The original documents are located in Box 54, folder "1975/12/08 - Economic Policy Board" of the James M. Cannon Files at the Gerald R. Ford Presidential Library.

ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE MEETING

AGENDA

December 8, 1975
8:30 a.m.
Roosevelt Room

1.	Conference on International Economic Cooperation	Robinson
2.	Economic Assumptions for 1977 Budget	Troika II

DRAFT
December 6, 1975

MEMORANDUM FOR THE ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE

SUBJECT: Economic and Policy Assumptions for the 1977 Budget: Tax Policy Decisions

The 1977 Budget will be published on January 19. Unless Congress acts in a surprising manner, the President's proposal for a $28 billion tax cut will not have been enacted by that date. A new effective date and possibly a new structure will have to be specified for the proposed tax cut and this date must be decided by December 12 for the purposes of the outlay, receipts, and economic assumptions that will appear in the 1977 Budget.

As of January 1, a number of scenarios are possible:

(1) A return to 1974 tax law because of a successful Presidential veto of congressional tax action that does not include a spending ceiling.

(2) A temporary extension of 1975 tax law.

(3) Something like the House's proposed tax cut enacted over the President's veto.

Regardless of the scenario that emerges, it is assumed that the Budget will propose a further tax cut to become effective sometime in 1976 and that for Budget purposes the President will adhere to his goal of a tax cut of $28 billion from 1974 levels accompanied by a $395 billion spending limit for FY 1977.

Any tax cut that become effective during 1976 will have to be made retroactive to January 1. Otherwise taxpayers would face the extremely difficult task of determining whether 1976 income and deductions occurred before or after the effective date of the new tax law.

However, this leads to a problem which can be illustrated by the following example. Let us suppose that the Congress has enacted an extension of 1975 withholding rates. This would lead to a $12 billion personal tax reduction compared to 1974 law. The President's original proposal was for an additional $8 billion in personal income tax cuts (total $20 billion) effective January 1, 1976. If the effective date of his proposal is delayed to, say, July 1, 1976 with the additional $8 billion cut retroactive to January 1, it would be necessary to make a decision regarding withholding rates.

If the cut in withholding rates is sufficient to provide taxpayers with the entire $8 billion during the six months remaining in 1976, either withholding rates will have to be raised in January 1977 or a further tax reduction will be required to keep rates constant.

Clearly, there will be strong pressures for the latter. This problem is very much more serious if 1974 tax law goes into effect January 1, 1976.

There are two ways out of this difficulty. First, withholding rates would be set at the levels which would prevail in 1977 and afterwards. If 1975 tax law is extended into 1976, or if the House bill is enacted, this would result in about $4 billion of overwithholding in 1976 which would be refunded in the spring of 1977. If 1974 tax law goes into effect on January 1, 1976, overwithholding would be about $10 billion which may make this approach less acceptable.

Secondly, the President's proposed tax cut could be phased in. For example, if the effective date for new withholding rates were July 1, and if the Congress had already provided a $12 billion reduction from 1974 levels effective January 1, an additional $4 billion in liability reductions could be proposed for 1976 to be followed by a further $4 billion reduction in 1977. Thus, the total reduction in 1976 tax liabilities would be $16 billion from 1974 levels and the total reduction in 1977 tax liabilities would be $20 billion from 1974 levels. In this way, withholding rates would be immediately lowered to their eventual 1977 levels on July 1, 1976. There would be no overwithholding in 1976. Moreover, the fiscal 1977 deficit would be reduced. However, there could be some technical problems. A special set of tax rates and exemptions would have to be designed for 1976, and some equity problems would be encountered in distributing the first phase of the eventual $28 billion tax cut. The business tax reductions could be phased in in a similar manner. The exact nature of the phase in of both personal and business cuts will depend on the choice of an effective date.

Needless to say, the choice of a strategy has important implications for the computation of budget totals and for the economic forecast.

The options regarding the basic strategy are summarized below. A discussion of different effective dates follows.

Options

Option 1: Implement the President's original proposal for a $28 billion reduction in tax liabilities from 1974 levels retroactive to January 1, 1976.

If this option is selected there are two options regarding withholding rates:

Option 1A: Lower rates sufficiently to provide the entire $28 billion cut during whatever remains of 1976.

This implies that withholding rates will rise in January 1977 unless the tax law is changed.

Option 1B: Lower withholding rates only to their eventual 1977 levels.

This implies overwithholding in 1976.

Option 2: Phase in the President's proposed tax cut.

The amount provided in 1976 will depend on the effective date of the withholding change and will be calculated so as to keep withholding rates constant between 1976 and 1977.

Decision

Option 1 ________ Implement the President's original proposal retroactive to January 1, 1976.

Option 1A ________ Implement magnified withholding rates.

Option 1B ________ Implement rates which will apply to permanent levels in 1977 and afterwards.

Option 2 ________ Phase in the President's proposed tax cut.

Regardless of the decision, the budget estimates and economic forecast will be dependent on an assumption regarding what tax law will be in effect on January 1, 1976. Hopefully, the events of the next week will clarify this problem.

Effective Date for New Withholding Rates

For budgetary purposes, three possible effective dates for new withholding rates are considered below. Obviously, any intervening date could be chosen.

April 1: This date precedes the First Concurrent Resolution on the Budget which must be passed by May 15. Consequently, Congress would have to impose a $395 billion spending ceiling in advance of their regular budget procedures. By the Budget's publication date, this may appear totally unrealistic. On the other hand, an early date minimizes the overwithholding problem if the full $8 billion cut is provided and withholding is not magnified.

July 1: This date follows the Concurrent Resolution by six weeks, and the $28 billion tax cut could be made contingent on that Resolution containing a $395 billion ceiling. However, six weeks does not leave much time for Congressional action and for prepration of new withholding tables by the IRS. This date makes it relatively easy to design a $4 billion personal tax cut in 1976 and an $8 billion cut in 1977.

October 1: This date leaves plenty of time for Congressional action on taxes if they pass a $395 billion budget ceiling. It also coincides with the beginning of the fiscal year which makes us immune from the criticism that we advocate the tax cut before the spending cut. On the other hand, there would be a 9-month delay in implementing the President's program, and the overwithholding problem would be more serious. This date also requires Congressional action uncomfortably close to the election.

Decision

April 1 __________

July 1 __________

October 1 __________

Other __________

We also face the difficult task of providing our forecasters and receipts estimators with some guidance as to the tax law that we expect to be in effect between January 1 and the effective date of the President's tax proposal. Hopefully, the events of the next week will clarify that problem.