Tax Justice Act of 1975

An Explanation and Summary

National Committee for Tax Justice, 1609 Conn. Ave., Wash. D.C. 20009

THE TAX JUSTICE ACT OF 1975

WHAT IS THE TAX JUSTICE ACT?

The Tax Justice Act of 1975 (TJA) is a proposal to reform the Federal tax system by closing all the loopholes that allow wealthy individuals and corporations to avoid paying their fair share.

By ending the billions of dollars worth of loopholes in our current tax laws, the TJA will make it possible to cut taxes substantially for the majority of Americans -- those with low and moderate incomes.

WHAT LOOPHOLES ARE CLOSED BY THE TAX JUSTICE ACT?

Among the many loopholes that the TJA would close are: the special treatment of capital gains; the Oil Depletion Allowance and other oil industry tax breaks; rapid depreciation of business machinery and real estate; foreign investment loopholes; tax-free state and municipal bonds; the 10 percent Investment Tax Credit; "tax-loss farming"; and others.

These tax preferences cost the Federal treasury tens of billions of dollars every year -- dollars that are made up by higher taxes on those of us who are not wealthy enough to take advantage of them.

WHO WROTE THE TAX JUSTICE ACT?

The TJA is unique because it was written by ordinary citizens, with the help of some of the nation's leading tax experts. Its provisions were hammered out by representatives of grassroots tax reform organizations from across the country, working with lawyers and economists from the Public Citizen Tax Reform Research Group and Taxation with Representation, a public interest organization of professional tax experts. Together these groups form the National Committee for Tax Justice (NCTJ).

HOW WILL THE TAX JUSTICE ACT BE INTRODUCED?

NCTJ members with many other local organizations are now working to get members of Congress to co-sponsor the Tax Justice Act. We hope to have it introduced sometime this spring. The introduction will be accompanied by a national conference of NCTJ members and other supporting organizations in Washington to discuss strategies for getting the TJA passed.

CAN THE TAX JUSTICE ACT BE PASSED THIS YEAR?

We do not expect the Congress to pass the whole TJA in one year. Tax reform has been on the back burner for many years, and still faces stiff opposition from vested political and corporate interests even in this year's

activist Congress. Closing all the loopholes will take a great deal of public education, organization, and grassroots lobbying. The TJA will serve as our "People's Program for Tax Justice" -- to measure our successes and to show the politicians what concerned citizens mean by real tax reform. However, we do expect that several provisions of the TJA will be won in 1975.

WHAT CAN OUR ORGANIZATION DO?

First, formally endorse the TJA. Then get your congressperson(s) to co-sponsor and support the bill when it is introduced in Congress this spring. Form a tax justice committee to educate your members and others about the need for basic tax reform and the TJA in particular. Work in coalition with other groups. Hold tax justice hearings, run petition and letter writing campaigns, have speakers to talk to other organizations.

For more information write the National Committee for Tax Justice
1609 Connecticut Avenue, N.W., Washington, D.C. 20009.

BRIEF SUMMARY OF THE TAX JUSTICE ACT

CAPITAL GAINS AND LOSSES

Capital Gains. Under the present tax code, one half of the gain made on the sale of a capital asset (stocks, real estate, machinery or equipment) which has been held over six months, is deducted from gross income and is therefore never taxed. Special treatment of capital gains is the largest single loophole in the tax system, costing the Treasury about $7 billion per year in lost revenues. Most of the benefits of this massive expenditure go to wealthy taxpayers, with 94 percent going to those with incomes over $10,000. In 1972 those with incomes over $100,000 saved an average of $39,168.49 -- more than 2,601 times as much as the family earning between $7,000 - $10,000 who saved an average of only $15.57; and more than 911 times as much as the average wage earner making between $15,000 - $20,000 who saved an average of $43.72. Statistics show that 78 percent of adults don't even own stock at all.

The TAX JUSTICE ACT (TJA) eliminates this special treatment of capital gains by treating the income the same way as ordinary income is treated.

The TJA would allow taxpayers on capital gains to avoid the problem of "bunching" -- that is of paying the tax all at once when the asset is sold which could produce such a large single piece of income that the taxpayer would be pushed into the higher brackets. *In the TJA the taxpayer could choose to pay the tax on the appreciation (increase in value) each year at the taxpayer's regular rate.* Thus the taxpayer would have the option to report as income the amount by which the value of the asset has increased and pay tax on it that year. When the asset is sold, only the last year's appreciation would be taxed.

For example, a $100 asset which is appreciating 5 percent per year would be worth $125 after five years. The taxpayer could choose to pay tax on that $25 of capital gains in one lump sum when the asset is sold after five years or pay tax on the $5 each year. This plan puts inflationary capital gains on the same footing as inflationary wage increases -- it doesn't compensate capital asset holders for losses in real value due to inflation, but neither does the tax code compensate wage earners for inflationary losses in their buying power.

Capital Losses. Currently long term capital losses can be deducted only from long term capital gains. Since only half the gain is now taxed, only half the loss is, in effect, deducted. *The TJA would make capital losses fully deductible from ordinary income.*

Capital Assets Transferred at Death. Now capital gains are taxed when the asset is sold or transferred. If, for example, a person buys stock for $100 and sells it five years later for $150, she/he would pay taxes on one half the profit or $25. However, if the owner dies before selling the stock, the heir would receive the $150 asset and would pay no tax at all. If the new heir sold

the stock for $150, she/he would pay no tax. If the heir holds the asset and does not sell, then the entire gain of $50 escapes all taxation (generation carryover) and the next generation could inherit the $150 plus its new value, say of $200, tax free and so on, collecting dividends all the while. This costs the Treasury $3 billion a year.

The TJA requires that tax on the accumulated gain be paid by the owner before the asset is transferred to the heirs. Several exceptions to this general rule are made to avoid working a hardship in certain situations: (a) Transfers at death to the surviving spouse will not be taxed. Instead, the value of the property will retain its original value (basis) when it is carried over to the inheriting spouse. The gain will therefore, be taxed eventually when it passes to the next generation, but not until both of the spouses (in effect joint owners) have died. (b) There shall be a lifetime exemption of $25,000 of the gain realized on a family home, business or farm which is allowed to the owner's estate. This is to avoid forced sales of those basic family assets to pay the tax. (c) The income tax would be allowed as a deduction in determining the taxable estate for estate tax purposes, so that the estate will not have to pay a tax on a tax.

CORPORATE TAXES

The corporate tax rate of 48 percent is a myth. As Table I shows, few companies pay at that rate. In 1973 commercial banks and oil companies enjoyed the lightest corporate tax burden. Twelve major commercial banks, much of whose tax benefits come from tax exempt municipal bond interest and foreign tax credits averaged a 3.6 percent tax rate. The six oil companies among the 15 largest industrial firms on Fortune Magazine's annual list, paid taxes at an average rate of 6.3 percent.

As corporations pay less than their share, the tax burden shifts more and more to low and middle-income taxpayers. Corporate income tax payments, as a percentage of federal revenue receipts, have declined from 33.6 percent in 1944, to 20.9 percent in 1964, to an estimated 14.6 percent in 1974. In contrast, individual income tax payments rose from 48.5 percent in 1944, to 62.7 percent in 1964, to an estimated 73.9 percent in 1974. Business and industry lower their tax burden by taking advantage of many corporate tax privileges on both foreign and domestic income. *The TJA, as explained in the following pages, will eliminate most of the special considerations for corporations.*

BUSINESS TAX SUBSIDIES

Investment Tax Credit. *The TJA repeals the investment tax credit which now allows a company to reduce its tax bill dollar for dollar by an amount equal to 10 percent of any investments in new machinery.* This credit, which costs the Treasury over $4 billion per year, was enacted in 1971 to stimulate a sagging economy and to cut the unemployment rate. In fact it has not achieved its purpose.

TABLE I

CORPORATE FEDERAL TAX BURDEN ON MAJOR COMPANIES IN SELECTED INDUSTRIES

All figures are percentages of 1973 pre-tax financial income[1]

INDUSTRY	NO. OF COMPANIES	AVER. U.S. TAX RATES ON WORLD-WIDE INCOME[2]	TOTAL WORLD-WIDE RATE ON WORLD-WIDE INCOME	HIGH COMPANIES	LOW COMPANIES
Fortune Magazine					
15 largest companies	15	15.7%	--	40.2%	0.9%
9 largest non-oil	9	22.0	--	40.2	2.8
6 largest oil	6	6.3	--	19.8	0.9
Chemical Companies	12	24.4	35.2	36.8	15.0
Commercial Banks	12	3.6	16.1	18.2	(19.3)[3]
Conglomerates	10	24.5	29.3	43.4	4.6
Drug Companies	12	22.1	36.7	32.5	7.3
Electronic Firms	11	33.7	41.2	49.1	6.5
Food Processors	10	28.4	41.5	39.0	12.3
Metals & Mining	10	17.3	25.5	33.6	(2.1)
Oil (excluding those in top 15)	10	11.5	37.0[4]	25.0	0.6
Retailers	11	29.4	33.5	41.2	0.5
Steel Companies	13	32.7	39.9	42.5	13.2
Timber Firms	10	32.2	40.9	43.4	24.4
Trucks & Equipment	10	31.8	39.1	44.3	22.9

[1] *The base figure for the computations summarized in the table is net earnings before federal income taxes. This base figure is derived by reducing the net earnings before income taxes, as shown on a firm's income statement, by the provision for state income taxes. This is done because state income taxes are merely another deduction for purposes of federal income taxes.*

[2] *The industry figures are unweighted for size. They are simple arithmetic averages of the effective rates for the companies in each industry and thus are not precise industry averages.*

[3] *These negative figures represent sufficient tax write-offs to completely avoid taxes in 1973. The surplus will further reduce taxes in 1974.*

[4] *These figures include payments by oil and gas companies to foreign governments not generally recognized as true taxes.*

A company cannot increase its employment or its sales by using tax incentives to purchase new equipment when its existing equipment is already lying idle due to slack demand as is the present situation. Currently, industry is operating at about 80 percent of capacity. A great deal of this tax subsidy is wasted on replacing machinery which the company would have bought without the subsidy. Thus, an indeterminate portion of the $4 billion is used on routine replacement of worn out industrial equipment and does nothing at all to encourage the purchase of new equipment or the creation of new jobs. The investment tax credit is one of the major subsidies big business uses to either pay very low tax rates or in many instances to pay no taxes at all.

Asset Depreciation Range. *The TJA repeals the Asset Depreciation Range (ADR) enacted in 1971 which permits rapid depreciation of assets.* The tax code permits a business to deduct a reasonable amount for the exhaustion and wear of property (machines, equipment) used in the business for the production of income. The problem is how to determine what the actual life of the asset will be and over how many years the deductions should be spread. The shorter the life, the higher the deduction each year and that lowers taxes. When the tax deduction exceeds the actual depreciation of the equipment or asset, then the owner of the asset receives a tax subsidy on the difference.

In 1962, the Treasury issued guidelines for depreciation deductions which specified years over which different kinds of assets could be depreciated, called "guideline lives." In addition, a "ratio reserve test" was established which limited the depreciation claimed by the taxpayer to the actual wearing out time of the equipment. They could not depreciate it faster than they were actually replacing the equipment. The ADR system abolished the ratio reserve test and allowed the guideline lives to be shortened an arbitrary 20 percent which increases the deductions greatly. It is estimated that repeal of ADR will raise $4.2 billion in revenues per year.

Straight Line Depreciation on Real Estate. *The TJA limits deductions for depreciation of real estate to the straight line method.* The deductions are computed so that a fixed amount is deducted each year over the useful life of the asset, i.e., if the asset is worth $100,000 and will last for twenty years, the taxpayer deducts $5,000 a year for twenty years to make up for the loss of value. Other methods of computing depreciation on real property such as declining balance and sum-of-the-years digits, all permit initial deductions for amounts larger than the actual exhaustion and wear and tear on property. These methods all allow accelerated depreciation which results in a very large deduction during the earlier years of property and constitute a tax expenditure by the Treasury and a tax subsidy or an interest free loan to the owner or industry.

The TJA eliminates all forms of accelerated depreciation on real estate. It limits depreciation on real estate to the straight line method which is the one most commonly used both for tax purposes and for corporate accounting and is the easiest to compute and apply.

Farm Loss Limitation. *The TJA limits deductions from the gross income of an individual for losses incurred in the operation of a farm to the amount of income from farming plus $10,000 of any non-farm income. Any amount of a farm loss disallowed under this provision will be treated as an expense of farming in the following tax year.*

Farming has become a tax shelter because farmers can use the cash method of accounting for tax purposes which allows them to deduct the cost of their operations (feed, labor, pasturage, live stock) in the year these expenses are incurred. Under the usual (accrual) method of accounting the expenses are deducted from the profits, which usually would not be realized until the following years.

The great fluctuation of good and bad years underscores the need for this cash method for real farmers. But corporations and wealthy individuals invest in farming ventures in order to use the accounting losses to offset their non-farm income and thus reduce their taxes. No real farmer ever wants a bad year -- but tax-loss farmers plan on bad years for the larger deductions.

For the wealthy investor much of the loss, of course, is an artificial tax loss. The investor takes the deductions for the advance costs associated with growing a crop or raising livestock and creates an immediate tax loss which he/she uses to offset income earned from a profession thus lowering the taxes. The investor can then take the income realized for selling the cattle at a later time when his/her tax rate is lower. Also, when the investor sells his/her share of the investment, the profit is considered a capital gain and will be taxed at half the ordinary tax rates. The advantages of the cash method to the full time farmer are minimal since the costs and profits will offset each other in each year and average out over the years of ownership.

There are major disadvantages in tax loss farming aside from the loss of Treasury revenue, estimated to be more than $840 million. The advantages of farming investments favor the monopolies and conglomerates of agribusiness over the independent small family farmer. Small farmers have been going out of business at an alarming rate -- due in part to the disadvantage of competing with a huge farm industry whose owners are more interested in losses than crops.

Percentage Depletion, Intangible Drilling Costs, Etc. The oil industry receives several tax subsidies. The percentage depletion allowance was developed to compensate oil companies for using up, or depleting, their oil supplies. The allowance was, however, a very costly and inefficient subsidy of the oil industry and was therefore repealed, at least in part, by the Congress in the Tax Reduction Act of 1975. However, the so-called independents were exempted. Over a period of years, the "independent" exemption will be phased down to a deduction of 15 percent on the first 1000 barrels of oil per day. This exemption was thought necessary to enable the independents to remain competitive with the big oil companies. However, the independent oil companies are making a higher profit margin, (getting a greater price for their oil) due to price

controls and paying a lower tax rate than the major oil companies. Therefore independents are more than competitive with the majors. The exemption of independents will be expanded in practice to include an increasing percentage of domestic oil production and will cost at least $650 million in lost revenue in 1975. *The TJA repeals the percentage depletion allowance completely.*

The TJA also repeals the provisions which allow the oil and gas companies to expense, i.e., deduct immediately, etc.

The TJA also repeals the provisions which allow the oil and gas companies to deduct immediately, to expense, the intangible expenses (labor, supplies, etc.) of drilling a well instead of capitalizing them (deducting over several years.) These provisions have allowed 70 to 90 percent of the cost of each well to be expensed (immediately deducted as a business expense) instead of capitalized and depreciated over the life of the well as they would normally be. Expensing of intangibles cost the Treasury $650 million in 1972. Depletion and intangible drilling expense deductions will cost about $3 billion in 1975 -- an average of $40 per taxpayer.

These tax subsidies were supposed to cut the price of fuel and encourage exploration. Our present fuel shortage proves that claims of encouraging exploration and development to guarantee an adequate supply of oil and gas are obviously not true. Nor have the subsidies kept prices down. But they have helped lower the taxes oil and gas companies pay.

In 1973 Texas Gulf paid no income taxes at all while seven oil companies paid at extremely low rates: Occidental 1.8 percent, Texaco 2.3, Gulf 3.1, Standard Oil of Ohio 3.5, El Paso Natural Gas 4.5, Union of California 9.6, Continental 9.9. The corporate tax rate is supposed to be 48 percent.

Rapid Amortization of Certain Business Expenditures. *The TJA repeals a number of sections in the present tax code which allow several specific types of investments to be amortized over five years instead of depreciated over the life of the asset.* Under current law, rapid amortization can be used for certain pollution control facilities, mine safety equipment, railroad rolling stock, child care and on-the-job training facilities. By amortizing costs, companies can often take even larger deductions than ADR would permit, which defers or permanently reduces taxes and saves the company money. Rather than being subsidized by the Treasury, in order to artifically lower the price of the product such expenses should be reflected in the price of the product, so that consumers pay the true economic price for the goods they use.

The costs of research and development can be treated in several ways at the option of the corporate taxpayer. The expenses can be capitalized (and depreciated), amortized over five years, or deducted immediately as a business expense.

Since the corporation chooses which method is used, the timing can be arranged so that the deductions can most effectively offset any income from the research. This can result in huge initial deductions or smaller ones spread out over five years or over the life of the asset.

Option to Deduct Certain Expenditures. *The TJA eliminates the option of expensing the costs immediately and also repeals the amortization clauses so that research and development costs must be capitalized and deducted over the years the asset is used.*

FOREIGN SOURCE INCOME

Earnings of Overseas Subsidiaries. *The TJA ends the current tax treatment for earnings of foreign subsidiaries of domestic corporations which currently remain untaxed until brought into this country.* Under present law, these earnings are not taxed until they are distributed to the parent corporation in the U.S. This allows corporations to defer, and sometimes completely avoid, the tax by reinvesting the money overseas. These earnings are, however, considered assets of the U.S. parent company for other purposes such as credit and for reporting its income to shareholders.

The deferral or avoidance of tax is therefore an incentive to U.S. corporations to build factories and offices overseas instead of at home where they would provide jobs for American workers. *To end this situation, the TJA provides for the taxation on a current basis of the undistributed earnings of domestically controlled foreign corporations.*

Domestic International Sales Corporations (DISC). *The TJA repeals the provisions which created the DISC tax system.* DISCs are subsidiaries of American companies set up to export American-made products to foreign countries. The income from the DISCs is taxed at capital gains rates, one half the normal rates. Enacted in 1971, this tax subsidy was to encourage export of American goods.

Estimated to cost the Treasury $100 million in 1972 and $170 million in 1973 in lost revenues, these costs were actually $250 million and $500 million respectively and will cost about $13 billion in 1976. The devaluation of the American dollar acted to increase exports and there is little evidence that DISCs do more than favor very large corporations with tax subsidies for doing what they would have done anyway. Furthermore, the DISC provisions apply to anything produced in this country regardless of the fact that some of the products are scarce, such as farm products and that extensive exporting raises domestic prices. Thus the American consumer pays more for a product or food to compete with an export price that is subsidized by the same consumer's taxes. The 1975 Tax Reduction Act only eliminated DISC benefits for natural resource and energy products.

Foreign Tax Overall Limitation. The foreign tax credit is designed to prevent the double taxation of foreign business income but it is now used to shelter taxable income. The amount of foreign taxes which can be credited against American taxes is computed by one of two methods: on a country-by-country basis or on an overall basis. In both cases, the company is allowed to credit a proportionate amount of taxes paid to foreign countries against its U.S. tax bill depending on what portion of its total income came from foreign countries.

The per country limitaion computes the income percent and resulting tax credit separately for each country. The overall limitation combines all foreign income and all foreign taxes to find the amount of credit due.

This is an advantage for companies doing business in countries which have a high tax rate, since these high foreign taxes can be averaged out against another country's lower rate. The U.S. tax rate is 48 percent, so any foreign tax rate higher than that would not ordinarily be fully creditable against U.S. taxes. The overall limitation, therefore, is a shelter since it permits companies which have excess credits from one country (a country with a tax rate higher than 48 percent) to apply their excess credits to countries with tax rates lower than the U.S. rate. This not only gives those companies a competitive advantage in the second foreign country, but in effect, the high tax countries, rather than the U.S., collect taxes on the income earned in low tax countries. Thus U.S. taxpayers subsidize the over taxation of U.S. company revenue by high tax countries.

The 1975 Tax Cut bill limited the amount of excess credits oil companies can use but did not eliminate them.

The TJA repeals the overall limitation so that all foreign tax credits would be computed on a per country basis.

Royalties Treated as Income Tax. Since many foreign governments own the mineral assets of their countries, the fee that is paid by American companies for extracting the mineral, such as oil, goes to the foreign government rather than to individual property owners. As a result the fee can be called a tax and taken as a credit against U.S. taxes when in fact it is a royalty and should be treated as a deduction. The credit is subtracted dollar-for-dollar from the tax liability while the deduction is worth only 48 cents on the dollar in reducing U.S. taxes.

The oil industry receives most of the advantages of this situation. Most of the oil price increases, including the recent large ones, have been termed "taxes" by the oil companies and deducted from their U.S. tax liability. The effect has been to eliminate U.S. tax liability on foreign oil production and, for companies using the overall limitation (see preceding section), to generate tax credits used to offset potential U.S. tax liability for income from low tax countries. Excess tax credits generated from oil production, even after offsets under the overall limitation, were $931 million in 1971.

Internal Revenue Service rulings condone this practice. *The TJA deals with the problem in two ways: First, elimination of the overall limitation insures that tax credits from oil production can not be used to offset a tax liability generated in low tax countries. Second, the TJA gives the Secretary of the Treasury the authority to challenge any claim for a foreign tax credit, to examine corporate records and to disallow claims for payments that are in reality royalties. The Secretary is required to report annually so that Congress can further tighten the rules if it is necessary.*

Western Hemisphere Trade Corporations and Other Tax Subsidies to U.S. Possessions and Less Developed Countries. *The TJA repeals the 14 percent tax cut given to corporations doing business outside the U.S. in the Western Hemisphere.* The special provisions for Western Hemisphere Trade Corporations started in 1942 as an exemption from World War II excess profits tax since it was thought unfair to tax such companies who were not reaping war time profits. The exemption has continued (changing to the present 14 percent reduction after the war) since then with no justification. Currently it is little more than a device for cutting taxes for export subsidiaries of U.S. firms, costing about $200 million per year.

The TJA also repeals special tax breaks for U.S. corporations operating in U.S. possessions whose income is completely exempt from U.S. taxation. It further eliminates the special foreign tax treatment available to U.S. companies with subsidiaries operating in less developed countries.

ESTATE AND GIFT TAXES

Integration of the Estate and Gift Taxes. A major problem with the estate and gift tax systems is that they discriminate in favor of those who give away part of their estate before death and the rest after death, as against those who pass on all of their wealth at death. Since both taxes are progressive, the person who transfers property by both gift and bequest gets to start at the bottom of two progressive rate structures and pays less tax than if the gifts were combined and taxed all at once. For example, a person who makes inter vivos (lifetime) gifts of $3 million and leaves a $2 million estate will pay lower taxes than if the two sums were "stacked" and the $5 million taxed at one progressive rate.

The TJA integrates the estate tax rate with inter vivos gifts so that the tax brackets for property transferred at death are determined by the combined amount of inter vivos gifts and the estate. One tax rate would apply to all gifts made cumulatively over the lifetime of the donor and the gifts made at death. To compute the tax, the amount of the estate would be "grossed up", that is, the total amount of inter vivos gifts would be added as if made after death, a tax is then computed on that total. Then the tax is reduced by the gift taxes already paid when the inter vivos gifts were made. The final amount -- the tax less credit for taxes already paid -- will be the amount of the estate tax due.

Generation Skipping Trusts. *The TJA eliminates the so-called generation skipping trust, the most criticized abuse of the estate tax.* Frequently, by using the trust device wealthy individuals transfer property to their children and then to later generations and only pay the estate tax once, instead of paying it each time the estate is transferred.

The decedent can set up a trust before death for the grandchildren but provide that the income and the assets of the trust be used and enjoyed by the children, who are made the trustees, during their lifetime. When the children die, the trust terminates and the remaining money is given to the grandchildren. Both generations have used and enjoyed the inheritance, but since the children never had full title, the money theoretically skipped their generation so it is not taxed to their estates. It is considered inherited directly by the grandchildren from the decedent. Three out of every five millionaires transfer some property in trust.

Limit on the Estate Charitable Deduction. Under present law an estate may take an unlimited estate tax deduction for bequests made to qualified charities. The gift tax also allows an unlimited charitable deduction. But under the income tax, a charitable deduction is limited to 50 percent of income. Many of the charitable contributions consist of stock of a family being given to a private foundation and, by making certain stock arrangements, the family can retain control over the business while removing most of its value from the estate tax base.

The TJA does not tamper with the fundamental structure of charitable deductions. It merely limits the estate and gift tax deduction to 50 percent of the value of the estate or of lifetime gifts in keeping with the 50 percent limitation under the income tax.

AID TO STATE AND LOCAL GOVERNMENTS

Repeal Interest Exemption on State and Local Bonds. Interest paid on state and local government bonds is totally exempt from federal income tax, a subsidy which cost the U.S. Treasury $2.9 billion in 1972. The exemption aids state and local governments because it induces borrowers to accept lower rates of interest since the bond interest is tax free. Wealthy individuals and commercial banks receive most benefit from these tax free bonds yet state and local governments are having to continually raise their interest rates and are thus receiving fewer benefits.

The TJA repeals the exempt status of state and local bonds.

Federal Payment of Interest Yield on State and Local Bonds. However some states and towns, especially many smaller communities, without some type of subsidy, would not be able to raise funds for community development. *Therefore, the TJA provides that the Federal government will pay 40 percent of the interest yield on state and local bonds to the localities issuing them with the exception of industrial development bonds.*

The current exemption saves local and state governments $1.9 billion in lower costs. However, it costs the Treasury $2.5 billion in lost taxes. A direct federal subsidy is far more efficient, giving a dollar's benefit to local governments at a dollar's cost to the U.S. Treasury.

INDIVIDUAL TAXES

Tax Credit. *The TJA substitutes a tax credit of $250 per person in lieu of the personal exemption of $750 now allowed for each taxpayer and each dependent.* This change will distribute the tax savings from this most basic tax allowance more evenly so that every taxpayer whether poor, middle income or wealthy will receive the same dollar benefits. The worth of an exemption depends on the taxpayer's tax bracket. The $750 exemption is worth $525 to the wealthy taxpayer in the 70 percent bracket (.70 x 750), $225 to the 30 percent bracket taxpayer and $105 to the lowest taxpayer. But the amount of a tax credit is subtracted from the total tax bill and therefore returns the same dollar amount to taxpayers regardless of their income or tax bracket.

Personal Tax Credit. *The TJA also substitutes a tax credit for the present personal deductions. The credit would be computed as 25 percent of the amount which, under present law, would be the total of all personal deductions. This credit will be subtracted from the final tax bill, so that every dollar of allowable personal deductions will be worth the same to every taxpayer regardless of her/his tax bracket.* At present a deduction of $100 is worth $70 to the wealthiest taxpayer but saves only $14 for the lowest bracket taxpayer.

The credit will reduce the taxes for all taxpayers who are now taxed at less than 25 percent and will increase taxes for those with higher tax rates. For single taxpayers earning less than $10,000 and for a family of four with an income under $20,000, income taxes will decrease. The tax savings are greatest for lower income people and decrease as they approach those break-even points.

Replacing the personal exemption and the personal deductions with tax credits, is one way the TJA will help distribute the excessive income tax burden now placed on low and middle income families. Table II shows how the tax credits would change the amount of income taxes paid.
(See table on next page.)

The $100 Dividend Exclusion. *The TJA repeals the provision in present tax law that allows an individual to exclude from gross income $100 of dividends received on corporate stock.* There is no similar exclusion for interest received on savings accounts, which is a much more common form of investment by middle and low income taxpayers.

TABLE II

TAX LIABILITY UNDER TAX JUSTICE ACT COMPARED TO PRESENT TAX CODE

Married Couple With 2 Dependents

Adjusted Gross Income	Present Tax Law[1]	Tax Justice Act[2]	Income Tax Savings	Present 1975 Social Security Tax[3]
$ 1,000	$ 0[4]	$ 0[4]	$ 0	$ 59
3,000	0[4]	0[4]	0	176
5,000	0[4]	0[4]	0	293
6,000	35[4]	0[4]	35	351
8,000	347	0	347	468
10,000	709	345	364	585
12,500	1,165	885	280	731
15,000	1,612	1,410	202	825
17,500	2,036	1,936	99	825
20,000	2,538	2,528	10	825
25,000	3,630	3,958	(328)[5]	825
50,000	11,345	13,935	(2,590)	825

Married Couple With No Dependents

$ 1,000	$ 0	$ 0	$ 0	$ 59
3,000	0	0	0	176
5,000	170	0	170	293
6,000	326	25	301	351
8,000	674	405	269	468
10,000	1,054	845	209	585
12,500	1,540	1,385	155	731
15,000	2,002	1,910	92	825
17,500	2,456	2,436	20	825
20,000	2,975	3,028	(53)	825
25,000	4,110	4,458	(348)	825
50,000	12,000	14,435	(2,355)	825

Single Person

$ 1,000	$ 0	$ 0	$ 0	$ 59
3,000	63	0	63	176
5,000	404	250	154	293
6,000	594	460	134	351
8,000	1,007	940	67	468
10,000	1,476	1,440	36	585
12,500	1,998	2,025	(28)	731
15,000	2,519	2,633	(114)	825
17,500	3,115	3,346	(232)	825
20,000	3,754	4,128	(375)	825
25,000	5,200	5,878	(678)	825
50,000	14,773	17,815	(3,043)	825

FOOTNOTES TO TABLE ON PRECEDING PAGE

[1] *Computed without reference to the tax tables for adjusted gross incomes under $10,000. Figures based on 1975 law and includes the $30 credit per exemption.*

[2] *Computed using the 25 percent credit in lieu of deductions and a $250 tax credit in lieu of personal exemption.*

[3] *Assumes payroll tax deductions for one worker in each family. Social Security tax is included here to show that taxpayers paying either low federal income taxes or none at all, still pay social security taxes.*

[4] *If the family qualifies for the earned income credit, a refund will be given of: $100 on $1,000 income; $300 on $3,000 income, $300 on $5,000 income and $165 on $6,000 income.*

[5] *( ) indicates additional tax due.*

Note: All figures were computed using deductions equal to 17 percent of adjusted gross income, or the standard deduction, whichever was applicable.

Mortgage Interest and Property Tax. *The TJA limits deductions now allowed for interest paid on mortgages and property taxes to amounts paid on the taxpayer residence. The deductions cannot exceed interest paid on the first $50,000 of a mortgage and the property taxes paid on property assessed at $70,000. No deductions will be allowed for rental or investment property in excess of the income from it.*

Fifty Percent Maximum Tax. Currently, while paying more than 50 percent taxes on earned income, a taxpayer may be paying little or no tax on unearned income such as interest on tax exempt municipal bonds or revenue from oil investments which is offset by the percentage depletion deduction. Therefore, the rate on such a taxpayer's total income may be very low. *The TJA repeals the present limitation of a 50 percent maximum tax on earned income. Higher rates will apply where appropriate.*

OUTLINE OF THE TAX JUSTICE ACT PROVISIONS

CAPITAL GAINS AND LOSSES

101 Repeal most provisions relating to capital gains so that capital gains will be treated as ordinary income.

102 Capital losses will be fully deductible against ordinary income.

103 Unrealized gain in the value of assets transferred at death or by gift shall be subject to an income tax at the time of death or the gift.

- The income tax would be allowed as a deduction in determining the taxable estate of a taxpayer for estate tax purposes;
- There shall be a lifetime exemption of $25,000 for income tax purposes;
- Complete exemptions of the income tax on unrealized gains would be allowed for transfers between spouses (carryover basis).

BUSINESS TAX SUBSIDIES

201 Repeal Investment Tax Credit.

202 Repeal Accelerated Depreciation Range (ADR) provisions.

203 Limit depreciation on real estate to straight line depreciation.

204 Limit deductions for farm losses to farm income plus $10,000 of non-farm income.

205 Repeal percentage depletion allowance and require the capitalization of intangible drilling and exploration costs (foreign and domestic).

206 Repeal amortization of certain business expenditures.

207 Repeal option to deduct certain expenditures.

FOREIGN SOURCE INCOME

301 End deferral of tax on earnings of overseas subsidiaries.

302 Repeal the Domestic International Sales Corporations (DISCs)

303 Repeal foreign tax credit overall limitation.

304 Royalties will not be treated as income tax.

305 Repeal Western Hemisphere Trade Corporation provisions and other tax subsidies to U.S. possessions and less developed countries.

ESTATE AND GIFT TAX

401 Integration of the Estate and Gift Tax systems.

402 Elimination of generation skipping trusts

403 Limits the charitable deduction for estate tax purposes to 50 percent.

AID TO STATE AND LOCAL GOVERNMENTS

501 Repeal interest exemption on state and local bonds.

502 Federal payment of interest yield on state and local bonds.

INDIVIDUAL TAXES

601 Provide a tax credit in lieu of the personal exemption.

602 Repeal the $100 dividend exclusion.

603 Substitute a tax credit for the personal expense deductions.

604 Limit deductions for mortgage interest and property taxes to primary residence.

605 Repeal the limitation of a 50 percent maximum tax on earned income.

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REVENUE ESTIMATES

Footnotes

[1] Estimate not available for reduction in $4.55 billion gain which would result from the exclusion of transfers to surviving spouse and the special $25,000 exclusion for the lifetime disposition of a residence, etc.

[2] Allocation between corporations and individuals based upon 1972 figures in Estimates of Federal Tax Expenditures, published by the Committee on Ways and Means, June 1, 1973.

[3] Based upon 1972 levels. Sources: Tax Notes, Tax Analysts and Advocates (TA/A), April 1, 1974, p. 16. Allocation between individuals and corporations based upon revenue estimates contained in H. Rept. 93-1502, 93rd Cong. 2d. Sess. 21 (Committee on Ways and Means, H.R. 17488, Energy Tax and Individual Relief Act of 1974).

[4] Source: Tax Notes, note 3 above at 16-17.

[5] Based on revenue estimates done by Thomas F. Leahy, former director of the revenue estimating staff, U.S. Treasury Department using statistics and existing law for 1973. These exact items were not included in the Federal Budget Analysis fiscal year 1976 estimates but they are not expected to differ greatly from the figures given.

[6] Source: Statement of Frank E. Morris, President, Federal Reserve Bank of Boston, House Ways and Means Committee, Panel Discussions on General Tax Reform, Panel No. 8, An Alternative to Tax-Exempt State and Local Bonds 1198 (February 23, 1973). For allocation between corporations and individuals, see note 2, above.

[7] Revenue gain less than $10 million.

REVENUE ESTIMATES

(In millions of dollars)
Fiscal Year 1976

	Revenue Change	
	Corporations	Individuals
A. Capital Gains and Losses		
101. Gains	$ 755.00	$ 4,165
102. Losses		
103. Capital assets transferred at death		4,550[1]
B. Business Tax Subsidies		
201. Investment Tax Credit	7,209.00	1,551
202. Asset depreciation range	1,590.00[2]	12[2]
203. Straight-line depreciation - rental	120.00[2]	420[2]
- non-rental	275.00[2]	215[2]
204. Farm Loss limitation	12.00[2]	188[2]
205. Percentage depletion and	738.00[2]	162[2]
intangible drilling costs	1,235.00[2]	130[2]
206. Rapid Amortization of certain expenditures	115.00	60
207. Option to expense certain expenditures	660.00	-
C. Foreign Source Income		
301. Earnings of overseas subsidiaries	620.00	-
302. Domestic international sales corporations	1,290.00	-
303. Foreign tax credit overall limitation	270.00[3]	30[3]
304. Royalties treated as income taxes	300.00[4]	-
305. Other tax preferences for corporate foreign source income		
a) Western Hemisphere Trade Corp.	50.00	-
b) Possessions Corporations	10.00	-
c) Less Developed Country Corp.	55.00	-
D. Estate and Gift Tax		
401. Integration of the estate and gift taxes	-	325[5]
402. Generation skipping trusts	-	300[5]
403. The estate charitable deduction	-	150[5]
E. Aid to State and Local Governments		
501. Interest exemption on state and local bonds		
502. Federal payment of interest yield on state and local bonds.	-33[6]	-17[6]
F. Individual taxes		
601. $250 personal tax credit	-	(-13,120)
602. The $100 dividend exclusion	-	360
603. Tax credit for personal expenses	-	-
604. Mortgage interest and property taxes on residences	-	-[7]
605. Maximum tax on earned income	-	[illegible]