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THE TAX REDUCTION AND SIMPLIFICATION ACT OF 1977

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It appears that Congress has begun to pass major tax legislation much more frequently than in the past. The Tax Reduction and Simplification Act of 1977 follows closely after the Tax Reform Act of 1976. At the present time, Congress is working on tax phases of the energy program and the President plans to propose major tax legislation to be effective in 1978.

Although, part of the 1977 legislation is simplification, it will be simple only to some taxpayers. For many others, including tax practitioners, it becomes even more complex. It involves a major change in definition of terms, and it creates some new terms. Under the old law, taxable income for individuals means adjusted gross income reduced by the standard deduction (or itemized deductions) and by personal exemptions. The new law redefines taxable income as adjusted gross income reduced by "excess itemized deductions" and by personal exemptions, and in a few cases, increased by "unused zero bracket amount", if any.

Zero bracket amounts, the flat standard deduction amounts, are set at $3,200 for joint returns, heads of household, and surviving spouse; $2,200 for single individuals; $1,600 for married individuals filing separately, and zero in any other case. The creation of the zero bracket means that for a joint return a 14 percent rate would start at a taxable income for $3,201, instead of taxable income of $1, as under present law.

The new tax tables will incorporate the standard deduction, personal exemptions, and the general tax credit. They are to be used by individuals whether or not they itemize deductions. The table is expected to be used by single individuals with up to $20,000 income and up to $40,000 on joint returns. Taxpayers whose itemized deductions exceed the flat standard deductions will deduct the excess itemized deductions to obtain the tax table income. Example: John Doe, a single taxpayer, has adjusted gross income of $18,000 and itemized deductions of $2,600. The taxable income would be computed as follows:

adjusted gross income		$18,000
itemized deductions	2,600	
less, standard deductions	2,200	
	400	400
Taxable Table Income		$17,600

Taxpayers who must add the unused zero bracket amounts are married individuals filing separate returns where either spouse itemizes deductions, non-resident alien, U. S. citizens entitled to benefits of Section 931, and individuals such as students, with little income, but with passive or investment income who are claimed as dependents by other taxpayers. An example follows: Mary Doe, a married woman has adjusted gross income of $12,000 and itemized deductions of $500. Her husband filed a separate return and itemized his deductions. Her tax table income is as follows:

adjusted gross income		$12,000
zero bracket amount	1,600	
less, itemized deductions	500	
	1,100	1,100
Taxable Table Income		$13,100

New Rate Schedules--New rate schedules are to be used by those ineligible to use the tax tables. Those ineligible to use the tax tables are those with taxable income above the tax table limits, those with too many exemptions, those using income averaging, alternative capital gains tax, maximum tax on personal tax, foreign income exclusion, and those who file a short period return due to change in accounting period.

The rate schedules are based on taxable income. The standard deduction is built into the rate schedules, however, an individual's adjusted gross income has to be adjusted to arrive at taxable income. Thus, the adjusted gross income is reduced by the sum of the excess itemized deductions, if any, and the personal exemptions; and to this figure is added any unused zero bracket amount, if applicable.

Thus, for many, the law is simplified since the standard deduction, personal exemptions, and general tax credit are included in the tax tables. However, as stated earlier, it will be more complex for many others.

Other changes in the tax law are as follows:

1. The act extends the general tax credit through 1978. The credit is the greater of (a) 2 percent of the first $9,000 of earned income, (b) $35 for each personal exemption the taxpayer may claim. Two additional changes are made. First, a taxpayer is entitled to include exemptions for age and blindness in determining his credit, and second, a married taxpayer who files separately must use the $35 per exemption method in computing his or her tax credit.

2. Earned income credit is extended for taxable years ending in 1978. The credit remains 10 percent of the first $4,000 of earned income and is phased out as earned income or adjusted gross income (whichever is larger) rises to $8,000.

3. Fiscal year taxpayers cannot prorate the new standard deduction since these new tables and schedules are not a change in the rate of tax. These changes do not have any pro-rate effect on 1976-1977 fiscal-year taxpayers.

4. The Sick-Pay Exclusion Repeal was postponed to tax years after 1976. This permits individuals who qualified for the Sick-Pay Exclusion in 1976 to file an amended return (Form 1040X) and claim the exclusion.

5. New Jobs Tax Credit. The new law creates a new jobs tax credit which provides employers with a tax incentive to create new jobs. Employers who hire additional employees during 1977 and 1978 can qualify for this credit for their tax years beginning in 1977 and 1978.

Generally, the credit is based on the unemployment insurance wages under the Federal Unemployment Tax Act (FUTA). Wages for FUTA tax purposes mean all wages paid for employment up to $4,200 in 1977. Employers not covered under FUTA with the exception of railroad and farm employees are not eligible for the jobs tax credit.

For tax years beginning in 1977, the jobs tax credit is 50 percent of the amount by which an employer's FUTA wages paid during 1977 exceeds 102 percent of FUTA wages paid during 1976. There is also an additional 10 percent credit for hiring certain handicapped individuals.

There are four limitations applicable to the amount of credit allowable as follows:

(1) 50 percent of the excess of total wages paid during the current year, over 105 percent of total wages paid during the previous year.

(2) 25 percent of FUTA wages paid during 1977 or 1978.

(3) $100,000 for any given year (except for additional credit for handicapped individuals.)

(4) The employer's income tax liability for the year.

The employer's deduction for wages must be reduced by the amount of the credit. For example, if an employer was entitled to $20,000 credit, he would have to reduce his wage deduction by $20,000 to determine the tax liability. If the tax liability was $18,000, a total of $18,000 credit could be used.

Other items of interest are as follows:

A. Employers who hire handicapped individuals who have been referred to the employer under a vocational rehabilitation referral plan may be eligible for an additional 10 percent credit.

B. Wages must be for a trade or business in the U. S. Maids, chauffeurs, or other household employees do not qualify.

C. Special rules apply to partnerships, Sub-chapter S corporations, and estates and trusts. In general, the credit will be allocated to the partners and shareholders.

D. Unused credit may be carried back three years and the remaining balance, if any, carried forward seven years.

Special rules apply to farmers. Instead of FUTA wages, farmers are to use social security records (FICA) up to $4,200.

An example follows: Mr. Farmer had FICA wages of $8,400 in 1976 and $12,600 in 1977; total wages were $11,000 in 1976 and $16,500 in 1977. The employer's tax liability before application of the job credit was $10,000. The jobs credit would be computed as follows:

(1)	FICA Wages paid in 1977		$ 12,600
(2)	FICA Wages paid in 1976	$8,400	
(3)	Multiplied by 102 percent	1.02	8,568
(4)	Difference		$ 4,032
(5)	50 percent above		.50
(6)	Tentative job credit		$ 2,016

FICA WAGE LIMITATION

(7)	FICA wages paid in 1977	$ 12,600
(8)	Multiplied by .25	
(9)	FICA Limitation	$ 3,150

TOTAL WAGE LIMITATION

(10)	Wages paid in 1977		$ 16,500
(11)	Wages paid in 1976	$11,000	
(12)	Multiplied by 105%	1.05	11,500
(13)	Difference		$ 4,950
(14)	Multiplied by 50%		2,475
(15)	Wage Limitation		$ 2,475
(16)	$100,000 Limitation		$100,000
(17)	Limitation based on tax liability		$ 10,000

Since line 6 is less than line 9, 15, 16, or 17, the job credit would be $2,016.

There is an additional limitation to be met, if handicapped employees are hired. The additional 10 percent credit for hiring handicapped workers cannot exceed 20% of the credit, otherwise allowable. (Excluding the $100,000 limitation)

See IRS Publication 902, "Tax Information on Jobs Tax Credit," for additional information.

Other provisions in the Act are:

1. The corporate tax rates due to expire in 1977 have been extended through 1978.

2. Taxpayers may file amended returns for 1976 and claim retirement income credit under the law prior to the 1976 Tax Reform Act.

3. Certain farming corporations do not have to adopt the accrual method of accounting until after 1977.

4. The effective date of the changes in foreign earned income exclusion is delayed until after 1976.

5. The tax treatment of intangible drilling costs were changed.

6. Special rules apply to the business use of a residence for day care services.

7. Certain changes affecting state legislator's travel expenses were made.

8. The act relieves certain taxpayers from liability for tax and interest for underpayment and under withholding of 1976 taxes attributable to changes in the Tax Reform Act of 1976.

9. Withholding changes of certain gambling winnings were made.

10. Amortization of certain child care facilities may be made.

11. County withholding taxes may be made from certain federal employees.

12. Changes in charitable conservation gifts were made.

Filing Requirements

	1976	1977
Single taxpayer	$2,450	$2,950
Single taxpayer (age 65 or over)	3,200	3,700
Married couple filing joint return.	3,600	4,700
Married couple filing jointly (one spouse age 65 or over)	4,350	5,450
Married couple filing jointly (both spouses age 65 or over)	5,100	6,200
Married taxpayer filing separate return	750	750
Surviving spouse.	2,850	3,950

Note: A taxpayer must file a return and pay social security taxes, if he has $400 or more of self-employment income.

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