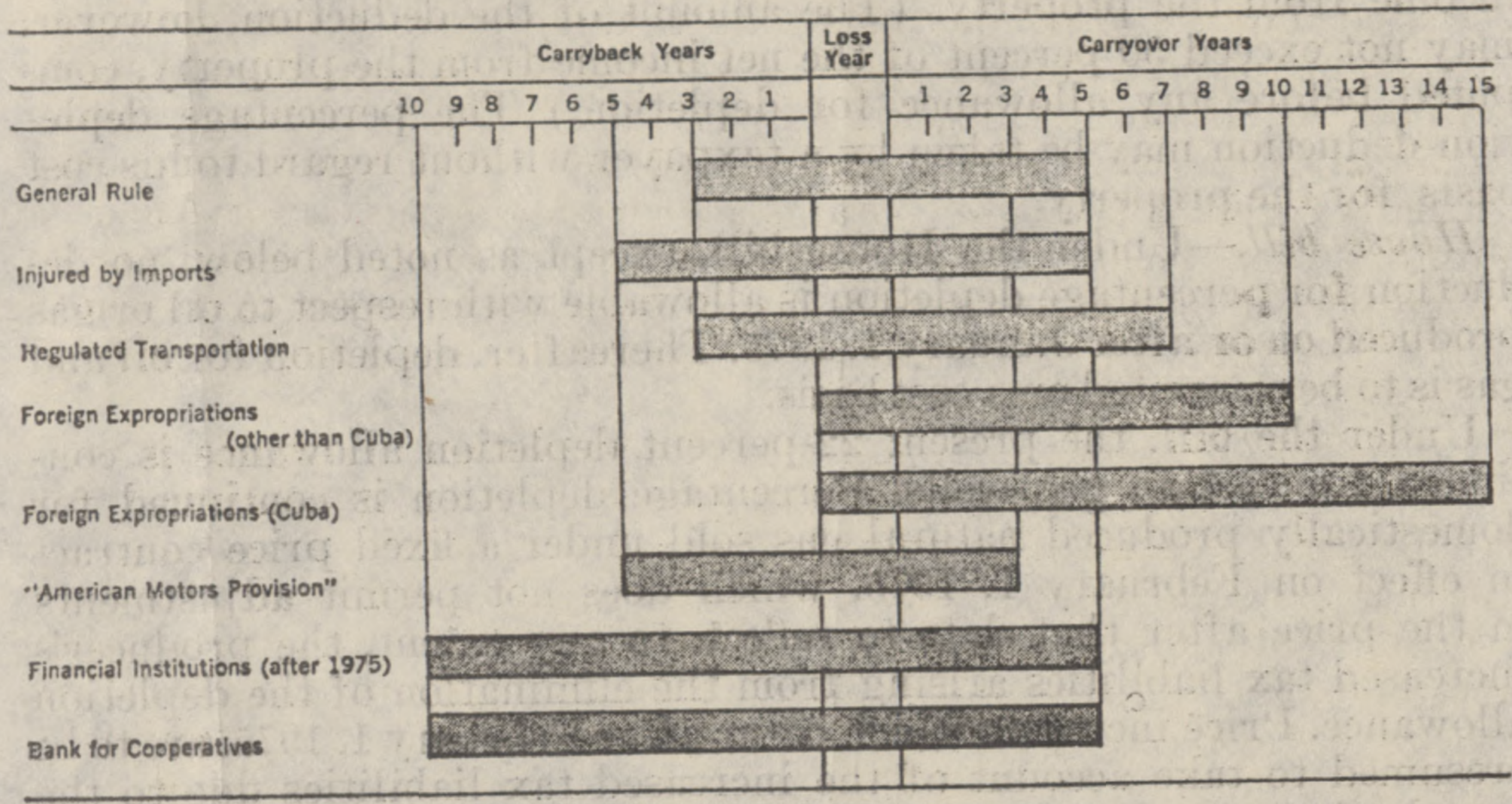
Alternative proposals.—The Congress has from time to time altered the general rule itself to reflect circumstances which apply to all taxpayers. The current economic situation raises the possibility that a considerable number of taxpayers subject to the general rule will have net operating losses so large as to exceed not only total income from the 3 years preceding the loss year but also income anticipated for the 5 years following the loss. These taxpayers, unlike others which have had more success in resisting the effects of the present economic downturn, are placed in the disadvantageous position of being unable to obtain the full benefit of their current losses by application against income earned during other years in the 9-year cycle. A lengthening of the general carryback period will provide many of these taxpayers with needed near-term funds through income tax refunds generated by the carryback of current losses. Even in the case of those taxpayers who can anticipate profit years in the near future, a lengthening of the general carryback would generate near-term funds through such refunds, which may be of greater value than the prospect of funds generated by deductions of carryovers in future years. In such cases, a current revenue loss may be offset in large part by increased future revenues, because the net operating losses deducted as current carrybacks would not be available for deductions as carryovers in future years.

One approach would be to allow, on an elective basis, any taxpayer to have a carryback period equal to the sum of the taxpayer's carryback and carryover periods under present law. For most taxpayers this would mean an eight-year carryback period, with no carryover. (For regulated transportation companies, this would mean a 10-year carryback with no carryover.) This election could be made only once. If the taxpayer subsequently wished to return to the rules of current law, it would have to repay the tax savings it realized from the use of net operating losses under this elective method, to the extent that those losses would otherwise have been "wasted," but not any interest attributable to the use of these funds.

If this provision were to apply to losses for 1974 and subsequent years, the estimated revenue loss in 1975 would be $0.5 billion. This amount would rise to $1 billion if the provision were to apply to losses for 1970 and subsequent years. Probably half (and perhaps more) of

the revenue losses referred to above would ultimately be recovered (because losses thus carried back would not be available as carryover deductions in future years).

CHART 1.—NET OPERATING LOSS CARRYBACK AND CARRYOVER PERIODS FOR DIFFERENT CATEGORIES OF TAXPAYERS



IX. Repeal of percentage depletion for oil and gas

Present law.—Under present law, percentage depletion in the case of oil and gas wells, is allowed at the rate of 22 percent of the gross income from the property. (The amount of the deduction, however, may not exceed 50 percent of the net income from the property, computed before any allowance for depletion.) The percentage depletion deduction may be taken by a taxpayer without regard to his cost basis for the property.

House bill.—Under the House bill, except as noted below, no deduction for percentage depletion is allowable with respect to oil or gas produced on or after January 1, 1975. Thereafter, depletion for oil and gas is to be computed on a cost basis.

Under the bill, the present 22-percent depletion allowance is continued for certain gas wells. Percentage depletion is continued for domestically produced natural gas sold under a fixed price contract in effect on February 1, 1975, which does not permit adjustments in the price after that date to reflect, to any extent, the producer's increased tax liabilities arising from the elimination of the depletion allowance. Price increases which occur after February 1, 1975, are to be presumed to take account of the increased tax liabilities due to the repeal of percentage depletion, unless the taxpayer demonstrates to the contrary by clear and convincing evidence.

Percentage depletion also remains in effect at a 22 percent rate for "regulated natural gas" produced and sold prior to July 1, 1976, if no price increase is permitted after February 1, 1975, which reflects, to any extent, the producer's increased tax liabilities as a result of the elimination of percentage depletion. "Regulated natural gas" is defined as gas subject to regulation by the Federal Power Commission (i.e., gas sold in interstate commerce). Any price increase which occurs after February 1, 1975, is to be presumed to take such increased tax liabilities into account, unless the taxpayer can demonstrate by clear and convincing evidence that this is not the case.

The House bill did not affect the status of geothermal steam for purposes of percentage depletion. Some courts have held that geothermal steam is a "gas" which is entitled to percentage depletion at a 22-percent rate. The current position of Treasury is that geothermal steam is not a gas entitled to percentage depletion. The House bill did not resolve this issue, and specifically left the matter open for final court determination. However, if the courts ultimately determine that geothermal steam is a gas which is entitled to percentage depletion, the House bill would allow depletion in this case at the current rate of 22 percent.

Revenue effect.—It is estimated that the provisions eliminating the deduction for percentage depletion in the case of oil and natural gas will result in a revenue gain of $2.2 billion in 1975 and $2.7 billion in 1976.

Effective date.—The repeal of the percentage depletion allowance applies generally to oil and natural gas produced on or after January 1, 1975.

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