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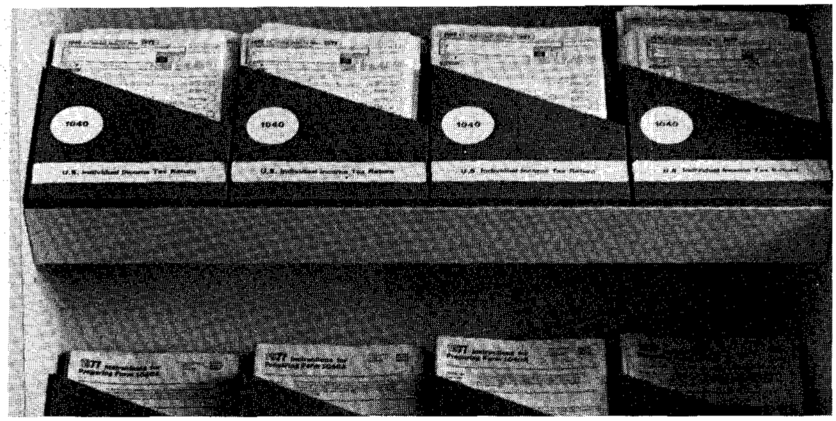

photo by John Clark Mayden

Note On Recent Changes In The Federal Income Tax

by H. Jerome Fenzel

Waiting for Congress to truly reform and simplify the Tax Code so that the "average" taxpayer could understand it is like waiting for Tampa Bay to win the Super Bowl. The Tax Reform Act of 1976, Pub. L. 94-455 (October 4, 1976), made some sweeping changes in the 1954 Code regarding corporate and individual tax rates, various income tax credits, as well as completely overhauling the estate and gift tax provisions. Also, many tax shelters enjoyed by more affluent taxpayers[1] have been severely limited, thus directing investor attention towards other higher-yielding ventures or more secure investments. The holding period for long-term capital gains and losses has been extended from six months in 1976 and prior years to nine months in 1977 and twelve months in 1978; the net capital loss offset against ordinary income was increased from $1,000 to $2,000 for tax years beginning in 1977 and $3,000 for subsequent years. These changes barely reflect the total and comprehensive reforms which were effectuated by the 1976 Act.

TAX SIMPLIFICATION

The ninety-fifth Congress instead of further reforming the Tax Code decided to make it a little bit simpler by passing the Tax Reduction and Simplification Act of 1977, Pub. L. 95-30 (May 23, 1977). President Carter, although not completely satisfied with the bill, signed the Act into law on the advice of Treasury Secretary Blumenthal. The bill, much to the chagrin of the millions of Americans who already had their fifty bucks spent, did not contain the anti-Arthur Burns $50 rebate. But the bill did contain many provisions which served to reduce taxes for many lower and middle-income taxpayers, thus fiscally stimulating the economy by converting would-be tax dollars into disposable income.

The effect of the Act was to extend some corporate and individual tax reductions which were due to expire at the end of 1977. It radically changed the standard deduction and the method for computing a person's tax liability, and delayed the effective dates for the elimination of the sick-pay exclusion as well as the harsher limitation to be set on income earned abroad.

REDUCTION OF INDIVIDUAL TAXES

The Tax Reduction and Simplification Act of 1977 (Act) extended through tax years ending in 1978 those individual tax reductions which were originally enacted by the 1976 Tax Reform Act. The 1977 Act provides for a $35 per capita tax credit and allows an extra $35 credit for those individuals over 65 years of age and for legally blind taxpayers.[2]

The 1977 Act also continued the earned income credit which benefits a taxpayer who heads a household for a child under 19 years of age and earns under $8,000 annually. This section is aimed principally at widows, divorcees, or unwed mothers who are forced to find employment in order to maintain a minimal level of care for their children.

Probably, the changes in the standard deduction methodology were the most significant in simplifying the individual's tax return preparation. The number of computations at arriving at one's tax liability from adjusted gross income have been reduced.

The old standard deduction was sixteen percent of adjusted gross income with a minimum deduction of $1,700 for single taxpayers and heads of households and $2,100 for married individuals filing jointly. The maximums for those classifications were $2,400 and $2,800 respectively.

The new simplified standard deductions are not based on percentages of adjusted gross income nor are they subjected to minimum or maximums. The standard deduction is now a flat amount depending on your marital status and how you file your return. The fixed deduction amounts are as follows:

Taxpayer	Standard Deduction
Single or head of household	$2,200
Married filing jointly	$3,200
Married filing separately	$1,600

The effect of the changes to the standard deduction would tend to increase the 1977 tax liability for single individuals with adjusted gross incomes over $12,000 when compared with the same amount of income in 1976. For single tax-

[1] farming syndicates, construction period interest for commercial real estate, interest expense deductions, sports franchises, additional first-year depreciation for partnerships and production costs of films, records, books, etc. to name a few.

[2] Congress apparently feels that blindness is a malady which deserves special tax considerations, but does not grant similar exemptions to those individuals being deaf, mute or otherwise seriously handicapped.

payers earning under $12,000, heads of household and married persons without dependents, the final tax liability would decrease in 1977 by using the new standard deduction amounts. No change in tax liability would result for those persons itemizing deductions; however, instead of these new standard deductions will result in less taxpayers electing to itemize.

The changes in the standard deduction also automatically raise the income levels at which persons are required to file tax returns. The new income levels are as follows:

Taxpayer	Income Level Pre-1977	1977 Act
Single or head of household	$2,450	$2,950
Married	$3,600	$4,700
Surviving spouse	$2,850	$3,950

REDUCTION OF BUSINESS TAXES

The Tax Reduction Act of 1975 increased the maximum surtax exemption for corporations from $25,000 to $50,000 of taxable income. The corporate income tax rates were also changed by the 1975 Act as follows:

	Pre-1975	1975 Act
up to $25,000	22%	20%
from $25,000-$50,000	48%	22%
over $50,000	48%	48%

These exemptions and rates have been extended by the 1977 Act through tax years ending in 1978. According to Washington sources, the Carter tax package will contain a number of measures for business tax relief, one being a cut in the corporate tax rate from 48 percent to 46 percent.

The 1977 Act provides for employers a New Jobs Tax Credit which is tied into the Federal Unemployment Tax Act (FUTA) payments. The maximum credit available is 50 percent of the first $4,200 (same wage base under FUTA) of wages paid to additional employees. The effective tax credit would depend on the employer's income tax rate. For example, if an employer is in the 50 percent tax bracket the maximum effective credit for an additional employee would be $1,050 (50% of $4,200 x 50% tax rate).

The New Jobs Credit is available for both corporate and individual employers but does not apply to domestic employees, employees not covered under FUTA, and employees of tax exempt organizations or cooperatives.

There are limitations on the amount of annual credit allowed to be used by employers, particularly on new or rapidly expanding businesses. The amount of the credit cannot exceed the employer's income tax liability for any one year but may be carried back three years and forward seven.

FUTURE REFORM

The original 1977 tax bill prepared by the Senate Finance Committee increased the investment tax credit from 10 percent to 12 percent (or from 11 or 11 1/2 percent to 13 or 13 1/2 percent, respectively, where the election for an employee stock option program (ESOP) also has been made), but was not a part of the final Act signed by the President.

However, it appears that the Carter tax package will be kind to businesses by boosting the investment tax credit to at least 12 percent not just on machinery and equipment, but also on structures. Hopefully, relief such as this will spur necessary business capital spending.

Other interesting changes which may be proposed by the Carter Administration in early 1978 are changes in the capital gains and loss structure, the double taxation of dividends, and the taxability of perquisites enjoyed by corporate executives. No matter what is finally enacted, it is quite certain that not only will the Internal Revenue Code not be revolutionized, but will continue to be incomprehensible by the majority of America's taxpayers.