ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE MEETING

AGENDA
8:30 a.m.
Roosevelt Room

December 30, 1975

PRINCIPALS ONLY

1. Tax policy — Treasury

2. Unemployment initiatives

FEDERAL ENERGY ADMINISTRATION
WASHINGTON, D.C. 20461

OFFICE OF THE ADMINISTRATOR

December 29, 1975

MEMORANDUM FOR ENERGY RESOURCES COUNCIL
EXECUTIVE COMMITTEE MEMBERS

FROM: FRANK G. ZARB 𝒵

Inasmuch as we have overlapping issues and membership, Bill Seidman and I have agreed that the ERC Executive Committee will meet with the Economic Policy Board's Executive Committee each Monday at 8:30 A.M. in the Roosevelt Room.

Principals only please.

MINUTES OF THE ECONOMIC POLICY BOARD EXECUTIVE COMMITTEE MEETING

December 29, 1975

Attendees: Messrs. Simon, Seidman, Lynn, Greenspan, Zarb, Robinson, Baker, Cavenaugh, Gorog, Penner, Porter, Ahalt, Hinton, Arena, Murphy, Farrell

1. Report of Interagency Fertilizer Task Force

The Executive Committee reviewed the December Status Report of the Interagency Fertilizer Task Force. The discussion focused on the work of the Task Force in improving fertilizer statistics with particular emphasis on inventories. Mr. Ahalt also reported on the threatened nationalization of the potash industry by the Saskatchewan Provincial Government.

2. Report of Conference on International Economic Cooperation

Under Secretary Robinson reviewed the results of the December 16 through 18 Conference on International Economic Cooperation held in Paris. He reported that the U.S. initiative of four separate commissions dealing with raw materials, development, finance, and energy was reconfirmed and launched, with members and co-chairmen selected. All commissions are scheduled to have commenced their work by February 11.

3. State of the Union Message

Mr. Seidman reported that the President would like to have Executive Committee members' ideas regarding a general theme and overall approach for the State of the Union message on an individual basis, and that these suggestions should be limited to approximately two pages in length.

Decision

Mr. Seidman's office will coordinate the submission of the State of the Union general theme papers from the Executive Policy Board to the President. Executive Committee members should submit their suggestions to Mr. Seidman's office no later than noon, Wednesday, December 31.

OPTIONAL FORM NO. 10
MAY 1962 EDITION
GSA FPMR (41 CFR) 101-11.6
UNITED STATES GOVERNMENT

Department of the Treasury
Washington, D.C. 20220

Memorandum

TO : Economic Policy Board Executive Committee DATE: DEC 29 1975

FROM : Charles M. Walker
William M. Goldstein

SUBJECT: Options with regard to the level of the Administration's activity in the tax reform area during 1976

In connection with preparation for the State of the Union message, the President should decide upon the level of activity which the Administration, acting through the Treasury Department, should undertake during 1976. Due to the significant tax reform matters already pending in Congress and past Administration proposals, it would appear that a substantial amount of activity will be carried on in any event.

Attached hereto please find a background memorandum which was prepared by the Office of Tax Policy for the Secretary on December 22, 1975. Such memorandum discusses the following four areas which include both the mandatory and optional levels of activity in the tax field.

1) Tax Cut and Spending Limitation. - Since the tax bill just signed by the President has the effect of extending tax cuts for 6 months only, it will be necessary for the Administration to make new proposals in this area to take effect as of July 1, 1976. While Congress is committed to matching any further tax cuts after that date with reductions in the level of Federal outlays during fiscal 1977, it is not committed to any particular tax cut extension following June 30, 1976. Since the President, on October 6, 1975, recommended permanent tax cuts at the annual level of $28 billion, the Administration will presumably press for the implementation of such cuts as of July 1, 1976. The EPB Executive Committee has been supplied with Mr. Collinson's memorandum of December 22, 1975, which sets forth the principal options for implementing deepened tax cuts as of July 1, 1976.

2) Congressional Program. - The Tax Reform Act of 1975 as passed by the House of Representatives will be considered by the Senate Finance Committee during the Spring of 1976. Since this legislation is in major part the result of Treasury proposals dating back to April 1973, we will presumably

support it before the Senate Finance Committee while seeking to make changes and additions to improve the Act. The Treasury Department will also be involved with Phase II of Tax Reform, as prescribed by the Ways and Means Committee, which will include hearings on such subjects as industrial development bonds, bank holding company tax relief, estate and gift taxes and the disclosure of tax returns. The estate and gift tax study will, of course, include the subject of estate and gift tax relief for small business which has been the subject of EPB consideration. In addition, the Ways and Means Committee will establish task forces on the subjects of capital formation and foreign source income which involve many important subjects on which the Administration has strong views. Foremost among these, included in the capital formation study, is the Administration's proposal for the integration of corporate and personal taxes.

3) Past Administration Initiatives. - The three principal past initiatives which will be considered further in 1976 have already been mentioned: tax reform as reflected in the Tax Reform Act of 1975; a combination of permanent tax cuts with a limitation on Federal outlays; and the capital formation program, including integration and the "utilities package."

4) Possible New Initiatives. - Broadened Stock Ownership - The EPB Executive Committee has considered this at some length and has been supplied with Mr. Collinson's memorandum of December 19, 1975. A major program of base broadening tax reform and simplification as urged by Secretary Simon in his Tax Foundation Speech - the EPB Executive Committee has been supplied with Mr. Bradford's memorandum of December 29, 1975. If this is adopted as an Administration initiative, it will represent a major undertaking by the Treasury Department. A third possible new initiative would be a more detailed review of tax expenditures. Finally, there have been various other initiatives suggested by Administration spokesmen many of which were set forth in Mr. Seidman's memorandum to the EPB Executive Committee of December 17, 1975.

Options

1) The Administration could maintain a low-profile in Federal tax matters, particularly tax reform matters, and simply react to congressional initiatives.

2) The Administration could concentrate on improvements in the Tax Reform Act of 1975 and continue to push its past initiatives in the Phase II hearings at Ways and Means and

3) In addition to the activity described in option 2, the Administration could press for major new initiatives such as the broadened stock ownership plan, the review of tax expenditures and, perhaps, several other new programs (including capital recovery programs) which have been suggested but not carefully studied to date.

4) In addition to options 2 and 3 above, the Administration could press for a major program of base broadening tax reform and simplification, recognizing that such a program might take several years to implement and might ultimately render certain of the other Administration initiatives moot.

RECOMMENDATION: That the Administration adopt option 4 above but limit its new initiatives to the broadened stock ownership plan, the review of tax expenditures and the major program of tax reform and simplification.

Attachment

December 22, 1975 6 p.m.

Background Memorandum

1976 State of the Union Message - Tax Legislation

In approaching the State of the Union message this year, the President should be fully aware of the rather extraordinary amount of "old business" on the Congressional agenda, as well as in prior Administration initiatives, which will be or should be considered by Congress before serious attention is paid to new proposals. Some of this old business - for example, the integration of the corporate income tax - is necessarily a long-term proposition so that it may be that certain new proposals - such as the plan for broadened stock ownership - can be acted upon before consideration, and certainly implementation, of other proposals is completed.

This memorandum and the attached materials cover four principal areas in an effort to give a full picture of the present situation in the tax legislation area. Even so, many proposals of great interest to particular groups which are filtering their way through Congress will not even be mentioned here. The four principal areas are:

I. Tax Cut and Spending Limitation.

II. The Congressional Program.

III. Past Administration Initiatives.

IV. Possible New Initiatives.

Over the next few weeks, considerable work will have to be done in the revenue estimation area if it is decided to push forward with significant new initiatives.

I. Tax Cut and Spending Limitation.

The Congress has now extended the 1975 withholding tax rates to the first 6 months of 1976, provided a reduction in full-year 1976 liabilities which corresponds to the half-year withholding cut -- and expressed its determination to reduce 1977 budget outlays by an amount equal to any further tax cuts applicable to that fiscal year. The reduction in revenues during the first half of calendar 1976 was designed to accomodate the $300.8 billion floor on fiscal 1976 receipts established in the second concurrent budget resolution.

According to our revenue estimates, the tax rules now applicable to 1976 will produce a reduction in liabilities, as compared with 1974 rules without regard to the investment credit changes, of $8.4 billion at 1976 levels of income. Since the expanded investment credit was not in effect in 1974, a true comparison of the 1976 and 1974 laws as applied to 1976 income would include at least an additional $1.5 billion for the half-year effect of the investment credit. Doubling the cuts already enacted for 1976, would, therefore, produce a $19.8 billion tax cut, compared to the $28 billion in tax cuts proposed by the President on October 6. The principal difference between the $19.8 billion figure and the $18 billion figure previously used derives from the use of 1976 rather than 1975 levels of income. If we applied the President's October 6 program to 1976 income levels, the total tax cut would approximate $30 billion.

The President has already announced that he will renew his efforts to increase the annual level of tax cuts commencing July 1, 1976 to $28 billion. This is consistent with his plan to submit a $395 billion budget for fiscal 1977. We must, therefore, devise a program - effective July 1, 1976 - to decrease the level of tax by $8 billion to $10 billion per year. Presumably such increase would be balanced between personal and business income taxes and would attempt to implement the relief for middle-income families contained in the President's October 6 message. In this connection, it should be noted that 40.4 percent of the benefits of the tax cut extension into 1976 will flow to taxpayers with adjusted gross income under $10,000 compared to approximately 29 percent in both the President's plan and the Tax Reform Act passed by the House. The benefits which have thus flowed to the lowest income classes have been taken primarily from the middle-income groups.

Since the mechanics of the tax cut extention - percentage standard deduction, percentage income credit and earned income credit - differ markedly from the President's program of increasing the personal exemption, adopting a flat standard deduction and reducing rates, we will have to decide whether to build permanent changes upon existing 1976 law or to substitute the President's mechanics on July 1, 1976 or January 1, 1977. We are developing alternative approaches and the tables to support them. See Mr. Collinson's memorandum to Mr. Gardner dated December 22, 1975.

Attached hereto are:

1) President's October 6, 1975 speech.
2) White House Fact Sheet dated October 6, 1975.
3) Simon Testimony - December 9, 1975.
4) Fact Sheet delivered to White House - December 20, 1975.
5) Revenue Estimates on Full year basis of the Tax Cut Extension Bill.
6) Memorandum to Mr. Gardner re: Deepened Tax Cuts - December 22, 1975.

II. The Congressional Program.

Major items of unfinished business will be acted upon by the tax-writing committees of Congress during the first half of 1976. To the extent we have not already done so, the Administration will have to develop a position on each subject to be considered. Many of the proposals, of course, began as Administration initiatives. The principal items already scheduled for Congressional consideration are as follows:

A. The Tax Reform Act of 1975. This bill, which has passed the House, will be considered by the Senate Finance Committee early in 1976. The Senate will probably act on this bill by June of 1976. The hearings and mark-up sessions will offer us the opportunity to recommend changes and additions to this legislation of which we generally approve.

Comparing the actual bill with our tax reform proposals of April, 1973, we find a combination of the Limitation on Artificial Accounting Losses and a broadening of the Minimum Tax in lieu of our version of LAL and the Minimum Taxable Income concept. We propose to review the House bill to be sure that it closes undesirable loopholes without impacting legitimate business transactions. We will continue to support the viability of the DISC program while seeking to terminate withholding taxes on dividends and interest paid to foreigners.

B. Tax Reform Act - Phase II. At the beginning of 1976, the Ways and Means Committee will take up certain important matters which were deferred in 1975. These include industrial development bonds, bank holding company tax relief, estate and gift taxes and disclosure of tax returns. We will need to firm up the Administration's position on the major estate and gift tax issues (including taxing capital gains at death). We will continue to oppose broadening the small issue exemption for IDBs. The Committee may also consider the taxable municipal bond option.

C. Ways and Means Task Forces. Two Committee task forces will commence action in January and are expected to report in April or May. The first will consider the taxation of foreign source income, particularly the question of deferral. It will also consider the foreign tax credit, the taxation of shipping income, the taxation of employees working overseas and State taxes on foreign source income.

The second task force will study the taxation of income from capital and its effect on capital formation. Included items will be: integration of corporate and personal taxes; deferral for reinvestment of public utility dividends; methods of capital cost recovery; net operating losses; capital gains and losses; and indexing the tax system. These are vitally important issues on which, in many cases, the Administration either has taken (integration; deferral for reinvestment of public utility dividends) or is considering (faster capital cost recovery) policy positions.

The Committee also proposed to study the feasibility of a Court of Tax Equity and the tax treatment of scholarships and fellowships, including student loans that are forgiven.

D. Financial Institutions Act of 1975. This Act, to be considered by the Senate Finance Committee, has an important provision which would allow commercial banks, thrift institutions and certain other investors a mortgage interest tax credit instead of a bad debt reserve deduction.

E. Environmental Protection Tax Act of 1973. The Domestic Council has shown recent interest in the historic structure portion of this Act.

III. Past Administration Initiatives.

In addition to the tax cut/spending limit package of October 6, 1975, the Administration has introduced two major tax programs which have been considered to varying degrees by Congress but not implemented. First, the reform package of April 1973 led directly to the Tax Reform Act of 1975 which, as noted above, will be considered by the Senate in 1976. We must follow through to see that these proposals become law.

The second major proposal was made in July of this year by Secretary Simon and dealt primarily with capital formation. The key provision is the proposal for the integration of the corporate income tax. As noted above, the Ways and Means Committee will have a task force considering the subject of our proposal in 1976; it is most important that we work with the task force to develop and seek support for an acceptable bill.

One portion of the July 8, 1975 proposal which was included by the President in his October 6 tax cut proposal was the electric utility package. Although little support was developed for this proposal in 1975, the Administration continues to regard it as signficant. Only one portion thereof is presently scheduled to be considered by the task force on capital formation.

Another aspect of the Administration's tax program which must be stressed in 1976 is the need for permanent tax reductions. In the case of the investment credit, in particular, the 1975 Act changes must be made permanent so that businessmen can plan accordingly.

Attached hereto are the following documents which either set forth or provide background for the Administration's major pending tax proposals:

1) Memorandum from Mr. Hickman to Secretary Simon - April 29, 1975.

2) Drafts of memoranda to the President - June 8 and June 16, 1975.

3) Secretary Simon's Testimony - July 8, 1975.

4) Secretary Simon's Testimony - July 31, 1975.

5) TLC's proposed Legislative Program - August, 1975.

6) Table showing tax effect of capital formation and electric utility proposals - September 12, 1975.

IV. Possible New Initiatives.

As the earlier portions of this memorandum indicate, Administration officials concerned with tax legislation and tax policy have a very full agenda for 1976 without regard to any new initiatives. We must deal with tax reduction, tax reform, capital formation, foreign source income and electric utilities. Nevertheless several new initiatives have been suggested which fall into two categories;

A. Initiatives which should be pursued. Tax policy indicates that the time has come for definitive proposals in the following areas:

1) Broadened Stock Ownership Plan (BSOP). The Administration has already devoted considerable effort to developing a position on this issue. Senator Long is know to favor the so-called ESOP and it seems imperative to counter with a proposal which has the advantages but not the flaws of the typical Kelso plan. Attached hereto is the most recent memorandum to the EPB on this subject.

2) Base Broadening Tax Reform. Secretary Simon called for action in this area on December 3, 1975 in a speech

which has been well received. The Tax Policy Office of the Treasury Department has prepared an initial memorandum outlining the parameters of a project of this type. The question would seem to be the degree of specificity with which the President should refer to this project. Note, however, the negative comments pp. 28-29 of the June 8, 1975 draft memorandum to the President.

3) Review of Tax Expenditures. The President could announce that OMB and Treasury have been directed to develop, in cooperation with the budget committees, a more effective procedure for annual budget review of tax expenditures. The relevant considerations are:

a) Tax expenditure limitation would supplement our program of regaining control of expenditures.

b) Use of the tax system as a substitute for direct expenditures might be slowed if it was clearer that tax expenditures would be scrutinized in the same way as direct expenditures.

c) One reason for our high tax rates is the high level of tax expenditures.

d) Eliminating tax expenditures from the Code would produce desirable tax simplification.

e) Unlike base broadening tax reform, this program is not inconsistent with proposing new tax expenditures like BSOP. It recognizes that the tax system, in conjunction with the market system, may be an efficient mechanism for creating generalized incentives for desired conduct but urges review of past and future tax expenditures.

f) A problem with this program is that Surrey and other reformers have taken too broad an approach and have characterized as tax expenditures some provisions (e.g., ADR) which may be justified as appropriate for accurate measurement of income. Embracing the tax expenditure concept may be regarded as betrayal by those who oppose the Surrey approach. The tax expenditure budget, however, is firmly encased in the Congressional procedure, and it cannot just be ignored. Instead, we should try to guide the procedure into positive channels.

B. Initiatives which require further study before they are proposed. The following ideas have been suggested for inclusion in the State of the Union message in Mr. Seidman's memorandum to the EPB of December 17, 1975. They are either completely new to the Tax Policy Office or they have not been considered in detail. In any event they require a great deal more study before identification as Administration initiatives. An important part of any such study, of course, would be the development of revenue estimates.

1) Accelerated depreciation of plants and equipment to encourage rapid construction in targeted areas of high unemployment. The definitional problems are obvious. How much incentive will be needed to accomplish the objective? If employment rises, what type of commitment will retain the benefits?

2) Special tax relief for those States with unemployment rates substantially higher than the national average. What type of relief?

3) Revision of the estate and gift tax laws to encourage private ownership of small business. Presumably, this will be considered by the Ways and Means Committee in Phase II. See Mr. Walker's draft memorandum to the President of December 16, 1975.

4) Provision of adequate incentives for direct investment in small technical enterprises. If this means extending loss-carryovers, broadening subchapter S and Code section 1244, and supporting certain other provisions of the Small Business Tax Simplification Act of 1975 (H.R. 237), we would have no objection, but this hardly seems worth mentioning in a State of the Union address. The same would be true of new forms of employee stock option plans. Employee stock ownership plans are considered above.

5) A graduated corporate income tax to aid small business. This would appear to be a reaction to the misconception noted in Secretary Simon's testimony to the Joint Economic Committee that small businesses pay a higher effective rate of tax than large businesses. The statistics are misleading because of the exclusion of foreign income taxes and the inclusion of loss corporations. In any event, the economists in the Tax Policy Office are strongly opposed to a graduated corporate income tax, and the proposal is inconsistent with the Administration's integration program.

6) Replacement cost depreciation. This is a radical proposal which merits much study. Presumably, the Ways and Means task force on capital recovery will consider this

proposal as well as other radical modifications to our present depreciation policy. The President might announce that we are working on this problem and considering all alternatives, but it is much too early to announce our choice.

Attached hereto are:

1) Memorandum to EPB re: BSOPs - December 19, 1975.

2) Secretary Simon's speech re: Basic Tax Reform - December 3, 1975.

3) Mr. Walker's speech re: Consumption Type Tax - December 3, 1975.

4) Memorandum to Secretary Simon Re: Basic Tax Reform - December 18, 1975.

5) Memorandum to Mr. Walker re: Basic Tax Reform - December 22, 1975.

6) Draft memorandum to President re: Estate and Gift Tax Relief for Small Business - December 16, 1975.

7) Mr. Goldstein's testimony re: Small Business - November 13, 1975.

8) Secretary Simon's testimony re: Small Business - November 21, 1975.

9) <u>Wall Street Journal</u> clipping re: tax rates of small business - December 10, 1975.

MEMORANDUM TO: Economic Policy Board

FROM: Dale S. Collinson DC

SUBJECT: Broadened Stock Ownership Plan

This memorandum describes a Broadened Stock Ownership Plan (BSOP). In general, employees would elect whether to participate by taking a reduced salary (payroll deduction) and having the difference (up to a maximum limit of $1,500) paid into the BSOP, which would be an employer-sponsored plan. In addition, employees who were not covered by an employer-sponsored BSOP could establish their own individual BSOP. The tax benefit would be deferral of tax on the amount paid into the BSOP and on earnings of the BSOP. Amounts withdrawn from the BSOP would be fully taxable at ordinary income rates.

Description of BSOP

The suggested BSOP has the following characteristics:

--It would (like an ESOP) be a qualified employer-established benefit plan meeting the participation, nondiscrimination and other relevant qualification requirements.

o Employees, including self-employed individuals, not covered by an employer-established BSOP could set up their own individual BSOP.

--Through the combination of employer-sponsored and individually-established plans, all employees and all self-employed individuals would be eligible to participate.

o e.g. governmental employees, members of the armed forces, and employees of exempt organizations could participate.

--The tax incentive (not available under an ESOP) would be the allowance of an exclusion from an employee's income for amounts contributed to the plan.

o Employees would elect individually whether to participate through a payroll deduction.

o For individually-established BSOPs the tax incentive would be the deduction from income of amounts contributed to the plan.

--The BSOP would be exempt from tax on its earnings.

--The maximum payroll deduction (or contribution to the plan) would be the lower of $1,500 or 15 percent of salary.

o The $1,500 limit would be phased out for individuals with earned income (for the preceding year) between $10,000 and $25,000.

--It would be limited to equity investments.

o For example, funds in a BSOP could be invested in employer stock, other stock, mutual fund shares, or a common trust fund invested in equities.

o A portfolio manager's guaranty of principal and a minimum yield would not prevent an investment from being considered an equity investment.

--It would be a long-term savings plan, as opposed to a retirement savings plan.

o That is, funds in a BSOP could be withdrawn without penalty after a period of time (say, 7 years) as well as upon death, disability and attainment of age 59-1/2. Earlier withdrawals would be subject to a 10 percent penalty, which could be gradually reduced after the funds had been held for some shorter period (say, 5 years).

o The 7-year restriction would be applied separately to each year's contributions (including earnings thereon). This would require a rule, presumably FIFO, for determining the order in which contributions would be considered withdrawn. It would also require allocation of earnings. Sponsors of BSOPs could be expected to computerize their accounting so that participants would be advised periodically of the amount that could be withdrawn without penalty (or with reduced penalty).

--Employers could match employees' contributions to the plan and would be allowed to deduct 150% of the amount of such matching contributions.

o The amount qualifying for the 150% deduction could not exceed one-half of the employees' contributions.

o As employer contributions to tax qualified plans are already fully deductible, within certain overall limits, the 150% deduction is necessary to provide a preferential incentive for employer contributions to BSOPs. In turn, employer matching contributions should induce greater employee participation.

Analysis

BSOP has the following advantages:

--Tax incentives targeted on broadened equity investment.

--Broad availability to all employees and self-employed individuals.

--Combination of employer-sponsored plan and individually-established accounts, together with additional deduction for employer contributions, enhances potential interest in establishing plans.

--Long-term savings feature, as opposed to retirement savings limitation, should also enhance participation.

--Earned income phase-out focuses incentives on low and middle income families and reduces potential of simply providing tax breaks for existing savings of higher income families.

The BSOP approach does, however, have certain disadvantages:

--Lack of neutrality as to investment medium, which creates some distortion of the market place competition for savings and potential that BSOP will be opposed by excluded financial institutions.

- o However, life insurance companies and banks may be able to develop investment media based on a stock portfolio that would qualify as an equity investment.

--The implementation of the limitation to long-term savings (seven-year restriction) could introduce significant complexity.

- o However, these may be manageable with modern computer technology.

--The impact in terms of promoting such goals as increased savings, improved worker productivity, and a stronger political base for the free enterprise system would be minimal in relation to the revenue loss.

--The allowance of a 150% deduction for employer contributions favors taxable employers and their employees as compared to nontaxable employers (governments, charities and other nonprofit employers) and their employees.

Revenue Effects

The revenue cost will vary with the extent of employee participation. The more employees participate, the greater will be the amount of equity investments purchased and the impact on broadened stock ownership, and the greater will be the revenue cost.

The extent of probable employee participation is very difficult to estimate. The limitation to low and middle income taxpayers and the limitation to equity investments tend to reduce participation. The broad coverage of all employees, the provision for matching contributions by employers, and the keying of BSOP to long-term savings rather than retirement savings tend to encourage savings.

Treasury estimates that:

--2.1 million individuals will participate.

--The annual amount contributed to BSOPs will be $1.2 billion.

--The annual revenue loss will be $0.36 billion.

This may be compared with:

--25,206,000 individuals who directly owned stock in 1975.

--$744 billion total direct investment of households in corporate equities.

--$968 billion total value of corporate stock outstanding.

Date: DEC 22 1975

MEMORANDUM FOR: ACTING SECRETARY GARDNER

From: Dale S. Collinson
Acting Tax Legislative Counsel

Subject: Deepened Tax Cuts

This memorandum describes two options for a deepened tax cut effective July 1, 1976, that would carry out the President's $28 billion tax cut program.

The options assume that the withholding tables put into effect on July 1, 1976, will be those that would be appropriate if the President's proposed tax cuts had been in effect for all of calendar year 1976. That is, over a twelve month period the new withholding tables would reduce withholding by approximately $21.6 (the full year cost of the President's proposed individual income tax cuts at 1976 levels of income), as compared to the 1974 withholding tables. This will mean that the same withholding tables would continue in effect without change for 1977 and subsequent years in conjunction with the President's proposed permanent tax cuts.

As compared to the liability reflected in withholding under the 1974 law, the reductions during 1976 in tax liabilities reflected in withholding under the Tax Cut Bill and the President's program may be summarized as follows:

Six months (Jan.-Jun) under Tax Cut Bill	-$ 6.3 billion
Six months (Jul.-Dec.) under President's program	-$10.8 billion
TOTAL	-$17.1 billion

	Initiator	Reviewer	Reviewer	Reviewer	Reviewer	Ex. Sec.
Surname	Collinson					
Initials / Date	/ 12/22	/	/	/	/	/

Form OS-3129
Department of Treasury

Option One

The first option would be to enact for 1976, effective for the full year, a tax cut that would approximately match the expected \$17.1 billion reduction in withholding tax liabilities. Under this option, the President's full \$21.6 billion individual income tax cut would become effective beginning January 1, 1977, and would be enacted at the same time as the deepened tax cut for 1976.

Attached is a description of a compromise tax cut plan that builds on the 6-month tax cut passed by the Congress and adds part of the President's proposals. Thus, the compromise plan includes an \$875 personal exemption deduction (rather than \$1000 as under the President's proposals) and rate reductions in between present law and the President's proposed rate reductions. The compromise plan would reduce 1976 liabilities by \$17.8 billion (stated in 1976 levels of income but excluding the earned income credit).

The compromise plan would supersede the 6-month tax cut. That is, individuals would determine their 1976 tax liabilities solely under the compromise plan. However, the compromise plan generally includes at least the specific tax cuts contained in the 6-month tax cut. The only case in which there is a cut back on the 6-month tax cut is the maximum standard deduction for single persons, which would be \$2200 under the 6-month tax cut and \$2100 under the compromise plan. That \$100 reduction in the maximum standard deduction would be fully offset by the \$125 increase in the personal exemption deduction (from \$750 to \$875).

Option Two

The second option would be to enact the President's proposed \$21.6 billion individual income tax cuts for 1976. Again, the deepened tax cuts would supersede the 6-month cuts. Because the reduction in tax liabilities would be \$21.6 billion while the reduction in withholding liabilities would be only $17.1 billion, there would be overwithholding of approximately $4.5 billion, which would be refunded to taxpayers during the first six months of 1977.

General Comment

The basic concept is that the new tax cut bill enacted before July 1, 1976, will supersede the 6-month tax cut. The 6-month bill is itself drafted on that assumption, with the full year cuts (at double the 6-month levels) right in the statute (though inoperative). The important issue is not whether the 6-month bill may be superseded as a legal matter but whether the deepened tax cut will adequately buy out the 6-month cuts as a political matter.

In general, it should be easier to buy out the tax cuts contained in the present tax cut bill than it would have been to buy out a 50% magnification of the 1975 Tax Reduction Act. That is, if the 6-month cuts were extended for a full year, the distribution of tax cuts would be closer to the distribution of tax cuts under the President's proposals than would a 50% magnification of the 1975 tax cuts. For example, the per capita personal exemption credit would be $35 rather than $45, so that a full year extension of the 6-month cuts would be less heavily weighted toward large families than a 50% magnification of the 1975 tax cuts. Thus, the President's full program ($21.6 billion in individual income tax cuts) should compare favorably with a full year extension of the 6-month cuts. However, the suggested compromise plan of $17.8 billion in individual income tax cuts plus a 5% earned income credit may not fully buy out a full year extension of the 6-month cuts. (Clearly it does not buy out a 10% earned income credit.) A computer run analyzing this comparison is presently in progress.

Administration Compromise Tax Reduction Structure for 1976 Liabilities
(Assumes Conference Bill is Enacted)

	Administration compromise
Individuals:	
Standard deduction:	
Minimum: single	$1,750
joint	$2,300
Maximum: single	$2,100
joint	$2,650
Percentage	16% 1/
Personal exemption	875
Per capita credit	17.50
Taxable income credit (alternative to the per capita credit)	1% of first $9,000
Earned income credit:	
Rate	5%
Income at maximum	$4,000
Income at phaseout	$8,000

Rate Changes

Single: Present law	Single: Compromise proposal	Joint: Present law	Joint: Compromise proposal
(percent)			
14%	13%	14%	13%
15	14	15	14.5
16	15.5	16	15.5
17	16	17	16
19	17.5	19	17.5
19	18	19	18
21	19.5	22	21.5
21	20	22	22
24	22.5	25	25
25	24.5	28	28.5
		32	33

Corporation:	
Rate for first $25,000	20%
Rate for second $25,000	22%
Rate above $50,000	47%

Office of the Secretary of the Treasury, Office of Tax Analysis December 17, 1975

1/ More precisely the percentage deduction should be $900 + 8 percent of adjusted gross income for single and head-of-household returns and $1,250 + 8 percent of adjusted gross income for joint returns.

INDIVIDUAL INCOME TAX REDUCTIONS

	Pre-1975 law	Tax Reduction Act of 1975	Present Tax Cut Bill	12 Months Extension
1. Standard deduction				
(a) Minimum standard				
Single returns	$1,300	$1,600	$1,500	$1,700
Joint returns	$1,300	$1,900	$1,700	$2,100
(b) Percentage standard	15%	16%	16%	16%
(c) Maximum standard				
Single returns	$2,000	$2,300	$2,200	$2,400
Joint returns	$2,000	$2,600	$2,400	$2,800
2. Tax credit				
(a) Per capita	None	$30	$17.50	$35
(b) Percent of taxable income	None	None	1% up to $9,000	2% up to $9,000
3. Earned income credit	None	10% up to $4,000	5% up to $4,000	10% up to $4,000
4. Housing credit	None	5% up to $40,000	None	None

FULLER DESCRIPTION OF [illegible] TAX CUTS

A. Individual Tax Cuts

The proposed permanent restructuring would replace the temporary increased standard deduction and the $[illegible] per taxpayer exemption credit provided by the 1975 Act. The changes assure that withholding will not be increased and that, in fact, there will be further tax reductions for the great majority of taxpayers. As compared to 1974 law, the President's proposal would:

-- Increase the personal exemption from $750 to $1,000.

-- Replace the present minimum standard deduction (low income allowance) of $1,300 and maximum standard deduction of $2,000 by a single standard deduction in a flat amount of $1,800 for a single taxpayer and $2,500 for a married couple ($1,250 for married person filing separately). This compares with the average standard deduction claimed in 1974 of $1,625 by married couples and $1,400 by single persons. (The 1975 Act made temporary changes in the standard deduction, which are described in Annex D.)

-- Provide rate reductions as shown in the tax rate schedules attached at Annexes A & B.

B. Business Tax Cuts

The President also proposes to:

-- Reduce the maximum corporate tax rate from 48 percent to 46 percent.

-- Continue the 1975 Act increase in the surtax exemption (which determines the amount taxable at rates below 48 percent) from $25,000 to $50,000 of taxable income.

-- Continue the 1975 Act reduction in the rate on the first $25,000 of taxable income from 22 percent to 20 percent (the second $25,000 of taxable income will be taxable at a 22 percent rate, with the balance of income taxed at a 46 percent rate).

-- Make permanent the 1975 Act increase in the investment credit from 7 percent (4 percent in the case of public utilities) to 10 percent.

-- Enact a six-point program to provide tax relief to electric utilities and to reduce dependency on foreign energy sources (see Annex C for full description).