

Issues In Federal Tax Revision

2. Tax Developments In 1974



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After a two-year drive for substantial "reform" in the Federal tax system, the 93rd Congress adjourned without enacting any major tax changes. The Committee on Ways and Means examined voluminous records of testimony and data on alternative methods of tax revision, and spent most of the year 1974 in an eventually unsuccessful attempt to reach agreement on a broad measure, the "Tax Reform Bill of 1974." A massive agenda of unresolved issues seems likely to serve as spadework for the new Congress, once current "emergency" tax questions are resolved. The issues are complex and intricate, as well as controversial.

This report, the second in a series, provides background on the tax issues considered by the 93rd Congress. A similar report, "Tax Developments in 1973," was issued about one year ago.

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TAX DEVELOPMENTS IN 1974

President Ford's recent tax proposals and statements of Congressional leaders make it clear that major efforts in the early months of 1975 will focus on tax changes to stimulate economic recovery and to deal with energy problems. The 93rd Congress gave some attention to both these questions, but its primary consideration was given to developing a broad-gauged tax revisor and "reform" measure. Only miniscule portions of the changes considered were enacted in 1974, and the intensive examination of numerous tax issues by the Committee on Ways and Means last year will serve as spadework for the new Congress, particularly insofar as longer run tax issues are concerned.

Summary of 1974 Developments

For almost two years the Committee on Ways and Means worked on a long agenda, in an attempt to report out a general tax bill. On September 11, 1974, the Committee released the draft of "The Tax Reform Bill of 1974," comprising almost 700 pages, and incorporating tentative decisions up to that time. After deliberating until late November, the Committee abandoned its efforts to reach final agreement on the measure originally contemplated. Instead, it approved a truncated bill, "The Energy Tax and Individual Relief Act of 1974." The Rules Committee did not clear the abbreviated bill for the House floor. Instead, minor tax changes, approved by both Houses in the closing hours before adjournment, came about as the result of a Senate amendment to a House-passed bill dealing with upholstery import tariffs.

In the course of the year there were several attempts in the Senate to by-pass the regular procedures by attaching "tax reform - tax relief" measures to other legislation, but these moves proved abortive. During the year, the Administration also presented several proposals aimed primarily at fighting inflation.

This report covers (1) the final decisions of the Committee on Ways and Means in 1974, which were firmed up in "The Energy Tax and Individual Relief Act of 1974," and (2) the tentative decisions on other issues which were included in the draft of "The Tax Reform Bill of 1974." Brief attention is given also to other developments, but reference is to major proposals only - those applicable to a significant number of taxpayers.

"THE ENERGY TAX AND INDIVIDUAL RELIEF ACT OF 1974"

This measure, H.R. 17488, approved by the Committee on Ways and Means on November 21, consisted largely of provisions from the omnibus tax bill which had been under consideration for some months. The Committee's report on H.R. 17488 noted that "this bill deals with major and the most pressing areas for reform of our tax laws. It is an installment on further tax reform which your committee already has under way and which it plans to report next year."

From a revenue standpoint, the most significant sections of the bill were proposals to (1) impose sharply higher taxes on oil and gas income and on all foreign source income; (2) reduce taxes for individuals - primarily those in lower-income groups; (3) and raise the investment tax credit for public utilities to levels comparable with other industries. The net revenue effects in the immediate future would have been negligible. By 1980, the measure, had it been approved, would have raised corporate taxes by \$2.79 billion annually and reduced individual taxes by \$1.99 billion, for a net revenue increase of some \$800 million.

Summary of the Major Provisions of H.R. 17488

1. *Tax treatment of oil and gas income.* (Revenue increase, \$2.5 billion in 1976, rising to \$3.9 billion by 1980).

- (a) "Windfall profits" (excise) tax of five years duration on the "windfall profit" element of the price of domestically produced crude oil, at graduated rates ranging from 10 to 85 percent, with a "plowback" credit against the tax for certain re-invested earnings.
- (b) Percentage depletion on domestic oil and unregulated natural gas generally (with some exceptions) to drop from 22 percent to 15 percent for 1974 and to zero for 1975 and later years.
- (c) For foreign oil and gas income, repeal percentage depletion effective January 1, 1974; repeal the per-country limitation on the foreign oil-related losses offset against domestic income; place stricter limits on foreign taxes attributable to foreign oil and gas income; deny DISC benefits with respect to income from export sales of energy-related natural resources; and restrict the right of the President to impose any quota, duty, tax, or fee on the importation of petroleum.

2. *Tax treatment of foreign income.* (Revenue increase: \$277 million in 1976, rising to \$387 million in 1980.)

Tighten the tax treatment of controlled foreign corporations and their shareholders; deny DISC benefits to certain items; repeal the per-country limitation on the foreign tax credit and in other ways limit allowances for foreign taxes; make changes in the taxation of money or other property moving out of or into the United States; modify the tax treatment of possessions corporations, and phase out over a five-year period the 14-percent lower tax rate for Western Hemisphere Trade Corporations.

3. *Decrease in individual income taxes.*

- (a) Raise the present low-income allowance of \$1,300 for both single and married taxpayers to \$1,600 for single persons and \$1,900 for married couples filing separately. (Revenue reduction: \$1.8 billion in 1976, rising to \$2.2 billion in 1980.)
- (b) Increase the standard deduction from 15 to 16 percent, and raise the ceiling from \$2,000 to \$2,300. (Revenue loss: \$559 million in 1976, increasing to \$679 million in 1980).
- (c) Allow individuals with more than \$30,000 of capital losses to carry them back for up to three years and offset them against capital gains in those prior years. (Revenue reduction: \$30 million in 1976; \$40 million by 1980).

4. *Investment tax credit for utilities.* (Revenue reduction: \$553 million in 1976, rising to \$977 million in 1980.)

Raise the investment tax credit for public utilities from 4 to 7 percent, the same rate as for other industries, and temporarily increase the 50-percent net income limitation.

5. *Other provisions.* The remainder of the proposals in the Committee's bill were included in the law enacted by Congress (see below).

In a separate action, the Committee on Ways and Means approved a bill exempting from taxable income the first \$500 of interest earned on savings accounts. Neither this measure nor the "Energy Tax and Individual Relief Act of 1974" was cleared by the Rules Committee for House consideration.

TAX CHANGES ENACTED BY CONGRESS

Three days before adjournment, the Senate transformed a noncontroversial upholstering tariff bill into a tax measure, and sent it to conference with the House. In the closing hours of the session both Houses approved the measure. Variouslly dubbed the (upholstery) "Pins and Needles" bill and the "Christmas Tree" bill, it was signed into law by President Ford on January 3, 1975. The provisions include the following:

1. Extend for one year the five-year rapid amortization provisions due to expire in 1974 for low-cost housing rehabilitation, pollution control facilities, railroad rolling stock, and coal mine safety equipment.
2. Provide permanent rules for accrued vacation pay.
3. Double the allowable maximum credit and deduction for contributions to political parties. (Technical changes were made in the provisions for taxing certain income of political organizations.)
4. Increase from 6 to 9 percent the interest rate paid by taxpayers on deficiencies and by the government on tax overpayments, effective July 15, 1975. (Revenue increase: \$300 million in 1975; \$465 million by 1980).
5. Repeal the provision requiring application of the Asset Depreciation Range to real estate after 1973.
6. Liberalize restrictions on real estate investment trusts with respect to treatment of foreclosed property.

OTHER ISSUES ON WHICH THE COMMITTEE ON WAYS AND MEANS REACHED ONLY TENTATIVE DECISIONS IN 1974

At the start, the Committee had before it the massive record of hearings held in 1973 (published in 18 parts, covering more than 7,000 pages) as well as Administration proposals related to problems of the energy shortage and general price inflation. The first item taken up by the Committee was the energy question. Although it cleared an oil and gas energy tax measure in late April, the Committee later decided to include these proposals as part of the broader measure it was working toward, rather than to submit them separately to the full House.

From May 1 to August 2, the Committee issued 21 press releases summarizing tentative decisions on a wide range of tax issues. On September 11, the panel began its "final markup" sessions, and released both the text of its draft bill and descriptions of each of the six titles. These were: (I) Changes primarily affecting individuals; (II) Changes primarily affecting corporations; (III) Changes in treatment of foreign income; (IV) Oil and gas energy tax act of 1974; (V) Administrative and miscellaneous changes; and (VI) Repeal and revision of obsolete, rarely used, etc., provisions (the so-called "deadwood" bill, first introduced in 1970).

Subsequently a number of the tentative decisions in the draft bill were reversed, some more than once, and on November 18 the Committee released another report, bringing up to date all tentative decisions. At about the same time the panel abandoned efforts to complete a tax bill as comprehensive as the one initially contemplated.

While H.R. 17488, as reported out, included Titles III (foreign income) and IV (oil and gas energy taxation) of the larger measure, this stripped-down bill omitted many issues which had claimed much of the attention of the Committee on Ways and Means earlier. The most

significant omissions from a revenue standpoint dealt with tax changes primarily affecting individuals, including revisions in the taxation of capital gains, the minimum tax on "preference" income; and various deductions, credits, and exclusions under the income tax.

A. Capital Gains Taxation. Capital gains taxation was apparently one of the most controversial of the items on the Committee's agenda. Under consideration were ways to free up locked-in capital gains or allow an adjustment for inflation; the length of the holding period for long-term gains or losses; the alternative tax; and the carryback of losses. The last tentative decisions reported were:

1. Raise the present 50-percent exclusion of long-term capital gains by excluding another 1 percent of the gain for each full year (in excess of 5 years, up to a maximum of 25 years) the taxpayer holds the asset. The added deduction would be limited to 20 percent of the gain on each asset and to 25 percent of the taxpayer's over-all net capital gain.
2. Lengthen the holding period for long-term gains or losses from six months to one year.
3. Eliminate the present 25 percent alternative tax rate for the first \$50,000 of capital gains.
4. Raise the amount of ordinary income against which capital losses may be offset to \$3,000 from \$1,000.

B. Minimum Tax and Related Changes. The taxation of "preference" income of individuals was the subject of lengthy discussion and considerable controversy in the Ways and Means Committee. Efforts were aimed at revising the minimum tax enacted in 1969, so as to raise tax payments on "preference" income and to curb "tax shelters." In the course of its discussions, the Committee backed off from earlier plans to expand the current definition of preference income to include various other types of income, but reduced present deductions, and raised the rates of tax above those it initially contemplated. The changes were intended to apply to individuals only, with no change in the minimum tax on corporate income. (An early version of the Committee's decisions would raise taxes from some high-bracket individuals by one-third or more, or around \$800 million annually altogether. No firm later estimates are available.) The Committee's last tentative decisions proposed:

1. A new minimum tax for individuals, in the form of an alternative to the regular income tax, instead of the present additional tax. Individuals would compute both regular tax and the minimum tax, and pay the higher of the two.
2. The new tax would apply to "economic income" (substantially the same as under present law) less an exemption and certain deductions.
 - (a) The basic exemption would be \$20,000 (instead of the present \$30,000), to be reduced dollar for dollar as income less deductions rises above that amount, and to be phased out entirely when the excess of economic income over deductions reaches \$40,000.
 - (b) Deductions would be limited to investment interest and expense to the extent of investment income, extraordinary medical expenses and casualty losses and charitable contributions.

3. Rates for the new minimum tax would be graduated from 7 to 35 percent of income included in the base (i.e., one-half the ordinary rates), instead of the present 10 percent flat rate.

To impose stiffer taxes on high-incomes which may escape taxation, the Committee decided to limit, in certain instances, the extent to which accounting losses can be used as off-sets against non-related income, the so-called Limitation on Artificial Accounting Losses (LAL), proposed by the Administration in 1973. Among the areas to which LAL would apply were farm losses, production of movies, personal property subject to a net lease, and real estate.

C. Deductions, Credits, and Exclusions under the Individual Income Tax. Proposals included the following:

1. Repeal the deductions for state gasoline taxes, one-half of medical insurance premiums, state disability and state or local stock transfer taxes, the \$100 dividend exclusion, and the sick pay exclusion.
2. Impose further limitations on deductions for medical expenses and casualty losses.
3. To balance out the foregoing increases, a "simplification" deduction of \$350 plus 2 percent of adjusted gross income up to \$650 would be permitted taxpayers who itemize deductions. Also part of the simplification package would be liberalization in the tax treatment of alimony payments, the child care allowance, and the retirement income credit.
4. Tighten the tax treatment of deductions for foreign travel expense and for vacation homes.
5. Raise the present \$3,000 limit on deductible away-from-home living expenses for members of Congress on the basis of changes in consumer prices since 1952, and provide for such "cost-of-living" increases at the beginning of each new Congress.

D. Other Tentative Decisions. Several dozen additional changes gained tentative approval of the Ways and Means panel. Generally, the revenue effects are negligible, and the changes would apply to only a limited number of taxpayers.

Over two dozen sections of the code were to be affected by changes designated as "primarily affecting corporations." These dealt with the tax treatment of small business, amortization and the investment credit for certain purposes, the ceiling on industrial development bonds qualifying for tax-exemption, certain accounting changes, and bank holding companies.

The "administrative and miscellaneous" provisions of the draft of "The Tax Reform Bill of 1974" included more than 20 changes, subdivided under the headings: administrative changes, political organizations, certain tax-exempt organizations, excise taxes, and other changes. Except for the provisions raising the interest paid on tax deficiencies and tax over-payments (which were enacted into law) the changes in this title would have had minor revenue effects.

Finally, the tentative bill of the Committee on Ways and Means incorporated the provisions of the so-called "deadwood" bill, to simplify the tax laws by removing from the code provisions which, in the Committee's judgment, are obsolete or no longer important and rarely used. This measure, developed over a number of years, would repeal almost 150 sections of the Internal Revenue Code and make some deletions in about 850 other sections.

OTHER TAX DEVELOPMENTS DURING 1974

During the year there were several moves in the Senate to circumvent the regular legislative tax procedures. Attempts were made to attach some type of major tax "reform" and relief measure as a rider to a House-passed bill. None of these efforts to push through major tax changes were successful.

In an economic address to a joint session of Congress on October 8, President Ford suggested several tax changes aimed largely at combatting inflation. These proposals, superseded by the President's recommendations in January 1975, would have imposed a temporary 5 percent surtax on corporations and middle and upper income persons, and made revisions in the investment tax credit.

CONCLUDING COMMENTS

The President submitted new proposals for tax revision in his State of the Union Message on January 15. While there appears to be bipartisan support for some tax reduction, there are wide-ranging views as to the dollar amount and the nature of tax cuts appropriate in the present economic climate. In view of the large projected deficit in the Federal budget, it seems likely that there will be renewed efforts at tax "reform," to raise certain taxes in order to pay for reductions in others.

The House Committee on Ways and Means, which will have first opportunity to consider various tax proposals in 1975, will operate somewhat differently than in the past. As a result of the recent House committee reorganization, the Committee has been enlarged from 25 to 37 members (18 of whom are new to the Committee). Moreover, the Committee will henceforth be reorganized into six subcommittees — social security; health insurance and medicare; trade; oversight; welfare; and unemployment insurance. However, no subcommittee on general taxation was formed, and taxes will be handled by the entire committee, as in the past. Representative Al Ullman will be the new chairman of the Committee, replacing Representative Wilbur D. Mills, who resigned in late 1974 after 16 years as chairman.

Chairman Ullman has laid out a timetable for the Committee's work on Federal taxation in 1975 which would bring an "anti-recession" tax reduction measure to the House floor no later than March 4. Following this work, the Committee would turn next to energy-related tax issues, and then to a resumption of its long drive for tax "reform."

January 1975