The original documents are located in Box 55, folder “1976/01/03 - Economic Policy Board” of the James M. Cannon Files at the Gerald R. Ford Presidential Library.

EPB EXECUTIVE COMMITTEE
MEETING
January 3, 1976
9:30 a.m.

Roosevelt Room

EPB EXECUTIVE COMMITTEE MEETING
2:00 p.m.
January 2, 1976

Roosevelt Room

DEC 31 1975

MEMORANDUM FOR THE DIRECTOR AND DEPUTY DIRECTOR

From : Rudy Penner /s/

Subject: Policy Issues in Special Analysis on Tax Expenditures

The Congressional Budget Act requires that a listing of tax expenditures, estimated on the basis of existing tax law, and proposed changes in tax expenditures be included in the budget. The Act's definition of tax expenditures is subject to varying interpretations, hence the inclusion of some items in the budget's list is a matter of policy judgment.

The following language appears in the text to explain why we are including some items this year that we said last year were not included in the definition of tax expenditures and why some additional items are included:

> "The specific list of tax expenditures presented in this analysis is somewhat different from that presented in the 1976 budget, where tax expenditures were listed for the first time. Further consideration of the conceptual problems of defining tax expenditures has led to listing four items which were discussed, but not deemed to be tax expenditure items in the 1976 analysis: deferral of income of controlled foreign corporations; exclusion of food stamps; capital gains at death; and maximum tax on earned income. Some additional items are listed for the first time in this special analysis either to reflect legislative changes or to make its coverage more nearly complete."

1. Four items not included in last year's budget but included in lists published by the Congressional Budget Committee. We propose that three of these items be listed in the budget. We believe it was a conceptual error not to include them last year; their inclusion this year would reduce controversy with congressional committees as to what is and what is not a tax expenditure. The numbers in parenthesis are the estimates in millions of dollars for 1975, 1976, and 1977, respectively.

- Deferral of income of controlled foreign corporations (590, 525, 365).

The introduction in last year's text explained our failure to include this item as follows:

"Earnings of foreign corporations. The general tax law does not seek to tax foreign entities or persons on income earned abroad. Thus, earnings of foreign corporations operating outside the United States are not taxable. The tax law does, however, tax U.S. shareholders on dividends from corporations, regardless of where those corporations are located or operated. The general principle, however, is that dividends are taxed only when received. For this reason, not taxing the income of controlled foreign corporations until received is part of the normal tax structure."

In fact, the earnings of controlled foreign corporations are taxed currently under certain circumstances (Subchapter F) and these circumstances were more broadly defined by the Tax Reduction Act of 1975 (which is why the estimates for 1976 and 1977 are lower than 1975). The proposed text for this year:

"The income of foreign corporations controlled by U.S. corporations or citizens is generally not subject to U.S. tax until income is repatriated. The income of foreign branches of domestic corporations is taxed like any other income. The deferral provision for foreign subsidiaries has the effect of allowing such corporations to be taxed like any other corporation doing business in particular foreign countries and may, in some circumstances, encourage investment abroad. The exceptions to the deferral provisions were expanded by the Tax Reduction Act of 1975, thereby reducing the amount of the tax expenditure for 1976 and subsequent years."

Decision: Include /_/
Exclude /_/

- Capital gains at death (2,400, 2,500, 2,710).

This item was excluded last year; the text strained mightly to provide an excuse:

"the failure to tax unrealized capital gains at death is treated here as part of the normal tax system and not a tax expenditure since no exchange or sale takes place. No estimate of the revenue loss due to the failure to tax capital gains at death could be made unless a specific technique of taxation is supposed such as averaging over a number of years."

Proposed text for this year:

"The failure to tax capital gains at death is treated as a tax expenditure. Realization in effect occurs since heirs use market values prevailing at the date the estate is valued to measure any subsequent capital gains or losses."

"At the death of a taxpayer the appreciation in value of assets held by that individual is not taxed as income. As the assets pass to an heir or other recipient that new holder takes the market value of the assets at the date the estate is valued as a basis against which to measure any future appreciation or loss. The appreciation during the lifetime of the decedent thus avoids any income tax. The estimated revenue losses due to this feature of the tax code are based upon including appreciated values in the income of a decedent during the final year of life and applying existing rules for capital gains taxation (including the 50% exclusion provision) and income averaging. If appreciation were taxed at death there would be a concomitant reduction in the value of estates, thereby reducing estate tax receipts. That reduction would amount to $930 million in 1977."

Decision: Include /_/
Exclude /_/

- Maximum tax on earned income (160, 175, 190).

Last year's text read:

"To illustrate the arbitrariness of accepting the existing rates as a norm, consider the maximum tax of 50% on earned income, introduced in 1972 by the Tax Reform Act of 1969. It is treated here as part of the normal structure because the great preponderance of all income is subject only to the 50% maximum rate. Had the rates applicable to unearned income been considered the norm, then the 50% maximum rate on earned income would have been identified as a tax expenditure."

Proposed text for this year:

"The Tax Reform Act of 1969 introduced a maximum tax rate of 50% on earned income in order to lessen the incentive for taxpayers with high earned incomes to seek out various tax avoidance techniques."

Decision: Include / /
Exclude / /

- Asset depreciation range (no estimates have been made). We continue to maintain that use of ADR is a legitimate way to measure depreciation and thus compute taxable income. Treasury staff argues that no reasonable estimates could be made even if ADR were defined as a tax expenditure item since so many taxpayers claim asset lives as short as ADR permits without formally using the ADR mechanism. IRS auditors generally accept this practice. On the other hand opinion on the Hill is strongly in favor of viewing this item as a tax expenditure. They can support that position by pointing out that ADR can't be used in calculating foreign income, hence it must be an incentive for domestic investment. This year's proposed text reads:

"With respect to machinery and equipment the asset depreciation range (ADR) system, which became effective in 1971, defines a band within which estimates of useful life will be deemed to be "reasonable." That band is determined by reference to broad classes of property and ranges 20% up and 20% down from a published figure designated as the "asset guideline period." The ADR system is a mechanism to arrive at a "reasonable allowance" and does not result in a tax expenditure as defined above."

Decision: Include / /
Exclude / /

2. Two items proposed for inclusion about which there can be some doubt and controversy.

- Exclusion of food stamps (135, 185, 220).

The issue here is drawing the line between government transfer payments where the exclusion from taxable income results in a tax expenditure and government services received in-kind where their value would not be imputed to taxpayers under a theoretically pure definition of income. The proposed text reads:

"Exclusion of the value of government services received in-kind. The imputed value of such direct government services as rent supplements and medicare would not be included in the base of a theoretically pure income tax. These benefits are received in-kind and cannot, therefore, be used like cash for purposes fully consistent with the recipients' preferences. The exclusion of the bonus value of food stamps from income subject to tax does result in a tax expenditure since it is so nearly equivalent to a cash receipt."

"Although not paid directly in cash, the bonus value of food stamps, which is the difference between their face amount and the lesser amount that program participants pay for them, is sufficiently similar to other Federal transfer program payments that their exclusion from income subject to tax results in a tax expenditure. Since only a few participants have income large enough to be taxable, the tax expenditure is small relative to total program outlays.

Decision: Include / /
Exclude / /

- Cooperatives: deductibility of noncash patronage dividends and certain other items (330, 345, 385).

After publication of last year's special analysis we received correspondence from a tax lobby group accusing us of violating the terms of the Budget Act by not listing this item. We responded saying we would study the issue. We propose listing it this year, though som doubts, on a conceptual basis, have been expressed to us by Treasury staff. Pro cooperative lobby groups may object if we list it. The proposed text is:

"Corporations organized as cooperatives may take advantage of several special provisions of the tax code that permit assets to be built up out of untaxed income. Noncash patronage dividends based on net income earned on business done with patrons may be deducted, as long as 20% of the total dividend is paid in cash and the patron has agreed to take the entire dividend into his income. Per-unit retains, that is amounts retained from the value of products marketed for patrons, may be deducted by the cooperative if patrons agree to take the face amounts into current income. Agricultural cooperatives meeting certain requirements are permitted to deduct dividends on capital stock and payments to patrons from nonpatronage income. Rural electric and telephone cooperatives may deduct noncash patronage dividends and patrons generally need not take such dividends into income. The tax expenditures reported in table F-1 are the estimated amount of corporate tax that would be paid if noncash patronage dividends, per-unit retains, dividends on capital stock, and payments to patrons out of nonpatronage income were not deductible. The increase in corporate taxes would be offset by a $xxx million reduction in personal taxes, since noncash patronage dividends and retains would no longer be taken into current income by patrons.

Decision: Include / /
Exclude / /

3. Other new items, the listing of which has not generated any controversy or doubt.

- Credit for purchase of new home (--, 625, 100).
- Earned income credit (--, 280, 135).
- Deferral of interest on savings bonds (525, 605, 685).
- Exclusion of special benefits for disabled coal miners (50, 50, 50).
- Expensing of construction period interest and taxes (1,510, 1,565, 1,635).
- Separation of exclusion of interest on State and local debt into three parts:
  - pollution control bonds (115, 190, 235);
  - general purpose debt (3,800, 4,185, 4,570);
  - industrial development bonds (175, 200, 220).

4. Estimating procedure for 1977.

Estimates for itemized deductions are sensitive to the standard deduction. If these items were estimated on the basis of "existing law" (as required by the Budget Act) they would, for 1977, be larger than anyone really expects them to be because no one expects that we shall return to 1974 standard deductions as specified under the 6-month provisions of the Revenue Adjustment Act. Treasury has estimated these items as if the full year provisions of the Revenue Adjustment Act were permanent. This follows the convention that we established in the

Current Services Budget of treating the temporary 1975 tax law as though it were permanent. The Budget Act can be interpreted to require that tax expenditures be estimated on a "current services" basis. Staff of the Budget Committees and CBO have informally indicated their acceptance of this estimating technique as reasonable.

5. Proposed changes in tax expenditures (see the last 3 gallies).

This required section of the special analysis covers only those tax proposals that are referred to elsewhere in the budget. Are there any amendments to be made in the text and Table F-2?

THE WHITE HOUSE

WASHINGTON

January 2, 1976

MEMORANDUM FOR THE PRESIDENT

FROM: WILLIAM F. GOROG wfg

THROUGH: L. WILLIAM SEIDMAN

SUBJECT Tax Incentives for Construction of Plants and Equipment in Areas of High Unemployment

This Memorandum has been prepared to provide additional information concerning a suggested initiative to provide incentives for job manufacturing creation in areas of high unemployment.

PROGRAM DESCRIPTION

The proposed plan would offer tax incentives to encourage construction of new facilities, or modernization of old plants in areas experiencing particularly high unemployment. This would be accomplished by allowing very rapid depreciation (10 years on buildings; 5 years on all capital equipment) pursuant to "Certificates of Necessity" issued by the Department of Labor.

The objectives of such a program would be:

1. Provide meaningful jobs ~~Revitalize industrial areas~~ in high unemployment labor areas;
2. Provide more employment opportunities for minorities and the disadvantaged who populate the major areas;
3. Stimulate construction in areas most seriously impacted;
4. On a longer range basis, to reestablish city and state tax bases.

QUALIFICATION FOR THE PROGRAM

Each month, the Department of Labor classifies major employment centers according to the magnitude of employment/unemployment. The classifications are based on reports prepared by the State Employment Security agencies covering employment and unemployment developments and an outlook in each area.

A "labor area" consists of a central city, or cities, and surrounding territory within commuting distance. It is an economically integrated geographic unit within which workers may readily change jobs without changing their place of residence. Labor areas usually include one or more counties, except in New England, where towns are considered the major georgraphical units.

Major labor areas usually have at least one central city with a population of 50,000 or more. In most instances, boundaries of major labor areas coincide with those of Standard Metropolitan Statistical Areas as determined by OMB in consultation with a Federal interagency committee.

The geographical boundaries of all classified areas are listed in a Manpower Administration publication entitled "Directory of Important Labor Areas."

It is recommended that this area classification already established by the Department of Labor be utilized to establish qualification for this program. It is suggested that the unemployment trigger be set to provide this tax incentive to the central city (or cities) within the major areas experiencing unemployment rates of 9% and above. Cities qualifying under this provision will be established utilizing the most up-to-date information available at the time legislation is passed. As of this point in time, 65 labor areas would qualify for the tax incentive. Tab A lists the areas which would qualify if this provision were adopted today.

DURATION DATES OF THE PLAN

The prime purpose of this incentive is to stimulate new construction or modernization of facilities during calender years 1976 and 1977. The program should not be distorted, however, to provide a means for windfall tax benefits for companies whose programs are presently under way or contemplated to start early in 1976. To accommodate both objectives, it is suggested that the plan provide that these incentives will apply to projects started between the dates of 1 July 1976 and 1 July 1977. The project would have to be of such a nature to reach completion within 36 months and the companies total employment in the area may not be reduced as a result of the project. The latter provision is to prevent the initiative from being used only for automation resulting in a net decrease in jobs. It should provide the incentive for companies to add new functions or new products to their facilities in the area, permitting introduction of higher productivity and new equipment without erosion of the total job base.

ESTIMATED REVENUE COST

This initiative is particularly attractive because of its minimal impact on expenditures and revenues.

The program utilizes mechanisms already in effect to establish criteria for the program, and would have minimal additional impact on the IRS. In the long-range sense, we are simply concerned with the cash flow effects of revenue loss. The rapid depreciation essentially would provide additional working capital for the company, but long-term tax effects would be neutral.

Revenue impact is difficult to forecast because of uncertain level of participation. We are able, however, to predict certain aspects of the revenue loss:

1. As a result of the fact that depreciation is simply accelerated by the program, the net revenue loss in the early years would be the differential between the accelerated and normal depreciation methods.
2. We estimate that using a 9% trigger, the first year revenue loss would be in the range of $200 million; second year revenue loss would be in the range of $400 million.
3. These numbers do not reflect gain in tax receipts which would result from additional employment, or the reduction in Federal expenditures for unemployment insurance resulting from the incentives.

SUMMARY

The proposal probably would be subject to attack on the grounds that it promotes economic inefficiency. This criticism is valid to the extent that adoption of the proposal would bias capital investment towards areas of high unemployment. This is an inevitable result if the program has full effect.

Since the objective of consideration of this proposal is to focus on areas of high unemployment, this criticism, while valid in an economic sense, validates our purpose.

Targeting investment incentives toward areas of high employment would enhance public understanding of the relationship between jobs and capital formation. Passage of any form of investment incentive probably depends on such an understanding. Liberalized depreciation is easier to explain to the public than other forms of tax relief -- thus this aspect of the proposal is also attractive.

Finally, it appears we will have difficulty in convincing the Congress that tax incentives for capital investment are in order. This proposal would have the dual effect of attempting to stimulate employment in urban areas, as well as providing a measure of tax relief for capital formation.

TAB A

MAJOR LABOR AREAS WITH UNEMPLOYMENT OVER 9%

STATE	Unemployment Rate
ARIZONA	
Phoenix	10.3
CALIFORNIA	
Los Angeles-Long Beach	9.4
Riverside-San Bernardino-Ontario	11.6
San Diego	9.9
San Francisco-Oakland	9.7
CONNECTICUT	
Bridgeport	11.9
New Britain	12.7
New Haven	10.2
Waterbury	12.2
FLORIDA	
Miami	12.2
Tampa-St. Petersburg	12.8
GEORGIA	
Atlanta	9.6
ILLINOIS	
Chicago	9.3
Rockford	10.8
LOUISIANA	
Shreveport	9.3
MASSACHUSETTS	
Boston	12.1
Brockton	12.0
Fall River	11.4
Lawrence-Haverhill	13.8

STATE	Unemployment Rate
MASSACHUSETTS (Continued)	
Lowell	12.3
New Bedford	14.4
Springfield-Chicopee-Holyoke	11.8
Worcester	12.7
MICHIGAN	
Battle Creek	11.9
Detroit	13.5
Flint	11.9
Grand Rapids	9.7
Lansing-East Lansing	10.7
Muskegon-Muskegon Heights	13.6
Saginaw	9.9
NEW JERSEY	
Atlantic City	9.9
Jersey City	11.4
Newark	10.8
Paterson-Clifton-Passaic	11.1
NEW YORK	
Buffalo	12.4
New York City	11.4
Syracuse	9.1
Utica-Rome	9.9
OHIO	
Hamilton-Middletown	9.6
Youngstown-Warren	9.8
OREGON	
Portland	9.0

STATE	Unemployment Rate
PENNSYLVANIA	
Philadelphia	10.4
PUERTO RICO	
Mayeguez	16.4
Ponce	22.2
San Juan	13.7
RHODE ISLAND	
Providence-Warwick-Pawtucket	11.7
SOUTH CAROLINA	
Charleston	9.5
Greenville-Spartanburg	9.0
TEXAS	
Beaumont-Port Arthur-Orange	9.1
El Paso	9.8
San Antonio	9.4
WASHINGTON	
Seattle	9.4
Tacoma	10.0

EXECUTIVE OFFICE OF THE PRESIDENT

OFFICE OF MANAGEMENT AND BUDGET

WASHINGTON, D.C. 20503

January 2, 1976

MEMORANDUM TO THE EXECUTIVE COMMITTEE OF THE ECONOMIC POLICY BOARD

From : Rudy Penner RP

Subject : Tax Expenditures in the 1977 Budget

Attached is a memorandum indicating the proposed changes in the list of tax expenditure items to be listed in the Budget. As indicated, there is a policy decision to be made regarding inclusion of some of these items. Note that the decision should be based on an interpretation of the definition of tax expenditures contained in the Congressional Budget Act. As noted in the text of the Special Analysis, listing tax expenditures should in no way carry a pejorative connotation.

Also attached is a set of gallies for the entire Special Analysis. The last section of the Analysis on proposed changes in tax expenditures will have to be revised to reflect decisions on additional tax proposals. Tax expenditures are also mentioned in Part 5 of the Budget "The Federal Program by Function" and in the Budget in Brief.

Attachments

SPEC. ANAL. F–6
NEW GALLEY

SPECIAL ANALYSIS F

TAX EXPENDITURES

cop.

The Congressional Budget Act of 1974 requires a listing of tax expenditures in the budget. Tax expenditures are defined by that act as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." Tax expenditures are one means by which public policy objectives are pursued by the Federal Government and, in most cases, can be viewed as alternatives to budget outlays, credit assistance, or other instruments of public policy.

Tax expenditures have varied objectives. Most tax expenditures are meant either to encourage certain economic activities or to reduce income tax liabilities for taxpayers in special circumstances. Among the economic activities encouraged by tax expenditures are investment, exporting, petroleum exploration and development, spending by State and local governments, and support of charitable institutions. The deductibility of medical expenses, casualty losses, and personal exemptions for the aged and blind are adjustments of tax liabilities to meet special circumstances.

The benefits of tax expenditures designed to encourage certain types of economic activity typically do not rest fully or even mostly with the corporations or individuals whose taxes are initially affected. An initial reduction in taxes tends to attract more resources to the preferred activity thereby competing away some or all of the short-run advantage conferred to particular taxpayers by the tax expenditures. Thus benefits often accrue to others in the form of lower prices for particular goods or services or in other ways become widely diffused. For example, the deductibility of charitable contributions does not merely lower individual or corporate liabilities; the institutions that receive the contributions also benefit as do individual beneficiaries of charitable institutions.

This Special Analysis only provides measures of the quantitative importance of various tax expenditures and does not attempt to evaluate their effectiveness. It should be emphasized that the listing of specific tax expenditure items does not imply either approval or disapproval of specific sections of the Internal Revenue Code any more than the listing of outlay items in ~~other parts of~~ the budget implies approval or disapproval.

Defining Tax Expenditures

Income tax provisions resulting in tax expenditures are defined as exceptions to the "normal structure" of the individual and corporate income tax. They reduce tax liabilities for particular groups of taxpayers. Excluded from this analysis, by definition, are negative tax expenditures or tax penalties, that is, exceptions to the normal structure of income taxes that result in increased tax liabilities for certain groups of taxpayers. There are only a few such exceptions: one example is the nondeductibility of gambling losses in excess of gambling gains where gambling is engaged in for profit.

The "normal structure" is not defined in the tax code. The concept has evolved in recent years from various congressional and public reviews of the U.S. tax system focusing on the definition of the income tax base and the rates applied to that base. Conceptually, it would be more appealing to begin with a theoretically pure tax structure as a standard. Tax rates under such a tax structure would be applied to all "economic income," which could be defined as receipts available to support consumption or additions to net wealth, plus the imputed value of in-kind consumption and imputed changes in net wealth. Tax expenditures could then be defined to result from any departures from a theoretically pure income tax. Unfortunately this is not possible. The concept of the normal structure recognizes that it is impractical to make the necessary imputations. Furthermore, the normal structure includes the separate taxation of individuals and corporations whereas a theoretically pure tax structure would integrate these two income taxes. Theoretically pure tax structures could be specified for other types of taxes such as a tax on consumption spending rather than on all income.

Sections of the tax code that specify the structure of progressive rates and that exclude low-income persons from tax liability are deemed a part of the normal tax structure. Existing rates are accepted even though there is no theoretical foundation upon which to support any particular degree of progressivity in the individual income tax rate structure or any particular corporate income tax rate. If a set of tax rates could be agreed to on normative grounds, it would be conceptually possible to identify and measure both positive and negative tax expenditures against such a norm. For example, if a single tax rate were taken as the norm, lower actual rates would result in tax expenditures and higher rates in negative tax expenditures or tax penalties.

When the rate structure is changed, for whatever reason, the new rates become part of the new normal structure according to the definition used in the analysis of tax expenditures. The Tax Reduction Act of 1975 and the Revenue Adjustment Act of 1975 increased the low-income allowance (minimum standard deduction) and introduced a tax credit for each personal exemption claimed by a taxpayer, thus altering the normal tax structure. Those alterations reduced the estimated revenue losses associated with many tax expenditure items primarily because fewer taxpayers will itemize their deductions.

The existing rate structure for individuals, ranging from 14% to 70%, and the corporate tax rates cannot be presumed to exist independently from current tax expenditures. If major tax expenditure items were deleted and budget outlays remained constant, tax rates would undoubtedly be set at lower levels so as to maintain an appropriate fiscal policy. Moreover, because tax expenditures tend to reduce the effective progressivity of the tax structure, it is quite likely that a less progressive set of tax rates would be established if tax expenditures were eliminated. Consequently, the concept of a normal tax structure becomes somewhat ambiguous and some arbitrary decisions have to be made in arriving at an operational definition of tax expenditures.

For the purposes of this analysis, the following features of the tax system are defined to be part of the normal tax structure and therefore not to result in tax expenditures:

- *The progressive rate schedules for the individual income tax.* No tax expenditure results because some income is taxed at lower rates than other income when progressive rate schedules are applied to all taxable income. The income averaging provision of the tax code is a part of the normal structure since it limits the impact of progressive rates when income increases significantly.
- *Personal exemptions and the low-income allowance.* These set levels of income, depending upon family size, that are not taxed by the individual income tax. However, deductions for additional personal exemptions for those over 65 and for the blind do result in tax expenditures because they depend upon more special circumstances. The percentage standard deduction, to the extent it exceeds the low-income allowance, also results in a tax expenditure because it substitutes for itemized deductions that are tax expenditure items.
- *Separate rate schedules for single and married taxpayers, married taxpayers filing separately, and heads of households.* Existing provisions regarding the definition of taxpaying units are accepted as part of the normal tax structure.

SPEC. ANAL. F-8

- *Deduction of business expenses.* The deduction of business expenses is necessary to determine taxable income. Tax expenditures do not ordinarily result from applying the definitions of business expenses prescribed by the Internal Revenue Code and Internal Revenue Service interpretative regulations. Tax expenditures do occur when the tax code permits business or investment expenditures that are capital outlays in economic terms to be treated as current expenses. A case in point is the expensing of research and development costs; they usually result in substantial future benefits. Another example is the expensing of interest and taxes during the construction of a building. In the case of depreciation the Internal Revenue Code allows as a deduction "a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) on property used in trade or business or for the production of income." To avoid judging every taxpayer's depreciation deductions against a standard of reasonableness, the code permits standard depreciation techniques and useful lives to be used. In some cases, such as accelerated depreciation on buildings, tax expenditures result because the permitted technique clearly results in excess depreciation being claimed. In other cases, such as 5-year amortization of railroad rolling stock, tax expenditures result because the useful life is artificially short. With respect to machinery and equipment the asset depreciation range (ADR) system, which became effective in 1971, defines a band within which estimates of useful life will be deemed to be "reasonable." That band is determined by reference to broad classes of property and ranges 20% up and 20% down from a published figure designated as the "asset guideline period." The ADR system is a mechanism to arrive at a "reasonable allowance" and does not result in a tax expenditure as defined above.
- *Exclusion of unrealized capital gains and losses.* Although the base of a theoretically pure income tax would include net capital gains on an accrual basis, practical problems prevent identifying and taxing unrealized capital gains for many types of assets, and the normal structure taxes only wealth accruals which are "realized." For this reason the failure to tax unrealized gains during the holder's lifetime is not listed as a tax expenditure. The failure to tax capital gains at death is treated as a tax expenditure. Realization in effect occurs since heirs use market values prevailing at the date the estate is valued to measure any subsequent capital gains or losses.
- *Exclusion of imputed income from owner-occupied housing and other sources.* A theoretically pure income tax could include in its base an imputation for the income received in kind from the occupancy of a home owned by the taxpayer and imputations for in-kind income from the ownership of other durable assets including art collections, furniture, and books. Because such imputations are difficult to make and are foreign to usual concepts of income, they are not considered in the computation of tax expenditures even though such exclusions of imputed income affect the allocation of the economy's resources, particularly by providing a stimulus to owner-occupied housing.
- *Exclusion of gifts and bequests received.* The tax system subjects gifts and bequests, which are usually made within a family, to taxes separate from the income tax. Tax expenditures could be defined to include departures from "normal" gift and estate taxes, though to do so would be beyond the scope of this analysis. The exclusion of scholarships and fellowships, which are usually granted by institutions, is treated as a tax expenditure.

INSERT -- SPECIAL ANALYSIS F-9

The specific list of tax expenditures presented in this analysis is somewhat different from that presented in the 1976 budget, where tax expenditures were listed for the first time. Further consideration of the conceptual problems of defining tax expenditures has led to listing four items which were discussed, but not deemed to be tax expenditure items, in the 1976 analysis: deferral of income of controlled foreign corporations; exclusion of food stamps; capital gains at death; and maximum tax on earned income. Some additional items are listed for the first time in this special analysis either to reflect legislative changes or to make its coverage more nearly complete. Despite these additions this analysis.....

- *Exclusion of the value of government services received in kind.* The imputed value of such direct government services as rent supplements and medicare would not be included in the base of a theoretically pure income tax. These benefits are received in kind and cannot therefore be used like cash for purposes fully consistent with the recipients' preferences. The exclusion of the bonus value of food stamps from income subject to tax does result in a tax expenditure since it is so nearly equivalent to a cash receipt.
- *Treatment of individuals and corporations as separate taxpaying entities.* A theoretically pure income tax would integrate the taxation of personal and corporate income so as to avoid multiple taxation of any particular type of income. Only individuals would be taxed: corporate income would be taxed as dividends are paid and retained earnings imputed to shareholders. However, for practical reasons, separate taxation is accepted as part of the normal tax structure for purposes of this analysis.
- *Foreign tax credits.* To avoid the double taxation of income earned abroad, and thus accommodate the U.S. tax system to international norms, the normal structure of income taxes includes tax credits for foreign taxes paid.

The distinction between the normal tax structure and those exceptions leading to tax expenditures is clearcut in most cases but in some it is essentially arbitrary. The distinction does not imply that the features of the normal tax system should be exempt from periodic analysis and review. Like tax expenditures, many features of the normal tax structure have major effects upon the level and composition of economic activity and the distribution of income; some features affect the everyday activities of corporations, trusts, and partnerships. Budget outlays, or other policy instruments, are alternative means to achieve the objectives of some of the features of the normal tax structure just as they are often a potential substitute for tax expenditures.

Insert

~~This analysis~~ does not attempt a complete listing of all special tax provisions. Some items are not considered because there is sufficient information available on which to base a sound estimate. Some items are omitted because of their relatively small quantitative importance. ⊙/in ⊙

MEASURING TAX EXPENDITURES

The tax expenditure estimates reported below in table F–1 have been prepared by the Treasury Department and as required by the Congressional Budget Act, are based upon tax law as of December 31, 1975. For the fiscal years shown, they estimate the loss of budget receipts resulting from each of these particular features of the tax system. No separate estimates can reasonably be made for the transition quarter. The Revenue Adjustment Act, enacted on December 23, 1975, was designed to maintain individual income tax withholding rates at 1975 levels for the first 6 months of calendar year 1976. ~~For purposes of estimating~~ To estimate 1977 tax expenditures the provisions of the Revenue Adjustment Act regarding standard deductions for individuals were annualized and treated as if they were permanent changes in the tax code. ~~(See Part 4 of the Budget—Budget Receipts.)~~

Each estimate is based upon two major assumptions. The first is that only the tax provision in question is deleted and all other features of the tax system, including the structure of rates, remain unchanged. The hypothetical deletion of the special tax provision increases the estimated taxable income for corporations or individuals; the existing marginal tax rates are then applied to the change in taxable income, giving the estimated tax expenditure. If, however, major tax expenditures were in fact deleted, as was noted earlier, some features of the normal income tax, such as rate structures or personal exemptions, would probably be changed so that the marginal rates used in making the estimates would no longer apply. Outlay or credit programs might also be altered or new tax expenditure items added. Such actions cannot, of course, be anticipated when individual tax expenditure estimates are made. For each itemized nonbusiness deduction for individuals the estimated revenue loss is based upon the amount by which the standard deduction is exceeded.

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The second major assumption used to make the estimates is that taxpayer behavior and general economic conditions remain unchanged in response to the hypothetical change in the tax laws. This assumption is required to estimate tax expenditures but it is, in most cases, unrealistic. In particular, to the extent that tax expenditures designed to encourage certain economic activities have been successful, their elimination would presumably change taxpayer behavior. Thus, if the tax credit for investment were deleted, both taxpayer behavior and general economic conditions would be expected to change with a resulting impact on budget receipts generally.

Whenever possible, sample data from tax returns are used to estimate tax expenditures. These data are not, however, available for the years presented in this analysis, as these returns have not yet been filed or tabulated. Consequently, the estimates must be made by extrapolating sample tax return data from past years by means of other, more current information including the economic forecast used in estimating budget receipts and outlays (see Part 3 of the Budget). Moreover, many tax expenditures result from excluded income, not reported on tax returns. In these cases estimates must be based upon other data sources. Any changes scheduled by existing law, such as the phasing in or out of specific provisions, are accounted for in the estimates.

The estimates of tax expenditures presented in this analysis are reduced by any minimum tax liabilities associated with particular items. The 10% minimum tax for tax preferences was introduced by the Tax Reform Act of 1969 in an attempt to insure that individuals and corporations receiving such tax preferences do not escape paying a share of the tax burden. Among the tax expenditure items included in the base of the minimum tax are accelerated depreciation on real property, excess reserves of financial institutions for losses on bad debts, percentage depletion in excess of cost depletion, and one-half of net long-term capital gains. The minimum tax is, in general, applied to the sum of preference items reduced by a $30 thousand exemption and the affected taxpayer's regular income tax liability for the year.

Some tax expenditure items affect the timing of deductions or the receipt of taxable income. Examples are depreciation in excess of straight line for buildings and rental housing and the deferral of income by domestic international sales corporations (DISC's). These provisions create a permanent tax expenditure even though for a particular taxpayer, transaction, or asset, the special provision may defer a tax rather than eliminate it. However, for a stable or growing business with an indefinite life, the deferral of taxes continues forever under most of these provisions. Furthermore, as the economy grows, these amounts increase over time. Estimates for these items attempt to show the difference between budget receipts under the current law and budget receipts if a different law had always been in effect. These figures therefore show more than the revenue that could be obtained in the first years of a transition from one tax law to another. They are long-run estimates at the levels of economic ~~activities~~ activity assumed for the years in question.

Tax expenditure estimates cannot be simply added together to form totals for functional areas or a grand total. In some cases the revenue gain resulting from the deletion of two tax-expenditure items would be greater than the sum of the individual estimates. For example, if interest income from State and local government securities were made taxable and capital gains were taxed at ordinary rates, many individuals would be pushed into higher tax brackets than if just one of these sources of income became fully taxable; the combined effect on revenue would be greater than the sum of the two separate estimates. In other cases, the revenue gain from the deletion of two items would be smaller than the sum of the individual estimates. For example, if the deductibility of mortgage interest payments and homeowner property taxes were both repealed, and the standard deduction unchanged, many individuals who now itemize their deductions would opt for the standard deduction, thus limiting the revenue gain. In general, elimination of multiple items that are personal deductions would increase revenue by less than the simple sum of the revenue gains from eliminating each item measured separately since many taxpayers would switch to using the standard deduction. Conversely, elimination of multiple items that are exclusions from adjusted gross income would increase revenue by more than the sum of the individual gains as taxpayers would be pushed into higher tax brackets. Moreover, if several major tax expenditure items were eliminated, the assumptions of no changes in economic behavior and conditions or in other features of the tax system would have little validity.

A few aggregations of related tax-expenditure items are presented and discussed in the next section. These aggregates have been specially estimated so as to account for the interactions referred to above, but ~~these aggregate estimates~~ do not consider the effect of changes in behavior. Where tax expenditures for both individuals and corporations result from the same tax code provision, such as the investment tax credit, the two estimates may appropriately be added together. cap.

Tax Expenditures by Function

Estimates of tax expenditures are grouped together by functional category and presented in table F-1. The estimates are shown separately for individuals and corporations. Whenever possible particular tax expenditures have been classified according to the functional categories used for budget outlays. Many tax expenditures do not, however, fit into these categories and for this reason three special functional categories have been added: business investment, personal investment, and other tax expenditures.

A brief description of each of the special tax provisions for which a tax expenditure estimate is shown in table F-1 follows.

National defense.—The supplements to salaries of military personnel, including provision of quarters and meals on military bases and quarters allowances for military families, and virtually all salary payments and reenlistment bonuses to military personnel serving in combat zones, are excluded from tax. Disability related military pensions are largely excluded from taxable income.

International affairs.—For citizens of the United States who are not employees of the Federal Government, income earned abroad up to $20,000 for each complete tax year is exempted from taxation if the taxpayer is a bona fide resident of a foreign country for an uninterrupted period that includes 1 full tax year or if he is present there 510 days during a period of 18 consecutive months. After 3 years, foreign resident taxpayers can exclude up to $25 thousand a tax year. Certain allowances received by Federal employees working abroad are also tax-exempt.

When a foreign subsidiary of a U.S. corporation operating in a less developed country (LDC) repatriates dividends to its parent corporation, that income may be reported net of foreign income taxes paid. U.S. tax liability is then calculated on that net amount and the foreign tax is taken as a credit. For non-LDC corporations income must be reported gross of foreign taxes paid. The failure to "gross up" dividends by the amount of the foreign taxes paid to LDC's results in a tax expenditure.

The profits of a domestic international sales corporation (DISC) are not taxed to the DISC but instead are taxed to the shareholders when distributed to them. This deferral is available for 50% of the export income of a DISC. To qualify as a DISC at least 95% of a corporation's gross receipts must arise from export activities. The resulting tax expenditure is expected to increase from $1.1 billion in 1975 to $1.6 billion in 1977 as additional DISC's are created and a large volume of export income is deferred. The Tax Reduction Act of 1975 denied DISC benefits to exporters of energy products. cap.

The income of foreign corporations controlled by U.S. corporations or citizens is generally not subject to U.S. tax until income is repatriated. The income of foreign branches of domestic corporation is taxed like any other income. The deferral provision for foreign subsidiaries has the effect of allowing such corporations to be taxed like any other corporation doing business in particular foreign countries and may, in some circumstances, encourage investment abroad. The exceptions to the deferral provisions were expanded by the Tax Reduction Act of 1975, thereby reducing the amount of the tax expenditure for 1976 and subsequent years.

Domestic corporations qualifying as Western Hemisphere trade corporations are entitled to a special deduction which reduces their tax rate from 48% to 34%.

Agriculture.—Farmers, including corporations engaged in agriculture, may deduct certain costs as current expenses even though these expenditures were for inventories on hand at the end of the year or capital improvements.

Capital gains treatment applies to the sale of livestock, orchards, vineyards, and comparable agricultural activities.

Natural resources, environment, and energy.—State and local governments issue bonds, the interest income from which is exempt from Federal tax, to finance pollution control facilities used by private firms. The total volume of tax-exempt bonds issued for this purpose has grown rapidly in recent years.

Certain capital costs necessary to bring a mineral deposit into production may be deducted as current expenses rather than spread over the useful life of the property. Included in this category are the intangible drilling costs of oil and gas wells, such as the wages of drilling crews, and the cost of developing other mineral deposits, such as expenditures for mine shafts, tunnels, and stripping.

Extractive industries may generally choose between two methods of recovering capital costs invested in the development of natural resources. Under one method, actual outlays, to the extent not immediately expensible, may be deducted as "cost depletion" over the productive life of the property, much as other businesses may take deductions for the depreciation of capital goods. Alternatively, businesses in the extractive industries may deduct a prescribed percentage of gross income (at rates ranging from 22% for oil and gas to 5% for certain minerals, but not more than 50% of net income or 65% of net income in the case of oil and gas) where "percentage depletion" exceeds "cost depletion." Percentage depletion is not limited to the cost of the investment as is cost depletion. The basis for "cost depletion" is reduced to the extent certain costs are recovered through expensing of exploration and discovery costs and intangible drilling costs. There is no comparable reduction in "percentage depletion" to allow for costs which are allowed as expenses. A tax expenditure estimated on the assumption that both were eliminated would be significantly smaller than the sum of the two separate items because percentage depletion would exceed cost depletion by a lesser amount if the basis for cost depletion were increased by depreciating exploration, discovery, and intangible drilling costs that are currently expensed. The Tax Reduction Act of 1975 significantly reduced the tax expenditure resulting from the application of percentage depletion to producers of oil and gas by limiting application of the provision to independent producers and royalty owners and to specific quantities of output. For those still eligible, ~~In addition,~~ the Act phases the percentage rate down from 22% through 1980 to 15% in 1984 and thereafter. cap.

Royalties from coal or iron ore deposits are treated as capital gains, rather than ordinary income.

The gain on the cutting of timber is taxed at rates applicable to long-term capital gains, rather than at ordinary income rates.

Taxpayers may elect to amortize a certified pollution control facility over a 5-year period rather than its longer expected useful life. If they so elect they may not claim the investment tax credit on the capital cost of the facility. This provision applies only to facilities placed in service before 1976.

Commerce and transportation.—Credit unions are exempt from Federal income tax.

Corporations organized as cooperatives may take advantage of several special provisions of the tax code that permit assets to be built up out of untaxed income. Noncash patronage dividends based on net income earned on business done with patrons may be deducted, as long as 20% of the total dividend is paid in cash and the patron has agreed to take the entire dividend into his income. Per-unit retains, that is, amounts retained from the value of products marketed for patrons, may be deducted by the cooperative if patrons agree to take the face amounts into current income. Agricultural cooperatives meeting certain requirements are permitted to deduct dividends on capital stock and payments to patrons from nonpatronage income. Rural electric and telephone cooperatives may deduct noncash patronage dividends and patrons generally need not take such dividends into income. The tax expenditures reported in table F–1 are the estimated amount of corporate tax that would be paid if noncash patronage dividends, per-unit retains, dividends on capital stock, and payments to patrons out of nonpatronage income were not deductible. The increase in corporate taxes would be offset by a $xxx million reduction in personal taxes, since noncash patronage dividends and retains would no longer be taken into current income by patrons.

Corporations under the permanent tax code, pay income tax at the rate of 22% on all taxable income plus a surtax of 26% on taxable income in excess of $25 thousand. Each corporation therefore enjoys a surtax exemption of $25 thousand. This exemption is intended to encourage small or new business. For 1975 only, the Tax Reduction Act of 1975 provided that the tax rate on the first $25 thousand of taxable income be reduced to 20% and that the surtax exemption apply to the second $25 thousand of taxable income. This temporary provision was extended for 6 months by the Revenue Adjustment Act of 1975.

Certain companies which operate U.S.-flag vessels on foreign trade routes receive an indefinite deferral of income taxes on that portion of their net income which is used for shipping purposes, primarily construction, modernization, and major repairs of ships.

Specified classes of railroad rolling stock are eligible for amortization over a 5-year period whether owned by railroad companies or by lessors, rather than their longer, expected useful life. If 5-year amortization is elected the investment tax credit cannot be claimed. This provision applies only to rolling stock placed in service before 1976.

Commercial banks, mutual savings banks, and savings and loan associations are permitted to deduct and set aside additions to bad debt reserves in excess of actual loss experience and reasonable expectations as to future losses. Commercial banks may maintain a reserve of 1.2% of uninsured loans. The ratio will phase down to 0.6% in calendar year 1981. Mutual savings banks and savings and loan associations may deduct 43% of income in calendar year 1976, provided they maintain stipulated fractions of their assets in "qualifying assets," primarily residential mortgages. Under current law their maximum deduction will phase down to 40% in 1979 and thereafter.

Individuals who itemize their deductions may deduct State and local gasoline excise taxes paid. The deduction of excise taxes on gasoline used for business purposes does not result in a tax expenditure since they would in any case be deductible as a business expense.

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Community and regional development.—Taxpayers may, under certain conditions, elect to compute depreciation on rehabilitation expenditures for low- and moderate-income rental housing over a 5-year period. Qualified rehabilitation expenditures may not exceed $15 thousand per dwelling unit and must exceed $3 thousand. This provision expired on December 31, 1975.

Education, training, employment, and social services.—Taxpayers may elect to amortize over a 5-year period expenditures incurred in acquiring, constructing, reconstructing, or rehabilitating child care or on-the-job training facilities. This provision expires at the end of 1976.

Recipients of scholarships and fellowships may exclude such amounts from taxable income, subject to certain limitations. The exclusion of educational benefits under the GI bill are included in Veterans Benefits and Services.

Taxpayers may claim personal exemptions for dependent children 19 or over who receive income of $750 or more per year only if the children are full-time students. The student may also claim an exemption on his or her own tax return, in effect providing a double exemption, one on the parents' return and one on the student's.

Contributions to nonprofit educational institutions are allowed as a deduction for individuals and corporations. (See the discussion of other charitable contributions under "Other Tax Expenditures.")

Child and dependent care expenses incurred to permit the taxpayer and his spouse to work may be taken as an itemized deduction up to a maximum of $400 per month. The deduction is reduced by 50 cents for each dollar of adjusted gross income in excess of a limit that was increased from $18 thousand to $35 thousand per year by the Tax Reduction Act of 1975.

A credit is allowed against income tax liability equal to 20% of first-year wages and salaries of employees placed in employment under the work incentive program. The credit for a taxable year cannot exceed $25 thousand plus 50% of the excess over that amount. A similar credit, on a temporary basis, was provided for employment of AFDC recipients by the Tax Reduction Act of 1975.

Health.—Payments by employers for health insurance premiums and other medical expenses are deducted as business expenses by employers and excluded from income by employees. The exclusion from employees' income gives rise to the tax expenditure.

Medical expenses in excess of 3% of adjusted gross income, including expenditures for prescribed drugs and medicines in excess of 1% of adjusted gross income, may be deducted by individuals as itemized nonbusiness deductions. Individuals may also deduct half of the premiums they pay for medical care insurance up to a maximum deduction of $150 per year, without regard to the 3% limitation. O/ cap.

Income security.—Most forms of government transfer payments to individuals, such as social security and unemployment benefits, are excluded from taxable income, If the taxpayer had no other source of income, these payments, even if taxable, would not generally be sufficient to result in any tax liability, given personal exemptions and minimum standard deductions. Since some recipients have property income, receive earnings (perhaps for only part of a year), or may file jointly with working spouses, tax expenditures result from these exclusions. The estimates include the effect of excluding from tax the $50 payments made to recipients of social security and certain other Federal programs provided by the Tax Reduction Act of 1975.

Although not paid directly in cash, the bonus value of food stamps, which is the difference between their face amount and the lesser amount that program participants pay for them, is sufficiently similar to other Federal transfer program payments that their exclusion from income subject to tax results in a tax expenditure. Since only a few participants have income large enough to be taxable, the tax expenditure is small relative to total program outlays.

Certain payments, up to $100 per week, financed by an employer in lieu of wages during periods of employee injury or sickness are excluded from the employee's taxable income.

Certain contributions to pension plans paid by employers, and amounts set aside by the self-employed and employees not covered by an employer's plan, are excluded from current individual gross income. The investment income earned by pension funds is not taxable currently. The resulting tax expenditures are composed of two elements: lower effective tax rates after retirement, due to lower incomes and special tax provisions enjoyed by the aged; and the excess of aggregate current contributions and investment earnings over aggregate amounts paid out in benefits. The self-employed can make deductible contributions to their own retirement plans equal to 15% of their income, up to a maximum of $7,500 per year. Employees not covered by an employer's plan may deduct annual contributions of 15% of compensation, up to a maximum of $1,500.

In addition to pension plans, many employers provide other employee benefits that are excluded from employee income. The employer's share of these benefits are deductible business expenses. Included in the meals and lodging item is the exclusion from the taxable income of ministers of the rental value of parsonages and housing allowances.

A taxpayer 65 or older may exclude from gross income any capital gain allocated to the first $20 thousand of the adjusted sales price on a sale of a personal residence. This is a once in a lifetime exclusion.

Rom. *The percentage standard deduction*—15% of adjusted gross income up to a limit of $2 thousand sets an upper limit on the tax liability for many taxpayers, predominately in the lower and middle-income range, and for that reason is classified under income security. For calendar year 1975 only, the Tax Reduction Act of 1975 provided a percentage standard deduction of 16% up to a limit of $2,600 for married persons filing joint returns and $2,300 for single persons. The Revenue Adjustment Act of 1975 maintained the 16% rate and made additional upward revisions in the limits for the percentage standard deduction for the first 6 months of calendar year 1976. The percentage standard deduction is a substitute for itemizing deductions: the estimates shown are for the amount by which the percentage standard deduction exceeds the low income allowance or the itemized deductions that would be taken in the absence of this provision, whichever is greater. This provision also encourages taxpayers to use the simplified short form 1040A.

Additional personal exemptions of $750 may be deducted by taxpayers who are over 65 or who are blind. These additional exemptions may not be claimed for the taxpayer's dependents.

A retirement income tax credit may be claimed by individuals who are retired, or over age 65, of up to $228.60 (15% of $1,524) for a single person, or $324.90 (15% of $2,286) for a married couple, based on retirement income from all sources except social security, railroad retirement, and other tax-exempt benefits. The provision was designed to permit taxpayers with taxable retirement income—a tax benefit approximately comparable to that accorded recipients of social security and similar tax-exempt benefit payments.

The aggregate effect of excluding social security and railroad retirement benefits for retirees, the additional exemption for persons over 65, and the retirement income credit are revenue losses of $4,590 million in 1975, $4,970 million in 1976, and $5,530 million in 1977. These aggregates are greater than the sum of the individual estimates because more elderly persons would be pushed to taxpaying levels of income or into higher tax brackets if all of these items were deleted from the tax code.

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The Tax Reduction Act of 1975 established, for calendar year 1975 only, an earned income credit for low-income workers with families. The maximum credit is 10% of a worker's first $4 thousand of earned income and phases out at $8 thousand of adjusted gross income. To the extent that the credit reduces or eliminates tax liabilities it results in a tax expenditure. Credits in excess of tax liabilities are rebated to individuals. These rebates are treated as budget outlays and are estimated to be $1.2 billion in 1976. The Revenue Adjustment Act of 1975 extended the earned income credit through calendar year 1976 at a 5% rate in order to make it equivalent to a 6-month extension.

Veteran benefits and services.—All compensation due to death or disability and pensions paid by the Veterans Administration are excluded from taxable income. GI bill benefits are also excluded.

General government.—Political contributions up to a maximum of $100 ($200 in the case of joint returns) may be deducted, or tax credits may be taken up to one-half of contributions but limited to $25 ($50 on joint returns).

Revenue sharing and general purpose fiscal assistance.—The interest on State and local government debt is excluded from Federal taxation. Both corporations, mainly commercial banks, and individuals receive this tax-exempt income. As a result, these governments are able to sell debt obligations at a lower interest cost than would be possible if such interest were subject to tax. The exclusion of interest on State and local government industrial development bonds and securities issued to finance pollution control facilities are classified elsewhere; only the effect of excluding interest on general purpose obligations and revenue bonds for public purposes such as toll roads is estimated for this function.

U.S. citizens and corporations receiving income from sources in a U.S. possession may, under certain conditions, exclude such income from tax.

The deductibility of nonbusiness State and local taxes provides indirect assistance to these governments. The deductibility of property taxes on owner-occupied homes and excise taxes on gasoline are classified elsewhere. The estimates shown here are primarily for the deductibility of State and local income and sales taxes.

Interest.—Holders of U.S. savings bonds are not required to include the interest on these securities in their taxable income until the bonds are redeemed, thereby deferring tax liabilities.

Business investment—The interest on industrial development bonds issued by State and local governments is excluded from taxable income. The proceeds of these bonds are used to finance private investment in manufacturing plants and other facilities. For that reason this item is classified as business investment rather than under revenue sharing and general purpose fiscal assistance to State and local governments.

To the extent that allowable depreciation for tax purposes exceeds the rate at which assets actually depreciate, business tax liabilities are deferred. Businesses may employ a variety of depreciation schedules for tax purposes, some of which cause a much larger part of asset values to be written off in early years of the asset's useful life than do others. An extra first-year depreciation deduction of 20% may be claimed for $10 thousand of tangible personal property ($20 thousand on a joint return) having a useful life of at least 6 years. The revenue costs of allowing buildings and rental housing to be depreciated for tax purposes by methods that reduce asset value more rapidly than straight-line depreciation (the method typically used in financial statements) are shown.

Research and development expenditures typically result in new products or processes, cost reductions, or other outcomes the benefits from which will, in nearly all cases, accrue on into the future. For tax purposes businesses may deduct all research and development expenditures in the year during which they are incurred rather than amortizing them over a number of years. The tax expenditure is estimated on the assumption that such expenditures are amortized over a 5-year period.

Taxpayers may deduct on a current basis interest and property tax payments made during the period when a building is under construction rather than include such costs of construction, along with other costs, in the value of the completed structure which would then be depreciated over its useful life.

Corporations may elect a 30% alternative tax rate on capital gains. The tax expenditure is estimated on the assumption that these gains would otherwise be taxed at 48%.

The investment tax credit was substantially modified by the Tax Reduction Act of 1975. For calendar years 1975 and 1976 the rate of the credit was increased from 7% to 10% (from 4% to 10% in the case of public utilities). The percentage is applied to the cost of qualifying property having a useful life of over 7 years (generally, tangible personal property used in a trade or business). The investment tax credit cannot be claimed for investments in land or buildings or for property used abroad. Lower rates apply to property with useful lives of 3 to 7 years. The maximum credit which may be offset directly against income tax liability in a taxable year is limited to $25 thousand plus one-half of the excess of tax liability over $25 thousand. Excess credits may generally be carried back 3 taxable years and forward 7 taxable years, after which they expire if still unused. The act provides a temporary increase in maximum credits that can be claimed by public utilities. The amount of used equipment on which the credit may be claimed was temporarily increased from $50 thousand to $100 thousand. An extra 1% credit may be claimed for 1975 and 1976 by corporations which elect to contribute that amount to an employee stock ownership plan funded by transfers of employer shares. As a permanent change, the Act allows investment tax credit to be claimed as progress payments are made on property that takes 2 or more years to construct. cap.

Personal investment.—Grouped together in this category are a number of tax expenditure items that affect individuals as investors and holders of real and financial assets.

The first $100 ($100 per taxpayer on a joint return) of dividend income may be excluded from taxable income.

Half of the gains from the sale of capital assets held more than 6 months is excluded from income. The estimates are computed on the assumption that half of the long-term gains currently excluded would be taxed at ordinary rates. Long-term capital losses may be deducted from gains but no more than $1 thousand of long-term losses may be deducted in any 1 year from ordinary income. No special recognition is made of the effect of inflation on the value of assets. Capital gains treatment under present law is complex for a number of reasons. It could be contended that:

1. Full taxation of realized capital gains, even with full taxation at death, could result in greater postponement of lifetime gains thereby, limiting tax revenues:
2. Current tax treatment of capital gains offsets, to some extent, the double taxation of corporate income paid out to taxable shareholders that is a consequence of not integrating corporate and individual taxes.
3. Averaging of capital gains over the length of the holding period would lower the estimated revenue costs.

At the death of a taxpayer the appreciation in value of assets held by that individual is not taxed as income. As the assets pass to an heir or other recipient that new holder takes the market value of the assets at the date the estate is valued as ~~a~~ basis against which to measure any future appreciation or loss. The appreciation during the lifetime of the decedent thus avoids any income tax. The estimated the N

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revenue losses due to this feature of the tax code are based upon including appreciated values in the income of a decedent during the final year of life and applying existing rules for capital gains taxation (including the 50% exclusion provision) and income averaging. If appreciation were taxed at death there would be a concomitant reduction in the value of estates, thereby reducing estate tax receipts. That reduction would amount to $930 million in 1977.

Life insurance policies, other than term policies, generally have a saving element in them. Savings in the form of policyholder reserves are accumulated from premium payments, and interest is earned on these reserves. Such interest income is taxable neither as it accrues nor as an element fo death benefits.

Capital gains on the sale of a home are recognized only to the extent that the "adjusted sales price" exceeds the cost of a new home purchased and occupied within 18 months before or after the sale (if a new house is constructed it must be occupied within 2 years after the sale). The "adjusted sales price" is the amount realized (gross proceeds less selling expenses) minus qualified "fixing up" expenses. A loss on a sale of a home is not deductible.

Owner-occupants of homes may deduct mortgage interest and property taxes (but not maintenance outlays or depreciation because the in-kind income from home ownership is not recognized) as itemized nonbusiness deductions. The tax expenditure from these two items combined would be $7.7 billion for 1977. This is less than the sum of the two separately because if both were deleted more taxpayers would save by using the standard deduction.

Taxpayers may deduct as an itemized nonbusiness deduction the amount in excess of $100 for each loss due to fire, theft, or other casualty to the extent not compensated by insurance or other payments. This may encourage individuals to hold assets that are uninsurable or to self-insure.

The Tax Reduction Act of 1975 provided, for part of calendar year 1975 only and subject to certain conditions, a tax credit equal to 5% of the purchase price of a new home, up to a maximum credit of $2 thousand. The credit was intended to stimulate the sale of new homes and draw down the inventory of unsold units, thereby creating an incentive for new housing construction. In a few cases taxpayers will not be able to claim the credit until they file their 1976 returns during fiscal year 1977.

Other tax expenditures.—Interest paid on consumer credit for any purpose is allowed as an itemized nonbusiness deduction for individuals.

Contributions to charitable, religious, or certain other nonprofit organizations are allowed as an itemized deduction for individuals, generally up to 50% of adjusted gross income. Taxpayers whose contributions to charitable or educational organizations are in the form of capital assets, usually securities, which have appreciated in value above their cost, obtain a deduction for the contribution at the appreciated value of the asset without taxation on the appreciation in value. Contributions to educational institutions are reported under Education, ~~and~~ Training, ~~and~~ Employment, and Social Services.

Corporations may deduct charitable contributions (including those made to educational institutions ~~, which are separately~~ reported ~~in the Education and Training and employment category~~) up to 5% of their income. In the absence of this provision of the tax code some of these contributions might be deductible as business expenses. The estimates are based on all reported contributions.

The Tax Reform Act of 1969 introduced a maximum tax rate of 50% on earned income in order to lessen the incentive for taxpayers with high earned incomes to seek out various tax avoidance techniques.

Proposed Changes in Tax Expenditures

The tax proposals that are a part of the 1977 budget would reduce somewhat nearly every estimated tax expenditure for 1977 presented in table F-1. The proposed increase in personal exemptions from $750 to $1 ~~thousand~~ ,000, increase in the ~~minimum~~ standard deduction to $2,500 for a married couple filing jointly and to $1,800 for a single taxpayer, elimination of the percentage standard, and changes in rate schedule would become effective July 1, 1976. These proposed changes in the normal structure of the individual income tax would ~~affect~~ reduce the number of taxpayers who itemize their deductions and would alter marginal tax rates in many instances. The proposed reduction in the basic corporate tax rate from 48% to 46% beginning on July 1, 1976, would reduce the tax expenditures associated with the corporate income tax. No attempt will be made here to reestimate each of the items.

Several proposals do affect particular tax expenditures more specifically and these will be briefly discussed. The estimates for these specific changes are shown in table F-2.

Excess of percentage standard deduction over low-income allowance.—The percentage standard deduction would be eliminated and hence the tax expenditure associated with the excess of the percentage standard deduction over the low-income allowance would disappear. Elimination of the percentage standard deduction would simplify tax returns; the resulting revenue gain would be more than offset by other proposed changes. Elimination of the percentage standard deduction is not proposed apart from the other proposed changes in personal exemptions, low-income allowances, and rate schedules.

Additional personal exemptions.—The additional personal exemptions for taxpayers who are blind or over 65 would be increased from $750 to $1 thousand.

Investment tax credit.—The increase in the investment tax credit from 7% to 10%, which was enacted for calendar years 1975 and 1976 only by the Tax Reduction Act of 1975, is proposed to be made permanent.

Corporate surtax exemption.—The features of the Tax Reduction Act of 1975 which, for calendar year 1975 only, reduced taxes on the first $50 thousand of corporate income are proposed to be made permanent beginning July 1, 1976.

Financial institutions.—The 1977 budget anticipates enactment of legislation that would reform the operation of the Nation's financial institutions. A part of that reform would be to adopt uniform tax rules for all types of banks. Special provisions currently prescribing maximum bad debt allowances that may be deducted in order to determine taxable income for savings and loan associations and mutual savings banks would be eliminated. In order to encourage financial institutions to hold residential mortgages a new tax credit would be introduced. The credit would be a percentage of interest income received on residential mortgages and would range from 1.5% to 3.8% depending upon the fraction of the institution's assets held in the form of residential mortgages. Individuals holding residential mortgages would be eligible for the credit at the 1.5% rate. The estimates shown in table F-2 assume that these tax changes become effective January 1, 1977.

Electric utilities.—The 1977 budget proposals include tax relief for the electric utility industry in order to stimulate construction of additional facilities. The proposal would:

—Increase the investment tax credit permanently to 12% on all electric utility property except generating facilities fueled by petroleum products.

—Give electric utilities full, immediate investment tax credit on progress payments for construction of property that takes 2 years or more to build, except generating facilities fueled by petroleum products.

—Extend to January 1, 1981, the period during which pollution control facilities installed in a pre-1969 plant or facility may qualify for 5-year straight-line amortization in lieu of normal depreciation and the investment credit.

—Permit 5-year amortization of the costs of either converting a generating facility fueled by petroleum products into a facility not fueled by petroleum products or replacing a petroleum-fueled facility with one not fueled by petroleum.

—Permit a utility to elect to begin depreciation of accumulated construction progress expenditures during the construction period.

—Permit a shareholder of a regulated public electric utility to postpone tax on dividends paid by the utility on its common stock by electing to take additional common stock of the utility in lieu of cash dividends.

The estimates shown in table F–2 assume that these tax changes become effective July 1, 1976.

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NEW GALLEY

Table F-1. TAX EXPENDITURE ESTIMATES BY FUNCTION

[In millions of dollars]

Table F-1. TAX EXPENDITURE ESTIMATES BY FUNCTION

[In millions of dollars]

Description | Corporations 1975 1976 1977 | Individuals 1975 1976 1977

Table F-1. TAX EXPENDITURE ESTIMATES BY FUNCTION

[In millions of dollars]

Description | Corporations 1975 1976 1977 | Individuals 1975 1976 1977

Description	Corporations			Individuals		
	1975	1976	1977	1975	1976	1977
National defense:						
Exclusion of benefits and allowances to Armed Forces personnel	-----	-----	-----	650	650	650
Exclusion of military disability pensions	-----	-----	-----	70	80	90
International affairs:						
Exclusion of income earned abroad by U.S. citizens	-----	-----	-----	130	145	160
Exclusion of gross-up on dividends of LDC corporations	55	55	55	-----	-----	-----
Deferral of income of domestic international sales corporations (DISC)	1,130	1,360	1,560	-----	-----	-----
Deferral of income of controlled foreign corporations	590	525	365	-----	-----	-----
Special rate for Western Hemisphere trade corporations	50	50	50	-----	-----	-----
Agriculture:						
Expensing of certain capital outlays	135	105	115	475	355	360
Capital gain treatment of certain income	30	30	40	455	490	565
Natural resources, environment and energy:						
Exclusion of interest on State and local government pollution control bonds	80	130	195	35	60	90
Expensing of exploration and development costs	500	650	840	120	155	195
Excess of percentage over cost depletion	2,010	1,080	1,020	~~445~~ 465	500	575
Pollution control: 5-year amortization	30	20	15	-----	-----	-----
Capital gain treatment of royalties on coal and iron ore	~~30~~ 10	15	20	40	45	50
Capital gain treatment of certain timber income	145	155	165	60	60	65
Commerce and transportation:						
Exemption of credit unions	115	125	135	-----	-----	-----
Cooperatives: deductibility of noncash patronage dividends and certain other items	330	345	385	-----	-----	-----
Corporate surtax exemption	3,345	5,020	6,190	-----	-----	-----
Deferral of tax on shipping companies	70	105	130	-----	-----	-----
Railroad rolling stock: 5-year amortization	55	30	10	-----	-----	-----
Financial institutions: excess bad debt reserves	880	815	570	-----	-----	-----
Deductibility of nonbusiness State gasoline taxes	-----	-----	-----	820	575	595
Community and regional development:						
Housing rehabilitation: 5 year amortization	40	35	25	65	55	40
~~Education, manpower and social services:~~ Education, Training, Employment, and Social Services:						
Exclusion of scholarships and fellowships	-----	-----	-----	200	210	220
Parental personal exemptions for student age 19 and over	-----	-----	-----	670	690	715
Deductibility of contributions to educational institutions	205	215	280	440	450	500
Deductibility of child and dependent care expenses	-----	-----	-----	295	325	420
Child care facilities: 5-year amortization	5	5	5	-----	-----	-----
Credit for employing AFDC recipients and public assistance recipients under work incentive program	10	10	10	-----	-----	-----

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Health:						
Exclusion of employer contributions to medical insurance premiums and medical care	-----	-----	-----	3,275	3,665	4,225
Deductibility of medical expenses	-----	-----	-----	2,315	2,020	2,095
Income security:						
Exclusion of social security benefits:						
Disability insurance benefits	-----	-----	-----	275	315	370
OASI benefits for aged	-----	-----	-----	2,740	3,045	3,525
Benefits for dependents and survivors	-----	-----	-----	450	495	565
Exclusion of railroad retirement system benefits	-----	-----	-----	170	185	200
Exclusion of unemployment insurance benefits	-----	-----	-----	2,230	3,350	3,290
Exclusion of workmen's compensation benefits	-----	-----	-----	505	555	640
Exclusion of public assistance benefits	-----	-----	-----	105	115	130
Exclusion of special benefits for disabled coal miners	-----	-----	-----	50	50	50
Exclusion of food stamps	-----	-----	-----	135	185	220
Exclusion of sick pay	-----	-----	-----	315	330	350
Net exclusion of pension contributions and earnings:						
Employer plans	-----	-----	-----	5,225	5,745	6,475
Plans for self-employed and others	-----	-----	-----	390	770	965
Exclusion of other employee benefits:						
Premiums on group term life insurance	-----	-----	-----	740	805	895
Premiums on accident and accidental death insurance	-----	-----	-----	50	55	60
Income of trusts to finance supplementary unemployment benefits	-----	-----	-----	5	5	5
Meals and lodging	-----	-----	-----	265	295	305
Exclusion of capital gain on home sales if over 65	-----	-----	-----	40	45	50
Excess of percentage standard deduction over ~~minimum standard deduction~~ low income allowance	-----	-----	-----	1,385	1,465	1,560
Additional exemption for the blind	-----	-----	-----	20	20	25
Additional exemption for over 65	-----	-----	-----	1,100	1,155	1,220
Retirement income credit	-----	-----	-----	130	120	110
Earned income credit	-----	-----	-----	-----	280	135
Veterans benefits and services:						
Exclusion of veterans disability compensation	-----	-----	-----	540	590	595
Exclusion of veterans pensions	-----	-----	-----	25	30	30
Exclusion of GI bill benefits	-----	-----	-----	255	330	280
General government: Credits and deductions for political contributions	-----	-----	-----	40	40	65
Revenue sharing and general purpose fiscal assistance:						
Exclusion of interest on general purpose State and local debt	2,665	2,890	3,165	1,135	1,295	1,405
Exclusion of income earned in U.S. possessions	245	240	285	-----	-----	-----
Deductibility of nonbusiness State and local taxes (other than on owner-occupied homes and gasoline)	-----	-----	-----	8,490	6,505	6,675
Interest: Deferral of interest on savings bonds	-----	-----	-----	525	605	685
Business investment:						
Exclusion of interest on State and local industrial development bonds	125	140	155	50	60	65

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Excess first-year depreciation	175	145	165	110	80	90
Depreciation on rental housing in excess of straight line	115	120	125	405	430	455
Depreciation on buildings (other than rental housing) in excess of straight line	220	275	280	220	215	215
Expensing of research and development expenditures	635	660	695	-----	-----	-----
Expensing of construction period interest and taxes	985	1,020	1,065	525	545	570
Capital gain: corporate (other than farming and timber)	695	760	900	-----	-----	-----
Investment credit	4,860	6,850	6,550	950	1,410	1,445
Personal investment:						
Dividend exclusion	-----	-----	-----	315	335	350
Capital gain: individual (other than farming and timber)	-----	-----	-----	5,090	5,455	6,225
Capital gains at death	-----	-----	-----	2,400	2,500	2,710
Exclusion of interest on life insurance savings	-----	-----	-----	1,545	1,695	1,855
Deferral of capital gain on home sales	-----	-----	-----	805	845	890
Deductibility of mortgage interest on owner-occupied homes	-----	-----	-----	5,405	4,545	4,710
Deductibility of property taxes on owner-occupied homes	-----	-----	-----	4,510	3,690	3,825
Deductibility of casualty losses	-----	-----	-----	280	300	330
Credit for purchase of new homes	-----	-----	-----	-----	625	100
Other tax expenditures:						
Deductibility of charitable contributions (other than education)	385	395	525	4,385	3,820	3,955
Deductibility of interest on consumer credit	-----	-----	-----	1,185	1,040	1,075
Maximum tax on earned income	-----	-----	-----	160	175	190

* All estimates are based on the tax code as of Dec. 31, 1975, with the exception that the provisions of the Revenue Adjustment Act of 1975 regarding the standard deduction for individual income taxpayers ~~and the corporate tax rate and surtax exemption~~ are treated as if they were permanent.

Table F-2

Estimates of Proposed Changes in Tax Expenditures, 1977
(in millions of dollars)

	Corporate	Individual
Excess of percentage standard deduction over low income allowance........................	-----	-1560
Additional exemption for the blind...............	-----	
Additional exemption for over 65................	-----	
Investment credit................................		
Corporate surtax exemption......................		-----
Financial institutions: excess bad debt reserves.		-----
Mortgage interest income tax credit..............		
Electric utilities:		
Investment tax credit.........................		-----
Pollution control: 5-year amortization........		-----
Conversion facilities: 5-year amortization.....		-----
Depreciation of progress payments..............		-----
Deferral of tax on reinvested dividends........	-----	

THE WHITE HOUSE

WASHINGTON

January 2, 1975

MEMORANDUM FOR THE PRESIDENT

FROM: L. WILLIAM SEIDMAN

SUBJECT: Broadened Stock Ownership Plans

The EPB Executive Committee has reviewed a range of employee and broadened stock ownership plans in recent weeks. A strong likelihood exists that Senator Long will continue to successfully push his employee stock ownership plan (ESOP), which is very similar to the Kelso Plan, in the Senate. There is general agreement that if a stock ownership plan is likely to be enacted that a plan more broadly-based than the Long approach is desireable.

Broadened Stock Ownership Proposal

The proposed plan developed by the EPB Task Force on Stock Ownership Plans has the following general features: (1) A Broadened Stock Onwership Plan (BSOP) can be established by an employer for the voluntary participation of his employees or by individuals. (2) Contributions to the plan are deductible from taxable income and must be invested in common stock. (3) Participation would be restricted to individuals in the middle and lower income ranges. (4) Contributions must remain invested for at least seven years after which funds could be withdrawn from the plan without penalty. (5) A limit would be placed on the amount of the annual contribution eligible for exclusion from income tax. (6) The permissible contribution would be phased down as the maximum income limit is approached to avoid a notch effect, i.e. individuals earning $24,500 being fully eligible to benefit from the maximum contribution allowed while individuals earning $25,001 being unable to participate at all in the plan.

Advantages of a Broadened Stock Ownership Plan

Proponents of a broadened stock ownership plan cite several advantages:

- The plan has broad coverage and would be available to government employees, service personnel, and employees of small businesses as well as to employees of large corporations with established stock purchase programs.

- The earned income limitation focuses the benefits on low and middle income families.

- The withdrawal penalty provision should tend to stabilize savings and provide support for the equity market.

Disadvantages of a Broadened Stock Onwership Plan

A broadened stock ownership plan has several disadvantages:

- The plan lacks neutrality in that it favors equity ownership as opposed to other forms of savings such as savings accounts or insurance.

- There is a valid question as to whether this vehicle would achieve its objectives of encouraging stock ownership, increasing aggregate savings, and increasing identification with the free enterprise system.

- Entails revenue losses estimated by the Treasury at between $360 million and $1.5 billion depending on the parameters of the program.

Differences from Other Savings Plans

1. Individual Retirement Accounts (IRAs)

- Contributions to IRAs can be invested in any assets. A BSOP would be restricted to purchases of common stock.

- No withdrawals can be made from an IRA without penalty until age 59 1/2 making it a genuine retirement program. A BSOP allows withdrawals after 7 years regardless of age.

- Individuals can participate in an IRA without any restriction as to their income level. A BSOP limits participation to low and middle income level individuals.

- Annual contributions to an IRA is limited to 15% of an individual's income or $1,500 whichever is less.

- An IRA is limited to employees not covered by an alternative employee retirement plan.

2. Keogh Plans

- Eligibility is limited to self-employed individuals.
- Annual contributions are limited to 15% of an individual's income or $7,500 whichever is less.
- Individuals can participate in a Keogh plan without any restriction as to their income level.
- Contributions to Keogh plans can be invested in any assets.

3. Kelso Plans

- Contributions to a Kelso plan must be invested in the employers stock.
- No withdrawals can be made from the plan without penalty until retirement.
- Current law provides a tax credit equal to 1 percent of investment for employer contributions to Kelso Plans. This is more generous than the tax privilege proposed for a BSOP, but to date few employers have taken advantage of this provision.
- Annual contributions are limited to the lesser of $25,000 or 25% of earnings.

A table comparing the Kelso, Keogh, IRA, and BSOP plans with estimates of the number of participants and the revenue loss is attached at Tab A. A table outlining alternative BSOP plans is attached at Tab B.

Table 2
Estimates of Retirement Plans 1975

	Type of Plan 1/	Maximum annual contribution	Source of contribution 2/	Eligibility to participate 3/
Employer Pension Plans	R	Lesser of $25,000 or 25% of earnings (15% of earnings for profit sharing)	E and W	PC
Profit Sharing Plans	R or S		E	PC
Stock Bonus (other than ESOP) Plans	R or S		E	PC
ESOP Plans	R or S		E	PC
Keogh Plans	R	Lesser of $7,500 or 15% of earnings	SE	SE
Individual Retirement Accounts	R	Lesser of $1,500 or 15% of earnings	W	SE and WPC
Proposed BSOP	S	Lesser of $1,500 or 15% of earnings	E and W	SE and WPC

Office of the Secretary of the Treasury
Office of Tax Analysis

January 2, 1976

1/ R = Retirement, S = Savings
2/ E = Employer contribution, W = Employee contribution, SE = Self-employed
3/ PC = Employer plan coverage
WPC = Without plan coverage
SE = Self-employed

BROADENED STOCK OWNERSHIP PLAN ALTERNATIVES

	A	B	C
Maximum annual amount eligible for exclusion from taxable income	$1,500	$1,500	$2,500
Maximum income eligible to participate in the plan	$25,000	$25,000	$50,000
Range of phase-out	$10-25,000	$20-25,000	$25-50,000
Restriction on withdrawl without a penalty	7 years	7 years	7 years
Estimated number of participants	2.1 million	2.4 million	2.5 million
Estimated revenue cost	$360 million	$500-600 million	$1.5 billion

SPECIAL SESSION

ECONOMIC POLICY BOARD

EXECUTIVE COMMITTEE MEETING

January 3, 1976

Roosevelt Room

9:30 a.m.

1.	Tax increases under the Compromise Plan for making a transition from the Revenue Adjustment Act of 1975 to the President's tax plan	Treasury
2.	Tax expenditure issues	OMB

MINUTES OF THE
ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE MEETING
January 2, 1976

ATTENDEES: Messrs. Seidman, Lynn, Greenspan, Gardner, Baker, Robinson, Cannon, Walker, Gorog, O'Neill, Penner, Porter

1. Estate and Gift Taxes

The Executive Committee discussed possible changes in Federal estate and gift tax laws to encourage private ownership of small businesses and small farms. The discussion focused on ways to prevent liquidation of family firms and family operated farms through extending the period for payment of estate taxes, deferring the payment of estate taxes, or exempting from taxation an increased portion of certain estates. There was a general consensus that tax deferral or extending the payment period were preferable approaches.

Decision

Mr. Walker will prepare a paper outlining various options for revising Federal estate and gift taxes for Executive Committee consideration.

2. Tax Expenditure Issues

Mr. Lynn raised the issue of congressional requests for inclusion in the budget of estimates of foregone tax revenues covering a variety of current practices and policies such as tax treatment of transfer payments to individuals, no capital gains tax at death, etc.

Decision

OMB will prepare a list of tax expenditure issues for Executive Committee consideration tomorrow.

3. Accelerated Depreciation for Construction of Plants and Equipment in High Unemployment Areas

The Executive Committee briefly discussed the proposal for accelerated depreciation to stimulate the construction of plants and equipment in areas of high unemployment and the relationship of the proposal to the Administration's proposal for tax incentives to stimulate the construction of energy facilities.

Decision

Messrs. Walker and Gorog will prepare an options paper specifying alternative parameters of the accelerated depreciation proposal.