THE WHITE HOUSE

WASHINGTON

INFORMATION

August 14, 1976

GRF

MEMORANDUM FOR THE PRESIDENT

FROM: L. WILLIAM SEIDMAN LWS

SUBJECT: The Tax Reform Bill (H.R. 10612)

At my request, the Treasury Department has prepared a memorandum summarizing the principal conference issues in the Tax Reform Bill (H.R. 10612) and reviewing the disposition of your tax initiatives, which is attached at Tab A.

You will note that the Senate Bill provides for a tax credit for higher education tuition expenses. Treasury opposes the credit on tax policy and revenue grounds. The Senate Bill tax credit applies to tuition expenses for university, college, and vocational school education, but does not include elementary or secondary education. An amendment to extend the credit to apply to elementary and secondary education was defeated on the Senate floor. The Republican Platform Committee has approved support for tax credits for education tuition expenses. You may wish to review the question of what position the Administration should take in the Conference Committee consideration of this issue. I would be pleased to discuss this with you some time next week at your convenience.

Attachment

A

THE SECRETARY OF THE TREASURY
WASHINGTON 20220

August 13, 1976

MEMORANDUM FOR THE PRESIDENT

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The attached memorandum summarizes the principal Conference issues in the Tax Reform Bill (H.R. 10612) and outlines the present status of the Administration-initiated tax proposals.

Despite our efforts, the Administration's tax proposals have not fared well. The deepened tax cuts, job creation incentive proposal, broadened stock ownership proposal and the sliding scale for capital gains did not advance very far in the legislative process. On the other hand, the prospects that meaningful estate and gift tax reform will be enacted this year are good.

With respect to the Tax Reform Bill, there are substantial differences between the House and Senate bills. These differences should be ironed out in the Conference. The House and Senate bills have a mixture of desirable and undesirable features but suffer from two fundamental deficiencies: (1) their failure to incorporate the deepened tax cuts, and (2) their complexity. While the cuts are not attainable this year, we will work with the conferees and staff in an effort to minimize, where possible, the degree of complexity.

Treasury officials are presently analyzing the bills and developing with the staffs of the Joint Committee and the tax-writing committees possible compromises which we may find acceptable. When these compromises are reached, we will have a better feel as to the overall merits of the Conference bill.

Attachment

George H. Dixon
Acting Secretary

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WASHINGTON 20220

August 13, 1976

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This memorandum summarizes the principal Conference issues in the Tax Reform Bill (H.R. 10612) and outlines the present status of the Administration-initiated tax proposals.

A. LEGISLATIVE OUTLOOK

The Conference is expected to begin on August 23 or 24 and is expected to extend into September, probably past Labor Day. This suggests that Congress will probably enact a 30-day extension of the present withholding rates which are scheduled to expire on August 31.

B. REVENUE CONSIDERATIONS

Treasury's receipt estimates, which at this point are preliminary, for the Senate bill are as follows:

($ billions)

Fiscal Year	Tax Cuts*	Other Provisions	Total**
1977	-$17.3	-$0.4	-$17.7
1978	-$14.8	-$1.9	-$16.7
1979	-$11.7	-$2.4	-$14.1
1980	-$12.2	-$2.6	-$14.7
1981	-$12.7	-$3.0	-$15.7

The details of the preliminary receipt estimates of the Senate bill tax cuts are set forth in Annex A.

* Not all of the tax cuts are permanent. The taxable income credit ($35 per person or 2 percent of the first $9,000 of taxable income, whichever is larger) was extended through calendar year 1977 only.

**Totals may not add due to rounding.

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C. STATUS OF ADMINISTRATION-INITIATED TAX PROPOSALS

1. Deepened Tax Cuts

The Administration's deepened tax cuts proposal was not adopted by the Senate. An attempt by Senator Dole on the Senate floor to increase the personal exemption from $750 to $1,000 failed. The tax cut provisions of the House and Senate bills are summarized in Annex B.

2. Broadened Stock Ownership Plan

The House had no opportunity to consider, and the Senate rejected, the Administration's Broadened Stock Ownership proposal. Instead, the Senate voted to increase (from 1 percent to 2 percent) and make permanent the additional investment tax credit for employers who contribute an equivalent amount to employee stock ownership plans.

3. Job Creation Incentive Proposal

The House had no opportunity to consider, and the Senate never seriously considered, the Administration's Job Creation Incentive proposal. Some Senators did indicate that the proposal was worthy of further consideration.

4. Estate and Gift Taxes

Although not precisely in line with the Administration's proposals for estate and gift tax relief, the Senate adopted provisions which:

-- increase the exemption (via a credit mechanism) to $197,000 by 1981,

-- increase the marital deduction,

-- provide special valuation rules for farms,

-- impose a tax on certain generation-skipping transfers, and

-- liberalize the liquidity relief provisions for family farms and small businesses.

The House Ways and Means Committee has ordered reported an estate and gift tax reform bill which:

-- integrates the estate and gift taxes (i.e., a single unified progressive rate schedule for estate and gift taxes on the basis of cumulative lifetime and deathtime transfers),

-- provides for a unified credit against estate and gift taxes which is phased in over three years and has the effect of increasing the exemption to $153,700 by 1979,

-- increases the estate and gift taxes marital deduction,

-- provides special valuation rules for farms and small businesses,

-- liberalizes the rules applicable to extension of time to pay estate taxes,

-- provides a "carryover basis" for property acquired from a decedent after December 31, 1976 (i.e., the basis of inherited property in the hands of the executor or heirs is the same as the decedent's basis so that the appreciation of the property during the decedent's lifetime is ultimately subject to income tax), and

-- imposes a tax on certain generation-skipping transfers.

5. Six-Point Electric Utility Tax Package

The six-point utility tax package, which would have provided incentives for the construction of nonpetroleum fueled energy facilities, was not considered by either the House or the Senate.

6. Withholding Taxes on Interest and Dividends Paid to Foreign Investors

The Administration's proposal to repeal withholding taxes on interest and dividends paid to foreign investors as a means of attracting foreign capital in the United States was rejected by the House and the Senate. With respect to withholding on bank interest, the Senate bill provides for a three-year extension of the present law exemption from withholding on such interest while the House bill provides for a permanent exemption.

7. Capital Gains Treatment

The Administration's proposed sliding scale for capital gains, as a means of alleviating partially the tax burden on inflationary gains, was rejected by the Senate. Although the Ways and Means Committee approved the sliding scale in 1974, it omitted those provisions from the present bill.

8. Taxable Bond Option

Although the Ways and Means Committee has ordered reported a bill on the taxable bond option proposal, the measure is presently stalled in the Rules Committee because of the apparent lack of minority member support of the bill. The Finance Committee has scheduled a hearing on this proposal, and numerous other bills, for August 23.

D. ISSUES IN TAX REFORM BILL CONFERENCE

The principal issues in the reform bill Conference are as follows:

1. Tax Cuts

The probable reconciliation of the House bill and Senate bill tax cuts will be a permanent extension of the cuts provided under the Tax Reduction Act of 1975 except that the taxable income credit ($35 per person or 2 percent of the first $9,000 of taxable income, whichever is larger) will be extended through calendar year 1977 only.

2. Tax Shelters and Minimum Tax

Both the House and the Senate versions of the bill contain provisions designed to curb tax shelter abuses and to strengthen the minimum tax. While the differences between the House bill and the Senate bill are significant, there is general agreement that legislation in this area is desirable.

The basic provisions in the House bill are a limitation on artificial accounting losses ("LAL") which limits the deductions attributable to tax shelter activities to the income generated from such activities, (2) an add-on minimum tax on items of tax preference, and (3) "at risk" limitations (limiting the amount of tax losses to invested capital and precluding deductions on the basis of nonrecourse indebtedness)..

The Senate rejected LAL and adopted an add-on minimum tax, certain "at risk" limitations, and limitations on certain deductions attributable to tax shelter activities.

The Administration recommended LAL in 1973 and has continued to support it. LAL was a companion proposal with MTI (minimum taxable income), an alternative tax which would have replaced the present add-on minimum tax. Our alternative minimum tax has been rejected by both the House and the Senate. LAL has generated vociferous and effective opposition, especially in the Senate.

Our best estimate is that LAL will not survive the conference in its present form. Instead, the bill will probably contain an "at risk" limitation and limitations on certain of the deductions attributable to tax shelter activities. With respect to the minimum tax, the only serious question will be whether a taxpayer may use the regular taxes he pays as an offset against his minimum tax liability. The House bill provides for no offset (thereby making the minimum tax a penalty tax for the use of preferences) whereas the Senate bill provides for a full offset.

3. Capital Formation

The Senate and the House bills contain provisions designed to encourage capital formation. Chief among these are (1) the increase to 10 percent in the investment tax credit (permanent in the Senate bill, to 1980 in the House bill), and (2) permanent additional 2 percent investment tax credit for equivalent employer contributions to an employee stock ownership plan ("ESOP") (in Senate bill but not in House bill). While the Administration supports the permanent increase to 10 percent of the investment tax credit, we are opposed to the 2 percent ESOP feature in the absence of the Administration-initiated broadened stock ownership proposal.

Other capital formation measures adopted by the Senate but not by the House include (1) special provisions for the shipbuilding, railroad and airlines industries, (2) a two-year extension of the period during which investment tax credits otherwise expiring in 1976 may be utilized, and (3) a special provision for contributions in aid of construction of water and sewage facilities. The Administration is opposed to these provisions on tax policy grounds.

4. Taxation of Foreign Income and DISC

Both the House and the Senate bills contain many desirable provisions affecting the taxation of foreign income. However, there are three major undesirable provisions:

-- With respect to DISC, the House and Senate bills adopt slightly different incremental approaches (i.e., limiting DISC benefits to export sales in excess of those in a base period). The Administration has urged that the DISC provisions not be amended at this time.

-- The Senate bill denies certain tax benefits (foreign tax credit, deferral and DISC) to bribe-related foreign income. The Administration is opposed to this provision on both tax policy and other grounds, preferring the disclosure approach you recently proposed.

-- The Senate bill denies certain tax benefits (foreign tax credit, deferral, and DISC) to taxpayers which participate in boycotts, with the impact on Arab boycotts of Israel. The Administration (State and Treasury) is strongly opposed to this provision.

5. Estate and Gift Taxes

There is increased speculation that estate and gift tax changes may be included in the Conference Committee tax reform bill. House floor action on the Ways and Means bill after the recess for the Republican convention (and during the early days of the Conference) could provide a mandate for the House conferees.

Because the Senate did not act on the unification and carryover basis issues, neither issue will be in conference (the House tax reform bill contains no estate and gift tax changes). While unification is not expected to be an important issue, it is unlikely that the House conferees will abandon the carryover basis provisions, which represent a major achievement for the liberal reform group.

Procedurally, it would be possible for the conferees to leave the estate and gift tax provisions technically in disagreement but agree to present to the House and Senate a separate amendment containing a conference compromise that included matters, such as a carryover basis provision, not in conference. The question then would be whether the Senate would accept such a compromise.

Treasury officials are presently engaged in preliminary analysis of the estate and gift tax provisions and discussions with interested parties.

6. Capital Gains

The House bill increases from $1,000 to $4,000 the amount of capital loss which may offset ordinary income. The House bill also increases from six months to 12 months the holding period requirement to qualify for long-term capital gain or loss treatment. The Senate bill contains neither of these provisions. The Administration supports the House bill provisions.

7. Energy-Related Provisions

The Senate bill contains several provisions providing for special tax incentives for energy-related facilities and equipment. The House bill contained none of these provisions, although similar provisions were passed by the House as H.R. 6860.

The Administration has opposed the energy provisions of this title on the ground that a free market system provides adequate incentives and that selective tax credits are undesirable and lead others to seek equal treatment. The Administration had proposed a credit for certain expenditures to insulate a personal residence. The Senate bill contains a more generous, refundable home insulation credit.

8. Tax Simplification

Both bills contain desirable tax simplification and equity measures dealing with (1) the mandatory use of tax tables for computing tax liability, (2) the retirement income credit, (3) the sick pay provisions, and (4) certain business-related individual deductions (business use of homes, rental of vacation homes). Two provisions merit further attention:

-- Under both the Senate and House bills, the child care deduction is converted to a credit; the Senate bill also makes the credit refundable. On tax policy grounds, the Administration is opposed to both the conversion to a credit and the refundability feature.

-- The House bill contains a provision limiting the deductibility of expenses for attendance at foreign conventions. The Senate bill does not (although the Finance Committee did report a provision supported by the Administration). Treasury continues to support the need for legislation providing reasonable limitations in this area.

9. Miscellaneous

Both bills, but particularly the Senate bill, are littered with 25 to 30 miscellaneous and special interest provisions. The following Senate bill provisions merit special attention:

-- The Senate bill contains a provision dealing with prepaid legal services plans (employer deduction for contributions, no tax to employee on account of contributions or receipt of services). The Administration has expressed opposition on tax policy and other grounds.

-- The Senate bill provides for a tax credit for higher education tuition expenses. Although Treasury is opposed to the tuition credit on tax policy and revenue grounds, it should be noted that the Republican Platform Committee is considering some form of the tuition credit concept. Accordingly, it may not be appropriate for the Administration to express opposition to this credit.

George H. Dixon
Acting Secretary

Preliminary
Estimated Revenue Effects of H.R. 10612,
the Tax Reform Bill of 1976,
as Passed by the Senate

Fiscal Years 1977-1981

($ millions)

	Fiscal Years				
	1977	1978	1979	1980	1981
Extension of tax cuts:					
Individual income tax reductions	-14,350	-9,293	-5,802	-5,975	-6,162
Per capita tax credit	-9,509	-3,462	--	--	--
Standard deduction	-4,146	-4,481	-4,506	-4,731	-4,968
Earned income credit 1/	-695	-1,350	-1,296	-1,244	-1,194
Corporate tax reductions	-1,676	-2,221	-2,406	-2,579	-2,771
10 Percent investment credit and $100,000 limitation on used property	-1,300	-3,306	-3,460	-3,617	-3,814
Total extension of tax cuts	-17,326	-14,820	-11,668	-12,171	-12,747
Other Senate provisions	-379	-1,920	-2,404	-2,565	-2,972
Total, extension of tax cuts and other provisions	-17,705	-16,740	-14,072	-14,736	-15,719

Office of the Secretary of the Treasury
Office of Tax Analysis

August 12, 1976

1/ Includes credit for disabled adult children.

Comparison of Tax Cuts
House and Senate Bills

	House Bill	Senate Bill
1. Individual Income Tax Reductions		
--Standard Deduction	16 percent of adjusted gross income (maximum of $2,600 for joint returns and $2,300 for single taxpayers).	Same as House bill except that maximums are $2,800 for joint returns and $2,400 for single taxpayers.
	o Permanent	o Permanent
--Low Income Allowance	$1,900 for joint returns; $1,600 for single taxpayers.	$2,100 for joint returns; $1,700 for single taxpayers.
	o Permanent	o Permanent
--Earned Income Credit	No extension	10 percent of earned income as does not exceed $4,000, reduced on a dollar-for-dollar basis as exceeds $4,000 (i.e., complete phase out at $8,000).
		o Permanent
--Taxable Income Credit	$30 per exemption or 2 percent of the first $12,000 of taxable income, whichever is greater.	$35 per exemption or 2 percent of the first $9,000 of taxable income, whichever is greater.
	o Through calendar year 1976 only	o Through calendar year 1977 only
2. Corporate Tax Reductions	Surtax exemption at $50,000 and normal rate of tax on first $25,000 of taxable income at 20 percent.	Surtax exemption at $50,000 and normal rate of tax on first $25,000 of taxable income at 20 percent.
	o 1976 and 1977 only	o Permanent

	House Bill	Senate Bill
3. Investment Tax Credit	10 percent credit and \$100,000 limitation on investments in used property. o 1977 through 1980 only	10 percent credit and \$100,000 limitation on investments in used property. o Permanent