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SUMMARY OF H.R. 3477

THE TAX REDUCTION AND SIMPLIFICATION ACT OF 1977

AS ORDERED REPORTED

ON

FEBRUARY 17, 1977

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PREFACE

This document is a summary of the principal provisions of H.R. 3477, as amended (The Tax Reduction and Simplification Act of 1977), prepared for the use of Members of Congress and their staffs.

In view of the significant revisions of the Internal Revenue Code included in this legislation, the limitations of attempting to describe such revisions properly in a "summary" should be borne in mind. The official report of the Committee on Ways and Means, which will be filed with the bill, is the ultimate legislative and interpretative authority. This document is intended to serve as a convenient condensation of the bill's principal provisions.

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I. INTRODUCTION

This pamphlet summarizes the action taken by the Committee on Ways and Means with respect to the tax provisions and special payment provisions of the Administration's economic stimulus program. The bill, H.R. 3477, was ordered favorably reported, as amended, by a roll call vote of 26–8. The Committee's bill contains three titles: (1) refunds of 1976 income taxes and payments to certain beneficiaries of income maintenance programs; (2) individual tax reductions and revision of the standard deduction and tax tables; and (3) business tax reductions. (Titles II and III include one-year extensions—through 1978—of individual and corporate tax cuts enacted in 1975 and 1976 and scheduled to expire at the end of 1977.)

In title I, the Committee modified the Administration's proposed $50 per person tax refund by phasing out the refund for those with adjusted gross incomes (AGI) between $25,000 and $30,000. Thus, a taxpayer with AGI of $30,000 or more would receive no tax refund. The Administration also proposed a $50 payment to each social security, SSI and railroad retirement beneficiary. The Committee adopted this proposal and added payments to recipients of AFDC, black lung benefits and Veterans Administration pensions and compensation. In addition, the Committee amendment precludes double payments of the tax refund and the payment to the above-mentioned beneficiaries (other than AFDC recipients), and beneficiaries of more than one of the income maintenance programs are to be entitled to only one $50 payment.

In title II, the Committee adopted the Administration's proposals for increasing the standard deduction, converting it into a floor under itemized deductions and revising the tax tables, rate schedules, and the definition of taxable income. With respect to the standard deduction change, the Committee bill sets what is now the standard deduction at $2,400 for single persons and $3,000 for married couples filing joint returns (as compared to the Administration's revised proposal of $2,200 and $3,000 for single and joint returns, respectively). These amounts will be built into rate schedules and tax tables as a zero rate bracket, so that the initial 14-percent bracket will begin at $2,401 for single returns and $3,001 for joint returns. There will also be floors under itemized deductions, so that taxpayers may deduct only those amounts in excess of the "zero bracket amount." The reduction in withholding rates due to the standard deduction changes is to go into effect on May 1, 1977. Also, the Committee bill includes the Administration's recommended one-year extension of the general tax credit (that is, the greater of $35 per person or 2 percent of the first $9,000 of taxable income) and the earned income credit. These credits would otherwise expire at the end of 1977.

In title III, the Committee substituted a new jobs tax credit for businesses for the Administration's proposal to allow businesses to elect

through 1980 either an increase in the investment credit from 10 percent to 12 percent or a credit of 4 percent of their social security tax. The Committee substitute generally provides a credit to employers for 1977 and 1978 equal to 40 percent of the first $4,200 of wages paid to new employees. The credit is computed by taking 40 percent of wages under the Federal Unemployment Tax Act (a maximum of $4,200 per employee) over the previous year's FUTA wages increased by 3 percent to account for normal employment growth. The maximum credit allowed for any employer is $40,000 per year. The Committee bill also provides an additional credit of 10 percent of the first $4,200 of wages paid to new employees who are handicapped, computed in essentially the same manner as the 40-percent credit. This additional credit is computed without regard to the $40,000 ceiling. Finally, the Committee bill includes the Administration's recommended one-year extension (through 1978) of the current $50,000 surtax exemption and the corporate tax rate schedule—20 percent of the first $25,000 of taxable income, 22 percent of the next $25,000 of taxable income, and 48 percent of taxable income in excess of $50,000.

This document also includes (in part III, below) tables of the budget effects of the bill for fiscal years 1977 and 1978. Table 1 (on page 10) sets forth the budget impact of the bill as amended by the Committee, and table 2 (on page 11) shows the budget impact of the Administration's proposals and the specific modifications made by the Committee.

II. SUMMARY OF PROVISIONS OF H.R. 3477, AS AMENDED

A. $50 Refund of 1976 Individual Income Taxes and Related Payments

Administration proposal

The Administration proposed a one-time refund of 1976 individual incomes taxes which in most cases would equal $50 for each taxpayer and dependent. For example, a family of four would generally receive $200. In two cases, the refund could exceed 1976 income tax liability; in all other cases, the refund would be limited to the amount of 1976 income tax (as was the case for the 1975 refund).

One category of people who could receive a refund in excess of tax liability is taxpayers who claim the earned income credit. (Enacted in the Tax Reduction Act of 1975, the earned income credit equals 10 percent of the initial $4,000 of earned income and is phased out as earned income or AGI rises from $4,000 to $8,000. It is available only to a taxpayer who maintains a household for a minor or student child or for an adult disabled dependent child. It is a "refundable" credit; that is, it can exceed tax liability).

The Administration proposed a second category of people for whom the refund could exceed tax liability to prevent a "notch"[1] in the refundable feature of the proposal. In general, this second category consists of people who would have been eligible for the earned income credit were it not for the income phaseout of that credit. Specifically, these are people with some earned income and a dependent child. There would still be a small number of cases in which the "notch" remains, but it is difficult administratively to eliminate the notch entirely and still provide the full $50 refund to recipients of the earned income credit.

In addition, the proposal included authorization of payments to the governments of the Virgin Islands, Guam and American Samoa to compensate for the reduction in their tax revenues which results automatically from the refund provision and certain other parts of the bill because they use a "mirror image" of the U.S. tax laws for their own income tax purposes.

The Administration proposal also contained a disregard provision which provides that the amount of the refund will not be treated as income or resources for purposes of any Federal or federally financed income maintenance program.

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[1] If the refund were allowed to exceed tax liability only for recipients of the earned income credit, there would be a "notch" at the income level at which the earned income credit phases out. For example, a 6-person family with AGI of $7,999 would be entitled to a 10 cent earned income credit under present law, which would make it eligible for the $300 refund under the Administration proposal. (A 6-person family does not pay tax on the first $8,067 of income under existing law because of the personal exemption, the minimum standard deduction and the general tax credit.) However if the refund could exceed tax liability only for recipients of the earned income credit, a one-dollar increase in income to $8,000 would eliminate the family's earned income credit and thereby reduce its refund from $300 to zero.

The refund proposed by the Administration would involve a revenue loss of $9.6 billion, all in fiscal year 1977. Of this, $1.3 billion would represent payments in excess of income tax liability.

Related payments.—The Administration also proposed a $50 payment to social security, SSI, and railroad retirement beneficiaries identical to the payment enacted in the Tax Reduction Act of 1975. This would require payments of $1.8 billion, all in fiscal year 1977.

Ways and Means Committee action

The Committee agreed to a refund of 1976 individual income taxes similar to that proposed by the Administration. The refund will be $50 per taxpayer and dependent, but will be phased out as adjusted gross income (AGI) rises from $25,000 to $30,000.[2] Thus, a family of four would receive a $200 refund if its AGI were $25,000, a $100 refund at AGI of $27,500 and no refund if its AGI were $30,000 or more.

The Committee also made a significant modification in the Administration's proposed $50 payment to beneficiaries of social security, SSI, and railroad retirement programs. The Committee decided to deny this payment to persons who receive the $50 per capita tax refund. Thus, a person who is a beneficiary of social security is not to receive the $50 social security payment if his per capita tax refund is $50; however, he is to receive the full $50 social security payment if he paid no taxes and is not eligible for a tax refund. The payment to a social security beneficiary is to be scaled down proportionately to the extent his tax refund is between $0 and $50.

The Committee also added new categories of people who are to be eligible for the $50 payment if they do not receive a payment under one of the other programs or a $50 per capita tax refund. These additional groups include recipients of Veterans Administration pensions or compensation, black lung benefits, and State-administered supplements to SSI. There also is to be a $50 payment to recipients of aid to families with dependent children (AFDC) if they do not receive a payment under one of the other programs; however, any AFDC recipient eligible for a tax refund would be entitled to the AFDC payment as well, due to the administrative problems in eliminating such double payments.

Revenue effect.—The tax refund under the Committee's bill is estimated to be approximately $8.6 billion ($1.3 billion of which represents payments in excess of income tax liability), and the related payments are estimated to be approximately $1.5 billion, all in fiscal year 1977.

B. Revision of Standard Deduction and Tax Tables

Administration proposal

Standard deduction increase.—Under present law, the standard deduction is 16 percent of adjusted gross income, but not less than a minimum standard deduction of $1,700 for single persons and $2,100 for joint returns, nor more than a maximum of $2,400 or $2,800 for

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[2] The phaseout is between $12,500 and $15,000 for married couples who file separate returns.

single and joint returns, respectively. These levels were made permanent by the Tax Reform Act of 1976.

The Administration initially proposed a flat standard deduction of $2,400 for single persons and $2,800 for married couples (the maximum standard deductions under present law). These amounts would increase the "marriage penalty" (in this case the loss of the minimum standard deduction when two single persons marry) from $1,300 under present law to $2,000. To alleviate this problem, the Administration recommended a flat standard deduction of $2,200 for single persons ($200 less than the current maximum standard deduction for single persons) and $3,000 for joint returns ($200 more than its original proposal). Using these flat dollar amounts for the standard deduction would reduce taxes in the lower and middle income brackets.

Tax forms and tax tables.—Under present law, there are two ways in which a taxpayer determines the amount of tax owed. A taxpayer either determines his tax from the tax bracket rate schedule by using the rate schedule and multiplying taxable income by the appropriate tax rate, or the taxpayer uses tax tables to look up the dollar amount of tax. The tax tables are considerably easier for the typical taxpayer to use than the rate schedules.

Under the Administration proposal, the standard deduction would be built into the tax tables and into the rate schedules. In addition, the proposal would allow itemizers (up to a certain income level) to use the tax tables.

Under the proposed flat standard deduction, taxpayers could itemize if their deductions exceeded the amount of the standard deduction floors. However, since the tax tables for itemizers would incorporate these standard deduction "floors," itemizers would deduct only the amounts in excess of the floors to determine the income which they would take to the tax table to find the amount of their tax.

Under the proposal, the $750 personal exemption and the general tax credit would be built into the tax tables. (The general tax credit is the greater of the $35 per capita or 2 percent of the initial $9,000 of taxable income.) This would allow a taxpayer whose income and number of exemptions are covered by the tax tables to determine tax liability from the tax tables without making separate calculations for exemptions or the general tax credit.

In order to permit the general tax credit to be built into the tax tables, the Administration proposed extending the $35 per capita element of the general tax credit to the extra exemptions for age and blindness.

The higher standard deduction would be reflected in reduced withholding beginning May 1, 1977.

Conversion of standard deduction into zero rate bracket and floor under itemized deductions.—The Administration's proposal included a major revision of the concepts of the standard deduction, itemized deductions, and taxable income. These proposed changes would not affect tax liability but would represent a change in the way some of these concepts are defined in the tax law and presented in the tax forms. Under the proposal, there would no longer be a "standard deduction" as such, and there would be a zero rate bracket in the tax tables and rate schedules equal to what is now the standard deduction

($2,200 for single returns and $3,000 for joint returns under the Administration's proposal). Thus, for a joint return, the 14-percent bracket would start at a redefined "taxable income" of $3,001, rather than at taxable income of $1 as under existing law. In effect, this would build the standard deduction into the rate schedules. However, because the standard deduction would be built into the rate schedules and tax tables as a zero rate bracket, it would be necessary for itemizers to subtract the amount of the "standard deduction" from their itemized deductions and deduct only those amounts in excess of this floor. Also, for individuals (but not for corporations) "taxable income" would be redefined to equal the amount of taxable income under present law plus the amount of the zero rate bracket (that is, the amount which is substituted for the standard deduction).

Ways and Means Committee action

The Committee adopted the Administration's standard deduction and tax table proposals with two changes. First, the Committee agreed to the Administration's revised increase in the standard deduction (which becomes a zero rate bracket and a floor under itemized deductions) to $3,000 for married couples filing joint returns, but increased the Administration's $2,200 level for single returns to $2,400 (the original Administration proposal).

In addition, the Committee adopted all of the Administration's simplification changes with respect to the revised tax tables and the conversion of the standard deduction into a zero rate bracket and a floor under itemized deductions. However, the Committee made a modification of the general tax credit for married couples filing separate returns.

Because of the optional feature of the general tax credit (2 percent of taxable income with a maximum of $90 for separate returns or the $35 per capita tax credit), the tax tables require two columns—one for each type of credit—in the case of married couples filing separate returns. This is necessary because both spouses are required to elect the same alternative. The Committee was concerned that having two columns in the tables and requiring a consistent election is confusing and would make it difficult for many taxpayers who file separate returns (usually married couples living apart) because often one spouse does not know which election the other spouse has made. The Committee amendment deals with this problem by limiting the general tax credit to the $35 per capita credit for married couples filing separate returns.

Revenue effect.—The tax reduction from these changes is estimated to be approximately $5 billion on an annual basis and will reduce receipts by approximately $1.8 billion in fiscal year 1977 and by approximately $6.7 billion in fiscal year 1978.

C. Tax Reduction for Business—New Jobs Tax Credit

Administration proposal

The Administration proposed a program of alternative business tax reductions. Each firm or self-employed person would choose between an additional 2 percentage points of investment tax credit (an increase from the present 10 percent credit to 12 percent, plus the additional investment credit for ESOPs) or a refundable income tax credit based on a fraction of social security payroll taxes. (A refund-

able tax credit is one that may exceed tax liability.) For each employer who would elect it, the payroll credit would be equal to 4 percent of the employer's share of payroll taxes (currently 5.85 percent of taxable payroll). For the self-employed, the payroll credit would be equal to 2 percent of the self-employed payroll tax (currently 7.9 percent). The credit for payroll taxes would not be available to nonprofit organizations and State and local governments.

The effective date for both the additional investment tax credit and the payroll tax credit proposals would be January 1, 1977. (The alternative selected by each taxpayer would be binding for all years through 1980.)

The reduction in business tax liability would be at an annual rate of $2.6 billion. The reduction in budget receipts would be $0.9 billion in fiscal year 1977 and $2.4 billion in fiscal year 1978.

Ways and Means Committee action

The Committee substituted a new jobs tax credit for the Administration's elective business tax credit proposal. Under the Committee's amendment, an employer is to receive a credit equal to 40 percent of the first $4,200 (a total of $1,680) of wages paid to each additional employee. The credit is to be equal to 40 percent of the difference between 1977 wages up to $4,200 per employee and 103 percent of 1976 wages up to $4,200 per employee. (The three-percent increase in the base reflects anticipated normal growth in employment.) In addition, to prevent an employer from merely substituting part-time or part-year new employees for old employees and to ensure that employment of any firm actually increases, the credit could not exceed 40 percent of the difference between total 1977 wages and 103 percent of total 1976 wages. The new jobs credit also is to be available for the same adjusted increase in employment in 1978 over 1977 levels. However, the new jobs credit expires after 1978.

In order to direct the primary benefit of the credit to smaller businesses, the maximum credit allowed to an employer is to be $40,000 per year. Also, the Committee amedment provides for an additional 10-percent credit for the first $4,200 of wages paid for additional handicapped employees. This additional credit is not subject to the $40,000 limit.

Employers, other than farm and railroad employers, are to use their 1976 and 1977 returns under the Federal Unemployment Tax Act (FUTA) as the basis for the first year's credit. When the FUTA base itself increases to $6,000 in 1978, employers are to use their FUTA records, adjusted to the $4,200 credit limit. Farm employers, who are not covered by FUTA until 1978, are to use their FICA (social security tax) records throughout the credit period, taking into account the $4,200 limit for each employee. Railroad Unemployment Insurace Act (RUIA) returns are to provide the basis for the credit for railroad employers.[3] The credit would not be available to State and local governments, tax-exempt organizations, or self-employed individuals.

The credit would be allowed up to 100 percent of income tax liability, with a 3-year carryback and a 7-year carryforward of unused credits. Special rules are to be applied to prevent abuse in cases of separate businesses under common ownership, sales and purchases of

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[3] A simple mathematical computation is used to equate the $4,800 RUIA base with the FUTA base. Other railroad records are to be used to compute the total pay limit.

businesses, changes in business form, and dismissals for the purpose of securing or increasing the credit.

Revenue effect.—The revenue loss associated with the new jobs credit is estimated to be approximately $0.7 billion in fiscal year 1977, $2.4 billion in fiscal year 1978, and $1.7 billion in fiscal year 1979.[4]

D. Extension of 1977 Individual and Corporate Tax Cuts to 1978

1. Extension of Individual Tax Reductions

Administration proposal

The Tax Reform Act of 1976 extended through 1977 the temporary individual tax reductions originally enacted in the Tax Reduction Act of 1975 and subsequently enlarged and extended through 1976. These are the general tax credit and the earned income credit. (The increases in the standard deduction enacted in 1975 and 1976 were made permanent by the Tax Reform Act of 1976.) The Administration proposed extending these tax cuts through 1978.

General tax credit.—The general tax credit equals the greater of (1) $35 per taxpayer and dependent or (2) 2 percent of the initial $9,000 of taxable income. Extending the credit through 1978 would reduce budget receipts by $6.8 billion in fiscal year 1978 and $4.0 billion in fiscal year 1979. (The Administration proposed extending the $35 credit to the additional exemptions for age and blindness, which is included in the revenue estimates.)

Earned income credit.—The earned income credit equals 10 percent of the initial $4,000 of earned income. It is phased out as adjusted gross income or earned income rises from $4,000 to $8,000 and is available only to people who maintain a household for a minor or student child or for a disabled adult dependent child. The credit may exceed tax liability; that is, it is a "refundable" credit, in contrast to the general tax credit, which is limited to tax liability. Extending the earned income credit through 1978 would have no impact on fiscal year 1978 receipts but would reduce receipts in fiscal year 1979 by $1.3 billion.

Ways and Means Committee action

The Committee agreed to extend the general tax credit and the earned income credit through 1978, and also extended the $35 credit to the extra exemptions for the aged and blind.

In addition, the Committee modified the earned income credit by clarifying eligibility of AFDC recipients for the credit.

Under present law, the earned income credit is available only to persons who "maintain a household" for a child or an adult disabled dependent child; "maintaining a household" means that a person furnishes more than one-half the cost of that household. For this purpose, AFDC payments with respect to any child are considered support provided by someone other than the parent under present law; therefore, recipients of AFDC for whom AFDC received with respect to their children constitutes more than one-half their income are not considered to be maintaining a household for their children and are

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[4] This estimate is based on the staff's best estimate of future employment growth. The revenue effect is, of course, sensitive to changes in employment. For example, employment growth of an additional 500,000 employees (above that assumed for the revenue estimate) earning at least $4,200 could add up to $840 million to the revenue cost.

not entitled to the earned income credit. The Committee modified the earned income credit to make it available to AFDC parents who would otherwise qualify for the credit.

2. Extension of Corporate Tax Reductions

Administration proposal

The Tax Reduction Act of 1975 increased the corporate surtax exemption from $25,000 to $50,000 and reduced the tax rate on the first $25,000 of corporate taxable income from 22 percent to 20 percent. Thus the corporate tax rate is 20 percent on the first $25,000 of taxable income, 22 percent on the next $25,000, and 48 percent on taxable income in excess of $50,000. These tax cuts were extended through 1977 in the Tax Reform Act of 1976. The Administration proposed extending them through 1978.

The reduction in budget receipts is estimated to be $1.0 billion in fiscal year 1978 and $1.3 billion in fiscal year 1979.

Ways and Means Committee action

The Committee agreed to extend the current $50,000 surtax exemption and the corporate rate reductions through 1978.

III. BUDGET EFFECTS OF H.R. 3477, AS AMENDED

This part presents the budget effects of the bill, H.R. 3477, for fiscal years 1977 and 1978. Table 1 shows the budget effect of the bill as amended by the Committee. Table 2 gives the budget impact of the Administration's proposal (H.R. 3477, as introduced) and the specific modifications made by the Committee.

Table 1.—Budget Effects of Committee Bill [1]

[In billions of dollars]

	Fiscal year	
	1977	1978
Revenue Effect of Committee Bill		
1. Refund of 1976 individual income taxes and related payments:		
Refunds of tax	—7.3	
Refunds in excess of tax liability	—1.3	
Payments to beneficiaries of various programs	—1.5	
Subtotal—refunds and related payments	—10.1	
2. Increase in standard deduction	—1.8	—6.7
3. Extension of $35 credit to aged and blind		—0.1
4. General tax credit for separate returns		(2)
5. New jobs tax credit	—0.7	—2.4
Subtotal—economic stimulus package	—12.7	—9.1
6. Extension of 1977 tax cuts through 1978:		
Individual tax cuts [3]		—6.8
Corporate tax reductions		—1.0
Subtotal—tax cut extension		—7.8
Grand total—Committee bill	**—12.7**	**—17.0**

[1] These estimates are preliminary and subject to revision in the official Committee Report.

[2] Less than $50 million.

[3] General tax credit; the extension of the earned income credit has no budgetary impact until fiscal year 1979.

[4] No budgetary impact until fiscal year 1979.

[5] Recipients of "black lung" benefits, State administered SSI benefits, and veterans compensation and pension benefits.

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

Table 2.—Budget Effects of Administration Proposal and Changes by Committee on Ways and Means [1]

[In billions of dollars]

	Fiscal year 1977	Fiscal year 1978
Administration Proposal		
1. Refund of 1976 individual income taxes and related payments:		
Refunds of tax	−8.3	-------
Refunds in excess of tax liability	−1.3	-------
Payments to social security, SSI, and railroad retirement beneficiaries	−1.8	-------
Subtotal—refund and related payments	−11.4	-------
2. Increase in standard deduction	−1.5	−5.6
3. Extension of $35 credit to aged and blind		−0.1
4. Business tax credits—offset against tax liability	−0.9	−2.3
Refunds in excess of tax liability		−0.2
Subtotal—economic stimulus package	−13.8	−8.1
5. Extension of 1975–76 tax cuts:		
General tax credit		−6.8
Earned income credit [4]		-------
Corporate tax reductions		−1.0
Subtotal—tax cut extension		−7.8
Total—Administration proposal	**−13.8**	**−15.9**
Ways and Means Committee Changes		
1. Refund of 1976 individual income taxes and related payments:		
Phaseout of refund	+1.0	-------
Elimination of double payments	+0.9	-------
Payments to AFDC recipients	−0.6	-------
Payments to other program beneficiaries [5]	−0.1	-------
Subtotal—change in refund and related payments	+1.3	-------
2. Standard deduction—increase for single returns	−0.3	−1.1
3. General tax credit for separate returns		(2)
4. Business tax credit—substitution of new jobs tax credit	+0.1	(2)
Total—change from Administration proposal	**+1.1**	**−1.1**

Note: See footnotes on p. 10.


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