The Heritage Foundation Issue Bulletin

No. 33 | The Heritage Foundation • 513 C Street • N.E. • Washington, D.C. • 20002 • (202) 546-4400

August 22, 1978

UPDATE ON THE REVENUE ACT OF 1978

STATUS

On August 10, 1978, by a vote of 362-49, the House of Representatives passed the "Revenue Act of 1978" known as the Jones Amendment, named after Representative James R. Jones (D-Okla.).

The bill has now been sent to the Senate where the Finance Committee, chaired by Senator Russell Long (D-La.), will be holding hearings. On August 17th, Secretary of the Treasury Blumenthal testified on the bill, and August 21-25 will be set aside for public witnesses. The tax legislation is not expected to reach the floor of the Senate until September.

PROVISIONS

"The Revenue Act of 1978" is essentially the Jones Amendment with some smaller pieces of legislation tacked onto it. Any resemblance between this bill and President Carter's original tax message is purely coincidental. (For an item-by-item analysis of President Carter's tax bill, see "An Analysis of the Carter Tax Proposal," Backgrounder No. 55, The Heritage Foundation, Washington, D.C., March 14, 1978.)

The elements of H.R. 13511 include the following:

A. The increase of the personal exemption from $750 to $1,000. The general tax credit of $35 per person has been eliminated.

B. The standard deduction for individuals will rise from $2,200 to $2,300 and for joint returns from $3,200 to $3,400.

C. The tax deductions for state and local gas taxes will be eliminated.

D. To offset inflation, every tax bracket will be widened by 6 percent.

E. Currently 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. This bill would repeal the itemized deduction, but keep the alternate credit.

F. The law does not include unemployment benefits paid under government programs as taxable income. Under this bill, all single taxpayers with incomes over $20,000 and married couples of $25,000 income will have their unemployment compensation benefits taxed.

G. Under existing law, individuals may 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 may also 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 President's plan would have allowed deductibility of medical expenses and casualty losses only when they exceeded 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.

The tax bill approved by the House would consolidate payments for medical expenses and health insurance premiums into a 3 percent of income floor, and medicines and drugs into a 1 percent of income floor. All other health-related expenses above those bases would be tax deductible.

H. Capital gains tax is the major portion of the tax code that is revised. Under this bill the first $100,000 of profit in the sale of a house would be excluded from capital gains taxes provided the seller lived in the house for two of the three years preceeding the sale. This exclusion could only be used once in a lifetime, and would apply to sales after July 26, 1978. The present law also allows individuals to postpone the capital gains tax if they sell a home and buy another (within eighteen months) at least as expensive as the selling price of the previous home.

The bill also exempts capital gains from the minimum tax and sets a ceiling on all gains (including those below $50,000) of 35 percent. It will also reduce the capital gains tax for corporations from 30 percent to 28 percent. The present maximum rate on capital gains is 49.1 percent.

I. The reduction of the corporate tax rates achieved in this bill is fairly dramatic. The following table on page 4 illustrates the changes in the corporate income tax.

A portion of the bill known as the Archer Amendment (named after its author, Representative Bill Archer, R-Tex.) would adjust capital gains on stock, personal property, and real estate for inflation, thus taking the profit that the federal government receives on inflation out of the tax code. (See attachments A & B)

J. Another provision of this bill would extend permanent status to the 10 percent investment tax credit which is now temporary. It would allow the credit to be used toward rehabilitating structures. At this time the credit can be used to offset only 50 percent of a firm's tax liability over the first $25,000, but H.R. 13511 would increase this to 90 percent within four years. 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.

K. In the bill passed by the House of Representatives, a tax credit to encourage firms to hire the disadvantaged was included. An employer would receive up to a $3,000 credit the first year the worker was hired,

CORPORATE TAX RATES

Under Present Law		President Carter's Proposals		H.R. 13511	
		Effective October 1, 1978			
Up to $25,000 taxable income	- 20%	Up to $25,000 taxable income	- 18%	Up to $25,000 taxable income	- 17%
In excess of $25,000 up to $50,000	- 22%	In excess of $25,000 up to $50,000	- 20%	In excess of $25,000 up to $50,000	- 20%
In excess of $50,000	- 48%	In excess of $50,000	- 45%	In excess of $50,000 up to $75,000	- 30%
		Effective January 1, 1978, the top rate would decline to 44%.		In excess of $75,000 up to $100,000	- 40%
				Above $100,000	- 46%

SAMPLE TAXES PAID BY FIRMS UNDER THE VARIOUS TAX PROPOSALS

Under Present Law		Taxes Paid	President Carter's Proposals		Taxes Paid	H.R. 13511		Taxes Paid
A. $5,000	taxable income -	$ 1,000	A. $5,000	taxable income -	$ 900	A. $5,000	taxable income -	$ 850
B. $40,000	" " -	8,300	B. $40,000	" " -	7,500	B. $40,000	" " -	7,250
C. $60,000	" " -	15,300	C. $60,000	" " -	15,000	C. $60,000	" " -	12,250
D. $85,000	" " -	27,300	D. $85,000	" " -	25,250	D. $85,000	" " -	20,750
E. $150,000	" " -	58,500	E. $150,000	" " -	54,500	E. $150,000	" " -	49,750
F. $500,000	" " -	216,000	F. $500,000	" " -	212,000	F. $500,000	" " -	210,750
G. $1,000,000	" " -	456,000	G. $1,000,000	" " -	437,000	G. $1,000,000	" " -	440,750

and $1,000 the second year. Workers who would qualify an employer for the credit include Vietnam veterans, members of families that receive food stamps, the handicapped, and recipients of Aid to Families with Dependent Children. With a price tag of $271 million in 1979, this program would replace the current one which costs about $2.4 billion.

ANALYSIS

As mentioned earlier, this tax bill has little resemblance to the one that President Carter presented to the Congress. Sensing that the country did not favor restricting job-related food and entertainment expenses, the Ways and Means Committee completely ignored the President's objection to the "three martini lunch" when it came time to write the bill. Those recommendations that were uncontroversial and corrective in nature (rather than revenue-producing) were incorporated in this bill. Examples are the provisions relating to Subchapter S corporations and the depreciation rules for small businesses.

However, President Carter's recommendations to take away tax exemption from state, local, and industrial development bonds; his increased taxation of commercial banks, mutual savings banks and savings and loan associations, and credit unions; his elimination of DISC and termination of tax deferrals that American companies have on taxes paid to the host countries of their foreign operations; his taking away tax exemption from certain types of medical, disability, and life insurance, employee death benefits and qualified retirement plans; his decision to take away the tax exemption on state and local income taxes, real property taxes, sales, and personal property taxes were all rejected.

Even though this bill is more of a tax reduction rather than a tax increase, it will not cover all areas. "The tax 'cut' bill passed by the House Ways and Means Committee will not keep taxpayers even with the impact of inflation and the higher social security taxes scheduled to take effect in 1979....The social security tax increase passed by Congress last year...will raise the payroll tax rate to 6.13 percent in 1979, against 6.05 percent this year and 5.85 percent in 1977. In addition, the amount of salary subject to the tax is to rise from $16,500 in 1977 and $17,700 in 1978 to $22,900 in 1979. Inflation affects the tax burden by kicking taxpayers into higher brackets. Salaries may increase by 7 percent a year, but even though most or all of the income is eaten up by inflation, taxpayers must pay higher tax rates on the additional income." ("Tax Cut Debate May Come Back to Haunt House Members," Robert J. Samuelson, National Journal, August 5, 1978, p. 1,247)

To say that the middle class will be getting tax relief by this bill would be true only if we do not take into consideration other spending programs of the federal government. Over the next five years, taxes will increase by $215.5 billion. 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. (Congressional Record, January 26, 1978, p. S612)

Since President Carter's original proposal called for a $25 billion tax cut, and H.R. 13511 is only $16 billion (including business tax cuts), the middle-class income taxpayer will still see his total tax bill go up this year.

CONCLUSION

When H.R. 13511 was being considered on the floor of the House, the Republicans proposed that the bill be recommitted to the Ways and Means Committee with the instructions that a vote on the Kemp-Roth tax cut plan be allowed when the bill was reported back to the House. The motion was defeated 240 to 177.* The Kemp-Roth bill calls for a deep across-the-board cut in personal income tax rates--an average of 30 percent--to be phased in over a three-year period. It also calls for a mild reduction in the top corporate rate, from 48 to 45 percent over three years, as well as an increase in the threshold--from $50,000 to $100,000--at which the top corporate rate takes effect.

However, now the action will take place in the Senate Finance Committee where Senator Russell Long is chairman. Long has proposed cutting the maximum capital gains rate to 27 percent, and tax cuts closer to $20 billion.

David A. Williams
Policy Analyst
Economics/Taxation

*See attachments A & B.

Attachment A

Vote Analysis (By Party)

1. Revenue Act of 1978 -- H.R.13511 (Archer Amendment)

The House adopted the Committee Amendment (Section 404) that adds language indexing capitol gains to the rate of inflation beginning in 1980.

	YES		NO		NOT VOTING		TOTALS	
Democrats:	114	(40%)	159	(55%)	14	(5%)	287	(100%)
Republicans:	135	(93%)	8	(5%)	3	(2%)	146	(100%)
TOTALS	249	(57%)	167	(39%)	17	(4%)	433	(100%)

2. Revenue Act of 1978 -- H.R.13511 (Kemp Motion)

The House requested a motion to recommit the bill to the Ways and Means Committee with instructions to report back forthwith containing an amendment to provide an across-the-board cut in individual income taxes averaging 33% phased in over three years.

	YES		NO		NOT VOTING		TOTALS	
Democrats:	37	(13%)	237	(83%)	13	(4%)	287	(100%)
Republicans:	140	(96%)	3	(2%)	3	(2%)	146	(100%)
TOTALS	177	(41%)	240	(55%)	16	(4%)	433	(100%)

Attachment B

Vote Analysis (By Region)

1. Revenue Act of 1978 -- H.R.13511 (Archer Amendment)

	YES		NO		NOT VOTING		TOTALS	
New England:	9	(36%)	15	(60%)	1	(4%)	25	(100%)
Middle Atlantic:	47	(59%)	30	(38%)	3	(3%)	80	(100%)
E. N. Central:	40	(47%)	43	(50%)	3	(3%)	86	(100%)
W. N. Central:	25	(71%)	10	(29%)	0	(0%)	35	(100%)
Border:	19	(60%)	11	(34%)	2	(6%)	32	(100%)
South:	76	(76%)	21	(21%)	3	(3%)	100	(100%)
Mountain:	13	(68%)	5	(26%)	1	(5%)	19	(100%)
Pacific:	20	(36%)	32	(57%)	4	(7%)	56	(100%)
TOTALS	249	(57%)	167	(39%)	17	(4%)	433	(100%)

2. Revenue Act of 1978 -- H.R.13511 (Kemp Motion)

New England:	10	(40%)	14	(56%)	1	(4%)	25	(100%)
Middle Atlantic:	26	(33%)	52	(65%)	2	(2%)	80	(100%)
E. N. Central:	41	(48%)	42	(49%)	3	(3%)	86	(100%)
W. N. Central:	16	(46%)	18	(51%)	1	(3%)	35	(100%)
Border:	13	(41%)	18	(56%)	1	(3%)	32	(100%)
South:	41	(41%)	55	(55%)	4	(4%)	100	(100%)
Mountain:	10	(53%)	8	(42%)	1	(5%)	19	(100%)
Pacific:	20	(36%)	33	(59%)	3	(5%)	56	(100%)
TOTALS	177	(41%)	240	(55%)	16	(4%)	433	(100%)

STATES AND REGIONS

New England

Connecticut
Maine
Massachusetts
New Hampshire
Rhode Island
Vermont

Middle Atlantic

Delaware
New Jersey
New York
Pennsylvania

East North Central

Illinois
Indiana
Michigan
Ohio
Wisconsin

West North Central

Iowa
Kansas
Minnesota
Missouri
Nebraska
North Dakota
South Dakota

Border States

Kentucky
Maryland
Oklahoma
Tennessee
West Virginia

Solid South

Alabama
Arkansas
Florida
Georgia
Louisiana
Mississippi
North Carolina
South Carolina
Texas
Virginia

Mountain States

Arizona
Colorado
Idaho
Montana
Nevada
New Mexico
Utah
Wyoming

Pacific States

Alaska
California
Hawaii
Oregon
Washington