

[COMMITTEE PRINT]

ANALYSIS OF ADMINISTRATION'S
TAX CUT RECOMMENDATIONS
AND POSSIBLE ALTERNATIVES

PREPARED FOR THE USE OF THE
COMMITTEE ON WAYS AND MEANS
BY THE STAFF OF THE
JOINT COMMITTEE ON INTERNAL REVENUE
TAXATION



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I. THE CURRENT ECONOMIC SITUATION

The year 1974 was marked by both inflation and recession. After moving ahead vigorously since the close of 1970, output and employment moved downward during the year while prices continued to rise sharply.

In 1974, real gross national product (that is, GNP in constant prices) registered the first annual decline since 1958 and the largest decline since 1946. (See table 1.) For the year as a whole, money GNP rose to \$1,397 billion—7.9 percent over 1973, but this increase merely reflected higher prices. After taking into consideration a 10.2-percent increase in prices (as measured by the GNP implicit price deflator which is the broadest measure of inflation), real GNP fell 2.2 percent. The decline in output and the rise in prices was especially marked in the fourth quarter of 1974 when real GNP fell at an annual rate of 9.1 percent and prices rose at a rate of 13.7 percent.

TABLE 1.—GROSS NATIONAL PRODUCT 1929-74

[In billions of dollars]

Year	Gross national product in current dollars	Gross national product in 1958 dollars	Year	Gross national product in current dollars	Gross national product in 1958 dollars
1929	103.1	203.6	1956	419.2	446.1
1933	55.6	141.5	1957	441.1	452.5
1939	90.5	209.4	1958	447.3	447.3
1940	99.7	227.2	1959	483.7	475.9
1941	124.5	263.7	1960	503.7	487.7
1942	157.9	297.8	1961	520.1	497.2
1943	191.6	337.1	1962	560.3	529.8
1944	210.1	361.3	1963	590.5	551.0
1945	211.9	355.2	1964	632.4	581.1
1946	208.5	312.6	1965	684.9	617.8
1947	231.3	309.9	1966	749.9	658.1
1948	257.6	323.7	1967	793.9	675.2
1949	256.5	324.1	1968	864.2	706.6
1950	284.8	355.3	1969	930.3	725.6
1951	328.4	383.4	1970	977.1	722.5
1952	345.5	395.1	1971	1,055.5	745.4
1953	364.6	412.8	1972	1,155.2	790.7
1954	364.8	407.0	1973	1,294.9	839.2
1955	398.0	438.0	1974 ^p	1,396.7	821.1

^p=preliminary.

Source: Department of Commerce.

The falling GNP figures for 1974 reflect widespread declines in both consumption and investment. Instead of registering their customary gains, personal consumption expenditures (measured in constant 1958 dollars) for both durable and nondurable goods fell. The decline was

particularly sharp for durable goods expenditures which dropped almost 9 percent for the year. About 8.9 million new cars were sold during the year—22 percent less than in 1973. The leading reasons for the weakness in consumer expenditures were falling disposable income, inflation, and lack of consumer confidence.

In contrast with 1973, when it rose 10 percent, real gross private investment fell 8.5 percent in 1974. Housing starts totaled only 1.4 million compared with 2.4 million in 1972 and 2.1 million in 1973. By November of 1974, housing starts were running at an annual rate of under 1 million.

As the economic situation deteriorated, unemployment rates rose—from 5.2 percent in January to 7.1 percent in December. This compared with average unemployment rates of 4.9 percent in 1973, 5.6 percent in 1972, 5.9 percent in 1971, and rates averaging 3.8 percent or less from 1966 through 1969. The December unemployment rate was the highest since 1958.

Despite the recession during the year, the consumer price index was 12.2 percent higher at the end of 1974 than at the start of the year. This was the highest rate of increase since 1946 when the index shot up 18.2 percent, reflecting the removal of wartime price controls. (However, for December, the increase in the consumer price index declined to an annual rate of 8.4 percent.) Although the wholesale price index dropped slightly in December, for the year as a whole, it rose even faster than the consumer price index, shooting up 23.5 percent.

Interest rates rose during most of the year, but declined toward the latter part of the year. They are now still at high levels, reflecting anticipations of continuing inflation. In January 1975, the prime rate fell to 9½ percent after having reached 12 percent in 1974. As of January 18-22, the Treasury bill rate (91 days—new issues) was 6.37 percent, long-term government bonds yielded 6.6 percent and AA corporate bonds 8.98 percent. (See tables 2 and 3.)

Corporate profits for 1974 were high in money terms. In the third quarter, corporate profits before taxes reached \$157 billion at a seasonally adjusted annual rate. However, \$52 billion of these profits were due to the effect of higher prices in raising inventory values. After the inventory valuation adjustment, third quarter profits amounted to \$105.8 billion, about the same as profits in 1973 but higher than profits of \$78.7 billion in 1971 and \$92.2 billion in 1972. It has been argued that the figures for corporate profits, even after the inventory valuation adjustment, overstate true profits because they do not take full account of the higher costs that will be entailed in the future in replacing plant and equipment. Most analysts anticipate a substantial decline in corporate profits in 1975.

TABLE 2.—MONEY MARKET RATES
[Percent per annum]

Period	Prime commercial paper ¹		Finance company paper placed directly 3 to 6 months ²	Prime bankers' acceptances, 90 days ¹	Federal funds rate ³	3-month bills ⁴			6-month bills ⁵			9- to 12-month issues			3- to 5-year issues ⁶	
	90 to 119 days	4 to 6 months				Rate on new issue	Market yield	Rate on new issue	Market yield	1-year bill (market yield) ⁵	Other ⁶	Rate on new issue	Market yield	1-year bill (market yield) ⁵		Other ⁶
	U.S. Government securities ⁴															
1967																
1968																
1969																
1970																
1971																
1972																
1973																
1974:																
Jan.	8.86		7.92	8.72	9.65	7.75	7.77	7.67	7.65	7.01	7.46	4.84	4.84	5.07		
Feb.	8.00		7.40	7.83	8.97	7.06	7.12	6.874	6.96	6.51	6.93	5.62	5.62	5.59		
Mar.	8.42		7.76	8.43	9.35	7.986	7.96	7.829	7.83	7.34	7.86	7.06	7.06	6.85		
Apr.	9.92		8.43	9.61	10.51	8.229	8.33	8.171	8.32	8.08	8.66	6.90	6.90	7.37		
May	10.82		8.94	10.68	11.31	8.430	8.23	8.196	8.40	8.21	8.78	4.75	4.75	5.77		
June	11.18		9.00	10.79	11.93	8.145	7.90	8.232	8.12	8.16	8.71	4.86	4.86	5.85		
July	11.93		9.00	11.88	12.92	7.752	7.55	8.028	7.94	8.04	8.89	7.30	7.30	6.92		
Aug.	11.79		9.31	12.08	12.01	8.744	8.96	8.853	9.11	8.88	9.54	8.64	8.64	8.38		
Sept.	11.36		9.43	11.06	11.34	8.363	8.06	8.599	8.53	8.52	8.95	8.04	8.04	7.98		
Oct.	9.55		9.03	9.34	10.06	7.244	7.46	7.559	7.74	7.59	7.59	7.04	7.04	6.94		
Nov.	8.81		8.50	9.03	9.45	7.585	7.47	7.551	7.52	7.29	7.29	6.94	6.94	6.94		

¹ Beginning Aug. 14, 1974, the rate is the average of the midpoint of the range of daily dealer closing rates offered for domestic issues; prior data are averages of the most representative daily offering rate quoted by dealers.

² Averages of the most representative daily offering rate published by finance companies, for varying maturities in the 90- to 179-day range.

³ Day averages for week ending Wednesday. Beginning with statement week ending July 25, 1973, weekly averages are based on the daily average of the range of rates on a given day weighted by the volume of transactions at these rates. For earlier statement weeks, the averages were based on the daily effective rate—the rate considered most representative of the day's transactions, usually the one at which most transactions occurred.

⁴ Except for new bill issues, yields are averages computed from daily closing bid prices.

⁵ Bills quoted on bank-discount-rate basis.

⁶ Selected note and bond issues.

Note: Figures for Treasury bills are the revised series described on p. A-35 of the October 1972 Bulletin.

Source: "Federal Reserve Bulletin," December 1974.

TABLE 3.—BOND YIELDS
[Percent per annum]

Period	Government bonds				Corporate bonds							Public utility	
	United States (long-term)	State and local			Aaa utility			By selected rating					
		Total ¹	Aaa	Baa	New issue	Recently offered	Total ¹	Seasoned issues			By group		
								Aaa	Baa	Industrial	Railroad		
1970-----	6.59	6.42	6.12	6.75	8.68	8.71	8.51	8.04	9.11	8.26	8.77	8.68	
1971-----	5.74	5.62	5.22	5.89	7.62	7.66	7.94	7.39	8.56	7.57	8.38	8.13	
1972-----	5.63	5.30	5.04	5.60	7.31	7.34	7.63	7.21	8.16	7.35	7.99	7.74	
1973-----	6.30	5.22	4.99	5.49	7.74	7.75	7.80	7.44	8.24	7.60	8.12	7.83	
1974-----													
January-----	6.56	5.23	5.03	5.49	8.21	8.21	8.15	7.83	8.58	7.97	8.34	8.27	
February-----	6.54	5.25	5.05	5.49	8.12	8.23	8.17	7.85	8.59	8.01	8.27	8.33	
March-----	6.81	5.44	5.20	5.71	8.46	8.44	8.27	8.01	8.65	8.12	8.35	8.44	
April-----	7.04	5.76	5.45	6.06	8.99	8.95	8.50	8.25	8.88	8.39	8.51	8.68	
May-----	7.07	6.06	5.89	6.30	9.24	9.13	8.68	8.37	9.10	8.55	8.73	8.86	
June-----	7.03	6.17	5.95	6.41	9.38	9.40	8.85	8.47	9.34	8.69	8.69	8.86	
July-----	7.18	6.70	6.34	7.10	10.20	10.04	9.10	8.72	9.55	8.95	9.08	9.35	
August-----	7.33	6.70	6.38	7.10	10.07	10.19	9.36	9.00	9.77	9.16	9.30	9.70	
September-----	7.30	6.77	6.49	7.18	10.38	10.30	9.67	9.24	10.12	9.44	9.46	10.11	
October-----	7.22	6.56	6.21	6.99	10.16	10.23	9.80	9.27	10.41	9.53	9.64	10.31	
November-----	6.93	6.54	6.06	7.01	9.21	9.34	9.60	8.89	10.50	9.30	9.59	10.14	

¹ Includes bonds rated Aa and A, data for which are not shown separately. Because of a limited number of suitable issues, the number of corporate bonds in some groups has varied somewhat. As of Dec. 23, 1967, there is no longer an Aaa-rated railroad bond series.

Note: Annual yields are averages of monthly or quarterly data.

Bonds: Monthly and weekly yields are computed as follows: (1) U.S. Government: Averages of daily figures for bonds maturing or callable in 10 years or more, from Federal Reserve Bank of New York. (2) State and local government: General obligations only, based on Thursday figures; from Moody's

Investor Service. (3) Corporate: Rates for "New issue" and "Recently offered" Aaa utility bonds are weekly averages compiled by the Board of Governors of the Federal Reserve System. Rates for seasoned issues are averages of daily figures from Moody's Investors Service.

Stocks: Standard and Poor's corporate series. Dividend/price ratios are based on Wednesday figures; earnings/price ratios are as of end of period. Preferred stock ratio is based on 8 median yields for a sample of noncallable issues—12 industrial and 2 public utility; common stock ratios on the 500 stocks in the price index. Quarterly earnings are seasonally adjusted at annual rates.

Some Factors Contributing to the Current Recession

No attempt is made here to enumerate all the causes of the current economic downturn. However, the factors outlined below appear worthy of note.

The money supply.—The Federal Reserve Board slowed down the rate of increase in the money supply in 1974 in an attempt to keep strong inflationary pressures under control. In 1974, the money stock (currency plus demand deposits) increased 4.4 percent compared with an average of 6.7 percent over the previous 5 years. Since the implicit GNP deflator rose 10 percent for the year, the money supply in real terms declined by over 5 percent during the year. This undoubtedly has had an important influence in slowing down the economy.

Fiscal situation.—As noted in table 4, the administration estimates deficits in the unified budget of \$35 billion for fiscal 1975 and approximately \$50 billion for fiscal 1976. These figures assume that the Congress will adopt the tax cut proposed by the administration and \$17 billion of spending cuts proposed by the administration, including a 5-percent ceiling on Federal pay and social security benefit increases. These anticipated deficits amount to 2.45 percent of GNP in 1974 and 3.3 percent of estimated GNP in 1975.

TABLE 4.—UNIFIED BUDGET TOTALS

[Fiscal years; in billions of dollars]

Description	1975			1976 current estimate
	1974 actual	Nov. 26 estimate	Current estimate	
Budget receipts.....	264.9	293	279	297-300
Budget outlays.....	268.4	302	313	348-350
Deficit (—).....	—3.5	—9	—35	1 50

¹ Approximate.

Source: Statement of Roy L. Ash, Director of the Office of Management and Budget, before the House Ways and Means Committee on the Public Debt Limit, January 23, 1975.

Despite the large actual deficits that are anticipated, many economists maintain that the Federal budget will be contractionary in 1975 unless offsetting action is taken. This is because the Federal budget when measured on a full employment basis (which assumes that potential real GNP grows 4 percent per year) is expected to have a much larger surplus this year than in the past. (The full employment budget differs from the actual budget because when the economy is at full employment, tax receipts are larger because the tax base is larger and certain expenditures, such as expenditures for unemployment insurance and food stamps, are smaller.) In recent years, the administration has used the full-employment surplus rather than the actual surplus or deficit as the measure of the effect of fiscal policy on the economy rather than the actual deficit.

In the fourth quarter of 1972, the Federal budget deficit on a full employment basis ran at an annual rate of \$13.6 billion, and in 1973, it had decreased to \$7.4 billion. In the third quarter of 1973, the full employment budget swung from a deficit to a surplus which continued throughout 1974. During 1975, the surpluses on a full employment basis are expected to continue, reaching an annual rate of close to \$31 billion in the second quarter (2 percent of GNP).

Oil.—The sharp increase in the price of imported oil which has resulted from the actions of the OPEC cartel now involves an annual cost to the United States of approximately \$25 billion or about \$18 billion more than in 1973. This has not only added to our balance-of-payments problem; it has also acted to dampen our economy since the outflow of such large funds siphons off purchasing power from the domestic economy. Some part of this resulting deflationary effect is (or will in the future) be offset by increased U.S. exploration for oil and gas, but the net dampening effect is still very large.

The Outlook Without a Tax Cut

Economic forecasters are practically unanimous in predicting that in 1975 the economy will continue to operate far below its potential. This is indicated in table 5 which presents the forecasts of a number of widely known forecasters. While the precise figure varies with different forecasters the table shows that real GNP in 1975 is generally expected to be lower than in 1974 though many forecasters anticipate a modest recovery beginning in mid-1975. At the same time, prices are expected to continue to increase sharply over much of the year and unemployment is expected to remain in excess of 7 percent. The Wharton (University of Pennsylvania) model, for example, projects unemployment rates in excess of 7 percent throughout 1976.

TABLE 5.—ECONOMIC FORECASTS FOR 1975

	1975 GNP (billions of dollars)	Percent		
		Real growth in GNP	Price increase	1975 average unemployment
Economists:				
Robert S. Einzig, Transamerica	1,528	-0.1	9.4	6.8
Robert A. Kavesh, New York University	1,522	-1.0	9.4	6.9
Norma Pace, American Paper Institute	1,521	-1.0	9.6	7.3
James M. Howell, First National Bank of Boston	1,521	-1.2	9.8	7.0
Gordon W. McKinley, McGraw-Hill	1,520	-0.2	8.9	7.0
Michael Sumichrast, National Association of Home- builders	1,520	+2.5	6.5	6.3
Richard S. Peterson, Continental Illinois National Bank	1,517	-1.0	9.7	6.9
Irwin L. Kellner, Manufacturers Hanover	1,512	-0.6	8.8	7.2
David M. Blank, Columbia Broadcasting System	1,510	-1.0	9.0	7.3
Robert Dennis, National Planning Association	1,508	-2.8	10.9	7.8
Sam I. Nakagama, Kidder, Peabody	1,508	-0.3	8.2	7.0
Robert J. Eggert, RCA	1,507	-1.6	9.6	7.4
Gary M. Wenglowksi, Goldman Sachs	1,503	-1.3	9.0	7.2
Raymond Saulnier, Barnard College	1,501	-1.3	8.9	7.3
A. George Gols, Arthur D. Little	1,500	-1.5	8.9	7.0
Norman Robertson, Mellon Bank	1,494	-1.6	8.9	7.3
Irving Schweiger, University of Chicago	1,492	-1.9	9.0	7.5
C. S. Overmiller, Exxon	1,491	-1.5	8.5	7.3
Albert H. Cox, Jr., Lionel D. Edie	1,488	-2.2	8.9	7.5
Theodore R. Eck, Standard Oil (Indiana)	1,485	-1.6	8.0	7.5
Albert T. Sommers, The Conference Board	1,480	-2.4	8.4	7.3
Ira Ross, Anchor Corp	1,473	-1.8	7.8	7.6
Hugh Stokely, Girard Bank	1,467	-0.2	5.3	7.6
A. Gary Shilling, White Weld	1,445	-3.5	7.0	8.3
Average	1,501	-1.2	8.7	7.3
Econometric models:				
MAPCAST, General Electric	1,526	-1.3	10.6	6.9
Wharton EFA, University of Pennsylvania	1,525	-1.0	10.3	7.1
Chase Econometrics	1,524	-0.8	9.8	6.7
Georgia State University	1,516	-0.6	9.1	6.5
RSQE, University of Michigan	1,511	-1.1	9.4	7.4
Data Resources	1,507	-0.9	8.9	7.3
University of California at Los Angeles	1,501	-1.8	9.4	7.7
Townsend-Greenspan	1,496	-2.4	9.5	6.8
Average	1,513	-1.2	9.6	7.1

With this pattern of forecasts for 1975, it is highly likely that in 1975 the actual GNP for this year will fall considerably short of the potential GNP. Table 6 presents data on actual and potential GNP and staff projections which suggest that actual GNP during 1975 may be as much as 14 percent under the potential GNP assuming the present budgetary picture with no tax cut. This gap will be \$215 billion, or \$1,000 per capita. This is significant for two reasons: first, it indicates that in the absence of remedial action, there will be a large loss of economic goods and services; and second, it suggests that tax reductions could be employed to stimulate the economy without creating substantial additional inflation in view of the large amount of available unused resources.

TABLE 6.—ACTUAL AND POTENTIAL GNP
[Billions of dollars seasonally adjusted annual rates]

Year and quarter	Actual GNP	Potential GNP ¹	GNP gap (potential less actual)
1971—I	1,027.2	1,081.4	54.2
1971—II	1,046.9	1,105.2	58.3
1971—III	1,063.5	1,126.0	62.5
1971—IV	1,084.2	1,141.0	56.8
1972—I	1,112.5	1,164.3	51.8
1972—II	1,142.4	1,182.9	40.5
1972—III	1,166.5	1,202.6	36.1
1972—IV	1,199.2	1,223.8	24.6
1973—I	1,248.9	1,258.3	9.4
1973—II	1,277.9	1,293.0	15.1
1973—III	1,308.9	1,332.1	23.2
1973—IV	1,344.0	1,373.2	29.2
1974—I	1,358.8	1,427.7	68.9
1974—II	1,383.8	1,474.3	90.5
1974—III	1,416.3	1,532.0	115.7
1974—IV	1,428.0	1,597.0	169.0
1975—I	² 1,448.6	³ 1,648.5	199.9
1975—II	² 1,484.4	³ 1,698.9	214.5
1975—III	² 1,529.0	³ 1,744.7	215.7
1975—IV	² 1,579.7	³ 1,792.7	213.0

¹ The increase of potential GNP assumes a growth rate in real terms of 4 percent each year, composed of an increase in the labor force of 1.8 percent, a decline in hours worked of 0.3 percent and a rise of output per man-hour of 2.5 percent. These trends may not be an accurate reflection of conditions during the oil embargo of late 1973 and early 1974. Like all measures of capacity, these are subject to a wide margin of error.

² Forecasts of Chase Econometrics, Inc.

³ Staff estimates using the methodology of the Council of Economic Advisers.

Source: Business Conditions Digest.

II. ECONOMIC EFFECT OF AN INDIVIDUAL INCOME TAX REDUCTION

Most economists believe that an individual income tax reduction at a time when there is excess capacity in the economy will increase the level of real income and employment. People will spend a fraction of their tax cut on consumer goods, which will create jobs and increase incomes. The individuals who receive these increases in income (as wages and profits) will spend some fraction of the increase, thus creating more jobs and still further increases in income. Businesses will respond to higher demand for their products by increasing their investments, assuming they get the needed financing, which will also expand the economy. There is some dispute about the precise magnitude of the "multiplier"—the increase in income that results for each dollar of tax reduction—but most estimates are between 1 and 2. The

multiplier, in any event, will vary depending on what type of tax reduction is enacted, what income groups receive the cuts, whether monetary policy is accommodating or offsetting, and whether there are offsetting spending cuts.

There are two principal arguments against a tax cut at the present time. Some argue that by stimulating the economy, a tax cut will increase the rate of inflation. There is probably some truth to this view: the recession can be expected to slow down the rate of inflation, and a shorter or milder recession will cause less of a reduction. With substantial slack in the economy, however, as there will be for the next several years, it does not appear probable that a tax cut of reasonable size will have much of an inflationary impact.

A second argument against a tax cut at this time is that it will not stimulate the economy because the higher deficit caused by the tax cut will drive up interest rates, crowd out private borrowing, and thereby reduce business investment. It is contended that this will offset the increased consumer spending caused by the tax cut, so that there will be no net stimulus to the economy. This "crowding out" argument has been made by the "monetarist" school of economists.

The "crowding out" theory appears to be most valid in times of tight money and least valid when credit conditions are relatively easy. In most recessions, the demand for money falls and interest rates decline, so that large government borrowing can occur without inducing increases in interest rates that are large enough to abort the recovery. There are several reasons why private borrowing should fall in 1975. Most economists expect business investment to fall in real terms in 1975 (and even in money terms, to increase only modestly); consumer borrowing is falling because the desire and ability to purchase autos and houses is weak; and firms are expected to liquidate the excessive inventories they accumulated in 1974. The main reason for increases in private borrowing in 1975 is the fact that many firms are now relatively illiquid, having drawn down their liquid assets and relied on short-term borrowing during the recent period of extremely tight money. Many firms will probably try to take advantage of any decline in interest rates to borrow in the long-term market in order to build up their liquidity positions. If monetary policy accommodates such a desire for increased liquidity with expansionary monetary policies, it appears that government deficits can be financed without large increases in interest rates. While government borrowing should increase the supply of liquid assets, this is likely to be offset by an increase in the demand for liquid assets by the private sector, so interest rates should not rise excessively.

Assuming moderately expansionary monetary policies, then, a tax cut should stimulate the economy; and the large gap between actual and potential output that probably will exist in the next several years should ensure that this stimulus will not seriously increase inflation.

III. DURATION OF THE TAX REDUCTION

The administration has proposed a tax cut for one year. The committee may want to consider a tax cut where part of the cut is for a longer period of time. A related issue is the extent to which a tax cut should be received in lump-sum refunds or reflected in lower with-

holding. Under the administration proposal, the entire tax reduction would be received in two payments during calendar year 1975, since it applies to 1974 tax liability.

There is likely to be a sizable gap between actual and potential output for the next several years if no tax cut is enacted. Even if the economy grows in real terms at 6 percent annually, which would be a vigorous recovery by historical standards, the economy will not reach full employment until 1980. Thus, the committee might want to consider some fiscal stimulus for at least the next two or three years.

Another consideration on the issue of the duration of a tax cut is the fact that inflation has the effect of raising individual income taxes, not only nominally but also in real terms. This occurs because inflation erodes the real value of the personal exemption and the minimum and maximum standard deductions and because it pushes people into higher rate brackets even when their real income is staying the same or declining. Individual income tax liabilities rose from \$103 billion in 1973 to \$118 billion in 1974, or by \$15 billion. The price level (as measured by the GNP implicit price deflator) was 10.2 percent higher in 1974 than in 1973, so that 1973 taxes in 1974 prices were \$113 billion, \$5 billion less than actual 1974 taxes. In addition, real personal income fell by 1.1 percent between 1973 and 1974. Given the progressivity of the income tax, a decline in income of this magnitude should have reduced taxes by 1.8 percent or \$2 billion. Thus, because of inflation, taxes were approximately \$7 billion higher in 1974 than they would have been had the rate brackets, personal exemption, and minimum and maximum standard deduction been adjusted upward for inflation. Instead of declining by \$2 billion owing to falling real incomes, income taxes in real terms rose by \$5 billion.

A disproportionate amount of this real tax increase in 1974 applied to low-income taxpayers. Using the Treasury computer tax model, the staff has estimated the distribution of this tax increase by income class, and this appears in table 7. The percentage increase in tax is greatest for the lower income classes. For people with AGI under \$3,000, inflation raised taxes by 43.3 percent, while the increase was 2.5 percent for people with AGI over \$100,000.

TABLE 7.—REAL TAX INCREASE IN 1974 CAUSED BY INFLATION

AGI class	Present law tax (millions)	Inflation-induced tax increase ¹ (millions)	Inflation-induced increase as percent of present law tax
\$0 to \$3,000.....	\$289	\$125	43.3
\$3,000 to \$5,000.....	1,779	283	15.9
\$5,000 to \$7,000.....	4,093	382	9.3
\$7,000 to \$10,000.....	9,251	612	6.6
\$10,000 to \$15,000.....	21,239	1,200	5.6
\$15,000 to \$20,000.....	20,910	1,162	5.6
\$20,000 to \$50,000.....	38,419	2,189	5.7
\$50,000 to \$100,000.....	11,883	612	5.2
\$100,000 and over.....	10,992	278	2.5
Total.....	118,855	6,842	5.8

¹ Staff estimate of the excess of actual taxes in 1974 over what taxes would have been had tax brackets, the personal exemption and the minimum and maximum standard deductions been adjusted upward for inflation.

The duration of a tax cut also may have a bearing on its effectiveness in causing people to spend it. This may depend, in part, on whether it is reflected in withholding or received in lump-sum payments. Economic theory suggests that people are more likely to spend tax cuts if they believe them to be permanent, which usually occurs when they are reflected in withholding. A lump-sum is more likely to be saved, so that it will be less effective in stimulating the economy. Surveys conducted by Albert Sindlinger and the Survey Research Center at the University of Michigan suggest that as many as two-thirds of the population would save or invest an unexpected refund, or use it to pay off debts. This result is consistent with previous surveys of how taxpayers would treat a large, unexpected refund. If this is true, to get the same fiscal stimulus a lump-sum payment has to be much larger than a tax cut that is reflected in withholdings.

On the other hand, there are some advantages of a lump-sum payment in the current situation. To the extent that it is spent, a lump-sum payment is more likely to be spent on durable goods, where the economy is particularly weak at present. Also, a cut in 1974 taxes will help people who were employed in 1974 but who are now out of work. Finally, a lump-sum payment can be paid out faster than any cut reflected in withholding.

IV. SIZE OF TAX CUT

In determining the appropriate size for a tax cut, the committee will want to consider the gap between actual and potential output (estimated at \$215 billion in the first quarter of 1975). Table 8 shows the revenue effects of the major tax changes since 1962. The 1964 income tax cut and the excise tax reductions of 1965 totaled \$18.0 billion. This was about 2.6 percent of GNP over the years 1965 and 1966. A \$16.1 billion tax cut in 1964 would be \$29.7 billion in current prices,

TABLE 8.—MAJOR TAX CHANGES SINCE 1962 AS A PERCENT OF GNP IN THE SAME YEAR

[Dollar amounts in billions]

Year	Act	GNP	Tax change	Tax reduction as a percent of GNP
1965	Revenue Act of 1964 fully effective	\$685	-\$15.2	2.2
1966	Excise Tax Reduction Act of 1965	750	-2.8	.4
1970	Tax Reform Act of 1969	977	-6.5	.6
1972	Revenue Act of 1971	1,158	-8.0	.8

and a tax cut equal to 2.6 percent of GNP would be \$39 billion. A tax cut of \$12 billion today would be the same fraction of GNP as was the \$8 billion tax cut in the Revenue Act of 1971.

Similarly, as the size of the economy grows, the deficits caused by tax cuts and by the recession itself will tend to be larger than in the past. Table 9 shows the unified budget receipts and outlays of the Federal Government and the Federal deficit both in absolute terms and as a fraction of GNP. In fiscal year 1959, as a result of the 1958 recession, the deficit was \$12.9 billion, or 2.7 percent of GNP. A deficit equal to 2.7 percent of GNP in 1975 would be \$41 billion. The deficit in the relatively mild 1970 recession was 2.3 percent of GNP, which is equivalent to a \$35 billion deficit in 1975.

TABLE 9.—UNIFIED BUDGET RECEIPTS, OUTLAYS AND SURPLUS OR DEFICIT AS A PERCENTAGE OF GROSS NATIONAL PRODUCT, FISCAL YEARS 1946-74

[In billions of dollars]

Fiscal year	GNP	Unified budget			As percent of GNP		
		Outlays	Receipts	Surplus (+) or deficit (-)	Outlays	Receipts	Surplus or deficit
1946.....	201.6	61.7	43.5	-18.2	30.6	30.6	9.0
1947.....	219.8	36.9	43.5	+6.6	16.8	19.8	3.0
1948.....	243.5	36.5	45.4	+8.9	15.0	18.6	3.7
1949.....	250.0	40.6	41.6	+1.0	15.6	16.0	.4
1950.....	263.3	43.1	40.9	-2.2	16.4	15.5	.8
1951.....	310.5	45.8	53.4	+7.6	14.8	17.2	2.4
1952.....	337.2	68.0	68.0	(1)	20.2	20.2	—
1953.....	358.9	76.8	71.5	-5.3	21.4	19.9	1.5
1954.....	362.1	70.9	69.7	-1.2	19.6	19.2	.3
1955.....	378.1	68.5	65.5	-3.0	18.1	17.3	.8
1956.....	409.4	70.5	74.5	+4.1	17.2	18.2	1.0
1957.....	431.3	76.7	80.0	+3.2	17.8	18.5	.7
1958.....	440.3	82.6	79.6	-2.9	18.8	18.1	.7
1959.....	469.1	92.1	79.2	-12.9	19.6	16.9	2.7
1960.....	495.2	92.2	92.5	+3	18.6	18.7	.1
1961.....	506.5	97.8	94.4	-3.4	19.3	18.6	.7
1962.....	542.1	106.8	99.7	-7.1	19.7	18.4	1.3
1963.....	573.4	111.3	106.6	-4.8	19.4	18.6	.8
1964.....	612.2	118.6	112.7	-5.9	19.4	18.4	1.0
1965.....	654.2	118.4	116.8	-1.6	18.1	17.9	.2
1966.....	721.2	134.7	130.9	-3.8	18.7	18.2	.5
1967.....	769.8	158.3	149.6	-8.7	20.6	19.4	1.1
1968.....	826.0	178.8	153.7	-25.2	21.6	18.6	3.1
1969.....	898.3	184.5	187.8	+3.2	20.5	20.9	.4
1970.....	954.6	196.6	193.7	-2.8	20.6	20.3	.3
1971.....	1,013.6	211.4	188.4	-23.0	20.9	18.6	2.3
1972.....	1,100.6	231.9	208.6	-23.2	21.1	19.0	2.1
1973.....	1,225.2	246.5	232.2	-14.3	20.1	19.0	1.2
1974.....	1,348.9	268.3	264.8	-3.5	19.9	19.6	.3

¹ Surplus of \$49,000,000.

Note: Details may not add due to rounding.

Table 10 shows the public debt as a fraction of GNP. While the debt has been rising in absolute terms, it has been declining steadily as a fraction of GNP. At the end of World War II, the debt was 134.4 percent of GNP. By 1960, this fraction had declined to 58.7 percent, and in 1974, it was 35.2 percent.

TABLE 10.—GROSS PUBLIC DEBT AND GROSS NATIONAL PRODUCT, FISCAL YEARS 1946-74
[In billions of dollars]

Fiscal year	GNP	Gross public debt ¹	Gross public debt as percentage of GNP
1946.....	201.6	271.0	134.4
1947.....	219.8	257.1	117.0
1948.....	243.5	252.0	103.5
1949.....	260.0	252.6	97.2
1950.....	263.3	256.9	97.6
1951.....	310.5	255.3	82.2
1952.....	337.2	259.1	76.8
1953.....	358.9	266.0	74.1
1954.....	362.1	270.8	74.8
1955.....	378.1	274.4	72.6
1956.....	409.4	272.8	66.6
1957.....	431.3	272.4	63.1
1958.....	440.3	279.7	63.5
1959.....	469.1	287.8	61.3
1960.....	495.2	290.9	58.7
1961.....	506.5	292.9	57.8
1962.....	542.1	303.3	55.9
1963.....	573.4	310.8	54.2
1964.....	612.2	316.8	51.7
1965.....	654.2	323.2	49.4
1966.....	721.2	329.5	45.7
1967.....	769.8	341.3	44.3
1968.....	826.0	369.8	44.8
1969.....	898.3	367.1	40.9
1970.....	954.6	382.6	40.1
1971.....	1,013.6	409.5	40.4
1972.....	1,100.6	437.3	39.7
1973.....	1,225.2	468.4	38.2
1974.....	1,348.9	464.2	35.2

¹ On June 30 each fiscal year.

At the same time, it should be noted that permanent tax cuts, if they are large, can erode Federal Government revenues so that it will be difficult to finance future increases in government expenditures. Table 11 shows the effects in calendar year 1974 of the major income tax changes made since 1962. The aggregate revenue loss is \$54 billion, of which \$30 billion resulted from the 1964 tax reduction. Much of this tax reduction was recouped as inflation and real economic growth raised individual income tax rates, so that individual income taxes were 10.3 percent of personal income in both 1962 and 1974.

TABLE 11.—REVENUE EFFECTS IN 1974 OF MAJOR TAX ACTIONS SINCE 1962 OTHER THAN TRUST FUNDS AND USER CHARGES

(In billions of dollars)

Tax action	1st year fully effective revenue effect	1974 revenue effect
Revenue Act of 1962:		
Investment credit:		
Individual.....	-0.3	-0.8
Corporation.....	-1.1	-3.6
Other provisions:		
Individual.....	+3.3	+3.3
Corporation.....	+5.5	+5.5
Total.....	-0.6	-3.6
Depreciation guidelines of 1962:		
Individual.....	-0.2	-0.1
Corporation.....	-1.0	-1.0
Total.....	-1.2	-1.1
Revenue Act of 1964:		
Individual.....	-12.2	-25.3
Corporation.....	-3.0	-4.9
Total.....	-15.2	-30.2
Excise Tax Reduction Act of 1965 ¹	-2.8	-3.7
Other excise tax legislation ²	(³)	-0.3
Tax Reform Act of 1969:		
Reform and relief:		
Individual.....	-8.1	-11.4
Corporation.....	+1.2	+1.6
Total.....	-6.9	-9.8
Termination of investment credit:		
Individual.....	+0.6	+0.8
Corporation.....	+1.9	+3.3
Total.....	+2.5	+4.1
Total.....	-4.5	-5.7
Asset depreciation range:		
Individual.....	(³)	(³)
Corporation.....	-1.0	-1.6
Total.....	-1.0	-1.6
Revenue Act of 1971:		
Individual.....	-4.1	-2.2
Corporation.....	-2.0	-3.6
Excise.....	-2.2	-1.8
Total.....	-9.2	-7.6
Grand total.....		-53.8
Individual.....		-38.7
Corporation.....		-9.3
Excise.....		-5.8

¹ Excluding reductions later rescinded.² Includes interest equalization tax, tax on foundations, and reductions in telephone tax.³ Less than \$50,000,000,000.

V. DISTRIBUTION OF THE TAX REDUCTION

The \$12 billion individual tax reduction proposed by the administration is concentrated among the middle- and upper-income groups. Because the income tax is progressive, a tax cut that is a flat percent of tax will be a larger fraction of income for high-income people than for low-income people. An argument favoring such a tax cut is that the weakness in the economy is disproportionately in the consumer durables sector, especially autos, and that only fairly large lump-sum payments will induce people to buy these "big ticket" items.

There are several reasons why the committee may want to consider a tax cut concentrated more in the lower- and middle-income groups. While upper-income people may be more likely to spend their tax refund on large purchases than low-income people, they are also more likely to save or invest it. While saving is usually helpful to the economy, it is generally believed that spending is more helpful during a recession.

A second reason for considering a cut directed more toward low-income families is that they tend to spend a larger fraction of their income on food and energy than do higher income people. Therefore, they have been most seriously affected by the sharp rises in food and energy prices that have occurred in the past two years. Some preference for the low-income group would be needed to restore the real income distribution to what it was two years ago.

Because of inflation, especially higher food and energy costs, the poverty level is now significantly higher than the income level at which people must start to pay income taxes. The poverty level and tax thresholds for recent years are compared in table 12. The tax threshold for a single person is \$2,050 (the \$750 personal exemption plus the \$1,300 minimum standard deduction). This was approximately the poverty level in 1972; but in 1975 the poverty level for a single person is estimated at \$2,694, so that a poor single individual can pay as much as \$80 in income tax. For a family of four, the tax threshold is \$4,300 (four exemptions worth \$750 each, plus the standard deduction). This also approximated the 1972 poverty level. Today, however, the poverty level for a four-person family is estimated at \$5,442, so that it can have an income tax liability of \$160. If the principle that poor people should be exempted from income tax is to be continued, the committee may want to provide substantial permanent tax cuts for low-income families.

TABLE 12.—COMPARISON OF THE LOW-INCOME THRESHOLD FOR NONFARM FAMILIES WITH THE FEDERAL INDIVIDUAL INCOME TAX THRESHOLD UNDER THE MINIMUM STANDARD DEDUCTION PROVISION OF PRESENT LAW AND UNDER THE MINIMUM STANDARD DEDUCTION PROVISION OF THE ENERGY TAX AND INDIVIDUAL RELIEF ACT OF 1974 (H.R. 17488)

Family size (persons)	Low-income threshold for nonfarm families				Income tax threshold	
					Present law	H.R. 17488
	1972 ¹	1973 ¹	1974 ²	1975 ³	\$1,300 plus \$750 per exemption	\$1,600 for single taxpayers, \$1,900 for joint returns, plus \$750 per exemption
1	\$2, 109	\$2, 247	\$2, 494	\$2, 694	\$2, 050	\$2, 350
2	2, 724	2, 895	3, 213	3, 470	2, 800	3, 400
3	3, 339	3, 548	3, 938	4, 253	3, 550	4, 150
4	4, 275	4, 540	5, 039	5, 442	4, 300	4, 900
5	5, 044	5, 358	5, 947	6, 423	5, 050	5, 650
6	5, 673	6, 028	6, 691	7, 226	5, 800	6, 400

¹ Source: Bureau of the Census, Social and Economic Statistics Administration, U.S. Department of Commerce.

² Estimated from the 1973 thresholds by assuming an 11-percent increase in the Consumer Price Index for 1974 over 1973.

³ Estimated by assuming an 8-percent increase in the Consumer Price Index for 1975 over 1974.

VI. ALTERNATIVE WAYS TO REDUCE INDIVIDUAL INCOME TAX

A. Tax refunds for 1974 tax liability

Present law.—Individual taxpayers who report their income on the basis of the calendar year (which is the case for almost all individuals) are required to file their 1974 tax returns by April 15, 1975. Individual income tax liabilities for calendar year 1974 currently are estimated at approximately \$118 billion.

Administration proposal.—The administration has recommended that individual taxpayers receive a cash rebate of 12 percent of their tax liabilities reported on their 1974 tax returns, up to a maximum refund of \$1,000. Married couples filing separate returns would receive a maximum refund of \$500 each. The refund would be paid in two equal installments—the first payment being made in May and the second payment being made in September. Under the proposal taxpayers are to compute and pay their 1974 tax liabilities when they file their tax returns without regard to any refund that is to be available to them. This proposal would not affect income tax liabilities for 1975 and later years.

Revenue effect.—The 12-percent rebate would involve a revenue loss of \$12.2 billion.

Staff analysis.—The main advantage of reducing taxes by allowing a refund on 1974 tax liability is that the tax reduction is clearly a temporary one, so that there is no permanent erosion of Federal revenues that will require tax increases or spending cuts sometime in the future. Also, the proposed refund pumps money into the economy quickly and directs some of the reduction to people who are unemployed now but who had income in 1974.

The disadvantage of a 1974 tax refund is that it is likely to induce less of an increase in consumer spending than would a tax cut that is reflected in withholding. This tendency to save or invest a large part of a lump-sum refund is supported by household survey data, which suggest that two-thirds of the recipients of a refund will save or invest it or use it to repay debts.

The specific tax refund proposed by the administration (12 percent of 1974 tax up to \$1,000) has been criticized on the grounds that much of the relief goes to those in the middle- and upper-income groups. The distribution of the reduction is shown in table 13. Eighty-five percent of the reduction is received by taxpayers with adjusted gross income over \$10,000. This concentration of a proportional tax refund in the middle- and upper-income groups, of course, is simply a reflection of the progressivity of the individual income tax. The \$1,000 limit on the refund limits the concentration among the upper income groups of the proportional tax refund to some extent, but the limit as a factor only when adjusted gross income exceeds \$41,000 for the typical married couple and \$34,000 for a single individual. (The limit applies at a lower income level for single people because their tax rates are higher.)

TABLE 13.—ESTIMATED DECREASE IN FEDERAL INDIVIDUAL INCOME TAX LIABILITY RESULTING FROM A REFUND OF 12 PERCENT OF 1974 INCOME TAX LIABILITY WITH A MAXIMUM REFUND OF \$1,000—BY ADJUSTED GROSS INCOME CLASS, 1974 INCOME LEVELS

Adjusted gross income class (thousands)	Number of returns with tax decrease (thousands)	Decrease in tax liability	
		Amount (millions)	Percent of total decrease
0 to \$3.....	4,057	\$30	0.2
\$3 to \$5.....	7,579	213	1.7
\$5 to \$7.....	8,273	491	4.0
\$7 to \$10.....	11,428	1,110	9.1
\$10 to \$15.....	15,952	2,549	20.9
\$15 to \$20.....	9,856	2,509	20.6
\$20 to \$50.....	9,006	4,498	36.9
\$50 to \$100.....	655	647	5.3
\$100 and over.....	160	157	1.3
Total.....	66,966	12,205	100.0

Note: Details may not add to totals because of rounding.

Alternative proposals.—There are many different ways to design a tax credit similar to that proposed by the administration. One way to concentrate the effect of the credit more in the lower income groups would be to reduce the limit on the credit to some lower level. A \$300 limit, for example, would apply for a married couple with two children if its AGI exceeded \$19,000 and for a single individual above \$15,000. The revenue impact of credits by percentage of tax rebated and maximum allowable rebate is shown in table 14. Another way to make the credit more progressive would be to phase it out as income exceeded the level at which the limit applies, so that taxpayers with incomes above a certain level would get no tax credit at all.

TABLE 14.—ESTIMATED DECREASE IN FEDERAL INDIVIDUAL INCOME TAX LIABILITY RESULTING FROM A PERCENTAGE REBATE OF 1974 INCOME TAX LIABILITY WITH A MAXIMUM ALLOWABLE REBATE

Maximum allowable rebate	Percentage of tax rebated																								
	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25					
	Decrease in tax liability (billions of dollars)																								
	[By percentage of tax rebate] and maximum allowable rebate]																								
\$50	2.58	2.67	2.74	2.80	2.84	2.88	2.91	2.94	2.96	2.98	3.00	3.02	3.04	3.05	3.07	3.08	3.09	3.10	3.10	3.10	3.11				
\$100	4.06	4.35	4.58	4.77	4.92	5.05	5.16	5.26	5.35	5.42	5.48	5.54	5.59	5.61	5.68	5.72	5.76	5.79	5.82	5.82	5.84				
\$150	4.81	5.32	5.74	6.09	6.39	6.65	6.88	7.07	7.24	7.38	7.52	7.64	7.75	7.84	7.91	8.01	8.09	8.16	8.22	8.22	8.27				
\$200	5.28	5.90	6.45	6.94	7.38	7.78	8.12	8.43	8.70	8.95	9.17	9.36	9.51	9.70	9.84	9.98	10.10	10.22	10.33	10.42	10.42				
\$250	5.51	6.26	6.92	7.52	8.06	8.56	9.02	9.44	9.81	10.15	10.46	10.75	11.00	11.24	11.46	11.66	11.81	12.01	12.17	12.30	12.30				
\$300	5.72	6.50	7.23	7.92	8.55	9.14	9.68	10.18	10.65	11.08	11.48	11.85	12.18	12.50	12.78	13.05	13.31	13.53	13.75	13.95	13.95				
\$350	5.85	6.67	7.46	8.20	8.90	9.56	10.18	10.75	11.29	11.79	12.27	12.71	13.13	13.52	13.88	14.21	14.53	14.82	15.10	15.35	15.35				
\$400	5.95	6.81	7.63	8.41	9.17	9.88	10.56	11.20	11.83	12.37	12.90	13.41	13.83	14.34	14.77	15.17	15.55	15.91	16.24	16.56	16.56				
\$450	6.03	6.91	7.76	8.58	9.37	10.13	10.85	11.54	12.20	12.82	13.42	13.98	14.51	15.02	15.51	15.97	16.41	16.82	17.22	17.59	17.59				
\$500	6.10	7.00	7.87	8.72	9.54	10.33	11.09	11.82	12.52	13.19	13.81	14.45	15.01	15.63	16.13	16.61	17.13	17.59	18.01	18.46	18.46				
\$550	6.16	7.08	7.96	8.83	9.67	10.49	11.28	12.05	12.79	13.50	14.18	14.81	15.47	16.07	16.65	17.21	17.74	18.25	18.74	19.21	19.21				
\$600	6.22	7.14	8.04	8.93	9.79	10.63	11.44	12.23	13.00	13.75	14.47	15.16	15.83	16.43	17.10	17.70	18.27	18.82	19.35	19.86	19.86				
\$650	6.28	7.20	8.12	9.01	9.89	10.74	11.58	12.40	13.19	13.96	14.71	15.44	16.14	16.82	17.48	18.11	18.73	19.32	19.83	20.43	20.43				
\$700	6.33	7.25	8.18	9.09	9.98	10.85	11.70	12.53	13.35	14.14	14.92	15.67	16.40	17.11	17.83	18.47	19.12	19.75	20.35	20.94	20.94				
\$750	6.38	7.31	8.24	9.16	10.06	10.94	11.81	12.66	13.43	14.31	15.10	15.87	16.63	17.37	18.09	18.78	19.46	20.12	20.76	21.37	21.37				
\$800	6.43	7.37	8.29	9.22	10.13	11.02	11.90	12.77	13.61	14.44	15.26	16.05	16.83	17.59	18.33	19.05	19.76	20.44	21.11	21.76	21.76				
\$850	6.48	7.42	8.35	9.27	10.19	11.10	11.99	12.85	13.72	14.57	15.40	16.21	17.01	17.79	18.55	19.29	20.02	20.73	21.43	22.10	22.10				
\$900	6.52	7.47	8.41	9.32	10.25	11.17	12.07	12.95	13.85	14.68	15.52	16.35	17.16	17.96	18.74	19.51	20.25	20.99	21.70	22.40	22.40				
\$950	6.55	7.52	8.46	9.39	10.31	11.23	12.14	13.03	13.92	14.78	15.61	16.38	17.31	18.12	18.91	19.70	20.46	21.21	21.95	22.67	22.67				
\$1,000	6.58	7.56	8.51	9.44	10.36	11.29	12.21	13.11	14.00	14.88	15.74	16.59	17.43	18.26	19.07	19.87	20.65	21.42	22.17	22.91	22.91				

For example, there could be a 10-percent credit against 1974 tax liability up to a maximum of \$300 (\$150 for a married individual who files a separate return), with the credit phased out between adjusted gross income levels of \$20,000 and \$30,000. This would involve a revenue loss of \$6.0 billion. The distribution by income class is shown in table 15. Twenty-two percent of the reduction goes to people with income below \$10,000.

Another way to make the credit more progressive would be to give it a progressive rate. For example, the credit could be 18 percent for someone with tax liability below \$500, 17 percent for a return with tax liability between \$500 and \$1,000 and so forth, with a maximum credit of \$240 (which would apply at \$8,000 of tax liability or approximately \$40,000 of income). This would involve a revenue loss of \$12.3 billion, approximately the same loss as in the administration proposal. The distribution of this reduction by income class is shown in table 16. Twenty-one percent of the reduction goes to people with AGI below \$10,000.

TABLE 15.—ESTIMATED DECREASE IN FEDERAL INDIVIDUAL INCOME TAX LIABILITY RESULTING FROM A REFUND OF 10% OF 1974 TAX LIABILITY WITH A MAXIMUM REFUND OF \$300 AND A PHASEOUT OF THE REFUND BETWEEN \$20,000 AND \$30,000 OF ADJUSTED GROSS INCOME—BY ADJUSTED GROSS INCOME CLASS, 1974 INCOME LEVELS

Adjusted gross income class	Number of returns with tax decrease (thousands)	Decrease in tax liability	
		Amount (millions)	Percent of total decrease
0 to \$3,000.....	4, 057	\$25	0.4
\$3,000 to \$5,000.....	7, 579	178	2.6
\$5,000 to \$7,000.....	8, 273	409	5.9
\$7,000 to \$10,000.....	11, 428	925	13.4
\$10,000 to \$15,000.....	15, 952	2, 115	30.7
\$15,000 to \$20,000.....	9, 856	2, 059	29.9
\$20,000 to \$50,000.....	6, 849	1, 184	17.2
\$50,000 to \$100,000.....	0	0	-----
\$100,000 and over.....	0	0	-----
Total.....	63, 994	6, 896	100.0

Note: Details may not add to totals because of rounding.

TABLE 16.—ESTIMATED DECREASE IN FEDERAL INDIVIDUAL INCOME TAX LIABILITY RESULTING FROM A GRADUATED PERCENTAGE¹ REFUND OF 1974 TAX LIABILITY WITH A MAXIMUM REFUND OF \$240, BY ADJUSTED GROSS INCOME CLASS, 1974 INCOME LEVELS

Adjusted gross income class	Number of returns with tax decrease (thousands)	Decrease in tax liability	
		Amount (millions)	Percent of total decrease
0 to \$3,000.....	4, 057	\$46	0.4
\$3,000 to \$5,000.....	7, 579	320	2.6
\$5,000 to \$7,000.....	8, 273	707	5.7
\$7,000 to \$10,000.....	11, 428	1, 535	12.4
\$10,000 to \$15,000.....	15, 952	3, 297	26.7
\$15,000 to \$20,000.....	9, 856	2, 911	23.6
\$20,000 to \$50,000.....	9, 006	3, 336	27.0
\$50,000 to \$100,000.....	655	159	1.3
\$100,000 and over.....	160	38	.3
Total.....	66, 966	12, 348	100.0

Note: Details may not add to totals because of rounding.

¹ The schedule of graduated percentages is as follows:

If the amount of 1974 tax is between—	The tax refund per return is—	If the amount of 1974 tax is between—	The tax refund per return is—
0 to \$500	18 percent of the tax.	\$4,500 to \$5,000	9 percent of the tax.
\$500 to \$1,000	17 percent of the tax.	\$5,000 to \$5,500	8 percent of the tax.
\$1,000 to \$1,500	16 percent of the tax.	\$5,500 to \$6,000	7 percent of the tax.
\$1,500 to \$2,000	15 percent of the tax.	\$6,000 to \$6,500	6 percent of the tax.
\$2,000 to \$2,500	14 percent of the tax.	\$6,500 to \$7,000	5 percent of the tax.
\$2,500 to \$3,000	13 percent of the tax.	\$7,000 to \$7,500	4 percent of the tax.
\$3,000 to \$3,500	12 percent of the tax.	\$7,500 to \$8,000	3 percent of the tax.
\$3,500 to \$4,000	11 percent of the tax.	\$8,000 and over	\$240.
\$4,000 to \$4,500	10 percent of the tax.		

There could also be a flat credit either per taxpayer, per exemption, or per return. This would have the greatest impact in concentrating the reduction among low-income families. The revenue cost of a nonrefundable \$75 credit per taxpayer would be \$7.8 billion. A nonrefundable \$75 credit per exemption would cost \$13.1 billion, and a nonrefundable \$75 credit per tax return would cost \$4.9 billion. The distribution of these alternatives is shown in tables 17, 18, and 19.

Still another alternative would be a flat credit of \$50 per tax return plus 7 percent of tax liability, with a maximum refund of \$260 and a phaseout between incomes of \$20,000 and \$30,000. This involves a revenue loss of \$7.7 billion. Thirty-three percent of the reduction goes to people with incomes below \$10,000. The distribution is shown in table 20.

B. Changes in the Standard Deduction

Present law.—Taxpayers who choose not to itemize their deductions can elect a standard deduction equal to 15 percent of adjusted gross income or \$1,300 (the minimum standard deduction or low-income allowance), whichever is greater. The percentage standard deduction is limited, however, to \$2,000. The standard deduction is the same for married couples as it is for single people. Taxpayers who do not itemize will use the minimum standard deduction when their income is less than \$8,667 and will be limited by the maximum standard deduction when income exceeds \$13,333.

Administration proposal.—The administration, as part of its energy tax package, proposes to increase the minimum standard deduction from \$1,300 to \$2,000 for single taxpayers and \$2,600 for married couples. This would, in effect, abolish the existing percentage and maximum standard deductions and put every taxpayer who does not itemize deductions on the new higher minimum standard deduction. This would cause more than 9 million taxpayers to switch to the standard deductions.

TABLE 17.—ESTIMATED DECREASE IN FEDERAL INDIVIDUAL INCOME TAX LIABILITY RESULTING FROM GRANTING A NONREFUNDABLE \$75 TAX CREDIT PER TAXPAYER,¹ BY ADJUSTED GROSS INCOME CLASS, 1974 INCOME LEVELS

Adjusted gross income class	Number of returns affected (thousands)		Decrease in tax liability	
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percent of total decrease
0 to \$3,000.....	4,057	2,525	\$206	2.6
\$3,000 to \$5,000.....	7,579	1,298	588	7.5
\$5,000 to \$7,000.....	8,273	585	796	10.2
\$7,000 to \$10,000.....	11,428	288	1,308	16.7
\$10,000 to \$15,000.....	15,952	83	2,101	26.8
\$15,000 to \$20,000.....	9,856	16	1,406	18.0
\$20,000 to \$50,000.....	9,006	3	1,308	16.7
\$50,000 to \$100,000.....	655	(²)	95	1.2
\$100,000 and over.....	160	(²)	23	.3
Total.....	66,966	4,798	7,830	100.0

¹ Joint returns counted as 2 taxpayers.

² Less than 500 returns.

Note: Details may not add to totals because of rounding.

TABLE 18.—ESTIMATED DECREASE IN FEDERAL INDIVIDUAL INCOME TAX LIABILITY RESULTING FROM GRANTING A NONREFUNDABLE \$75 TAX CREDIT PER PERSONAL EXEMPTION, BY ADJUSTED GROSS INCOME CLASS, 1974 INCOME LEVELS

Adjusted gross income class	Number of returns affected (thousands)		Decrease in tax liability	
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percent of total decrease
0 to \$3,000.....	4,057	2,558	\$207	1.6
\$3,000 to \$5,000.....	7,579	1,728	659	5.0
\$5,000 to \$7,000.....	8,273	1,427	1,031	7.9
\$7,000 to \$10,000.....	11,428	1,144	2,030	15.5
\$10,000 to \$15,000.....	15,952	466	3,750	28.7
\$15,000 to \$20,000.....	9,856	46	2,649	20.3
\$20,000 to \$50,000.....	9,006	7	2,515	19.2
\$50,000 to \$100,000.....	655	1	193	1.5
\$100,000 and over.....	160	(¹)	47	.4
Total.....	66,966	7,376	13,081	100.0

¹ Less than 500 returns.

Note: Details may not add to totals because of rounding.

TABLE 19.—ESTIMATED DECREASE IN FEDERAL INDIVIDUAL INCOME TAX LIABILITY RESULTING FROM GRANTING A NONREFUNDABLE \$75 TAX CREDIT PER RETURN, BY ADJUSTED GROSS INCOME CLASS, 1974 INCOME LEVELS

Adjusted gross income class	Number of returns affected (thousands)		Decrease in tax liability	
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percent of total decrease
0 to \$3,000.....	4,057	2,525	\$206	4.2
\$3,000 to \$5,000.....	7,579	940	540	11.1
\$5,000 to \$7,000.....	8,273	242	612	12.5
\$7,000 to \$10,000.....	11,428	108	854	17.5
\$10,000 to \$15,000.....	15,952	55	1,195	24.5
\$15,000 to \$20,000.....	9,856	10	7.9	15.1
\$20,000 to \$50,000.....	9,006	3	675	13.8
\$50,000 to \$100,000.....	655	(¹)	49	1.0
\$100,000 and over.....	160	(¹)	12	.2
Total.....	66,966	3,883	4,883	100.0

¹ Less than 500 returns.

Note: Details may not add to totals because of rounding.

TABLE 20.—ESTIMATED DECREASE IN FEDERAL INDIVIDUAL INCOME TAX LIABILITY RESULTING FROM A REFUND OF \$56 PLUS 7 PERCENT OF 1974 TAX LIABILITY WITH A MAXIMUM REFUND OF \$260 AND A PHASEOUT OF THE REFUND BETWEEN \$20,000 AND \$30,000 OF ADJUSTED GROSS INCOME, BY ADJUSTED GROSS INCOME CLASS, 1974 INCOME LEVELS

Adjusted gross income class	Number of returns affected (thousands)		Decrease in tax liability	
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percent of total decrease
0 to \$3,000.....	4,057	1,903	\$172	2.2
\$3,000 to \$5,000.....	7,579	660	493	6.4
\$5,000 to \$7,000.....	8,273	163	696	9.0
\$7,000 to \$10,000.....	11,428	44	1,216	15.7
\$10,000 to \$15,000.....	15,952	22	2,272	29.4
\$15,000 to \$20,000.....	9,856	6	1,932	25.0
\$20,000 to \$50,000.....	6,448	0	953	12.3
\$50,000 to \$100,000.....	0	0	0	0
\$100,000 and over.....	0	0	0	0
Total.....	63,593	2,789	7,734	100.0

Note: Details may not add to totals because of rounding.

Revenue effect.—The administration proposal would involve a revenue loss of \$5.2 billion at 1974 income levels. Table 21 shows the distribution of the reduction by income class. Eighty-nine percent of the reduction goes to taxpayers with incomes below \$15,000.

TABLE 21.—ESTIMATED DECREASE IN FEDERAL INDIVIDUAL INCOME TAX LIABILITY RESULTING FROM INCREASING THE MINIMUM STANDARD DEDUCTION TO \$2,000 FOR SINGLE PERSON RETURNS AND \$2,600 FOR JOINT RETURNS, BY ADJUSTED GROSS INCOME CLASS, 1974 INCOME LEVELS

Adjusted gross income class	Number of returns affected (thousands)			Decrease in tax liability	
	Total number with tax decrease	Number made nontaxable	Number shifting to the standard deduction	Amount (millions)	Percent of total decrease
0 to \$3,000.....	4,039	3,125	99	\$236	4.5
\$3,000 to \$5,000.....	7,379	1,425	580	800	15.3
\$5,000 to \$7,000.....	7,746	490	1,371	1,055	20.2
\$7,000 to \$10,000.....	9,292	112	2,772	1,464	28.0
\$10,000 to \$15,000.....	9,756	(¹)	2,948	1,112	21.3
\$15,000 to \$20,000.....	3,202	(¹)	1,168	363	6.9
\$20,000 to \$50,000.....	1,331	(¹)	482	190	3.6
\$50,000 to \$100,000.....	24	(¹)	8	6	.1
\$100,000 and over.....	3	(¹)	1	1	(¹)
Total.....	42,770	5,153	9,429	5,226	100.0

¹ Less than 500 returns or 0.05 percent.

Note: Details may not add to totals because of rounding.

Staff analysis.—The standard deduction serves two purposes: it provides tax relief to low-income families and it simplifies the income tax by giving taxpayers an alternative to itemizing their deductions.

In the past, Congress has used the personal exemption and the low-income allowance to make sure that people with incomes below official government poverty levels do not pay Federal income taxes. Inflation, however, especially higher food and energy costs, has raised the poverty level substantially in the past two years, but there has been no corresponding increase in the level at which people pay income taxes, the tax threshold. Table 22 shows projected poverty levels for 1975 and what the tax threshold would be under the administra-

tion proposal. The administration proposal raises the tax threshold above the poverty level for all family sizes of fewer than five, and substantially above the poverty level in the case of two- and three-person families.

TABLE 22.—1975 POVERTY LEVELS AND TAX THRESHOLDS UNDER ADMINISTRATION PROPOSAL TO RAISE THE MINIMUM STANDARD DEDUCTION \$2,000 FOR SINGLE INDIVIDUAL AND \$2,600 FOR MARRIED COUPLES

Family size:	1975 poverty level	Present law tax thresholds	Tax threshold under admin- istration proposal	Tax threshold under alternative proposal
1-----	\$2,694	\$2,050	\$2,750	\$2,650
2-----	3,470	2,800	4,100	4,000
3-----	4,253	3,550	4,850	4,750
4-----	5,442	4,300	5,600	5,500
5-----	6,423	5,050	6,350	6,250
6-----	7,226	5,800	7,100	7,000

¹ Minimum standard deduction of \$1,900 for single returns and \$2,500 for joint returns.

The administration proposal distinguishes between single and joint returns, which now have the same standard deduction, by giving joint returns a \$1,300 increase and single returns a \$700 increase. This differentiation follows the pattern of the Energy Tax and Individual Relief Act, reported by the Ways and Means Committee at the end of the last session of Congress. In that bill, the minimum standard deduction was increased by \$300 for single returns and \$600 for joint returns. The argument for making such a distinction is that married couples have higher living costs than single people and that there should not be a substantial tax penalty for marriage.

Any change in the standard deduction would be more understandable to taxpayers if it were permanent, which probably is why the administration proposes it as part of its energy package instead of its tax reduction package.

Alternative proposals.—The administration proposal effectively abolishes the percentage and maximum standard deductions. The committee may want to continue these alternatives as a way of giving tax relief to middle-income families and simplifying the income tax for that group. For example, the committee could raise the minimum standard deduction from \$1,300 to \$1,900 for single returns and \$2,500 for joint returns; raise the percentage standard deduction from 15 percent to 16 percent; and raise the maximum standard deductions from \$2,000 to \$2,500 for single returns and \$3,000 for joint returns. This would have a revenue loss of \$5.1 billion and would cause 9.9 million to switch to the standard deduction. The income distribution reduction is shown in table 23.

A smaller increase in the standard deduction would be the one included in the Energy Tax and Individual Relief Act. That bill raised the minimum standard deduction to \$1,600 for single returns and \$1,900 for joint returns; raised the percentage standard deduction to 16 percent; and raised the maximum standard deduction to \$2,300. The revenue loss would be \$2.1 billion, and it would cause 4.1 million to switch to the standard deduction. The income distribution of this reduction is shown in table 24.

TABLE 23.—ESTIMATED DECREASE IN FEDERAL INDIVIDUAL INCOME TAX LIABILITY RESULTING FROM INCREASING: THE MINIMUM STANDARD DEDUCTION TO \$1,900 FOR SINGLE PERSON RETURNS AND \$2,500 FOR JOINT RETURNS; THE PERCENTAGE STANDARD DEDUCTION TO 16 PERCENT; AND THE MAXIMUM STANDARD DEDUCTION TO \$2,500 FOR SINGLE PERSON RETURNS AND \$3,000 FOR JOINT RETURNS, BY ADJUSTED GROSS INCOME CLASS, 1974 INCOME LEVELS

Adjusted gross income class	Number of returns affected (thousands)			Decrease in tax liability	
	Total number with tax decrease	Number made nontaxable	Number shifting to the standard deduction	Amount (millions)	Percent of total decrease
0 to \$3,000.....	4,039	2,837	99	\$221	4.4
\$3,000 to \$5,000.....	7,347	1,278	545	707	13.9
\$5,000 to \$7,000.....	7,671	445	1,287	931	18.3
\$7,000 to \$10,000.....	9,194	88	2,674	1,297	25.6
\$10,000 to \$15,000.....	9,821	(¹)	2,663	958	18.9
\$15,000 to \$20,000.....	4,053	(¹)	1,546	541	10.7
\$20,000 to \$50,000.....	1,998	(¹)	1,016	404	8.0
\$50,000 to \$100,000.....	38	(¹)	18	13	.3
\$100,000 and over.....	4	(¹)	2	2	(¹)
Total.....	44,164	4,649	9,851	5,074	100.0

¹ Less than 500 returns or 0.05 percent.

Note: Details may not add to totals because of rounding.

TABLE 24.—ESTIMATED DECREASE IN FEDERAL INDIVIDUAL INCOME TAX LIABILITY RESULTING FROM INCREASING: THE MINIMUM STANDARD DEDUCTION TO \$1,600 FOR SINGLE PERSON RETURNS AND \$1,900 FOR JOINT RETURNS; THE PERCENTAGE STANDARD DEDUCTION TO 16 PERCENT; AND THE MAXIMUM STANDARD DEDUCTION TO \$2,300, BY ADJUSTED GROSS INCOME CLASS, 1974 INCOME LEVELS

Adjusted gross income class	Number of returns affected (thousands)			Decrease in tax liability	
	Total number with tax decrease	Number made nontaxable	Number shifting to the standard deduction	Amount (millions)	Percent of total decrease
0 to \$3,000.....	4,021	1,459	67	\$138	6.4
\$3,000 to 5,000.....	7,164	692	325	379	17.7
\$5,000 to \$7,000.....	7,112	112	694	450	21.0
\$7,000 to \$10,000.....	7,934	13	1,414	564	26.3
\$10,000 to \$15,000.....	7,975	(¹)	816	304	14.2
\$15,000 to \$20,000.....	3,106	(¹)	599	205	9.6
\$20,000 to \$50,000.....	1,185	(¹)	202	101	4.7
\$50,000 to \$100,000.....	24	(¹)	4	4	.2
\$100,000 and over.....	3	(¹)	1	(¹)	(¹)
Total.....	38,523	2,277	4,120	2,144	100.0

¹ Less than 500 returns or 0.05 percent.

Note: Details may not add to totals because of rounding.

C. Refundable tax credits

Present law.—None.

Administration proposal.—In connection with its energy tax package, the administration has proposed to make an annual payment of \$160 to married couples who file joint returns if their prior year's adjusted gross income is less than \$4,500 and an annual payment of \$80 to single people whose prior year's income is less than \$2,250. For joint returns, the payment is reduced by \$4 for every \$25 of income above \$4,500, so that it would phase out at an income of \$5,500. For single people, the phaseout would occur at an income of \$2,750. The purpose of this credit is to offset the effect of higher energy prices resulting from the administration's energy proposals.

Revenue effect.—The revenue loss from these payments is estimated at \$2 billion annually.

Staff analysis.—It has been argued that there should be some relief for people who do not now pay income tax. This could be provided through some type of refundable tax credit or payment to nontaxpayers. Even if the administration's energy program is not enacted, a refundable credit may be desirable to offset the impact of the social security payroll tax on the poor.

A problem with the administration proposal for payments to nontaxpayers is that the Internal Revenue Service will have trouble locating many of the eligible people. Because there are no records of many nontaxpayers, there is considerable potential for abuse. This could be dealt with by linking the refundable credit to the receipt of earned income, since the IRS deals with almost all earners through either income or social security tax withholding or the self-employment tax.

Alternative proposals.—The Senate has attached a "work bonus" proposal sponsored by Senator Long to several House bills, but the House has consistently rejected it in conference. The work bonus plan is a 10-percent refundable tax credit on wages and salaries up to a maximum credit of \$400. The credit would be phased out as income from all sources, including tax-exempt income, exceeded \$4,000, with a \$1 reduction in the credit for each \$4 of income over \$4,000. The phaseout would be completed at income of \$5,600. The work bonus would be available only to families with children. It can be viewed either as a wage subsidy or a rebate of social security taxes to low-income households. Its revenue cost is estimated at \$700 million.

There are several criticisms of the work bonus proposal that can be remedied if the revenue cost is increased. The reduction in the credit of \$1 for each \$4 of wages introduces a high implicit marginal tax rate (or benefit-loss rate) into the tax system. When combined with regular income taxes, social security taxes, food stamps, public housing and other programs, this can lead to significant work disincentive in the income range in which the phaseout occurs. This problem can be greatly reduced by slowing down the phaseout of the credit, although this increases the revenue cost by making the credit available to more people.

Also, the work bonus plan has been criticized for being limited to families with children and to wage and salary income. This could be changed by extending it to all earners and to self-employment income.

The refundable credit could equal 5 percent of earned income (both wages and self-employment income) up to a maximum credit of \$200. The credit would be reduced by \$1 for each \$10 of adjusted gross income in excess of \$4,000, so that it would be phased out at incomes of \$6,000. This credit would involve a revenue loss of approximately \$3.3 billion, all of which would be received by low- and moderate-income people. The distribution is shown in table 25.

D. Social Security Tax Reduction for Low-Income Workers

Present law.—Social security taxes are paid at a uniform rate on all covered earnings (up to \$14,100 in 1975) by workers, employers and self-employed individuals. The tax rate for 1975 is 5.85 percent (4.95

percent OASDI and .9 percent HI). Social security benefits, however, are weighted in favor of people with low average earnings.

Administration proposal.—None.

Staff analysis.—In deciding whether to reduce social security taxes, the committee should consider the nature of the whole social security program and the financial problems of the social security trust fund.

TABLE 25. ESTIMATED DECREASE IN FEDERAL INDIVIDUAL INCOME TAX LIABILITY RESULTING FROM GRANTING A REFUNDABLE TAX CREDIT OF 5 PERCENT OF WAGE AND SALARY AND SELF-EMPLOYMENT INCOME WITH A MAXIMUM CREDIT OF \$200 AND A PHASEOUT OF THE CREDIT BETWEEN \$4,000 AND \$6,000, BY ADJUSTED GROSS INCOME CLASS, 1974 INCOME LEVELS

Adjusted gross income class (thousands)	Number of returns affected (thousands)		Decrease in tax liability ¹	
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percent of total decrease
0-\$3.....	16,270	3,719	\$1,196	45.0
\$3-5.....	8,081	1,692	1,255	47.3
5-7.....	3,947	96	204	7.7
7-10.....	0	0	0	0
10-15.....	0	0	0	0
15-20.....	0	0	0	0
20-50.....	0	0	0	0
50-100.....	0	0	0	0
100 and over.....	0	0	0	0
Total.....	28,298	5,507	2,655	100.0

¹ Does not include an additional \$600,000,000 to cover the credit on wage and salary and self-employment income of earners who are nonfilers under the 1970 filing requirements.

In brief, the idea of social security as a contributory social insurance program has come to mean to many people that because individual social security taxes have been paid, social security benefits are a right that has been bought and paid for. In addition, the fact that an individual knows that he is paying a tax is seen as promoting a sense of fiscal responsibility in that increases in costs will be reflected in increased taxes. There has always been some concern that if workers were not required to make some contribution toward financing their benefits, the general acceptance of their "earned right" to such benefits would decrease to the point that eventually benefits would be determined on a "needs test" basis. Although a temporary tax relief program would not necessarily do violence to the generally accepted concept of the program, temporary social actions tend to become permanent. Therefore, consideration should be given to requiring at least a minimum social security tax payment by low-paid workers in any tax relief provision.

It is important to bear in mind that the social security program will require significant infusions of new money if the program is to be maintained on a financially sound basis. It will be important for the Committee to consider during the present session the long-range and short-range financing problems facing the program. Therefore, it seems important that if any social security tax relief proposal is adopted to accommodate the present economic situation, it be designed, as much as possible, so that it does not prejudice the shape of more basic changes which may be made in the near future.

Alternative proposals.—One method of decreasing the social security taxes paid by low-income workers would be to provide a reduction or exemption of social security taxes with respect to a certain portion of earnings and an increase in the tax rate so that employees whose earnings equal or exceed the maximum amount taxable would pay the same dollar amount in social security taxes as under present law. The reduced receipts would be made up by a payment from the general fund of the Treasury. The cost would be determined by the level of earnings exempt from social security taxes and by the change in tax rates.

As stated earlier, consideration should be given to adopting a proposal in the form of a rate reduction in social security taxes on first dollar earnings rather than by means of a total exemption of earnings from social security taxes. The tax on the first \$3,000 of earnings could be reduced by 50 percent and the rate on earnings above that level could be increased to 6.71 percent, which would gradually phase out the reduction. Under this alternative, all workers with earnings below \$14,100 would get some tax relief. This would mean a revenue loss of \$3.8 billion based on 1974 earnings.

There could be a tax exemption for the first \$1,200 of earnings coupled with a rate increase from 5.85 percent to 6.345 percent. This would have the effect of reducing the tax reduction gradually as earnings rose, but some reduction would be provided for all workers with earnings below \$14,100. The revenue cost would be \$3.3 billion at 1974 income levels.

The alternatives could be accomplished either by reducing the amount of social security taxes withheld from current earnings or by providing a refund or a credit of the prior year's social security taxes when the worker files his income tax return. Although these and all other alternative tax relief plans present some technical administrative problems, the problems are not considered insurmountable.

They could be resolved by establishing a social security tax withholding schedule combined with income tax withholding. Alternatively, the proposal could be adopted by providing for a refund of social security taxes on 1974 earnings and such a proposal could be extended to later years. The present income tax system provides a method of making employee refunds in cases in which excess social security taxes have been paid.

As stated earlier, consideration should also be given to adopting a proposal in the form of a rate reduction in social security taxes on first dollar of earnings rather than by means of a total exemption of earnings from social security taxes.

The tax on the first \$3,000 of earnings could be reduced by 50 percent and the rate on earnings above that level could be increased to an amount that would gradually phase out the reduction. This would mean a revenue loss of \$3.8 billion.

E. Optional Tax Credit in Place of the Personal Exemption

Present law.—Taxpayers receive a \$750 personal exemption for each taxpayer and each dependent with an additional exemption for taxpayers who are age 65 or over or blind.

Administration proposal.—None.

Alternative proposals.—The personal exemption has been criticized for being worth more to high-bracket taxpayers than to low-bracket ones. A \$750 exemption is worth \$525 to a taxpayer whose marginal tax rate is 70 percent, but only \$105 to someone in the 14-percent bracket. To remedy this situation, it has been proposed that taxpayers be given the option of claiming a tax credit in place of their personal exemptions. A \$225 optional credit would mean a revenue loss of \$9.6 billion, and a \$250 optional credit would involve a loss of \$13.2 billion. The distribution of these reductions is shown in tables 26 and 27.

The optional credit would concentrate a large tax reduction in the low- and middle-income groups. For a \$225 optional credit, the credit option would be used only by taxpayers below the 30-percent bracket, who are generally families with income below \$25,000 or single people with income below \$16,000.

There are, however, several problems with the optional credit. Unlike increases in the standard deduction, an alternative way to reduce taxes for low- and middle-income taxpayers, the optional credit does not simplify the tax system; rather, it adds a significant complication. Also, the optional credit creates wide disparities in income tax for families with different numbers of dependents. Under present law, a three-person family with income of \$10,000, which uses the standard deduction, pays a tax of \$1,048, while a four-person family in the same position pays \$905, a difference of \$143. With the optional credit, the three-person family would pay \$815 while the four-person family would pay \$590, so that the difference in their taxes would widen from \$143 to \$225.

Some of the benefits of the optional tax credit could be obtained if a tax credit for the taxpayer and his spouse were allowed in addition to the existing personal exemption. A \$75 credit would involve a revenue cost of \$7.8 billion.

F. Rate Reduction

Present law.—Under present law, there are separate rate schedules for married couples who file joint returns, single people, married people who file separate returns and heads of households. The rates for joint and single returns are shown in tables 28 and 29.

Administration proposal.—As part of its energy package, the administration has proposed rate reductions in the low-income brackets, offset by increases in the middle brackets that have the effect of almost phasing out the reductions. The administration's proposed reductions are also shown in tables 28 and 29. For joint returns, the administration proposes to reduce the beginning rate from 14 percent to 7 percent, and there are other reductions in the brackets below \$6,000. (The administration proposes splitting the current \$4,000-to-\$8,000 bracket into two separate brackets.) There are rate increases in the brackets between \$16,000 and \$24,000, so that families with taxable incomes above \$24,000 receive only a \$130 tax reduction regardless of their income. For single people, the administration proposes to reduce rates in brackets below \$8,000 and to raise them in brackets between \$20,000 and \$26,000 so that single people with taxable income over \$26,000 also receive \$130 tax reductions.

TABLE 28.—PRESENT LAW AND PROPOSED RATE TABLE FOR MARRIED INDIVIDUALS FILING JOINT RETURNS AND CERTAIN SURVIVING SPOUSES¹

Taxable income		Present law		Proposal	
Over	Not over	Pay	+ Tax rate (percent)	Pay	+ Tax rate (percent)
—	\$1,000	—	14	—	7
\$1,000	2,000	\$140	15	\$70	10
2,000	3,000	290	16	170	13
3,000	4,000	450	17	300	15
4,000	8,000	620	19	—	—
(4,000)	² (6,000)	—	—	450	17
(6,000)	² (8,000)	—	—	790	19
8,000	12,000	1,380	22	1,170	22
12,000	16,000	2,260	25	2,050	25
16,000	20,000	3,260	28	3,050	29
20,000	24,000	4,380	32	4,210	33
24,000	28,000	5,660	36	5,530	36
28,000	32,000	7,100	39	6,970	39
32,000	36,000	8,660	42	8,530	42
36,000	40,000	10,340	45	10,210	45
40,000	44,000	12,140	48	12,010	48
44,000	52,000	14,060	50	13,930	50
52,000	64,000	18,060	53	17,930	53
64,000	76,000	24,420	55	24,290	55
76,000	88,000	31,020	58	30,890	58
88,000	100,000	37,980	60	37,850	60
100,000	120,000	45,180	62	45,050	62
120,000	140,000	57,580	64	57,450	64
140,000	160,000	70,380	66	70,250	66
160,000	180,000	83,580	68	83,450	68
180,000	200,000	97,180	69	97,050	69
200,000	300,000	110,980	70	110,850	70

¹ Applies for a qualified surviving widow or widower in the first 2 years after the year in which the spouse died.
² Proposed new brackets; split of present law \$4,000 to \$8,000 bracket.

TABLE 29.—PRESENT LAW AND PROPOSED RATE TABLE FOR UNMARRIED INDIVIDUALS (OTHER THAN CERTAIN SURVIVING SPOUSES AND HEADS OF HOUSEHOLDS)

Taxable income		Present law		Proposal	
Over	Not over	Pay	+ Tax rate (%)	Pay	+ Tax rate (%)
—	\$500	—	14	—	7
\$500	1,000	\$70	15	\$35	9
1,000	1,500	145	16	80	11
1,500	2,000	225	17	135	13
2,000	4,000	310	19	—	—
(2,000)	¹ (3,000)	—	—	200	16
(3,000)	¹ (4,000)	—	—	360	18
4,000	6,000	690	21	540	20
6,000	8,000	1,110	24	940	23
8,000	10,000	1,590	25	1,400	25
10,000	12,000	2,090	27	1,900	27
12,000	14,000	2,630	29	2,440	29
14,000	16,000	3,210	31	3,020	31
16,000	18,000	3,830	34	3,640	34
18,000	20,000	4,510	36	4,320	36
20,000	22,000	5,230	38	5,040	39
22,000	26,000	5,990	40	5,820	41
26,000	32,000	7,590	45	7,460	45
32,000	38,000	10,290	50	10,160	50
38,000	44,000	13,290	55	13,160	55
44,000	50,000	16,590	60	16,460	60
50,000	60,000	20,190	62	20,060	62
60,000	70,000	26,390	64	26,260	64
70,000	80,000	32,790	66	32,660	66
80,000	90,000	39,390	68	39,260	68
90,000	100,000	46,190	69	46,060	69
100,000	—	53,090	70	52,960	70

¹ Proposed new brackets, split of present law \$2,000 to \$4,000 bracket.

Revenue effect.—These rate reductions will mean a revenue loss of \$10.6 billion. The distribution of the reduction is shown in table 30.

Alternative proposals.—A rate reduction such as the one proposed by the administration implies a degree of permanence. The committee, however, could enact a rate reduction that is more clearly labeled as

temporary. For example, there could be a temporary rate reduction of three percentage points in each tax bracket, which would cost \$16.2 billion. This would be a proportional reduction with respect to taxable income and, therefore, would be more progressive than a proportional tax credit, as proposed by the administration for 1974, unless one of the progressive variants of the credit, as described above, is adopted. The distribution of this tax reduction is shown in table 31. If applied to 1975 tax liability, the rate reduction could be reflected in withholding. The rate reduction, however, would be less progressive than increases in the standard deduction.

G. Increases in the Personal Exemption

Present law.—Taxpayers receive a personal exemption of \$750 for each taxpayer and each dependent. In addition, taxpayers age 65 or over or blind receive an extra exemption. The exemption was last increased in 1972.

Administration proposal.—None.

TABLE 30.—ESTIMATED DECREASE IN FEDERAL INDIVIDUAL INCOME TAX LIABILITY RESULTING FROM SUBSTITUTING NEW TAX RATE SCHEDULES ¹ FOR THOSE UNDER PRESENT LAW, BY ADJUSTED GROSS INCOME CLASS, 1974 INCOME LEVELS

Adjusted gross income class	Number of returns affected (thousands)		Decrease in tax liability	
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percent of total decrease
0 to \$3,000.....	4,057	16	\$121	1.1
\$3,000 to \$5,000.....	7,579	31	647	6.1
\$5,000 to \$7,000.....	8,273	14	1,071	10.1
\$7,000 to \$10,000.....	11,428	21	1,859	17.5
\$10,000 to \$15,000.....	15,952	6	3,129	29.5
\$15,000 to \$20,000.....	9,856	6	2,033	19.2
\$20,000 to \$50,000.....	9,006	2	1,631	15.4
\$50,000 to \$100,000.....	655	(²)	85	.8
\$100,000 and over.....	160	(²)	21	(²)
Total.....	66,966	96	10,597	100.0

¹ The new rate schedules are those proposed by the administration. See tables 28 and 29.

² Less than 500 returns, or 0.05 percent.

Note: Details may not add to totals because of rounding.

TABLE 31.—ESTIMATED DECREASE IN FEDERAL INDIVIDUAL INCOME TAX LIABILITY RESULTING FROM A DECREASE OF 3 PERCENTAGE POINTS IN EACH TAX BRACKET RATE, BY ADJUSTED GROSS INCOME CLASS, 1974 INCOME LEVELS

Adjusted gross income class	Number of returns affected (thousands)		Decrease in tax liability	
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percent of total decrease
0 to \$3,000.....	4,057	16	\$54	0.3
\$3,000 to \$5,000.....	7,579	15	349	2.1
\$5,000 to \$7,000.....	8,273	14	749	4.6
\$7,000 to \$10,000.....	11,428	3	1,620	10.0
\$10,000 to \$15,000.....	15,952	6	3,548	21.9
\$15,000 to \$20,000.....	9,856	6	3,288	20.3
\$20,000 to \$50,000.....	9,006	4	5,104	31.4
\$50,000 to \$100,000.....	655	(¹)	976	6.0
\$100,000 and over.....	160	(¹)	545	3.4
Total.....	66,966	64	16,235	100.0

¹ Less than 500 returns.

Note: Details may not add to totals because of rounding.

Alternative proposals.—Large tax reductions could be achieved by increasing the personal exemption. The extent of inflation since 1972 would suggest a \$150 increase to maintain the 1972 value of the exemption in real terms. The distribution of this reduction is shown in table 32. The distribution of an increase to \$850 is shown in table 33.

TABLE 32.—ESTIMATED DECREASE IN FEDERAL INDIVIDUAL INCOME TAX LIABILITY RESULTING FROM INCREASING THE PERSONAL EXEMPTION DEDUCTION FROM \$750 TO \$900, BY ADJUSTED GROSS INCOME CLASS, 1974 INCOME LEVELS

Adjusted gross income class	Number of returns affected (thousands)		Decrease in tax liability	
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percent of total decrease
0 to \$3,000.....	4,057	918	\$81	1.4
\$3,000 to \$5,000.....	7,579	608	255	4.3
\$5,000 to \$7,000.....	8,273	265	403	6.8
\$7,000 to \$10,000.....	11,428	212	795	13.5
\$10,000 to \$15,000.....	15,952	60	1,509	25.5
\$15,000 to \$20,000.....	9,586	11	1,182	20.0
\$20,000 to \$50,000.....	9,006	4	1,436	24.3
\$50,000 to \$100,000.....	655	(1)	192	3.3
\$100,000 and over.....	160	(1)	54	.9
Total.....	66,966	2,077	5,906	100.0

¹ Less than 500 returns.

Note: Details may not add to totals because of rounding.

TABLE 33.—ESTIMATED DECREASE IN FEDERAL INDIVIDUAL INCOME TAX LIABILITY RESULTING FROM GRANTING A \$225 OPTIONAL TAX CREDIT IN LIEU OF THE PRESENT \$750 PERSONAL EXEMPTION DEDUCTION, BY ADJUSTED GROSS INCOME CLASS, 1974 INCOME LEVELS

Adjusted gross income class	Number of returns affected (thousands)		Decrease in tax liability	
	Total number with tax decrease	Number made nontaxable	Amount (millions)	Percent of total decrease
0 to \$3,000.....	4,057	3,381	\$240	2.5
\$3,000 to \$5,000.....	7,579	2,119	762	7.9
\$5,000 to \$7,000.....	8,273	1,709	1,107	11.5
\$7,000 to \$10,000.....	11,428	1,337	2,045	21.3
\$10,000 to \$15,000.....	15,858	524	3,282	34.2
\$15,000 to \$20,000.....	9,477	58	1,657	17.3
\$20,000 to \$50,000.....	5,145	4	504	5.3
\$50,000 to \$100,000.....	5	1	1	(1)
\$100,000 and over.....	1	(1)	(1)	(1)
Total.....	61,821	9,133	9,599	100.0

¹ Less than 500 returns, \$500,000, or 0.05 percent.

Note: Details may not add to totals because of rounding.

The problem with lowering taxes in this way is that less of the reduction would be concentrated in the low- and middle-income brackets than is the case with increases in the standard deduction or rate reductions, such as those proposed by the administration. Also, increases in the exemption would probably be permanent.

VII. ALTERNATIVE WAYS TO REDUCE CORPORATE TAXES

A. Increase In Investment Tax Credit

Present law.—Present law provides a 7-percent investment tax credit (4 percent with respect to certain public utility property). The investment tax credit is available with respect to: (1) tangible personal property; (2) other tangible property (not including a building and structural components) which is an integral part of manufacturing, production, etc., or which constitutes a research or storage facility; and (3) elevators and escalators. Generally, the credit is not available with respect to property used outside the United States.

To be eligible for the credit, the property must be depreciable property with a useful life of at least 3 years. Property with a useful life of 3 or 4 years qualifies for the credit to the extent of one-third of its cost; property with a useful life of 5 or 6 years qualifies with respect to two-thirds of its cost; and property with a useful life of 7 years or more qualifies for the credit to the full extent of the property's cost. (However, in the case of used property, not more than \$50,000 of cost may be taken into account by a taxpayer as qualified investment for purposes of the credit for a taxable year.) Property becomes eligible for the credit when it is placed in service.

The amount of the credit that a taxpayer may take in any one year cannot exceed the first \$25,000 of tax liability (as otherwise computed) plus 50 percent of the tax liability in excess of \$25,000. Investment credits which because of this limitation cannot be used in the current year may be carried back 3 taxable years and then carried forward 7 taxable years and used in those years to the extent permissible within the limitations applicable in those years.

Present law provides for a recapture of the investment credit to the extent property is disposed of before the end of the period (that is, 3-5, 5-7, or 7 or more years) which was used in determining the amount of the credit originally allowed. Thus, if property is disposed of, or otherwise ceases to be qualified, the tax for the current year is increased (or unused credit carryovers are reduced) by the reductions in investment credits which would have resulted if the credit were computed on the basis of the actual useful life of the property rather than its estimated useful life.

Public utility property.—The definition of public utility property, to which the 4-percent investment tax credit applies, is property used predominantly in the trade or business of furnishing or selling (1) electrical energy, water, or sewage disposal services, (2) gas through a local distribution system, or (3) telephone service, telegraph service through domestic telegraph operations, or other communications services (other than international telegraph services). In general, the reduced credit applies only if the rates for these services or items are established or approved by certain types of governmental regulatory bodies.

With respect to the treatment of the investment credit of regulated companies for ratemaking purposes, special limitations are imposed on the allowance of the credit to prevent the tax benefits of the credit from automatically being passed on the consumers. These limitations are applicable to property used predominantly in the trade or business of furnishing or selling (1) the products or services described in the preceding paragraph and (2) steam through a local distribution system or the transportation of gas or steam by pipeline if the rates for those businesses are subject to government regulation.

The special limitations generally provide that the investment credit is not to be available to a company with respect to any of its public utility property if any part of the credit to which it would otherwise be entitled is flowed through to income (i.e., increases the utility's income for ratemaking purposes); however, in this case the tax benefits derived from the credits may (if the regulatory commission so requires) be used to reduce the rate base, if this reduction is restored over the useful life of the property.

If within 90 days after enactment of the Revenue Act of 1971 the taxpayer is elected, then the investment credit is to be available to a company with respect to any of its public utility property if the credit to which it would otherwise be entitled is flowed through to income ratably over the useful life of the property; however, in this case there must not be any adjustment to reduce the rate base.

However, immediate flow-through would be permitted with respect to property which is flow-through property under the accelerated depreciation rules enacted as part of the Tax Reform Act of 1969 if the taxpayer elected this treatment within 90 days after enactment of the Revenue Act of 1971. Further, a special election is provided with respect to local steam distribution systems and gas or steam pipelines where the regulatory body involved determined that the natural domestic supply of gas or steam was insufficient to meet the present and future requirements of the domestic economy. In this case, if the taxpayer elected (within 90 days after enactment of the Revenue Act of 1971) the investment credit is not be available unless (1) no part of the credit is flowed through to income and also (2) no part of the credit is used to reduce the rate base.

Administration proposal.—The administration has proposed that the investment tax credit be increased for one year to 12 percent for all taxpayers, including public utilities. The temporary higher credit is to apply to property placed in service in 1975 and to property ordered during 1975, if placed in service before the end of 1976. In addition, the credit would also be available to the extent of construction, reconstruction or erection of eligible property by or for a taxpayer during 1975, without regard to the date when the completed property is placed in service.

In the case of utilities the 12 percent credit would continue to apply for two additional years after 1975 with respect to qualified investment in electrical power plants other than oil- or gas-fired facilities.

Also, with respect to utilities, the 50 percent limitation on the amount of credit which may be claimed in a year above the first \$25,000 of a taxpayer's income tax liability would be temporarily increased.

Utilities would be permitted to use the credit against up to 75 percent of their tax liability above the first \$25,000 of liability for 1975. Thereafter, the limitation would decrease by five percentage points for each year after 1975 (that is, 70 percent in 1976, 65 percent in 1977, 60 percent in 1978, 55 percent in 1979) until the limitation is decreased to the 50 percent limitation, generally applicable to other taxpayers, in 1980 and later years.

The temporary increase in the credit would be effective retroactively to January 1, 1975.

Revenue effect.—The administration estimates that tax liabilities will be reduced by \$4 billion annually as a result of the increases in the investment tax credit. This is an estimate of the direct effect and does not include an estimate of secondary effects that could result from the initial impact.

Staff Analysis.—As indicated in the section on individual tax reductions above, the economic situation is bad and likely to get worse without significant fiscal stimulation. A balanced program which encourages both consumption and investment may well be a more effective method of stimulating the economy than attempting to focus all the tax stimulus on consumption. In addition to providing short-run stimulation to the economy, an increase in the amount of investment is desirable for other reasons.

First, additional investment which increases productivity is itself anti-inflationary in that it increases the amount of output available to meet consumer demands in the future (although this obviously is not a problem at the present time). Second, increased productivity results in lower production costs which means that money wage increases will not have the same degree of upward pressure on product prices that they would in the absence of growing productivity. This also has implications for our balance of payments and the exchange rate of the dollar.

Third, it appears that unless in the future the stock of capital is increased significantly there will be serious problems in providing enough jobs for those entering the labor force. Over the past few years, the rate of investment has not been sufficient to provide the necessary increase in productivity or to provide the capital necessary to employ the labor force. The long-term outlook for the ability of our economy to provide the necessary level of investment to create needed capital is analyzed in a paper, "Capital Needs in the Seventies", by Barry Bosworth and James Duesenberry (one of the panelists who appeared before the committee). Their conclusion was that it would be possible for us to meet our capital needs, but "just barely." And to have any chance of meeting these requirements it is necessary to both increase saving and to return the economy to full employment growth. The investment credit should be useful in meeting both of these objectives. It provides an investment stimulus to move the country toward full employment. In addition, it should help to increase total saving in the economy because a dollar of investment financed through the investment credit represents corporate saving which is not matched by a comparable decrease in saving elsewhere in the economy.

The short-term lack of investment is indicated by the fact that the amount of investment for new plant and equipment in fact is expected

to increase by only \$5 billion from 1974 to 1975, an increase from \$112 billion to an expected \$117 billion. Given the expected increase in prices for plant and equipment, this is not keeping up with the higher price of plant and equipment and represents a decline in the real level of investment. For manufacturing the decline in the rate of growth is even more pronounced. As shown in Table 34, investment for manufacturing increased 20.5 percent from 1973 to 1974 but is expected to increase only 9 percent between 1974 and 1975. Part of the shortfall in investment is because of the tight financial position in which many corporations find themselves. This is a result not only of declining sales but of tight monetary policy and the impact of inflation on corporate profits and cash flow. Corporate profits, in many instances, include significant amount of inventory profit which results from the increase in prices of goods corporations held in inventory. But these profits are generally not available for the purpose of additional plant and equipment expenditure because, in many cases, they are required to purchase new inventory at the currently prevailing higher prices.

TABLE 34.—EXPENDITURES FOR NEW PLANT AND EQUIPMENT BY U.S. BUSINESS,¹ 1973-75

(Dollar amounts in billions)

	1973	1974 ²	1975 ³	Percent change	
				1973-74	1974-75
All industries.....	\$99.74	\$111.92	\$117.09	12.2	4.6
Manufacturing.....	38.01	45.80	49.92	20.5	9.0
Durable goods.....	19.25	22.67	23.08	17.7	1.8
Primary metals ⁴	3.43	4.80	5.50	40.4	14.4
Blast furnace, steel works.....	1.38	2.03	2.55	46.6	25.8
Nonferrous.....	1.67	2.29	2.41	37.2	5.3
Electrical machinery.....	2.84	3.06	2.88	7.7	-6.0
Machinery, except electrical.....	3.42	4.26	4.62	24.8	8.4
Transportation equipment ⁴	3.12	3.83	3.51	22.8	-8.3
Motor vehicles.....	2.28	2.81	2.57	23.1	-8.5
Aircraft.....	.53	.77	.69	43.4	-10.3
Stone, clay, and glass.....	1.49	1.48	1.36	-.3	-8.1
Other durables.....	4.96	5.23	5.22	5.5	-.3
Nondurable goods.....	18.76	23.13	26.83	23.3	16.0
Food including beverage.....	3.11	3.21	3.20	3.1	-.3
Textile.....	.77	.85	.70	10.8	-17.1
Paper.....	1.86	2.55	2.90	37.0	14.1
Chemical.....	4.46	5.63	7.16	26.3	27.2
Petroleum.....	5.45	7.87	10.07	44.3	28.0
Rubber.....	1.56	1.48	1.38	-5.4	-6.6
Other nondurables.....	1.56	1.55	1.43	-.4	-8.2
Nonmanufacturing.....	61.73	66.12	67.17	7.1	1.6
Mining.....	2.74	3.10	3.67	13.2	18.6
Railroad.....	1.96	2.48	3.17	26.5	27.7
Air transportation.....	2.41	1.97	1.78	-18.2	-9.6
Other transportation.....	1.66	2.03	2.34	22.5	14.9
Public utilities.....	18.71	20.60	21.46	10.7	4.2
Electric.....	15.94	17.65	17.87	10.7	1.2
Gas and other.....	2.76	2.95	3.60	6.6	21.9
Communication, commercial and other ⁵	34.26	35.94	34.75	4.9	-3.3

¹ Data exclude expenditures of agricultural business; real estate operators; medical, legal, educational, and cultural services; and nonprofit organizations.

² Preliminary.

³ Estimates are based on expected capital expenditures reported by business in late November and December 1974. The estimates for 1975 have been adjusted when necessary for systematic biases in expectations data.

⁴ Includes data not shown separately.

⁵ Includes trade, service, construction, finance, and insurance.

Note: Details may not add to totals because of rounding.

Source: U.S. Department of Commerce, Bureau of Economic Analysis.

Public Utilities.—In addition to the problems affecting industry generally, public utilities are adversely affected for a number of reasons that are peculiar to the industry. These reasons led the committee to provide an increase in the investment credit for public utilities in both the comprehensive tax reform bill the committee considered last year and the Energy Tax and Individual Relief Act of 1974 (H.R. 17488) which the committee reported out last November.

The lower investment credit was given for public utilities because regulatory agencies presumably consider requirements when deciding on changes in rate levels. Moreover, it was believed that the volume of investments made by regulated public utilities would be determined in large part by the growth of other industries, rather than their own. In addition, much of the benefit to regulated utilities was viewed as likely to be passed on in lower rates to consumers, thus offsetting much of the stimulus to investment.

In the past several years, a number of changes in the economic environment have in combination seriously reduced the ability of regulated public utilities to obtain capital funds. Some utility regulatory commissions have been slow to increase rates to cover increased fuel costs and inflation induced increases in other operating costs. These factors taken together have reduced the internal cash flow available to utilities to self-finance expansion in productive capacity.

External financing also has been restricted recently. The aggregate book value of public utility common stock presently exceeds by a substantial margin its aggregate market value because of the severely depressed level of stock market prices. Debt financing is a limited alternative because many utilities have reached as high a debt-equity ratio as is practicable in view of the level of fixed obligations reached. In addition, long-term interest rates applicable to public utility bonds are so high that few public utilities dare to commit themselves to elevated fixed debt charges for long periods of time.

In considering this issue previously, the committee was concerned that the economic growth of other industries would be restricted in several years because more and more public utility companies now are announcing deferrals of capital construction plans. Timely growth by other industries requires that utilities have available sufficient capacity to meet additional demand. As a result, the reasons for providing only a partial investment tax credit no longer are viable.

In addition, many public utilities currently have below normal net taxable earnings and, thus, do not receive the full benefit of the investment credits because of the applicable limitations. As a result, the administration has recommended an increase in the 50-percent net income limitation (which applies to tax liability in excess of \$25,000) for a temporary period to allow these utilities to use more of their investment tax credit against taxes during this period.

The estimated revenue going to public utilities under the administration proposal is about \$1 billion out of the \$4 billion total cost of increasing the credit to 12 percent on a temporary basis.

TABLE 35.—INVESTMENT CREDIT CLAIMED IN 1972: BY SELECTED INDUSTRIES ON CORPORATION RETURNS AND TOTAL ON INDIVIDUAL RETURNS

[Amounts in millions of dollars]

	Investment credit claimed	
	Amount	As percent of all corporate investment credit
Corporate:		
Total, all industries.....	\$2,956	100.0
Agriculture, forestry and fisheries.....	22	.7
Mining, hard minerals.....	24	.8
Crude petroleum, natural gas and petroleum refining.....	151	5.1
Contract construction.....	74	2.5
Manufacturing other than petroleum refining:		
Food and kindred products.....	115	3.9
Chemicals and allied products.....	173	5.9
Primary metal industries.....	90	3.0
Machinery except electrical.....	96	3.2
Electrical equipment and supplies.....	116	3.9
Motor vehicles and equipment.....	125	4.2
All other manufacturing.....	481	16.3
Transportation.....	211	7.1
Communication.....	374	12.7
Electric, gas and sanitary services.....	372	12.6
Trade.....	258	8.7
Finance, insurance, and real estate.....	171	5.8
Services.....	103	3.5
Individual:		
Total, individual.....	700	
Grand total, corporate and individual.....	3,656	

Source: Preliminary Statistics of Income, 1972: Corporation Income Tax Returns; and Individual Income Tax Returns, Department of the Treasury, Internal Revenue Service.

The expected use of the higher investment credit by various industries is suggested by the amount of investment credit actually claimed in the past. Table 35 shows the investment credit claimed in 1972, the latest year available. Obviously the expected results would differ somewhat from the credits claimed in 1972. For example, motor vehicles would probably get less and petroleum and gas more, but the general pattern would remain much the same.

Alternative Proposals.—The Administration has proposed a temporary increase to 12 percent in the investment credit in order to provide immediate stimulus to additional investment. There are several aspects of this that the committee may wish to consider. In evaluating the Administration's recommendation in the 1971 Act, the committee rejected a similar proposal to increase the investment credit to 10 percent on a temporary basis. This was done on the grounds that a temporary increase in the credit might be disruptive in that it would move additional investment into the year of the higher credit but at the cost of having a sharp dropoff in investment the subsequent year, and this would be excessively destabilizing. On the other hand, the Administration might well repeat its recommendation for a permanent increase in the investment credit to 10 percent later this year when the committee again considers tax reform.

The committee might, as an alternative, wish to consider increasing the investment credit to 10 percent on a permanent basis at this time.

The Administration also proposed a January 1 effective date for its investment credit increase. The committee has agreed that the effective

date is to be January 22, 1975 (or possibly an earlier date). That is, property placed in service after this date is to be eligible for the new rules.

An increase in the investment credit to 10 percent would result in a revenue loss of \$2.7 billion annually assuming a January 22 effective date.

A modification of the administration's proposal for utilities, which the committee might consider in conjunction with a 10-percent investment credit, would focus on the profit squeeze of utilities by increasing the 50 percent of tax limit to 100 percent rather than to 75 percent as proposed by the administration. This would increase the revenue cost of a 10-percent credit by \$50 million, to a total of approximately \$2.8 billion, of which utilities would receive about \$900 million.

Another aspect of the administration's proposal the committee may wish to consider is the proposed availability of the credit for construction, reconstruction or erection of eligible property during 1975 regardless of when the property is placed in service. This is a significant change from present law which provides the credit only when property is placed in service. This change would make the credit more like "progress payments" on contracts. Such a change in the credit would remove one of the objections to a "two-tier" credit, namely, that it discriminates against long lead time items which would not be completed during the period the higher credit was in effect. Greater production of these items would, therefore, not be encouraged by a temporary increase in the credit unless some provision of the type proposed by the administration were adopted. However, if the committee does not agree to a two-tier credit (as by providing a permanent increase to 10 percent), then this "progress payments" approach is less significant in terms of stimulus effect.

B. Corporate Tax Rate Reductions

Present law.—Under present law, corporate income is subject to a normal tax at a rate of 22 percent and a surtax at a rate of 26 percent (for a total tax rate of 48 percent). However, the first \$25,000 of corporate income is exempt from the surtax. In effect, then, the first \$25,000 of corporate income is taxed at the rate of 22 percent and the income in excess of \$25,000 is taxed at a 48 percent rate.

Administration proposal.—The administration in connection with its energy package (but not its temporary anti-recession package has proposed to reduce the corporate tax rate from 48 percent to 42 percent effective for 1975 and thereafter. It would accomplish this by reducing the surtax rate from 26 percent to 20 percent. Under the proposal, the first \$25,000 of corporate income would continue to be taxed at the rate of 22 percent, but the income in excess of \$25,000 would be taxed at the reduced rate of 42 percent.

Revenue effect

The administration estimates that this rate reduction represents an annual revenue loss of \$6 billion.

Staff analysis

It has been argued that business needs a permanent form of tax relief to offset the rising cost of energy and to increase the amount of

capital available to business for reinvestment. Such investment, in turn, may increase productivity and reduce unemployment. It has also been argued that real corporate profits have been declining in recent years, and that the inflated value of inventories on corporate books and the use of historical cost depreciation have produced paper profits which are taxed to corporations without increasing the actual profits which are available for investment or distribution to shareholders. On the other hand, the fact that corporations are net debtors means that the real value, and hence the real burden, of their outstanding debt decreases during a period of inflation. This reduction of the real burden of corporate debt for corporations substantially offsets the "overstatement" of corporate profits resulting from historical cost depreciation and the taxation of inventory profits.

If funds are available to reduce corporate taxes, it might well be that a better use of these funds would be to begin the integration of the individual and corporate rate structures. This could be done by allowing a deduction for dividends paid, or by giving the shareholder a credit for the tax paid on the dividend he receives by the corporation (increasing the amount treated as a dividend for this purpose by the amount of this tax), or by extending the use of the partnership method which presently is available in the case of subchapter S corporations with 10 or fewer shareholders to corporations more widely held. Any of these techniques could be implemented to a limited degree depending upon the revenue available for this purpose. European countries have developed integration plans along this line to reduce the impact of the tax at the corporate level and have used them much more extensively than has the United States. Such changes, however, probably would require considerably more time for consideration by the committee than is available for this bill.

Another problem with the administration proposal is that much of the value of the tax reduction, which will cost an estimated \$6 billion annually, will be concentrated in the hands of large corporations. For example, the administration proposal in this area would afford no relief at all to small businesses, especially those which have taxable income of \$25,000 or less. Moreover, under the administration proposal, the corporations which have the largest profits would receive the most relief. Many would argue that the need of small business for tax relief is even more critical, since small businesses have little control over the marketplace and are hit even harder by such factors as inflation and a reduction in consumer confidence than are large businesses.

Alternative proposals.—One method of reducing corporate tax liability, while concentrating much of the relief in the area of small business, would be to increase the surtax exemption. For example, the present \$25,000 exemption might be increased to \$35,000, which would mean that the first \$35,000 of corporate taxable income would be taxed at a rate of 22 percent, while any additional corporate income would be taxed at a 48 percent rate, as under present law. This would result in an annual tax savings of \$2,600 for a corporation having \$35,000 or more of taxable income. Under present law the tax on \$35,000 of taxable income is \$10,300 (22 percent of the first \$25,000 of income, plus 48 percent of the remaining \$10,000); under this alternative proposal the tax would be \$7,700 (22 percent of \$35,000).

On the other hand, a corporation with \$35,000 of taxable income would receive only \$600 of tax relief under the administration pro-

posal (due to the decrease of 6 percent in the surtax). Of course, a large corporation which had substantial profits would receive far more relief under the administration proposal, than under the alternative proposal, because the 6 percent rate reduction would apply to a very large base of corporate income.

It is estimated that the revenue effect of increasing the surtax exemption by \$10,000 would be an annual revenue loss of \$600 million. Of this approximately \$400 million, or about two-thirds of the revenue, would go to small businesses.¹ In contrast, of the \$6 billion revenue loss from the reduction in the corporate rate to 42 percent proposed by the administration, 5 percent would go to small businesses.

If the surtax exemptions were increased to \$50,000, this would result in a revenue loss of \$1.2 billion, of which \$730 million, or about 60 percent, would go to small business.

It should be recognized that an increase in the surtax exemption level from \$25,000 to \$35,000 would not afford any relief to very small businesses (those with incomes of \$25,000 or less). However, these small businesses are already taxed at the lower normal tax rate of 22 percent. The above proposal extends the 22-percent rate to a higher level of income. If the committee is interested in providing some relief for those small businesses with incomes of \$25,000 or less, one method would be to reduce the normal tax rate, that is, the 22-percent rate. It is estimated, for example, that to reduce the normal tax rate by one percentage point would result in an annual revenue loss of about \$900 million; a reduction in the normal tax rate of 2 percentage points would approximately double this loss to \$1.8 billion. If the committee were interested in this approach, the loss could be offset to a large extent by a corresponding increase in the surtax rate.

C. Dividend Reinvestment Plans of Public Utilities

Present law.—Generally under present law a distribution of a stock dividend is a mere readjustment of the stockholders' interest in the corporation and is not income to the stockholder. No corporate assets are paid out, and the distribution merely gives each stockholder more pieces of paper to represent the same interest in the corporation. On the other hand, if a corporation declares a dividend payable at the election of each stockholder, either in additional common stock or in cash, the stockholder who receives a stock dividend is in the same position as if he received a taxable cash dividend and purchased additional stock with the proceeds and thus is taxed currently on the value of the stock received.

Administration proposal.—None.

Alternative proposal.—Public utility stock is quite commonly held by stockholders who are looking for a relatively safe and large return on investment. Utilities generally have been able to pay annual dividends due to the return on investment which is generally permitted by the State or Federal rate-making agency. At the present time, however, utilities have been faced with the dilemma of obtaining capital for modernization and yet paying the cash dividends which many of its stockholders have come to expect. One way for a utility to obtain new capital is to issue new stock. Many potential investors, however, will not subscribe to such an issue because of new doubts con-

¹ Small businesses are defined for this purpose as businesses having \$100,000 or less of income.

cerning utilities' ability to pay dividends. A second way to obtain capital is to encourage those existing investors who do not need cash dividends to take additional shares of stock in lieu of cash by means of a stock reinvestment plan. However, the current taxation of those shareholders who elect to take stock rather than cash tends to discourage shareholders from exercising their election to take stock in lieu of cash.

One means of facilitating stock reinvestment plans for public utilities is to provide that a distribution of stock of a regulated public utility pursuant to a dividend reinvestment plan is not to be subject to tax until the stock is disposed of. Under a qualified reinvestment plan, the stockholders of the public utility who so elect would receive a distribution of stock of the public utility specifically designated as stock issued under a qualified reinvestment plan. This distribution of stock would not be taxed to the stockholder until the time that the stock is disposed of. At that time the stockholder would have dividend income equal to the amount which was deferred (i.e., the fair market value of the stock at the time it was received). Any proceeds from the disposition in excess of that amount would be capital gain.

D. Net Operating Loss Carrybacks and Carryovers

Present law.—Present law, in general, provides that a taxpayer is allowed to carry a net operating loss back as a deduction against income for the 3 years preceding the year in which the loss occurred and to carry any remaining unused losses over to the 5 years following the loss year. This general rule enables taxpayers to balance out income and loss years over a moving 9 year cycle, to the extent of taxable income in the 3 years preceding and the 5 years following any loss year.

Present law also provides exceptions to the general three year carryback-five year carryover rule in the case of certain industries or categories of taxpayers, as indicated in chart 1. One exception allows certain regulated transportation corporations to carry back and deduct net operating losses for the usual 3 years and to carry over such losses for 7 years. Another exception prohibits the carryback of a net operating loss to the extent the net operating loss was attributable to a foreign expropriation loss. However, a 10-year carryover period is allowed for the foreign expropriation loss (15 years in the case of a Cuban expropriation loss). A third exception, applicable to financial institutions for taxable years beginning after December 31, 1975, will lengthen the carryback period for net operating losses to 10 years and allow the usual 5-year carryover period. Similarly, a bank for cooperatives is presently allowed to carry net operating losses back for 10 years and forward for 5 years. A fourth exception is provided for taxpayers which have incurred net operating losses resulting from increased imports of competing products under trade concessions made pursuant to the Trade Expansion Act of 1962. Where a taxpayer has elected to obtain certification as provided by this Act, it is allowed a 5-year carryback period and the usual 5-year carryover period. Finally, present law also contains a provision designed for American Motors Corporation permitting a 5-year carryback period and a carry-

over period of 3 years for losses incurred for taxable years ending after December 31, 1966, and prior to January 1, 1969.

Administration proposal.—None.

Alternative proposals.—In addition to providing exceptions to the general rule concerning the carryback and carryover of net operating losses, the Congress has from time to time altered the general rule itself to reflect circumstances which apply to all taxpayers. The current economic situation raises the possibility that a considerable number of taxpayers subject to the general rule will have net operating losses so large as to exceed not only total income from the 3 years preceding the loss year but also income anticipated for the 5 years following the loss. These taxpayers, unlike others which have had more success in resisting the effects of the present economic downturn, are placed in the disadvantageous position of being unable to obtain the full benefit of their current losses by application against income earned during other years in the 9-year cycle. A lengthening of the general carryback period will provide many of these taxpayers with needed near-term funds through income tax refunds generated by the carryback of current losses. Even in the case of those taxpayers who can anticipate profit years in the near future, a lengthening of the general carryback would generate near-term funds through such refunds, which may be expected to be of greater value than the prospect of funds generated by deductions of carryovers to future years. In such cases, a current revenue loss may be expected to be offset by increased future revenues, because the net operating losses deducted as current carrybacks would not be available for deductions as carryovers in the future years.

Two proposals are outlined which would allow taxpayers to use lengthened carryback or carryover periods:

(1) One proposal would permit each taxpayer to elect a 10-year carryback period instead of the present general rule of 3 years carryback and 5 years carryover. In the case of a taxpayer which has been in business for less than 10 years, this proposal would provide for a moving 11-year cycle during the taxpayer's first 10 years so that during the first year of operations, the taxpayer would be entitled to carry its loss forward for 10 years; in its second year, it would have a one-year carryback and 9-year carryover; and so forth until, after it has concluded its tenth year of operations, the taxpayer would have a 10-year loss carryback and no carryover.

The taxpayer would be permitted to elect the 10-year carryback, but could return to the general rule (3 years back and 5 years forward) only upon compliance with appropriate requirements of the Internal Revenue Service to prevent abuse and to facilitate administration of the provision. If this approach is to be made generally available, then it may be necessary to strengthen existing provisions of law which are intended to prevent trafficking in net operating losses. Assuming that 1974 is the first year losses from which are affected by this provision, the increase in refunds by the Treasury in 1975 is estimated at 500 million or more. If losses incurred since 1970 are affected by the provision, the increase in refunds by the Treasury during 1975 is estimated at \$1 billion or more.

(2) Another possible means of using the net operating loss carryback and carryover provisions to address the current economic difficulties is to provide additional exceptions to the general rule to aid specific classes or groups of taxpayers for which current economic hardships are particularly severe. (See chart 1, which presents various rules already in the code for certain types of taxpayers.) Several statutory remedies have been suggested in this area:

(a) One proposal is to provide for a 10-year loss carryback with no carryforward for losses incurred in years beginning after December 31, 1969, and ending before January 1, 1972. This proposed amendment would apply only to domestic corporations which are regulated air transportation companies engaged in providing both domestic and international air transportation and which meet certain other criteria. The estimated revenue effect of this proposal is a loss of \$40 million.

(b) One taxpayer has proposed that it be allowed a special 10-year carryback of the net operating loss it incurred in 1973. This proposal would lengthen the carryback period solely for this one loss year and would not affect future years. The revenue cost of this proposal is \$65 million.

(c) Another suggested exception to the general rule would provide for a 10-year carryback only for those taxpayers which are in extreme present financial distress. It would be necessary in this situation to formulate some type of objective standards so that the qualification of a taxpayer for this exception could be readily ascertained.

Bank for Cooperatives

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(2) The table set forth below is to be substituted for Table 33 on page 30 of the pamphlet.

TABLE 33—ESTIMATED DECREASE IN FEDERAL INDIVIDUAL INCOME TAX LIABILITY RESULTING FROM INCREASING THE PERSONAL EXEMPTION DEDUCTION FROM \$750 TO \$350, BY ADJUSTED GROSS INCOME CLASS, 1974 INCOME LEVELS

Adjusted gross income class	Number of returns affected (thousands)		Decrease in tax liability	
	Total number with the decrease	Number with contaxable	Amount (millions)	Percent of total decrease
0 to \$3,000	4,037	625	\$37	1.4
\$3,000 to \$5,000	7,579	274	175	4.4
\$5,000 to \$7,000	8,273	195	272	5.9
\$7,000 to \$10,000	11,423	152	537	13.5
\$10,000 to \$15,000	15,937	50	1,011	23.5
\$15,000 to \$20,000	9,635	8	791	17.9
\$20,000 to \$50,000	9,005	2	520	12.2
\$50,000 to \$100,000	655	(1)	123	3.2
\$100,000 and over	180	(1)	35	.9
Total	66,555	1,307	3,957	100.0

1 Less than 50 returns.

Note: Details may not add to totals because of rounding.

CHANGES IN TABLES IN PAMPHLET OF STAFF ANALYSIS OF
TAX CUT RECOMMENDATIONS

(1) Tables 26 and 27 referred to on page 27 of the pamphlet are set forth below.

TABLE 26--ESTIMATED DECREASE IN FEDERAL INDIVIDUAL INCOME TAX LIABILITY RESULTING FROM GRANTING A \$225 OPTIONAL TAX CREDIT IN LIEU OF THE PRESENT \$120 PERSONAL EXEMPTION DEDUCTION, BY ADJUSTED GROSS INCOME CLASS, 1974 INCOME LEVELS

Adjusted gross income class	Number of returns affected (Thousands)		Decrease in tax liability Amount (millions)		Percent of total decrease
	Total number with tax decrease	Number with nonrefundable	Amount with tax decrease	total decrease	
0 to \$3,000	4,037	2,231	\$292	752	2.5
\$3,000 to \$5,000	7,579	2,119	712	1,019	7.9
\$5,000 to \$7,000	8,273	1,707	1,107	1,407	11.5
\$7,000 to \$10,000	11,528	1,327	2,045	2,445	21.3
\$10,000 to \$15,000	11,528	937	1,557	1,712	17.5
\$15,000 to \$20,000	9,477	58	1,557	1,557	17.5
\$20,000 to \$25,000	5,145	4	501	501	5.3
\$25,000 to \$50,000	5	1	1	1	(1)
\$50,000 to \$100,000	1	(1)	(1)	(1)	(1)
\$100,000 and over	1	(1)	(1)	(1)	(1)
Total	61,221	9,133	9,559	10,000	100.0

1 Less than \$50 returns, \$50,000, or 0.05 percent.

Note: Details may not add to totals because of rounding.

TABLE 27--ESTIMATED DECREASE IN FEDERAL INDIVIDUAL INCOME TAX LIABILITY RESULTING FROM GRANTING A \$200 OPTIONAL TAX CREDIT IN LIEU OF THE PRESENT \$120 PERSONAL EXEMPTION DEDUCTION, BY ADJUSTED GROSS INCOME CLASS, 1974 INCOME LEVELS

Adjusted gross income class	Number of returns affected (Thousands)		Decrease in tax liability Amount (millions)		Percent of total decrease
	Total number with tax decrease	Number with nonrefundable	Amount with tax decrease	total decrease	
0 to \$3,000	4,037	2,231	\$352	752	1.9
\$3,000 to \$5,000	6,279	2,032	546	1,019	10.2
\$5,000 to \$7,000	11,423	1,615	2,591	1,917	19.7
\$7,000 to \$10,000	15,982	765	4,455	3,132	31.8
\$10,000 to \$15,000	9,025	69	2,621	1,822	18.2
\$15,000 to \$20,000	6,595	1	1,621	1,621	16.2
\$20,000 to \$50,000	1	1	1	1	(1)
\$50,000 and over	1	(1)	(1)	(1)	(1)
Total	65,595	11,122	13,162	10,000	100.0

1 Less than \$50 returns, \$50,000, or 0.05 percent.

Note: Details may not add to totals because of rounding.

(2) The table set forth below is to be substituted for Table 33 on page 30 of the pamphlet.

TABLE 33--ESTIMATED DECREASE IN FEDERAL INDIVIDUAL INCOME TAX LIABILITY RESULTING FROM INCREASING THE PERSONAL EXEMPTION DEDUCTION FROM \$120 TO \$150, BY ADJUSTED GROSS INCOME CLASS, 1974 INCOME LEVELS

Adjusted gross income class	Number of returns affected (Thousands)		Decrease in tax liability Amount (millions)		Percent of total decrease
	Total number with tax decrease	Number with nonrefundable	Amount with tax decrease	total decrease	
0 to \$3,000	4,037	2,231	\$37	102	1.4
\$3,000 to \$5,000	7,579	2,119	71	102	4.6
\$5,000 to \$7,000	11,423	132	537	537	13.5
\$7,000 to \$10,000	15,982	53	1,011	1,011	25.5
\$10,000 to \$15,000	9,025	8	591	591	14.8
\$15,000 to \$20,000	6,595	8	423	423	10.6
\$20,000 to \$50,000	1	(1)	123	123	3.2
\$50,000 and over	1	(1)	35	35	.9
Total	65,595	11,307	3,967	4,000	100.0

1 Less than \$20 returns.

Note: Details may not add to totals because of rounding.

