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AN ANALYSIS OF THE CARTER TAX PROPOSAL

INTRODUCTION

"I would never, never do anything that would hurt the middle American wage earner." -- Jimmy Carter. (Quoted in The Atlanta Constitution, March 7, 1976.)

At the time President Carter made this statement, no doubt he was very sincere. Yet, it is the opinion of many observers that the cumulative effect of the changes in Social Security, the energy taxes, and the new tax reform package will result in a massive tax increase for those in the middle and upper-middle income brackets. "Generally this proposal will lower taxes for families with incomes under $20,000 and raise them for those with incomes above that level."[1]

"For families with incomes of $20,000 a year and up, the individual income tax cuts Carter has proposed will not be enough to offset pending Social Security tax increases; these families will see their total taxes rise if Congress accepts the President's plan."[2]

On Saturday, January 21, 1978, President Carter released a proposal that called for a $25 billion income tax reduction for individuals and businesses while eliminating $9 billion in tax shelters for upper-income and middle-income taxpayers. Breaking down the program, lower- and middle-income taxpayers would get reductions of $17 billion,

[1] The President's 1978 Tax Program, Fact Sheet 7, p. 2, January 21, 1978, Department of the Treasury.

[2] Art Pine, "Bigger Tax Cut to Middle-Income Families is Seen," The Washington Post, January 31, 1978, p. A5.

$6 billion to small businesses and large corporations, while $2 billion would be reduced by the elimination of the excise tax on phone calls and the reduction of the payroll tax for unemployment insurance.

According to President Carter, about 94 percent of the tax relief will go to individuals and families earning less than $30,000 per year. Those earning between $5,000 and $10,000 will receive a 23 percent cut in their income taxes, while those earning between $30,000 to $50,000 will pay only 5 percent less in their taxes. Because of the Carter tax changes coupled with the increase in Social Security taxes, the following are the effects of the President's tax program:

	PRESENT LAW			CARTER'S PROPOSAL			CHANGE IN TAXES		
Wage Income	Income Tax	FICA Tax	Total Tax	Income Tax	FICA Tax	Total Tax	Income Tax	FICA Tax	Total Tax
$ 5,000	-300	292	-8	-300	306	6	0	+14	+14
10,000	446	585	1,031	134	613	747	-312	+28	-284
15,000	1,330	877	2,207	1,072	919	1,991	-258	+42	-216
20,000	2,180	965	3,145	1,910	1,226	3,136	-270	+261	-9
25,000	3,150	965	4,115	2,830	1,404	4,234	-320	+439	+119
30,000	4,232	965	5,197	3,910	1,404	5,314	-322	+439	+117
40,000	6,848	965	7,813	6,630	1,404	8,034	-218	+439	+221
50,000	9,950	965	10,915	9,870	1,404	11,274	-80	+439	+359
100,000	28,880	965	29,845	29,470	1,404	30,874	+590	+439	+1,029

Source: Secretary of Treasury

Figures are for a family of four with a single wage-earner. FICA is Social Security.

Chart taken from article by Phil Gallery, "Tax Cut Plan Spelled Out By Carter," The Washington Star, January 22, 1978, p. 1.

TAX DECREASE

Considering social security taxes and income taxes alone, a family of four with a single wage-earner making $20,000 per year will get a tax reduction of only $9 under President Carter's plan. At an annual income of $25,000, total taxes for this family would go up $119. President Carter has also called for the replacement of the $750 per-person exemption with a $240 personal tax credit. The President's rationale is that the tax exemptions favor the wealthy over those with more modest incomes. He further points out that the $240 "per capita credit will be worth $960 whether that family is middle class or wealthy (for a family of four)." Furthermore, "...a single tax credit will simplify tax return preparation by eliminating the confusion caused by the existing combination of exemptions and alternative credits."[3]

[3] The President's 1978 Tax Program, p. 7.

For incomes of $20,000 or less, the $240 credit appears to be better than the $750 personal exemption, but not by much. If we were to take a family of four earning $20,000 -- joint return with no itemizing, what would be the effect of Carter's tax changes?

Using 1977 tables, the following occurs:

$750 Personal Exemption		$240 Tax Credit	
$20,000		$20,000	
-3,200	-- standard deduction	-3,200	-- standard deduction
16,800		16,800	
-3,000	-- (personal exemption 4 x $750)		
13,800	-- taxable income		
1,380	+ 22% of excess over $11,200	2,260	+ 25% of excess over
1,952		15,200 =	$2,660
- 140	(4 x general tax credit $35)	- 960	($240 tax credit x 4)
$ 1,812	net tax	$1,700	net tax

Therefore using President Carter's $240 tax credit against a 1977 tax rate, a family of four would pay $112 less in taxes than if they used the $750 personal exemption. The President does admit that those earning more than $20,000 will have increased taxes under this plan. "Generally, this proposal will lower taxes for families with incomes under $20,000 and raise them for those with incomes above that level."[4] In fact, the substitution of the credit for the personal exemption would result in raising taxes for those earning $20,200 and above. It is estimated that the credit proposed would increase taxes on half of all returns by about $5 billion and decrease taxes on the other half by roughly $3.5 billion. This results in a general net tax increase of $1.5 billion and, therefore, 400,000 taxpayers who earn between $20,000 and $30,000 will probably pay $48 million more in taxes than they presently pay.

When Secretary of the Treasury Blumenthal appeared before a House Ways and Means Committee hearing, Representative Bill Archer (R-Texas) asked him, "Do you think $20,000 a year is rich?" Mr. Blumenthal replied, "No," but that the tax increases would be small and furthermore would affect only 23 percent of American families. Of course, it should be pointed out that in addition to these increases in income taxes, a family of four earning $20,000 a year would see their social security taxes go up $261. If they earned $25,000, their social security taxes would rise $439 with a net tax increase of $119, and at the $30,000 level their social security taxes would increase by $439, resulting in a net tax increase of $117.

Another proposal of the President that will result in lower income taxes for individuals is a change in the tax rates. At the present

[4] Op. Cit. Fact Sheet 7, p. 2.

time, the rate schedule ranges from a low at 14 percent to a high at 70 percent, but under the proposed changes the schedules will shift downward to 12 and 68 percent respectively, with the top rate of 68 percent applying to incomes in excess of $200,000 for joint returns, and $100,000 for single returns. The new rates will preserve the progressivity of the income tax program, that is, the taxes get progressively larger as you move up the income scale.

SINGLE PERSONS

Annual Income	Current Law	Carter Plan
$ 0 - 10,000	$ 217	$ 181
10,000 - 15,000	1,593	1,519
15,000 - 20,000	2,768	2,591
20,000 - 30,000	4,236	3,917
30,000 - 50,000	8,254	7,660
50,000 - 100,000	18,465	17,889
100,000 - 200,000	42,015	41,714
200,000 - up	161,723	167,760

MARRIED COUPLE (Filing Jointly)

Annual Income	Current Law	Carter Plan
$ 0 - 10,000	$ 168	$ 95
10,000 - 15,000	1,104	983
15,000 - 20,000	2,084	1,906
20,000 - 30,000	3,615	3,308
30,000 - 50,000	6,921	6,535
50,000 - 100,000	17,020	16,647
100,000 - 200,000	40,403	40,956
200,000 - up	132,121	137,148

Chart compiled by the Associated Press. *The Washington Star*, *Op. Cit.*, p. A10.

A further decrease in individual (and to a certain extent business) taxes will be the repeal of the excise tax on communications -- namely, telephone and teletypewriter exchange services. Elimination of this 4 percent tax should reduce the cost of living for individuals and, by lowering business costs, be an incentive to reduce consumer prices. It is estimated that individual telephone users will save $650 million in 1979, while business users will save $550 million.

Presently the federal unemployment insurance tax is 0.7 percent and under the Carter plan it will be reduced to 0.5 percent, effective January 1, 1979. Unemployment benefits to workers are paid for by taxes paid by the employer on the first $6,000 of each worker's earnings.

Reduction of this tax will enable the employer to pass these savings on to the workers in the form of wage increases, to the consumers in the form of lower prices, to the stockholders in the form of increased dividends, or in the form of hiring more workers, construction of new plants and purchasing of additional tools and equipment. Estimates are that this measure will release $0.8 billion to private enterprise in calendar year 1979.

TAX INCREASES

Even though the President's tax program is portrayed as a tax reduction proposal, significant portions of it will increase taxes for the taxpayer.

A. Deductions for State and Local Taxes

At the present time, individuals are allowed to itemize state and local income taxes, real property taxes, sales, personal property, and gasoline taxes. Under the Carter proposal the only taxes allowed to be itemized would be income and real property taxes. All the others would be eliminated as itemized deductions.

Arguments For

The Carter Administration justifies this change in tax policy by the following: (1) Elimination of these tax deductions will result in simplified tax forms and a reduction in errors in the tax returns. (2) Three-quarters of the taxpayers do not itemize the sales tax. (3) Our nation's energy goals do not justify the gasoline tax deductions. (4) The reductions in taxes traditionally accomplished by giving deductions for these taxes can be achieved by simply lowering the tax rates, but still eliminating the deductions.

Arguments Against

To many individual entrepreneurs, the deduction for gasoline taxes is a necessary ingredient of economic survival. Traveling salesmen depend on their cars as essential instruments of their sales program, just as necessary as the individual product they are selling. Many individuals feel it is unfair for the federal government to tax income used to pay other taxes, and the $3.9 billion extra they will have to pay as a result of this measure could be better spent at the local level rather than through the bureaucracy in Washington.

B. Political Contributions

Presently the law allows an itemized deduction of up to $200 or a credit of half of the first $100 for political contributions on a joint return. The President would repeal the itemized deduction but keep the alternative credit.

Arguments For

The deduction is more valuable to those in a higher income bracket than those in a lower one, whereas the credit is of equal value to all taxpayers. Elimination of this deduction will further simplify tax returns.

Arguments Against

Repeal of the itemized deduction will increase taxes by about $5 million a year. A $200 political contribution is not a windfall to the rich, as this deduction amounts to only 55¢ a day. At a time when our society is encouraging the political involvement of its citizenry, the repeal of this deduction will shrink small political contributions and cause politicians to rely on money from special interest groups. Finally, President Carter's change discriminates against those taxpayers who conserve on other expenses and channel the savings into political contributions. Furthermore, there is a question whether First Amendment rights are being abridged by the restrictions on political contributions.

C. Medical and Casualty Deductions

Under existing law, individuals can deduct medical expenses if they exceed 3 percent of income, and up to $150 of their medical insurance premiums. Uninsured casualty losses that exceed $100 are also allowed to be deducted. Individuals can count towards that 3 percent base medicines and drugs over 1 percent of adjusted gross income, and the remaining amount of their health insurance premiums.

The change in this system, advocated by the President, would be that medical expenses and casualty losses would be deductible only when they exceed 10 percent of adjusted gross income. In the future, drug expenses and health insurance premiums would be treated the same as other medical expenses, and these medical expenses would include only payments for medical purposes.

Arguments For

This plan will make the tax system fairer and simpler. Taxpayers with high incomes are able to use the deductibility of casualty claims to self-insure by the tax system. This change will eliminate burdensome record-keeping and complex regulations that confuse taxpayers.

Arguments Against

This is another tax increase that will hurt all taxpayers at a time when medical costs are going up for all income groups. This proposal will increase taxes by about $1.9 billion in 1979.

D. Entertainment Expenses, Foreign Conventions and First Class Air Fares

President Carter's plan will eliminate deductions claimed by business for theater and sporting event tickets, club dues, yachts, hunting lodges and first-class air fare, and limit business lunch deductions to half the cost of the meal. It would further limit tax deductions claimed by business and professional groups for foreign conventions.

Arguments For

President Carter feels that these expenses have little or no connection with legitimate business transactions and, therefore, businessmen should absorb their costs rather than having the taxpayers do so. According to the late President Kennedy, "Expense account living has become a byword in the American scene. This is a matter of national concern, affecting not only our public revenues, our sense of fairness, and our respect for the tax system, but our moral and business practices as well."

Arguments Against

No doubt many of these practices could be considered frivolous or at least secondary to the exercise of business, but there may be an exception, and that is the business lunch. Would-be reformers say that if "Joe Blue-Collar" with his ham sandwich does not get a deduction for his lunch, why should "Mr. Executive" with the London Broil get one? A plausible answer to this is that when the blue-collar eats his lunch, he ceases work, while many business transactions are consumated during a "working lunch."

The hotel, restaurant, and resort industry would be severely affected by this change. Waiters, bartenders, busboys plus all those with support functions within a restaurant would see their incomes drop, and possibly lose their jobs. Robert E. Juliano, representative for the 450,000 member Hotel and Restaurant Employees and Bartenders International Union claims that full prohibition of expense account meals would cost 75,000 jobs in the industry,[5] and even Treasury Secretary Blumenthal conceded that it might reduce employment in that industry by 1 percent, even though he thought it would lead to a "better allocation of resources" and actually increase overall employment.[6] It is unfortunate that at a time when the Administration is seeking to reduce unemployment and find jobs for minorities, it is a revision in the tax code which creates jobs for those on the bottom of the economic ladder. The only institution that would possibly benefit from this tax change would be Xerox. Peter DuBois of Barron's says that when two businessmen meet for lunch, each would request a copy of the bill and each would put in as a business expense half the total.[7]

[5] Congressional Quarterly, November 26, 1977, p. 2478.

[6] Congressional Quarterly, January 28, 1978, p. 165.

[7] "Up & Down Wall Street," Barron's, October 3, 1967, p. 1.

The changes regarding entertainment expenses will increase taxes by $1.2 billion for certain taxpayers. The deductions for first class air fare that will be disallowed will increase taxes for certain individuals by $0.3 billion while the changes regarding foreign conventions will have no significant change in taxes.

E. Minimum Tax

Presently, taxpayers are required to pay a minimum tax on income that is shielded from current taxation because the tax code excludes from income one-half of capital gains, allows deductions for depletion of minerals in excess of the amounts that would be allowed on the basis of cost, and permits accelerated depreciation on real estate. The law applies a 15 percent minimum levy on all preference income that exceeds the greater of $10,000 or one-half of an individual's regular tax liability.

President Carter's proposal would keep the $10,000 reduction, but eliminate the rule allowing one-half of a taxpayer's regular income tax liability to be subtracted from the minimum tax.

Arguments For

According to the President, this change "will make the minimum tax more progressive and more sharply focused deterrent to the use of tax shelters." Furthermore, this change will make the tax system fairer by raising the effective tax on those with substantial preference income.

Arguments Against

The progressiveness of this tax is the most compelling case against it. At a time when the U.S. is lagging in capital formation, it is vitally important that the upwardly mobile taxpayer be given every incentive to save, and not be subject to heavy-handed taxation. The effect of progressive taxation on capital formation and fixed investment is devastating. The following statistics illustrate this problem:

NONRESIDENTIAL FIXED INVESTMENT
AS PERCENT OF REAL NATIONAL OUTPUT

1960-1973*

United States	13.6
Japan	29.0
West Germany	20.0
France	18.2
Canada	17.4
Italy	14.4
United Kingdom	15.2
11 OECD Countries (1960-1972)	19.4

*OECD Concepts of Investment and National Product 1973 Estimated

Source: Department of the Treasury News Release
April 1, 1975

The life blood of American enterprise is capital. Unless funds are set aside for plants and equipment, then jobs will suffer. No amount of public jobs will solve our unemployment problem when the base for private jobs is drying up. The decline in capital formation should be the concern of everyone.

"Gross capital formation as a percentage of Gross National Product has been substantially below the level over the long period 1869-1928 -- then 20.1 percent compared with 15.2 percent for 1966-1975 (15.8 for 1946-1975). A decline of nearly one forth is significant. Far more deserving of concern has been the change in net capital formation. The 1966-1975 rate of 6.8 percent of Net National Product was less than 60 percent of the 1869-1928 rate."[8]

Even more significant than the decline in capital formation is our weak growth rate in productivity. "The growth rate in plant and equipment per worker dropped from 2.6 percent in 1965-1970 to 1.6 percent in 1970-1975. The annual increase in worker productivity fell by more than half -- from 2.4 to 1.0 percent."[9]

When the productivity growth rate of the U.S. is compared with the rest of the West, the concern of businessmen and tax specialists alike is better appreciated.

PRODUCTIVITY GROWTH, 1960-1973
(Average Annual Rate)

	Manufacturing Output Per Man Hour
United States	3.3
Japan	10.5
West Germany	5.8
France	6.0
Canada	4.3
Italy	6.4
United Kingdom	4.0
11 OECD Nations	6.1

Source: (Quoted from The Need for Adoption of a Capital Cost Recovery System, presented by Charles W. Rau of Allis-Chalmers Corp. to the Cast Metals Federation, Washington, D.C., February 22, 1977, Slide #4.

[8] C. Lowell Harriss, "Capital Shortage Issues Bearing on Future Tax Policy," The Tax Executive, Vol. XXIX, No. 4 (July 1977), p. 293. (Published by the Tax Executives Institute, Inc.)

[9] Ibid., p. 296.

Finally, the business community is extremely pessimistic that, even under the existing tax code, the needed capital for expansion in the future can be produced. The Business Roundtable conservatively estimates that there will be a gap of $50 billion a year in future capital formation.

ESTIMATED BUSINESS CAPITAL SHORTFALL

Needed:	$ 312 billion a year	
Depreciation:	$ 120 billion	
Retained Earnings:	36 billion	
New Debt:	96 billion	
New Equity Shares:	10 billion	(Best year to date: 11.4 billion in 1971)
	$ 262 billion raised at the most	
Leaving a gap of:	50 billion a year	

Source: (Rau, Slide #2)

And so, this change on the minimum tax will increase taxes for certain individuals by $0.3 billion in 1979, and will add another obstacle on the road to increased capital formation.

F. Real Estate Depreciation and Tax Shelters

President Carter's proposed changes in this area will probably not evoke a large opposition from the public. Included in this tax package is a provision limiting deductibility of a tax shelter investor's paper losses to losses for which the investor actually had a personal liability. Under present law, this provision covers only some shelters.

Other restrictions on shelters proposed by the President include a reclassification of some limited partnerships that presently qualify for special treatment for tax purposes, prohibition of deferral of tax on interest on annuities -- except for those judged to be legitimate retirement funds, and a stepping up of IRS audits of tax shelter partnerships. These proposals will bring in additional tax revenues of $0.2 billion in 1979 rising to $1.0 billion in 1983.

G. Capital Gains

President Carter has previously recommended abolishment, or at least curtailment, of preferential treatment of capital gains. He has now backed down from this proposal. Presently, taxpayers are only required to include 50 percent of their income from capital gains in their tax base. Another provision of the tax code sets a 25 percent tax ceiling on the first $50,000 of capital gains. This 25 percent ceiling, known as the "alternative tax," is what Carter wants to eliminate.

Therefore, rather than reducing the capital gains, as many businessmen advocate, he is keeping it as it is. In addition, he is eliminating the alternative tax which presently helps taxpayers in the 50 percent tax bracket and enables them to receive an extra tax break on the first $50,000 of capital gains.

Arguments For

The elimination of this "alternative tax" will end an unjustified benefit for taxpayers whose marginal tax rate exceeds 50 percent. This makes treatment of capital gains more equitable.

Also the "alternative tax" introduces additional complexity into the system and its repeal will simplify the tax laws.

Arguments Against

Special treatment of capital gains is not a bail-out for the rich, but helps the middle class also. Half of those reporting capital gains in 1975 (the latest year for which figures are available) had an adjusted gross income of $15,000 or less, and half of the total capital gains tax take came from families reporting adjusted gross incomes of $30,000 or less.[10]

Many think that the rate of taxation of capital gains should be changed by providing for reduced taxes proportionate to the length of time a capital asset is held. This would allow for new investment and would recognize that much of capital gains is caused by inflation. "According to the Business Roundtable, over 80 percent of the capital gain on common stocks, as measured by Standard and Poor's Index of Common Stocks, from 1960 through 1973, was merely inflation gain."[11]

The business community realizes that preferential treatment of capital gains is an integral part of economic growth and jobs creation. Many observers of the stock market predict that a more favorable view towards capital gains by government would improve the employment situation in the country. "A reduction in the capital gains tax would unlock billions of dollars, much of which would be reinvested in new or small businesses thereby creating jobs for hundreds of thousands of people," says Edward R. Greeff, a senior partner in Adams and Peck, a member firm of the New York Stock Exchange. "I've been in Wall Street since 1933," he says.[12]

Finally, the elimination of the "alternative tax," will transfer $0.1 billion in 1979 from the private sector to the federal government at a time when President Carter wants to strengthen the job creation role of private enterprise, not weaken it.

[10] Shirley Scheibla, "Capital Gains Tax," Barron's, October 3, 1977, p. 26.

[11] Ibid., p. 7.

[12] Edward Cowan, "Into the Arena With Tax Reform, The New York Times, September 25, 1977, p. F1.

H. Medical, Disability, and Life Insurance

Currently, employer paid premiums on the first $50,000 of health, accident and disability insurance are tax-free to the employee. This also applies to the benefits received under these plans. Also tax-free status is given to employer-paid premiums on the first $50,000 of group life insurance coverage. Under the President's proposals, the tax exempt status will be taken away from these plans unless they apply to all employees, not just officers, shareholders and higher-paid employees.

Arguments For

This will make the tax system fairer by making sure that tax benefits for health plans are made available to all employees and not just to the higher-paid ones or to the officers of the corporation.

Arguments Against

Talents and abilities of people are as varied as their earnings. Take for example, two managers, one with the ability to make correct decisions 5 percent of the time more than the other. That 5 percent superiority is worth $50,000 in a $1,000,000 business, compared with $5,000 in a $100,000 business. Therefore, the larger business will gain more with the superior man than would the small company. If we compare two common laborers who differed by 5 percent in their ability, their decisions would not affect the total wealth as much as those of the top executives. Ergo, the difference in their talents would not be so magnified.

This accounts for the difference in salaries between management and non-management, and explains why benefits are more liberal for top management. Top management personnel are worth more to a company, and their decisions affect a greater amount of money than those of non-management.

American corporations recognize this fact and accordingly give their top management extra benefits that take into account the manager's heavy financial responsibility.

For the federal government to eliminate the tax protection for these type of plans is an indication of shortsightedness in the government and a lack of understanding of proven and beneficial corporate practices.

The President's plan is expected to increase taxes by less than $50 million in 1979.

I. Employee Death Benefits

Under the President's proposal the $5,000 employee death benefit exclusion will be repealed, whereas under the present law the first $5,000 paid by an employer on the death of an employee is not included in taxable income.

Arguments For

Tax exemption for employee death benefits is beneficial more to those in the 50 percent or greater tax bracket. These death benefit plans frequently favor officers, shareholders, and higher-paid employees to the detriment of the rest of the employees. Elimination of this benefit will not hurt the heirs of the dead employee since tax relief will be provided by tax exemption for insurance proceeds.

Arguments Against

The President makes a mistake when he assumes that the death benefit plans are offered primarily to high-income individuals rather than to employees in general. These plans are an essential part of the benefit package given to almost all employees who work for major corporations and small businesses in the country today. To tax the heirs of certain employees on the first $5,000 of death benefits is a cruel action and is a indication of the insensitivity of the President's tax advisors to the needs of many citizens.

J. Qualified Retirement Plans

Qualified plans receive preferential tax treatment, but they are not allowed to favor officers, shareholders, or higher-paid employees. However, the non-discrimination requirement can be met by integrating the plan with Social Security so that it provides no coverage for employees below the social security wage base. This wage base is the wage or salary on which social security taxes are paid and benefits are calculated. In 1978 it will be set at $17,700 and by 1981 it will rise to $29,700 with automatic inflation adjustments afterward. Under present law contributions for an employee and the earnings on them are not taxed until the employee receives them as pension benefits on retirement.

Employer contributions to the plan are immediately tax deductible. With President Carter's proposal, these qualified retirement plans will no longer be permitted to exclude those wages of employees that are below the social security wage base. Also, for every 1.8 percent in contributions to retirement plans on salaries above the wage base, at least 1 percent in contributions will be required on salaries below the wage base.

Arguments For

It is accepted that special tax treatment of qualified plans is necessary because Social Security does not provide adequately for retirement. However, lower-paid employees should not be excluded from private pension plans on the grounds that they are covered by Social Security.

Arguments Against

See Arguments Against in the previous remarks on Medical, Disability, and Life Insurance.

K. Unemployment Compensation Benefits

The law does not include unemployment benefits paid under government programs as taxable income. President Carter proposes that all single taxpayers with incomes over $20,000 and married couples of $25,000 income will have their unemployment compensation benefits taxed. Fifty cents of every dollar earned above those amounts will be taxed.

Arguments For

"Empirical studies confirm the fact that the existence of unemployment compensation adds to unemployment. The tax-free nature of unemployment compensation increases the incentive to remain unemployed. The exclusion therefore contributes, to some extent, to the period of unemployment and the consequent cost of maintaining unemployment coverage."[13]

Individuals and families with high sources of income should have their unemployment benefits taxed because the exclusion of these benefits is worth more to those in the higher marginal tax brackets than to those in the lower brackets.

Arguments Against

It is quite true that unemployment compensation benefits tend to encourage certain workers to stay unemployed rather than accept jobs. However, why should those workers earning $20,000 or families earning $25,000 be singled out for taxation when the problem is at the other end of the wage scale. It is apparent that those earning between $5,000 - $10,000 annually would be better off on unemployment than those in the $20,000 and up bracket. The unemployment compensation benefits of the 50 states are a positive incentive for those in the lower and lower-middle income category to stay unemployed. For example:

As of July 1, 1977, the following states have the lowest unemployment benefits.[14]

[13] The President's 1978 Tax Program, Department of the Treasury, January 30, 1978, p. 178.

[14] Statistics obtained from Mr. Charles Little of the Unemployment Benefits Association, Suite 460 South, 1800 M Street, N.W., Washington, D.C. 20036.

Puerto Rico	- $60 a week	- These states do not have a dependency allowance
Mississippi	- $80 a week	
Texas	- $84 a week	
Indiana	- $74-$124 a week	- This state has a dependency allowance

The following states have the highest unemployment benefits.

Connecticut	- $160-$174 a week	- This state has a dependency allowance
New York	- $95 a week	This state has no dependency allowance
September, 1977, it went to	- $115	
September, 1978, will go to	- $125	

If the two extremes are taken, Puerto Rico with $60 a week and Connecticut with $160 a week (assuming no dependents in either case) the incomes covered by these benefits range from a low of $3,120 per annum to a high of $8,230 per annum. These figures correlate very closely with those of the federal government. 65.2 percent of all tax returns with unemployment compensation come from those earning $10,000 or less. This same group accounts for 54.1 percent of the total unemployment compensation. Those earning $20,000 or more account for only 7.3 percent of all returns with unemployment compensation.[15]

To charge that those earning over $20,000 annually receive a disproportionate slice of the unemployment compensation benefit pie is to stretch credibility.[16]

In conclusion, President Carter's analysis that unemployment compensation is a positive factor in keeping people on the unemployment rolls is correct. However, if he wants to change this situation, he should make unemployment compensation taxable for all income groups, not only for those earning $20,000 a year or more. In light of the facts, it is apparent that those in the lower or lower-middle income groups have their wages almost totally replaced by unemployment benefits; therefore, their economic incentive to seek employment is not very high. Common sense indicates that the individual earning $20,000 or more will not stay on unemployment benefits very long because they are only a small fraction of his previous wages. This proposal will increase tax liabilities on that portion of the population by $0.2 billion in 1979.

[15] Table IIE-8, p. 179 "Distribution of Unemployment Compensation and of Personal Income Tax Savings from Exclusion," Office of the Secretary of the Treasury; Office of Tax Analysis, January 26, 1978. The President's 1978 Tax Program.

[16] For a more detailed analysis on the issue of wage replacement, one should read Martin Feldstein's article, "Unemployment Compensation: Adverse Incentives and Distribution Anomalies," National Tax Journal, Vol. 27, No. 2 (June 1974), p. 231.

TAX TREATMENT OF BUSINESS

A. Reduction of the Corporate Tax Rates

Under present law, the corporate tax rates are 20 percent on the first $25,000 of taxable income, 22 percent on income in excess of $25,000 up to $50,000, and 48 percent on all income in excess of $50,000.

The President's plan shows that effective October 1, 1978, the corporate rate will be reduced to 18 percent of the first $25,000 of taxable income, 20 percent of the next $25,000 and 45 percent of taxable income in excess of $50,000. Effective January 1, 1980, the top rate will decline to 44 percent.

The President has also advocated a change in the surtax. This surtax imposed by section 11(c) of the Tax Code, which is currently 26 percent, will be reduced to 25 percent effective October 1, 1978, and to 24 percent on January 1, 1980. The surtax exemption which is currently at $50,000 will remain.

Analysis

It is generally conceded that there is a capital shortage, and, therefore, it is necessary for a revision in the corporate income tax. The rates that the President is advocating are acceptable to the business community and the President should have no problem with Congress on this. The change in the surtax is also needed, although tax specialists feel that the $50,000 corporate surtax exemption should be increased to $100,000 with a 20 percent tax on the amount subject to the exemption to encourage capital growth of small business.

The changes asked for by the President would reduce corporate income taxes $6.0 billion in 1979.

B. The Investment Credit

The 10 percent investment tax credit was scheduled to go back to 7 percent (4 percent for utilities) on January 1, 1978. The President's proposal will make the 10 percent permanent. Whereas the credit was only available for investment in business machinery and equipment, but not for buildings or their structural components, the credits now will be extended to new industrial buildings and to investments made to rehabilitate existing industrial buildings. However, only manufacturing and utility buildings will be eligible for the credit. All buildings placed into service after December 31, 1977, will be eligible for credit to the extent of construction costs incurred after that date, while expenditures made after that date for rehabilitation of existing structures will be eligible for the credit.

Under existing law, the investment credit may be applied to all of the first $25,000 of tax liability, but to no more than 50 percent of the remainder. The new law will allow the credit to offset 90 percent of the tax liability in any year, but not the complete liability.

Formerly, certain qualified pollution control equipment was eligible for a maximum investment credit of only 5 percent if the taxpayer elected to amortize the cost of this equipment over a five-year period. Now the full 10 percent investment credit will be extended to pollution control equipment that qualifies for the special five-year amortization.

Analysis

The need for an increase in the Investment Tax Credit has been attested to by both Administration and industry economists. The tie-in between investment and jobs is unmistakable and the federal government is perhaps beginning to notice this. By the 1950's, American business was investing an average of $84,000 per worker joining the labor force. In the 70's this has slipped to $60,000 for every new worker.

Today, Japan is the free-world leader in productivity growth, nearly 11 percent annually. It also leads in private investment, funneling an average of 35 percent of its GNP back into capital expenditures. West Germany follows with 26 percent, France with 25 percent, and the United States follows with a weak 18 percent.

Because the United States ranks low in capital investment, it is also on the bottom in growth of real wages and benefits. In the decade 1965-1975, the real income of the American worker increased only 15.7 percent, yet in Sweden it increased 68.8 percent, in Germany 78.1 percent, and in Japan 137.9 percent. In 1950, the United States per capita income was twice that of Sweden or Switzerland. Today, both of those nations have surpassed us, and other industrial nations are closing the gap.

The business community is not pleased with the prospect of making the 10 percent Investment Tax Credit permanent. They remember Carter's advocacy of a 12 percent ITC for the Tax Reform Bill of 1977, and they still advocate a 12 percent credit, without the limitations that the current law and the Carter proposal places on them. Industry also believes it needs a fast, first year tax write-off for all federally mandated environmental and safety facilities. Since these facilities are added costs, do not add to the efficiency of the company, and do not improve the product significantly, businessmen feel that tax write-offs for these huge investments could be quickly recovered for reinvestment in job-producing and profit-producing facilities.

It is estimated that the President's proposals will reduce taxes for industry $2.4 billion in 1979, and $7.2 billion in 1983, of which $4.5 billion will be the result of the permanent extension of the 10 percent credit.

C. Elimination of DISC

Under present law, the United States companies may defer tax on a portion of their export-related income by selling their product to a Domestic International Sales Corporation (DISC). For example, XYZ Company, the manufacturer, sells its finished product to XYZ Company, the DISC. The DISC markets the product overseas and the break comes when the DISC is exempted from paying half of the normal United States income tax on its overseas profits. This exemption is a deferral, and lasts as long as the DISC continues to export.

The DISC was created in 1971 to slow the growing imbalance between exports and imports. Since many foreign producers received subsidies from their home governments, the Nixon Administration felt that the United States exports would be more competitive if they got a lower tax rate, and so the DISC was formed.

President Carter's proposal will repeal DISC over a three-year period. Starting by 1979, DISC tax benefits will be reduced by one third so that by 1981, DISC will be eliminated.

Arguments For

The DISC has turned out to be a far more costly and less effective program than originally claimed. In 1974, DISC produced $3 billion worth of United States exports but legally denied the United States Treasury $1.2 billion in taxes. In 1975, the revenues denied were $1,390 million. Because of the provisions of the Tax Reform Act, this loss was reduced to $870 million in 1976. The projected revenues lost for 1977 and 1978 are estimated to be $1.0 billion and $1.2 billion respectively.

Even though there are more than 5,000 DISC's, about 40 companies get more than half the DISC benefits. Senator Edward M. Kennedy (D-Mass.), who is one of the leaders in eliminating DISC, puts it this way:

> "DISC is a windfall for large multinational United States exporters who would be exporting anyway...what we are really talking about is that extraordinary tax subsidy of the wealthiest and most powerful corporations in the country. They can thrive without this benefit and it ought to be repealed."

Arguments Against

DISC has been a factor in increasing our exports and improving our balance of trade. The taxes on profits arising from United States exports far outweigh the small losses in revenue to the Treasury. Since the enactment of DISC, the United States exports have doubled. DISC generates jobs. According to David C. Garfield, Vice-Chairman of Ingersoll-Rand, the benefits from DISC have allowed the company to increase employment by some 7,000 since 1971. From 1975 to 1976, General Electric's overseas sales climbed from $1.6 billion to $1.9 billion. General Electric estimates that 37,000 of its 274,000 employees depend on the export trade for their jobs.

Senator Abraham Ribicoff (D-Conn.) says: "DISC is the key to reducing the trade barriers created by the tax practices of many of our trading partners....It was not designed to give anybody a tax break."

DISC does not get a subsidy. Webster's dictionary defines a subsidy as, "a grant of money from a government to a private enterprise considered as beneficial to the public." DISC does not receive a subsidy from anyone; rather the law allows it to keep revenue that would otherwise go to the federal government in taxes. The government is lowering the tax rates for DISC. If the federal government would cut the taxes for all United States corporations, it would increase their competitiveness in foreign trade, and also allow corporations to have more funds available for capital formation.

The DISC is not a subsidy for rich corporations, but rather a belated recognition that perhaps those corporations who produce revenues should be allowed to keep some of them.

D. Terminating Deferral

Present law gives the United States companies a credit against American taxes for taxes paid to the host countries of their foreign operations. President Carter would phase out the entire program over a three-year period starting in 1979. After 1981, the earnings of a United States controlled foreign corporation will be taxed currently whether or not those earnings are paid to the United States shareholders (usually parent companies) as dividends.

Arguments For

By eliminating this tax deferral, American companies will have no incentive to invest in foreign countries just to evade taxes. The current tax laws and regulations are written so that only the large corporations, with their pools of lawyers and accountants, can benefit from the tax loopholes.

This, of course, gives a competitive advantage to them over smaller businesses and, therefore, distorts the marketplace. Finally, by taking away the tax deferral, large corporations will be prevented from investing in foreign countries and from ignoring their responsibility for creation of domestic jobs.

Arguments Against

For U.S. companies to be taxed by both the foreign countries in which they operate and by their own government would be an unwise practice.

American firms would be forced to eliminate part or all of their operations abroad, and the real losers would be American workers who would lose their jobs as well. By taking away the tax deferral from American firms, they would be put at a competitive disadvantage with foreign firms -- since many of these foreign firms are either nationalized by, subsidized or not taxed by their own countries. There could be a point where these foreign firms become so strong, that they eliminate certain American companies in the world marketplace and, therefore, cause unemployment here at home.

Finally, one of the recurrent arguments used for the repeal of tax deferral is that these tax privileges allow companies to invest in foreign countries which, in turn, either destroy or otherwise stop creation of new jobs in America. That statement is an example of the "lump of labor fallacy." It assumes that there are a limited number of jobs available whereby the acquisition of a job by one person of necessity requires that another lose his job. There is no evidence to support such a contention. It should be noted that the number of people holding jobs grew from less than a million during colonial times to over 90 million holding jobs now. All evidence suggests that this trend will continue, and the short history of the DISC's illustrates the positive affect that international trade has on the growth of jobs.

President Carter's proposal will raise taxes for these companies $0.1 billion in 1979 rising to $0.9 billion in 1983.

E. Simplification of ADR

ADR or Asset Depreciation Range is a system which enables taxpayers and corporations to depreciate their assets for income reporting purposes. Under the ADR system, the IRS prescribes a range of guidelines which taxpayers can use in setting the useful lives of their assets. Under President Carter's proposal, the ADR system will be simplified. Salvage value will be disregarded under the revised system. Elaborate reporting requirements will be replaced by Treasury Surveys which will require responses from only a small number of taxpayers each year. Only the straight-line and declining balance methods of depreciation will be allowed under ADR. These proposals will have little impact on taxes.

Analysis

Inflation has rendered asset depreciation range or useful life guidelines absolutely useless by making it impossible to recover the original cost of obsolete or worn-out equipment on a timely basis. Accelerated depreciation is essential so that equipment investment can be recovered in a five-year period or less, with a ten-year recovery period for industrial buildings. The foundry industry has been particularly hurt in this regard. This industry is one of the nation's most basic industries, comprising some 4,500 units which produce up to 22 million tons of all types of castings annually, having a value in excess of $13 billion. It employs over 400,000 production workers, and 80 percent of the firms in the industry employ less than 100 persons. The American foundry industry has found that competing foundries in other nations have grown rapidly because they have been permitted to take faster write-offs and have enjoyed the luxury of receiving capital as soon as an investment is made rather than having to wait until a facility is operative.

Consider how the United States compares to other industrial nations for plant and equipment investment as a percentage of GNP for the years 1960-1973: Japan's investment rose 27 percent; 20 percent in West Germany, 18 percent in Canada and France, 15 percent in Italy, 14 percent in the United Kingdom, and 13 percent in the United States.

Because of inflation, the asset depreciation range is completely ineffective, and can only be improved by a switch to accelerate depreciation. President Carter's proposals will not be effective in this area.

F. Small Business

The President has made a few recommendations that will be helpful to small business. They should present no problems with Congress and the public.

1. Stocks in a Small Business

Usually a loss on stock is a capital loss and is treated less favorably than an ordinary loss. Under President Carter's proposal, an exception in the present law (section 1244 of the Internal Revenue Code) that treats a loss on certain stock in a small business as an ordinary loss will be broadened, increasing the amount of stock that can come under the exception. Also, some technical rules that could prevent stock in a small corporation from coming under the exception will be eliminated.

2. Subchapter S

A Subchapter S corporation is taxed like a partnership where the shareholders pay tax on the earnings of the corporation but the corporation itself generally does not pay any tax. If a Subchapter S corporation loses money, the shareholders are generally, but not always, allowed to deduct the losses. A new Subchapter S corporation cannot have more than 10 shareholders under present law.

President Carter's proposal will allow Subchapter S corporations to have up to 15 shareholders and make it easier for them to deduct losses. Some technical rules in the code will also be simplified.

G. Taxation of Financial Institutions

Another of President Carter's proposals that will probably engender little opposition in the Congress or with public is the taxation of certain financial institutions. The following are the proposed changes:

1. Commercial banks will be required to base future additions to their bad debt reserves on their own actual experience in the current and five preceding years. Previously, the deduction for bad debts was

based on a fixed percentage of their eligible loans, regardless of their actual losses.

2. Mutual savings banks and savings and loan associations will be required to reduce their special bad debt deduction of 40 percent of net taxable income to 30 percent over a five-year transition period. Under present law, the deduction was to have been phased down to a permanent level of 40 percent in 1979.

3. Credit unions will be taxed on their income for the first time. After a five-year transition period, they will be taxed on the same basis as savings and loan associations.

The President may get some opposition on this last proposal. Most credit unions are non-profit, and are for the exclusive use of their members and families. They are similar to agricultural cooperatives and can be set up by employees of almost any kind of business. Because they do not advertise to the public nor openly compete against other financial institutions, the Congress may be hesitant in taxing them. The estimated increase in tax liabilities as a result of the President's changes will be $0.3 billion in 1979.

H. Accrual Accounting for Agricultural Corporations

The President will require all farm corporations, except those taxed like partnerships and those with less than $1 million of gross receipts, to use accrual accounting methods. Non-corporate syndicates will also be required to use accrual accounting. Under the present 1976 Tax Reform Act, all farm corporations except family farms were required to use accrual accounting methods. The family farm could use the cash method. Before the 1976 Act, all farms could use the cash method. A family farm is a corporation in which at least 50 percent of the stock is owned by members of the same family. Tax rules require taxpayers who sell products to report their income by the accrual method, and thereby accumulate their production costs in inventory until the product is sold. Cash accounting permits immediate deduction of expenses incurred whether or not the product is sold.

Arguments For

Absentee farmers have used cash accounting to claim artificial losses, thereby enjoying an unfair competitive advantage over the active farmer. Switching over to accrual accounting will simplify the tax laws and make the tax system more equitable.

Arguments Against

Accrual accounting adds the value of inventory to the taxable income. Since the value of the goods and equipment in the inventory must be based on an objective factor, that factor would be the price of the same good in the marketplace. If a tractor sold for X dollars, and the next year the price went up because of inflation, then that price would be the replacement cost of the tractor, even though the farmer could write off the original cost in depreciation. So, a $12,500 tractor bought in 1970 might cost $32,000 in 1978 because of inflation.

Another objection to accrual accounting is that farm commodities are difficult to measure in price because of price fluctuations. The major objection that farmers have to this new method, is that it would necessitate a more complicated set of books for the farmer to maintain. The farmer has enough trouble contending with OSHA, EPA, FDA, FTC and all the myriad of federal, state and local agencies without tackling a complicated system of accounting. Both the National Grange and the American Farm Bureau are opposed to accrual accounting and they contend that the problems associated with it will add to the farmers' already heavy burden.

One of the most ironic aspects of the federal government requiring farmers to use accrual accounting is that the government does not even use the system itself. In 1956, the second Hoover Commission strongly urged the implementation of this method, and this led to Public Law 84-863 which required all government agencies to install accrual accounting "as soon as practical." This method is now standard practice within federal agencies, but in 1967 the President's Commission on Budget Concepts made further suggestions along this line. "It also recommended accrual accounting and the presentation of the annual budget on an accrual expenditure basis. This was endorsed by two Presidents, but was not implemented during their administrations. Again, Congress appeared to prefer the 'obligation' type budget. There were some improvements made in accruals for the year-end statements of the federal government, but not always at the installation or operating level."[17]

In January 1976, Secretary of the Treasury William Simon announced that the Treasury Department would develop a consolidated financial statement to be published in early 1978. The prototype statement was released November 15, 1976. The Carter Administration has continued with the yearly Consolidated Financial Statements, but they are using the "obligation" type budget rather than a strict accrual-accounting budget.[18]

Finally, farmers reject the federal government requiring them to use accrual accounting on principle. If accrual accounting is so beneficial to farmers, they will switch to it of their own accord. They don't need the federal government requiring them to do this for their own good. There are very few people in the country who believe that the federal government knows more about farming than the farmers, and it behooves the government to refrain from placing further burdens on the backs of the family farmers.

[17] Arthur Anderson and Co., Sound Financial Reporting In the Public Sector: A Prerequisite to Fiscal Responsibility. Appendix 3, p. 33 (1975).

[18] For further information on accrual accounting in government, see "An Analysis of the 'Truth In Government Accounting Act' /H.R. 2408/," Issue Bulletin, The Heritage Foundation, Washington, D.C., February 9, 1977.

TAX EXEMPT FINANCING

A. State and Local Taxable Bond Option

Under present law, interest payments received from debt obligations issued by state and local governments and their instrumentalities are exempt from Federal taxes.

All debt obligations issued by the federal government are subject to federal income tax. President Carter has proposed that state and local governments have the option of issuing either conventional tax-exempt bonds or taxable bonds which will receive a subsidy from the Treasury for a fixed percentage of their interest costs. The choice will be entirely a matter for the state or local government to decide. For 1979 and 1980, the federal government will pay 35 percent of the interest costs on taxable bonds issued by state and local governments. For bonds issued thereafter, the interest subsidy will be 40 percent of the interest costs.

Arguments For:

This proposal will add to tax fairness and increased efficiency in the use of public resources. It is important that the tax exemption of interest on state and local bonds still be preserved, yet the windfall to higher income persons who do not pay tax on such interest can be reduced. This proposal will provide a benefit to state and local taxpayers through lower interest costs on government borrowings.

Arguments Against

Ending the federal tax exclusion on municipal bonds would thrust state and local governments into the private security markets, placing new costs and burdens on property taxpayers. The taxes would be borne by all property owners and taxpayers in all income brackets, so that everybody would pay for elimination of the tax deduction on municipal bonds, not only the people who purchase them.

Some critics of tax exemption for municipal bonds claim that people who invest in these bonds are stealing from the taxpayers through a tax break. The reality of the situation is that the return on these bonds is less than that of corporate bonds, and if you took away the exemption investors would not buy the government bonds. The result would be that essential improvements in state and local government facilities could only be made by increases in taxes, and the losers would be those in the lower income categories who are the largest users of these facilities.

President Carter's plan is to make municipal bond interest subject to regular taxes, but give the issuing authority a federal subsidy to help pay the higher interest rates.

This action would be just another in the continual erosion of states' rights and sovereignty. The states were envisioned by the Founding Fathers as having complete sovereignty in certain areas, while turning over to the federal government other rights for the good of the Republic. Many observers feel that the states are now administrative subdivisions of the federal government. The federal government is claiming that this will not increase authority over the states and local governments. However, that argument was used in behalf of federal aid to education, and now the nation's educators are revolting against the control that HEW and other federal agencies have on our educational institutions.

According to the Department of the Treasury, the estimated net costs to the federal government for the calendar years 1979 and 1983 are less than $50 million and $0.6 billion respectively.

B. Industrial Development Bonds

Under current law, industrial development bonds are securities issued by state and local governments for the benefit of private borrowers. Interest on these bonds are tax exempt only in the following cases:

1. bonds issued to provide financing for certain facilities such as pollution control equipment, sports arenas and convention halls, airports and industrial parks;

2. small issues where the amount of the bonds sold does not exceed $1 million or the total capital expenses on the facility being financed do not exceed $5 million; and

3. facilities (including hospitals) of private, non-profit organizations.

President Carter has proposed the following changes:

1. Interest on industrial development bonds issued for pollution control and industrial parks will no longer be tax exempt.

2. Bonds issued by state and local governments to finance hospital construction for private non-profit institutions will no longer be tax exempt unless there is a certification by the state that a new hospital is needed.

3. The size of projects which may be financed with tax exempt "small issues" of industrial development bonds will be increased from $5 million to $10 million, but the tax exemption will only be allowed for facilities constructed in economically distressed areas.

4. Industrial development bonds that continue to qualify for tax exemption may be issued as taxable bonds with the federal government subsidizing 35 percent of the interest costs of taxable bonds issued in 1979 and 1980 and 40 percent of the interest costs of bonds issued thereafter.

Arguments For

The tax exemption for pollution control bonds encourages firms to invest in environmental technology which, because of unproven methods or other reasons, would not receive funding in the private marketplace. Many pollution control investments have been effectively mandated by the requirements of federal law and by EPA regulations. Because these regulations compel firms to undertake the desired investments, tax exemption no longer functions as an effective incentive.

Unwise or inefficient private investment is encouraged by the tax exemption of interest income on industrial development bonds. This tax exemption also drives up the cost of municipal finance.

By ending the tax exemption for bonds issued to finance construction of unneeded hospital facilities for private non-profit hospitals, the undesirable incentive to build excess facilities will be eliminated, and the Administration's efforts to control rapidly growing hospital costs will be supported.

Restricting to distressed areas, the use of tax exempt financing for small issues of industrial development, will curtail the total volume of tax exempt bonds issued and will channel this subsidy to areas most in need. Furthermore, restricting the use of tax exempt industrial development bonds will limit the amount of interest income which escapes taxation, and will curtail the use of tax exempt financing by private borrowers.

Arguments Against

The tax exemption for pollution control bonds has served a useful purpose in two ways. First, it encourages construction of pollution control facilities by private industry, rather than the government forcing them to construct the facilities. Second, by giving tax exemption for these bonds it allows companies to recover their investment, and thereby aids in capital formation.

The argument is that unwise private investment is encouraged by the tax exemption of industrial development bonds. No evidence of such is offered by the proponents. On the other hand, much of the economic growth in the Sunbelt has been encouraged by the liberal issuance of industrial development bonds.

With respect to the tax exemption of construction bonds for private-nonprofit hospitals, it could be argued that the federal governments's deficit spending has served to crowd out funds in the private market normally available for this type of construction. It is estimated that all of these changes in industrial bond financing will increase taxes less than $50 million in calendar year 1979, rising to $0.3 billion in 1983.

IMPACT ON THE ECONOMY

Two recent studies have calculated the effect of the Carter tax programs on the economy as a whole. The first one, prepared by the Staff of the Joint Committee on Taxation of the Congress, points out that President Carter's tax reductions are too small to offset the increased social security taxes, energy taxes and inflation-induced tax increases.

TAX INCREASES[1]
(In Billions)

	Fiscal Year					
	1979[2]	1980	1981	1982	1983	TOTAL
Social Security	9.5	12.7	24.2	32.6	35.3	114.3
Inflation[3]	13.4	9.0	10.4	12.1	13.8	58.7
Energy Taxes[4]	2.9	12.3	15.4	7.7	4.2	42.5
Total	25.8	34.0	50.0	52.4	53.3	215.5
CARTER TAX PACKAGE						
Tax Cuts	30.4	37.1	41.9	46.4	52.4	208.2
Tax Increases	5.3	10.4	13.2	15.6	17.5	62.0
Net tax cuts	25.0	26.6	28.6	30.8	34.9	145.9

1. Prepared by the Staff of the Joint Committee on Taxation
2. Includes Fiscal 1978 increase of $7,200,000,000 and Fiscal 1979 impact of $18,600,000,000
3. Estimate based on 5 to 6 percent inflation rate
4. Based on energy tax bill passed by House

Source: Congressional Record, January 26, 1978, p. S612

Over the next five years, taxes will increase by $215.5 billion as a result of these expanded programs. The taxes will include $114 billion in new social security taxes, $58.7 billion in inflation-induced tax increases and $42.5 billion in new energy taxes. This is compared with the President's cumulative $145.9 billion tax cut which leaves a gap of $70 billion.

For a micro-view of the effect of Carter's tax program on a specific income, a tax study done by Robert E. H. Ferguson for the House Republican Study Committee ("The Tax Burden," January 27, 1978) should be reviewed. It analyzes the cumulative effect of President Carter's increase in social security payroll taxes, the energy taxes as passed in the House version of the energy bill, and the taxes resulting from the effects of inflation on the federal income tax structure. It should be noted that the President's $25 billion tax cut was not included in the study, but as mentioned previously, the tax cut does not include social security and energy taxes.

One table in the study points out, that by 1990, at an inflation rate of 6.5 percent, the family earning $15,500 today will have an adjusted after tax nominal income of $9,688.

TABLE 6

TOTAL NOMINAL INCREASES IN THE TAX BURDEN

Year	Increases in Taxes Due to Inflation Effect	Increases in Taxes Due to House Energy Bill	Increases in Taxes Due to Social Security Law	Adjusted After Tax Nominal Income
1977	$ 0	$ 0	$ 0	$14,008
1978	123	72	0	13,813
1979	251	272	14	13,471
1980	422	378	14	13,194
1981	592	442	70	12,904
1982	792	487	85	12,644
1983	1,022	569	90	12,327
1984	1,286	572	97	12,053
1985	1,584	546	192	11,685
1986	1,930	*-	191	11,887
1987	2,319	-	203	11,486
1988	2,776	-	217	11,015
1989	3,320	-	231	10,457
1990	3,898	-	422	9,688

This table assumes:

1. A 1977 income of $15,500
2. An annual increase in the CPI of 6.5%
3. The wage earner receives a 6.5% cost of living annually
4. The House passed energy bill becomes law (inclusive of rebates)

*Energy taxes will continue past 1985; however, estimates and figures in the bill only extended through 1985.

The standard of living for most Americans is falling and will continue to fall because of recent increases in taxes. It should be noted that the table only shows the increases from the old law to the new law with regard to Social Security, and therefore the full liability of social security payroll taxes is understated in this presentation.

It is apparent that Carter's tax program will be a heavy burden on the middle class. Inadvertantly, the President has said essentially the same thing. The changing of the $750 personal exemption to a $240 tax credit was described by the President as "designed to increase the progressivity of the tax system."

This change will result in an income transfer of $3.7 billion from those earning more than $20,000 per year to those earning less.[19] The rest of the tax program also seems to be an income shift from those in the upper-middle and upper income brackets to those in the lower and lower-middle income brackets. These changes include elimination of deductions for certain state and local taxes, the repeal of itemized political contributions, the severe change in medical and casualty deductions, the elimination of many business expense deductions, and many others. The view that upper-income taxpayers represent a vast, untapped source of income flies in the face of reality. Statistics of Income - 1975, issued by the Internal Revenue Service, shows the exact opposite.

a. The 1,119 individuals who reported incomes in excess of $1 million had an average taxable income of $1,570,000, and their taxes averaged $1,011,317 or 65 percent of taxable income.

b. Taxpayers with income over $50,000 a year represent 11.2 percent of all taxable income, but they pay 20.6 percent of all taxes.

c. While the average tax payment for all taxpayers was $2,020, the average payment for individuals with taxable income of $50,000 or more was $26,814.

d. Taxpayers earning more than $100,000 a year claimed a total of $6.5 billion in deductions; those earning less than $15,000 a year claimed deductions of more than $117 billion.

e. The 3.6 million taxpayers with incomes over $30,000 pay 35 percent of all income tax revenue. The 40 million taxpayers with incomes under $15,000 a year pay 25 percent of total collections.

[19] See "Table IV. -- $240 Credit in Lieu of the $750 Exemption, 1977 Income Level," Congressional Record, January 26, 1978, p. H334.

This data effectively destroys the myth that upper-income taxpayers have further monies available for taxation.

As for the net affect that President Carter's tax program will have on business, perhaps the Wall Street Journal editorial of January 27, 1978, gives a hint. "If business isn't overjoyed with President Carter's tax favors on its behalf, there is one simple explanation: Businessmen ...know how to add."

Two days before that editorial, the private consulting firm of Malmgren, Inc. of Washington, D.C., prepared an economic impact analysis of Carter's tax package and its effect on business. The picture was not very optimistic.

NET IMPACT OF PRESIDENT'S MAJOR TAX PROPOSALS ON U.S. CORPORATIONS

Legend: + represents benefits
- represents increased taxes

	Treasury Revenue Impact Estimates (millions)			
	1978	1979	1980	1981
TAX REFORM				
DISC (Domestic - Inter Sales Corp.)	-193	-664	-1,228	-1,513
Deferral		-88	-280	-768
Entertainment (martinis)	-1,125	-1,500	-1,600	-1,800
Corp. Real Estate Shelters		-40	-118	-194
Corp. "at risk" (Shelters)		-14	-10	-8
Investment tax credit				
50% to 90% of tax liability		+882	+576	+114
Application to fixed structures	+1,100	+1,400	+1,600	+1,800
Tax Reductions	+1,350	+5,900	+8,500	+9,200
SOCIAL SECURITY				
Corporate Share (½ of total)		-3,200	-4,700	-9,000
ENERGY				
House Version				
COET (net of rebates) (wellhead tax)				
(crude oil equalization tax)		-3,000	-8,600	-11,500
Users (net)			-398	-88
Senate Versions				
none				

TOTAL GAINS OR LOSSES TO CORPORATIONS

Without Energy Taxes	+1,132	+2,676	+2,740	-2,169
With Energy Taxes	+1,132	-324	-6,258	-13,669

Prepared by Malmgren, Inc., January 25, 1978

Many businessmen note that corporate profit rates may not rise at the 12 percent to 13 percent rate on which the Treasury Department has based their revenue estimates.

CONCLUSION

An objective look at the Carter's tax reform package reveals that the business portion of these changes will result in increased taxes for industry, and that the changes in individual taxes will not offset the massive increases in taxes for the middle-class that will occur in conjunction with higher social security and energy taxes. The President will have a difficult time getting this proposal past the Congress intact in an election year.

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