[COMMITTEE PRINT]

TAX REDUCTION PROGRAM

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INDIVIDUAL TAX REDUCTIONS

PREPARED FOR THE

COMMITTEE ON FINANCE
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BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

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I. ONE-TIME INCOME TAX REFUNDS AND RELATED PAYMENTS

A. House Bill

Tax refund

The House bill includes a refund of 1976 individual income taxes. The refund would be $50 per taxpayer and dependent, but would be phased out as adjusted gross income (AGI) rises from $25,000 to $30,000.[1] Thus, a family of four would receive a $200 refund if its AGI were $25,000, a $100 refund at AGI of $27,500 and no refund if its AGI were $30,000 or more. Table 1 shows the income distribution of the tax refund in the House bill.

Table 1.—Distribution by Income Class of the $50 Tax Refund Under the House Bill [1]

[By adjusted gross income class—Calendar year 1976 income levels]

Adjusted gross income class	Number of returns affected (thousands)	Tax refund	
		Amount (millions)	Percent of total refund
Under $5,000	10, 713	$981	11. 4
$5,000 to $10,000	19, 500	2, 004	23. 4
$10,000 to $15,000	16, 080	2, 230	26. 0
$15,000 to $20,000	11, 782	1, 907	22. 2
$20,000 to $30,000	9, 910	1, 454	17. 0
$30,000 and over [1]			
Total	67, 984	8, 577	100. 0

[1] Under the House bill, the refund is phased out completely for those with AGI of $30,000 and over.

Note.—Details may not add to totals because of rounding.

Generally, the refund would be limited to the amount of tax liability. In two cases, however, it could exceed tax liability.

One category of people who could receive a refund in excess of tax liability would be taxpayers who claim the earned income credit. (Enacted in the Tax Reduction Act of 1975, the earned income credit equals 10 percent of the initial $4,000 of earned income and is phased out as earned income or AGI rises from $4,000 to $8,000. It is available

[1] For married persons filing separate returns, the phaseout would be between adjusted gross incomes of $12,500 and $15,000.

only to a taxpayer who maintains a household for a minor or student child or for an adult disabled dependent child. It is a "refundable" credit; that is, it can exceed tax liability.)

The House bill includes a second category of people for whom the refund could exceed tax liability to prevent a "notch" [2] in the refundable feature of the proposal. In general, this second category consists of people who would have been eligible for the earned income credit were it not for the income phaseout of that credit. Specifically, these are people with some earned income and a dependent child. There will still be a small number of cases in which the "notch" remains, but it is difficult administratively to eliminate the notch entirely and still provide the full $50 refund to recipients of the earned income credit.

In addition, the bill includes authorization of payments to the governments of the Virgin Islands, Guam and American Samoa to compensate for the reduction in their tax revenues which results automatically from the refund provision and certain other parts of the bill because these possessions use a "mirror image" of the U.S. tax laws for their own income tax.

Related payments

The bill includes a special $50 payment to beneficiaries of social security, SSI, railroad retirement, black lung programs, State supplements to SSI, and Veterans' Administration pensions and compensation. A beneficiary of more than one program is limited to one $50 payment. The bill also denies this special payment to persons who receive the $50 per capita tax refund. Thus, a person who is, for example, a beneficiary of social security is not to receive the $50 social security payment if his per capita tax refund is $50; however, he is to receive the full $50 social security payment if he is not eligible for a tax refund either because he paid no taxes or was subject to the income phaseout. The payment to a beneficiary is to be scaled down proportionately to the extent his tax refund is between $0 and $50.

There is also to be a $50 payment to each recipient of aid to families with dependent children (AFDC) who is not a beneficiary under one of the other income maintenance programs described above. However, the House bill provides that any AFDC recipient does not become disqualified for the $50 payment merely because he or she is also eligible for a tax refund.

The bill allows the Secretary of the Treasury to waive the rules against double payments if he determines that applying them to certain categories of people would unduly delay the payments. In these cases, the Secretary must report to Congress the circumstances of the waiver.

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[2] If the refund were allowed to exceed tax liability only for recipients of the earned income credit, there would be a "notch" at the income level at which the earned income credit phases out. For example, a 6-person family with AGI of $7,999 would be entitled to a 10 cent earned income credit under present law, which would make it eligible for a $300 refund under the House bill. (A 6-person family does not pay tax on the first $8,067 of income under existing law because of the personal exemption, the minimum standard deduction and the general tax credit.) However, if the refund could exceed tax liability only for recipients of the earned income credit, a one-dollar increase in income to $8,000 would eliminate the family's earned income credit and thereby reduce its refund from $300 to zero.

Disregard provisions

The House bill also provides that the tax refund and related payments are to be disregarded in determining eligibility or benefits under federal or federally assisted income maintenance programs.

Budget effect of House bill

The tax refund under the House bill is estimated to be approximately $8.6 billion ($1.3 billion of which represents payments in excess of income tax liability), and the related payments are estimated to be approximately $1.9 billion, all in fiscal year 1977.[3]

B. Administration Proposal

Original proposal

The original Administration refund and payment proposal was similar to the provision in the House bill except that it did not include (1) the income phaseout of the tax refund; (2) the special payments to beneficiaries of AFDC, black lung programs, Veterans Administration pensions and compensation and State supplements to SSI; and (3) the rules to prevent double payments. Table 2 shows the distribution of the Administration's $50 tax refund proposal.

Table 2.—Distribution by Income Class of the Administration's $50 Per Capita Tax Refund

Adjusted gross income class	Number of returns (millions)	Amount of tax decrease (thousands)	Percent of tax decrease
Under $5,000	10, 713	$981	10. 2
$5,000 to $10,000	19, 500	2, 004	20. 9
$10,000 to $15,000	16, 080	2, 230	23. 2
$15,000 to $20,000	11, 782	1, 907	19. 9
$20,000 to $30,000	9, 910	1, 699	17. 7
$30,000 to $50,000	3, 298	567	5. 9
$50,000 to $100,000	947	169	1. 8
$100,000 and over	216	36	. 4
Total	72, 445	9, 594	100. 0

Note.—Details may not add to totals because of rounding.

Budget effect.—The Administration proposal would have involved a tax refund of $9.6 billion, of which $1.3 billion would have been payments in excess of tax liability. The $50 payment to beneficiaries of social security, SSI, and railroad retirement programs would have involved outlays of $1.8 billion.

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[3] The estimate in the House committee report ($1.5 billion) assumed complete elimination of double payments. Subsequent analysis indicates that this will not be the case; therefore, this cost estimate has been increased to $1.8 billion.

Current Administration position on House bill

The Administration supports some of the provisions in the House bill that differ from its original $50 refund and special payments proposal, but it opposes others. It supports the income phaseout of the tax refund, the extension of the $50 payment to AFDC recipients and the rules to prevent double payments. However, the Administration opposes the extension of the $50 payment to recipients of black lung benefits and Veterans Administration (VA) pensions and compensation. In his testimony before the Finance Committee, Secretary Blumenthal stated that the Administration opposes these provisions in the House bill because most recipients of black lung benefits and VA pensions would receive a tax refund or would benefit from the special payments to social security or other income maintenance beneficiaries and there are serious administrative problems in enforcing the rules against double payments in the case of VA beneficiaries. (These issues are discussed below under the heading of "Coverage and Double Payments", in section D.)

C. Tax Reduction Act of 1975

The Tax Reduction Act of 1975 included a refund of 1974 individual income taxes. The bill was enacted on March 29, 1975, and most of the refund checks were mailed in May and early June.

The refund equaled 10 percent of 1974 tax liability, with a maximum refund of $200 per tax return and a minimum refund of $100. The refund, however, could not exceed 1974 tax liability; that is, a taxpayer could not receive a cash refund in excess of the tax he owed. The refund was phased down from $200 to $100 as adjusted gross income (AGI) rose from $20,000 to $30,000. (For example, if an individual had AGI of $25,000, the maximum refund was $150.)

The aggregate amount of the 1975 refund was $8.4 billion. Table 3 shows the distribution of this refund by income class at 1976 income levels.

Table 3.—Distribution by Income Class of 1975 Tax Refund

[Dollars in millions; returns in thousands—1976 income levels]

Adjusted gross income class	Number of returns	Amount of tax decrease	Percent of decrease
Under $5,000	7, 341	$588	7. 0
$5,000 to $10,000	18, 277	1, 805	21. 5
$10,000 to $15,000	15, 923	2, 109	25. 1
$15,000 to $20,000	11, 744	2, 109	25. 1
$20,000 to $30,000	9, 897	1, 348	16. 0
$30,000 to $50,000	3, 290	329	3. 9
$50,000 to $100,000	942	94	1. 1
$100,000 and over	212	21	. 2
Total	67, 626	8, 403	100. 0

Note.—Details may not add to totals because of rounding.

In addition, the Act included a $50 payment to beneficiaries of social security, supplemental security income (SSI) and railroad retirement programs. The cost of these payments was $1.7 billion.

D. Staff Analysis

Effect on consumer spending

The main issue concerning the proposed refund is the extent to which people will spend it to purchase consumer goods and services. In public discussion, economists and other experts have expressed widely divergent views on this question: some think the refund will be treated as ordinary income and spent, while others think it will be treated as an increase in wealth and largely saved.

Economists have done several studies of cases when people have received unexpected lump-sum payments, and the authors have generally concluded that, when the payment is small relative to annual income, it is treated as any other source of income and spent after a period of time. These studies, however, are based on payments made in the 1950's and may not be relevant to the current situation.

A crude way to analyze the effect of the 1975 refund on consumer spending is to examine the behavior of consumers after the 1975 refund. In the five quarters preceding the receipt of the refund, consumers saved an average of 7.6 percent of their after-tax income. In the second quarter of 1975, when the refund was paid, this saving rate rose to 9.6 percent, indicating that people initially saved much of their refunds. The increased saving was reflected in a sharp increase in deposits in checking accounts. The high savings rate in the second quarter, however, does not mean that all of the refund was saved. Assuming a savings rate on other income of 7.6 percent, the overall savings rate would have been 10.4 percent in the second quarter had all of the refund been saved. The actual savings rate of 9.6 percent, therefore, suggests that as much as one-third of the refund may have been spent in the second quarter. Probably more of it was spent in the third and fourth quarters, but it is hard to draw any firm conclusions from the data. (The savings rates were 7.4 and 7.5 percent, respectively, in the third and fourth quarters of 1975, or slightly below normal.)

Employment impact of refund

The economic impact of the refund depends on the extent to which it increases consumer spending. Any increase in consumer spending will initially reduce existing inventories but eventually will stimulate increased production, which will lead to increased employment. The people who receive the increased income as a result of the increase in production will spend some of their additional income. This spending will lead to a further increase in income and employment—the so-called "multiplier effect."

A one-time refund will only have a temporary effect in stimulating the economy. After the refund has been spent and the multiplier effects have worked themselves out, the economy will return to the same path on which it would have been without the refund.

Monetary effects of the refund

Depending on the decisions of the Federal Reserve System, the refund may raise interest rates temporarily. Many people will initially deposit their refund checks in the bank, as was done after the 1975 refund. Thus, the refund causes a sharp increase in the demand for money. Unless the Federal Reserve System permits a corresponding increase in the supply of money, short-term interest rates will rise. Subsequently, as people take the money out of the bank to spend it, use it to repay debts or use it to buy some other asset, interest rates will decline again approximately to their former level.

This was the pattern of short-term interest rates after the 1975 refund. The Treasury bill rate rose from 5.3 percent in May 1975 to 6.5 percent in August and subsequently declined below its earlier level. This pattern of interest rates was an unfortunate effect of the 1975 refund. Chairman Burns has indicated in testimony before the House Banking Committee that the Federal Reserve intends to supply enough reserves to the banking system to accommodate the temporarily increased demand for money resulting from the refund, in which case the refund should not cause a rise in interest rates.

It is sometimes alleged that the refund, by increasing the Federal deficit, will cause interest rates to rise because the Government borrowing will reduce the availability of funds for private borrowing. As long as the economy is operating well below its potential output, however, this should not be a problem. While the increased Federal borrowing as a result of the refund will increase the demand for funds in the credit market, the refund will lead to an exactly offsetting increase in the supply of funds. First, part of the refund itself will be saved, thereby supplying funds to the credit market. Second, to the extent the refund is spent by consumers, it will lead to increased income for others; and there will be both additional taxes and additional saving out of this additional income. This will be sufficient to finance the entire amount of the additional Federal Government borrowing resulting from the refund.

Administrative considerations

From an administrative standpoint, if it is desired that the tax refunds and payments are distributed as quickly and widely as possible, the main consideration is that a family's refund should be based on data that is readily available to the Internal Revenue Service from tax returns or is available to other agencies on computer tapes. When the IRS receives an individual tax return, it transfers certain information from the return onto a computer tape called the "Individual Master File." The processing of a tax refund is made considerably easier if the formula under which the refund is computed is based only on data available on the Individual Master File.

An alternative way to administer the refund would be to allow individuals to file new forms in order to claim their tax refund. This would involve considerable paperwork, and since the IRS cannot really audit these forms, there is much potential for abuse. (On the other hand, the Administration estimates that more than 6 million persons will receive double payments under the tax refund and the payment to Social Security, SSI and railroad retirement beneficiaries in the House bill despite the efforts to prevent double payments.) If forms are used, many people eligible for the refund or payment may not file the appropriate forms even if they are eligible for a refund.

Coverage and double payments

Under the Administration's original proposal, there would have been a number of people who would get no refund or who would not get the full $50 per capita. These would be people who do not have tax liability large enough to utilize the full $50 per capita refund, who do not receive social security, SSI or railroad retirement, who do not claim the earned income credit, and who do not have either earned income or dependent children.

The House bill would broaden the number of persons eligible to receive the $50 payment by extending it to beneficiaries of various other income maintenance programs—aid to families with dependent children (AFDC), State supplements to Federal supplemental security income (SSI), black lung benefits and Veterans Administration pensions and compensation. Aside from those persons who will be excluded by the income phaseout of the tax refund, the main groups that will be excluded from the program under the House bill are persons with no tax liability who are either (1) single but not dependents of taxpayers or (2) married couples without children.

The House was also concerned that under the Administration's proposal some people would get more than one $50 payment. These cases involving double payments would include (1) social security, SSI or railroad retirement beneficiaries who also are eligible for the $50 tax refund and (2) dependents who themselves are eligible for the refund because they pay income tax and who also generate a $50 refund for their parents. The Administration estimated that there would be 20 million double payments under its original proposal, but it acknowledges that this estimate is very imprecise. The House bill adds considerably to the potential for double payments by broadening eligibility to several new groups.

The House bill contains a provision to eliminate the double payments to the extent it can be done without unduly delaying the payments. There are, however, situations in which this cannot be readily achieved, because there is insufficient information available from the various programs. For example, a dependent child could receive a $50 tax refund as a result of earning at least $3,100 during the summer (enough to have $50 of tax liability) and also, because the child does not support himself, generate a $50 tax refund for his parents as a result of his being claimed as a dependent on their tax return. When the parents file their tax returns, they do not indicate the child's social security number. Accordingly, there is currently no way to eliminate this form of double payment, and the House bill permits it.

There appear to be many cases in which it will be administratively difficult to enforce the rules preventing double payments to social security, SSI and other beneficiaries under the House bill. The Treasury Department estimates that in 6 million of these cases the social security, etc., beneficiary is claimed as a dependent on someone else's tax return and, therefore, would generate a $50 refund for some taxpayer. (Often, these will be cases when people claim elderly relatives or child survivors as dependents.) Since dependents' social security numbers do not appear on tax returns, this type of double payment cannot be eliminated under the House bill.

The House requirement for the elimination of double payments will eliminate most of the double payments which would otherwise be made to social security, SSI, black lung or rairoad retirement beneficiaries who themselves file tax returns and will receive a tax refund. The Secretary of the Treasury is empowered to waive the rules preventing double payments when this would involve undue delay.

Under the House bill, an AFDC recipient may receive a $50 payment even if he or she also receives a tax refund, because of the administrative problems in eliminating this type of double payment. It will also be difficult under the House bill to eliminate double payments to many recipients of Veterans Administration pensions and compensation and to many social security beneficiaries, and it may well be that the Secretary will exercise his waiver authority in these cases.

Suggestions for reducing both the administrative burden and the number of double payments are included below in Section E, "Alternative Proposals."

Continuing Payments Under 1975 Special $50 Payment Provision

The $50 special payment under the 1975 Tax Reduction Act was payable only to social security, SSI, or railroad retirement beneficiaries who got a benefit under those programs for March 1975 and who had an address for check payment purposes within the United States. Since the law did not specifically say that the United States address had to be in force as of March 1975, however, the Social Security Administration has decided that the requirement can be met at any time. Thus, someone who got a social security payment for March 1975 outside the United States will be given his $50 payment whenever he again has a check payment address within the United States. As a result, payments are continuing to be made under this provision which was enacted to provide economic stimulus in 1975. The committee may wish to repeal the provision in the 1975 law effective upon enactment of H.R. 3477.

E. Alternative Proposals

Alternative income phaseouts

Under the House bill, taxpayers with adjusted gross income of less than $25,000 will receive the full $50; those over $30,000 will receive no refund; and those between $25,000 and $30,000 will receive a refund of less than $50 (depending on their adjusted gross income). The refund could be phased out over a range different from the $25,000–$30,000 range in the House bill.

Table 4 shows the revenue effects of phaseouts of the tax refund based on different adjusted gross income levels than the phaseout in the House bill. It would also be possible to phase down the refund from $50 to $25 over these income ranges, in which case the revenue savings, as compared to the Administration proposal, would be half those implied by table 4.

Table 4.—Revenue Effect of Income Phaseouts of the $50 Per Capita Refund

Adjusted gross income phaseout	Revenue loss from refund (millions)	Returns denied the refund (thousands)
No phaseout (Administration's proposal)	$9, 594	------------
$15,000 to $20,000	6, 241	15, 371
$20,000 to $25,000	7, 762	7, 734
$20,000 to $30,000	8, 169	4, 461
$25,000 to $30,000 (House bill)	8, 577	4, 461
$25,000 to $35,000	8, 776	2, 831
$30,000 to $35,000	8, 976	2, 831
$30,000 to $40,000	9, 078	1, 985

Under the House bill, taxpayers with adjusted gross incomes over $30,000 receive no refund—unless they receive social security or other benefits. (Similarly, social security beneficiaries with adjusted gross income between $25,000 and $30,000 will receive a total refund of $50 each while persons who do not receive social security or other benefits will be eligible only for a phased down refund). The Committee may wish to phase out or eliminate the payment to recipients of social security, railroad retirement, black lung and VA benefits by adjusted gross income in the same way as it is phased out or eliminated for persons not receiving these benefits. This phaseout could be done by the IRS at the same time that the computer tapes are checked to eliminate double payments, although this phaseout would be subject to the same inaccuracies that characterize the rules against double payments. Such a phaseout of these special payments would save approximately $25 million in outlays.

Permanent or temporary tax reductions

An alternative to the refund and special payments in the House bill is to enact permanent or temporary individual income tax reductions of approximately the same size that are reflected in lower withholding rates. It would be difficult to achieve the same distributional impact as the refund and payments in the House bill, because much of the refund goes to people without tax liability.

One proposal (embodied in S. 730) is to reduce individual tax rates in the bottom tax brackets. For joint returns, the tax brackets below $8,000 of taxable income are 14, 15, 16, 17 and 19 percent. These could be reduced to 8, 10, 12, 15 and 18 percent, respectively. At taxable income of $8,000, this would involve a tax reduction of $210, and there would be smaller tax reductions at lower levels of taxable income. S. 730 includes rate increases in the higher tax brackets to take some of this tax cut away from higher-income taxpayers. The brackets between taxable incomes of $12,000 and $24,000, which are now 25, 28 and 32 percent, could be increased to 26, 30 and 33 percent, respectively. This would phase down the tax cut to $50 at taxable income of $24,000 and above. There could be similar rate changes for heads of households, other single people, and married persons filing separate returns. The overall revenue loss from these changes would be $9.2 billion at 1976 income levels and $9.9 billion at 1977 income levels. While the revenue loss from the refund occurs entirely in fiscal year 1977, the loss from cuts in withholding rates would occur largely in fiscal year 1978 and subsequent years. Such a tax reduction for individuals could be limited to a given period—say, two years (1977 and 1978).

Another way to reduce individual taxes would be a uniform percentage reduction in tax liability. In calendar year 1977 individual income tax liability is expected to be $160 billion, so that a 6-percent across-the-board cut in individual income tax liability would reduce tax liability by about $9.6 billion. Depending on how this reduction is effected, most or all of the revenue loss under this proposal would occur in fiscal year 1978.

Possible amendments to House refund and special payment provisions

If the committee agrees to a tax refund and special payment program similar to that in the House bill, it may want to consider several ways of modifying specific features of the House bill while retaining the same basic structure.

Social security, SSI and railroad retirement

Under the House bill, beneficiaries for March 1977 whose benefit checks are issued by December 31, 1977, would be eligible for the special $50 payment. This requires maintaining in place the administrative machinery to make the $50 payments and eliminate double payments through the end of the year. Moving up the cutoff from December 31, 1977, to April 30, 1977, would simplify the administration of the refund. The effect of this would be to deny the refund to beneficiaries who are not in "current payment" status in March, but who will get retroactive payments later in the year. However, these would generally be people who retired in late 1976 or early 1977 and who therefore probably have tax liability for 1976 and thus would be eligible for the tax refund. Such people would not be eligible for a $50 special payment in any event because of the rules against double payments.

The possibility of phasing out the social security and railroad retirement payment based on adjusted gross income is discussed above under the heading of "Alternative income phaseouts."

Some of the double payments discussed above under "Coverage and Double Payments" could be eliminated, however, by limiting the tax refund to taxpayers, spouses and dependent children, which would reduce the revenue loss from the refund by $150 million. This change, however, would also eliminate the tax refund in some cases in which an adult dependent does not receive a $50 special payment. Another way to reduce double payments would be to deny the social security payment to child beneficiaries when there is no adult beneficiary in the family unit, on the assumption that in most of these cases the parent has earned income and therefore will receive a tax refund for the child's exemption.

Veterans Administration benefits

The $50 payment to VA beneficiaries in the House bill presents another problem of double payments. The Veterans Administration possesses data on income only for beneficiaries of need-related pension and parents programs. There are 5.4 million VA beneficiaries. From this group, the VA can eliminate a double payment to approximately 1.5 million beneficiaries who report social security or railroad retirement benefits.

As an alternative to actually screening the pension caseload to eliminate those who are social security or railroad retirement beneficiaries, the statute could be written to make the $50 payment available only to those whose pension payments are of an amount which indicates that they do not receive even a minimum social security benefit (approximately $1,200 per year for a single individual or $1,800 for a veteran or widow with dependents). This type of rule could be more easily applied than a case-by-case review of pensioners, even by automatic data processing. It would result in payments of the $50 benefit to about 900 thousand pensioners (30 percent of the total of about 2.9 million persons who get VA pensions). The Veterans Administration can also identify about 0.1 million foreign residents who are eligible under the House bill. This would leave 3.8 million people potentially eligible to receive $50 payments under the House bill. The VA possesses social security numbers only for about 72 percent of this group, and most of these are unvalidated. Most of these remaining 3.8 million beneficiaries probably would receive a tax refund or payment under one of the other programs, but it will be difficult to eliminate double payments in at least 1 million cases under the House bill and possibly in many more.

The Administration proposes eliminating the payment to VA beneficiaries because of these administrative problems. If the committee decides to retain a payment to VA beneficiaries, there are several ways to reduce the number of double payments. The $50 payment could be eliminated recipients of disability compensation whose disability is 50 percent or less, on the assumption that these people will probably receive a tax refund. This would eliminate 1.9 million potential $50 payments. This would leave 1.9 million beneficiaries potentially eligible for the $50 payment. A $50 payment to each of the remaining VA beneficiaries would cost $100 million.

The number of double payments could be reduced still further by denying the $50 payment to recipients of need-related VA benefits whose benefit is below a certain amount, on the assumption that most of these people have some other source of income that would entitle them to a tax refund or a special payment, or that they are dependents of other taxpayers.

Finally, the number of double payments could be reduced by mailing an application form to the remaining VA beneficiaries. Those people who do not receive a tax refund or a special payment under one of the other programs could certify the relevant facts and claim a $50 payment under the VA program. This approach, however, involves administrative complications with processing several hundred thousand application forms.

State supplements to Supplemental Security Income (SSI)

The House bill provides a $50 payment to people who do not get Federal SSI but do receive State supplements to SSI. There are about 500,000 people in this category. This provision presents administrative difficulties in States which administer the supplements themselves because they do not all maintain data in a usable form.

The Federal SSI level is now $167.80 per month for an individual and $251.80 for a married couple; the people receiving only State supplementation have incomes exceeding these levels, typically from social security. In view of this, the committee may wish to delete this part of the House bill. If it decides to retain the $50 payment to this group, it may wish to have the payments to beneficiaries of State-administered supplementation programs administered by the States themselves under rules similar to those provided for the payment to AFDC recipients. (There are about 50,000 people in the State-administered programs who get no Federal SSI.)

Black lung benefits

The Administration recommends deleting the $50 payment to recipients of black lung benefits on the grounds that over 80 percent of this group receive social security. (There are about 475,000 black lung beneficiaries.) There appears, however, to be little administrative difficulty in eliminating these cases of double payments as well as the double payments between black lung benefits and the tax refund. If the committee wants to avoid the need to cross check the black lung computer tape with the IRS Master File, it could permit double payments between black lung benefits and the tax refund.

AFDC recipients

There would be some administrative advantage to changing the date for eligibility for the AFDC payment from March to April 1977. When it is time to mail the $50 checks, the State and local administrators of AFDC will have more current addresses on the people who receive benefits in April than for the March beneficiaries. Also, the elimination of double payments between Social Security and AFDC will be easier because the month of receipt will then be the same in both cases.

About 4 percent of AFDC beneficiaries also receive social security, and the State and local governments should be able to eliminate these double payments without too much difficulty. Relatively few AFDC beneficiaries, however, receive railroad retirement, black lung or VA benefits; and the program would be administratively simpler for the State and local governments if double payments were permitted between AFDC and these other categories (just as the House bill permits double payments to AFDC recipients who receive the tax refund). In AFDC records, these other benefits are often lumped together in a category of "other income," which is difficult to identify specifically.

Under the House bill, there will be a number of payments to AFDC recipients who also receive a tax refund. The only feasible way to eliminate these double payments would be to mail application forms to AFDC recipients requiring them to certify that they are not eligible for a tax refund. This approach would involve receiving and processing several million application forms.

Technical issues

There are several technical issues to be decided by the Committee if it agrees to a refund of individual income taxes or payment to certain recipients. The House bill contains the following features which the Committee may want to examine:

(1) The House bill requires that both the tax refund and social security payment be disregarded in determining benefits under federal or federally assisted aid programs.

(2) The House bill also extends the time period in which the IRS could make interest-free tax refunds from 45 to 60 days.

(3) Some States allow a deduction for Federal income taxes under their State income taxes, in which case the refund would automatically increase State taxes. Others may attempt to have people include the Federal refund in gross income. To prevent such a State tax increase, the House bill provides that the refund is not to be considered as income or as a reduction in Federal income taxes for State tax purposes.

(4) The refund automatically reduces the income tax collections of Guam, the Virgin Islands and American Samoa. Congress could appropriate funds to compensate these possessions. It was estimated that the Tax Reduction Act of 1975 and its extensions reduced income tax revenues of the Virgin Islands by $22.9 million in 1975 and 1976, of which $2.7 million was the 1974 refund. A bill, originating out of the Interior committees enacted in the 94th Congress, authorized $8.5 million in payments to the Virgin Islands to compensate for this revenue reduction. The House bill authorizes an appropriation to compensate these three possessions for their revenue loss from the refund and the change in the standard deduction for 1977.

II. REVISION OF THE STANDARD DEDUCTION, TAX TABLES, AND TAX RATE SCHEDULES

A. Present Law

Under present law, the standard deduction is 16 percent of adjusted gross income (AGI), but not less than a minimum standard deduction of $1,700 for single persons and $2,100 for joint returns, nor more than maximums of $2,400 or $2,800 for single people and joint returns, respectively. These levels were made permanent by the Tax Reform Act of 1976.

Under present law, there are two ways in which a taxpayer determines the amount of tax owed. A taxpayer either determines tax liability by using the rate schedule and multiplying taxable income by the appropriate tax rate, or by looking up the dollar amount of tax in tax tables. The tax tables are considerably easier for the taxpayer than the rate schedules.

The tax tables where a taxpayer looks up, rather than computes, tax liability are based on filing status (joint return, single return, etc.) and taxable income. These taxable income tables were provided by the Tax Reform Act of 1976. They replaced the prior tables based on adjusted gross income (AGI) and the number of exemptions, in which standard deductors with AGI below $15,000 looked up their tax. (Prior to 1976, itemizers and standard deductors with AGI over $15,000 were required to use rate schedules.)

A taxpayer must now compute the standard deduction (or itemized deductions) and subtract the appropriate amount from adjusted gross income. Then the taxpayer must multiply $750 by the number of personal exemptions claimed and subtract the resulting amount to obtain taxable income. Most taxpayers now look up the amount of tax before credits in a tax table based on taxable income. (This table covers taxable income up to $20,000 and is used by approximately 93 percent of all taxpayers.) The taxpayer must then compute the general tax credit, which is the greater of $35 per person or 2 percent of taxable income up to $9,000. The taxpayer must then subtract this credit from the tax determined under the tables to obtain the tax after credits. (See the illustration of a computation under present law in table 6, below.) If there are additional credits (such as the credit for the elderly or child care credit), they too must be subtracted.

B. House bill

Revision of the standard deduction

The House bill eliminates the present minimum, percentage and maximum standard deductions and replaces them with what is, in effect, a flat standard deduction of $2,400 for single persons, $3,000 for married individuals filing joint returns, and $1,500 for married individuals filing separate returns. These new flat levels are converted into a new "zero bracket amount" (explained in detail below). This increase in the "standard deduction" will reduce tax liability by $5.0 billion in calendar year 1977 ($4.8 billion at 1976 income levels). Of this reduction, 88 percent will go to taxpayers with incomes under $15,000 and 96 percent to taxpayers with incomes under $20,000. The new levels of the "standard deduction" will equal or exceed itemized deductions on approximately 5½ million more returns than the current standard deduction, and it will no longer be permissible to itemize deductions on these returns. Thus, the percentage of taxpayers who itemize will fall from 31 percent to 25 percent. Table 5 gives the income distribution of the tax change from the increase in the standard deduction in the House bill.

Table 5.—Effect of the House Bill's Change in the Standard Deduction

[By adjusted gross income class—calendar year 1976 income levels[2]]

Adjusted gross income class	Number of returns affected (thousands)			Decrease in tax liability	
	Total number with tax decrease	Number made nontaxable	Number shifting to the standard deduction	Amount (millions)	Percent of total decrease
Under $5,000	7,221	2,714	284	$615	12.8
$5,000 to $10,000	16,964	935	1,676	2,080	43.2
$10,000 to $15,000	12,282	43	2,431	1,541	32.0
$15,000 to $20,000	5,602	2	724	386	8.0
$20,000 to $30,000	2,892	(1)	354	154	3.2
$30,000 to $50,000	428	(1)	41	32	.7
$50,000 to $100,000	62		5	6	.1
$100,000 and over	5		1	1	(1)
Total	45,456	3,694	5,514	4,814 [2]	100.0

[1] Less than 500 returns or 0.05 percent.

[2] This distributional table reflects, for the revised standard deduction, the decrease in tax liability at calendar year 1976 income levels, the latest year for which distributional data are available.

Note.—Details may not add to totals because of rounding.

Tax tables

The House bill eliminates the present tax tables based on taxable income and replaces them with tax tables based on the number of exemptions and "tax table income" (explained below) for both itemizers and nonitemizers. For taxpayers who do not itemize, tax table income equals adjusted gross income; they will simply total their adjusted gross income and look up their tax liability in the tables.

Itemizers will subtract an amount equal to their "standard deduction" (the new zero bracket amount) from their itemized deductions and then subtract the remaining "excess itemized deductions" from adjused gross income to obtain tax table income. Approximately 96 percent of all taxpayers will be able to look up their tax liability in these new tax tables.

Tax tables are to be provided at least for all individuals in each filing status with tax table income of $20,000 or less. The tables will cover as many exemptions and as high a tax table income level as practicable. The Internal Revenue Service has the authority to determine the ceiling amount for income levels and the number of exemptions below which taxpayers would be able to use the tax tables. It is anticipated that the Service will publish tax tables in the ranges of approximately $20,000 and 3 or fewer exemptions for single persons and $40,000 and 9 or fewer exemptions for joint returns.

The House bill also permits some taxpayers, such as certain dependents claimed by other taxpayers, who are not entitled to a standard deduction under present law and who could not use the pre-1976 AGI tax tables, to use the new tables. These taxpayers would be required to make one additional but simple computation (involving an unused zero bracket amount, explained below) in order to determine their tax table income.

Taxpayers ineligible for the tax tables include those with tax table income above the table limits or with too many exemptions, as well as those who compute their tax using income averaging, the alternative capital gains tax, the maximum tax, or the section 911 foreign income exclusion, those who file a short period return under section 443(a)(1) on account of a change in annual accounting period, and estates and trusts. A separate rate schedule is provided for estates and trusts, which do not get a standard deduction under present law.

Conversion of standard deduction into zero bracket amount and floor under itemized deductions

By incorporating the flat standard deduction into a zero rate bracket in the tax tables and rate schedules, the House bill eliminates the need for the separate concept of the standard deduction in the Code and the subtraction of the standard deduction in computing tax liability. This change permits additional simplifying modifications in the tax law and in the tax forms.

From a technical viewpoint, the most significant change in the House bill is the redefinition of taxable income. Although this change alters a basic concept, it will affect few taxpayers because the bill makes conforming changes to insure that there is no (or only minimal) effect on taxpayers' liabilities and because the tax forms generally do not require reference to Internal Revenue Code definitions. This redefinition of taxable income facilitates simplification in the forms for the vast majority of taxpayers.

Under present law, taxable income for individuals means adjusted gross income reduced by the standard deduction (or itemized deductions) and by personal exemptions. The House bill defines tax table income as adjusted gross income (AGI) reduced by the excess itemized deductions (if any) and in certain cases, increased by the unused zero bracket amount (if any). Taxpayers who must add their unused zero bracket amount are married individuals filing separate returns where either spouse itemizes deductions, nonresident alien individuals, U.S. citizens entitled to the benefits of section 931, and individuals (such as students) with little earned income but with passive or investment income who are claimed as dependents by other taxpayers. Only a few taxpayers would actually have to compute taxable income under the changes made by the House bill.

Under this simplified approach, the taxpayer will look up "tax table income" in the new tax tables to determine tax liability. Only taxpayers with tax table income or exemptions in excess of the levels incorporated in the tax tables will need to compute taxable income and use the rate schedules. The schedules will also incorporate the "standard deduction" as a zero rate bracket.

The zero bracket amount (which is effectively equivalent to the present law standard deduction, but is incorporated in the tax tables and rate schedules and not generally used independently) is set at $3,000 for joint returns and surviving spouses, $2,400 for unmarried individuals, $1,500 for married individuals filing separately, and zero in any other case. This amount creates a floor under itemized deductions, which under the bill may be separately subtracted from adjusted gross income only to the extent they exceed this floor. The creation of the zero bracket means that for a joint return the 14-percent bracket would start at taxable income of $3,001, instead of at taxable income of $1, as under present law.

Itemizers will still receive the full benefit of their itemized deductions, because the amount of the zero rate bracket, the floor under itemized deductions, will be built into the tax tables and rate schedules. However, most itemizers will not have to compute and subtract their personal exemption or calculate and subtract the general tax credit. All of these computations will be built into the tax tables, just as they will be for those who do not itemize.

A comparison of the computations required of taxpayers using the tax tables under the House bill with the computations required under present law is outlined in Table 6, below.

Table 6.—Examples of Tax Computations Under Present Law and House Bill

Case 1.—Standard Deduction, Family of 4, $15,000 Income

Present law

1.	Adjusted gross income	$15,000
2.	Determine standard deduction (16 percent of income but not less than $2,100 nor more than $2,800) and subtract from income	2,400
3.	Difference, line 1 less line 2	12,600
4.	Multiply number of exemptions by $750	3,000
5.	Subtract line 4 from line 3	9,600
6.	Look up tax in tax table	1,727
7.	Compute general tax credit (greater of $35 times number of exemptions; or 2 percent of line 5 but not more than $180)	180
8.	Subtract line 7 from line 6 to get tax after credit	$1,547

House bill

1.	Adjusted gross income	$15,000
2.	Look up tax from new tax table	1,420
	(The lower tax under the House bill reflects the increase in the standard deduction.)	

Case 2.—Itemized Deductions for Those on Tables, Family of 4, $15,000 Income With $4,000 Itemized Deductions

Present law

1.	Adjusted gross income	$15,000
2.	Total itemized deductions	4,000
3.	Difference, line 1 less line 2	11,000
4.	Multiply number of exemptions by $750	3,000
5.	Subtract line 4 from line 3	8,000
6.	Look up tax in tax table	1,375
7.	Compute general tax credit (greater of $35 times number of exemptions; or 2 percent of line 5 but not more than $180)	160
8.	Subtract line 7 from line 6 to get tax after credit	$1,215

House bill

1.	Adjusted gross income	$15,000
2.	Itemized deductions	4,000
3.	Floor on itemized deductions	3,000
4.	Excess itemized deductions, line 2 less line 3	1,000
5.	Tax table income, line 1 less line 4	14,000
6.	Tax after general tax credit from new tax table	$1,215

Technical and conforming changes resulting from new concepts

The House bill makes several conforming and technical amendments to the Code to reflect the elimination of the standard deduction and the adoption of the new definition of taxable income, as well as the use of the new related terms, "zero bracket amount" and "excess itemized deductions."

In cases where the effect of the new definition of taxable income would result in a substantive or economic change from the effect of the present law definition, the bill provides amendments which, in general, preserve the effect of present law but which incorporate the new terms in this bill.

The House bill also makes the appropriate changes in filing requirements and withholding rates.

Change in general tax credit

To make it possible to use tax tables which incorporate the general tax credit, the House bill also provides the $35 per capita credit option in the general tax credit for purposes of the extra exemptions for the aged and blind.

To further simplify the tax form and tax computation, a change is made in the general tax credit for married individuals filing separate returns. Because of the optional feature of the general tax credit (2 per cent of taxable income with a maximum of $90 for separate returns or the $35 per capita tax credit), the tax tables for married individuals filing separately would require two columns, one for each type of credit. This would be necessary because both spouses are required to elect the same alternative. Two columns and a consistent election are not only confusing, but compliance is difficult for many taxpayers filing separate returns because they often do not know the election the other spouse has made.

The bill deals with this problem by limiting married couples filing separate returns to the $35 per capita tax credit and eliminating the 2 percent of taxable income credit for such returns. Since most married couples who file separate returns are in fact separated, one spouse frequently is unable to claim any exemption for dependents and therefore selects the 2 percent of taxable income credit. The maximum tax increase that could result from the elimination of the 2-percent credit is $55 (the difference between the $90 maximum on the 2-percent credit and the $35 per capita credit).

Effective date

The changes in the standard deduction tax table and taxable income definition are effective for taxable years beginning after December 31, 1976. The changes in withholding rates are effective on May 1, 1977.

Revenue effect

It is estimated that the changes in the standard deduction will reduce receipts by $1.8 billion in fiscal year 1977, $6.7 billion in fiscal year 1978, and $5.2 billion in fiscal year 1979. The large revenue loss in fiscal year 1978 is due to the substantial refunds resulting from the late start of reduced withholding in 1977. In addition, extensions of the $35 credit to the aged and blind will reduce receipts by $77 million in fiscal year 1978, and the restriction of the general tax credit in the case of married individuals filing separate returns will increase receipts by about $42 million in fiscal year 1978.

C. Administration Proposal

Initially, the Administration proposed a flat standard deduction of $2,400 for single persons and $2,800 for married couples (the maximum standard deductions under present law). These amounts would have changed the "marriage penalty" (in this case the loss of a standard deduction when two single persons get married), which ranges under present law from $1,300 to $2,000, to a flat $2,000 in all cases. To avoid increasing the marriage penalty excessively the Administration changed its recommendation to a flat standard deduction of $2,200 for single persons ($200 less than the current maximum standard deduction for single persons) and $3,000 for joint returns. This would increase the marriage penalty by $100 over present law to $1,400 for people using the minimum standard deduction and reduce it in a number of other cases for taxpayers who were entitled to more than the present minimum standard deduction.

The Administration disagrees with the House decision to set the standard deduction for single individuals at $2,400, and continues to support changing the standard deduction to $2,200 for single individuals and $3,000 for married couples.

As shown in table 7 below, the Administration's proposed increase in the standard deduction would reduce revenues by $4.2 billion in calendar year 1977 ($4.0 billion at 1976 income levels), 88 percent of which would go to taxpayers with incomes under $15 000 and 96 percent to taxpayers with incomes under $20,000. As table 7 indicates 2.1 million single returns which previously claimed a standard deduction between $2.200 and the $2,400 maximum, would have a tax increase averaging about $52. This compares to 44.6 million returns with a tax decrease (which would average about $90).

The Administration supports the simplification provisions of the House bill dealing with the standard deduction, the tax tables and the tax rate schedules, all of which were among the changes recommended in the Administration's initial proposals.

Table 7.—Impact of the Administration's Proposed Flat Standard Deduction of $2,200 for Single Persons and Heads of Household and $3,000 for Married Couples[1]

[1976 Income level]

Adjusted gross income class	Net decrease in revenue (millions)	Percentage distribution	Cumulative percentage distribution	Returns with tax decrease (thousands)	Returns with tax increase (thousands)	Tax increase (millions)	Average tax increase (actual)
Under $5,000	$477	11.8	11.8	7,200			
$5,000 to 10,000	1,715	42.5	54.3	16,842			
$10,000 to 15,000	1,355	33.6	87.9	11,557	596	$15	$25.17
$15,000 to 20,000	322	8.0	95.9	5,602	1,094	64	58.50
$20,000 and over	163	4.0	100.0	3,387	372	29	77.96
Total	4,032	100.0		44,588	2,063	108	52.35

[1] This proposal would cause an estimated 5,200,000 returns to switch to the standard deduction.

D. Staff Analysis

Standard deduction

The present individual income tax forms need to be simplified. The forms have become too long and too congested and are themselves a source of complexity and taxpayer confusion and error. To the extent that the flat standard deduction will remove lines from the form, it appears to be an appropriate step. Also, the increase in the standard deduction adopted in the House bill would make it worthwhile for approximately 5½ million more taxpayers to not itemize deductions, raising from 69 to 75 percent the percentage of taxpayers not itemizing. (The Administration's proposal would result in only 300,000 fewer taxpayers not itemizing.)

Since 1974, 6.8 million returns have become nontaxable. The House bill will remove an additional 3.7 million returns from the tax rolls. Seventy percent of the returns made nontaxable have adjusted gross incomes below $5,000.

As shown in Table 8, below, the number of taxable returns rises as inflation and economic growth increase incomes above the nontaxable levels provided in major tax Acts. For example, in 1970, the first year after the Tax Reform Act of 1969, the number of taxable returns dropped from 63.7 million to 59.3 million. But, the number of taxable returns increased every year thereafter until the first of the most recent tax reduction acts was passed in 1975, when tax cuts and an economic recession together caused the substantial decrease in the tax rolls. There is a similar pattern in the ratio of the number of exemptions on taxable returns to the general population, as shown in table 8.

Table 8.—Taxpaying Population, 1964–76

Year:	*Taxable returns (millions)*	*Ratio of exemptions on taxable returns to total population (percent)*
1964	51.3	76.7
1965	53.7	78.8
1966	56.7	81.6
1967	58.7	83.1
1968	61.3	85.2
1969	63.7	87.4
1970	59.3	83.6
1971	59.9	82.8
1972	60.9	81.9
1973	64.3	83.9
1974	67.2	86.0
1975	[1] 61.8	77.7
1976	[2] 66.8	82.5

[1] 1975 Preliminary Statistics of Income.
[2] Estimated.

In the past, the Congress has used the minimum standard deduction (which under the House bill will in effect become the same standard deduction amount for everyone) to establish, in conjunction with other provisions, the tax-free income level approximating the poverty level. This policy started with the Revenue Act of 1964. A higher floor may now be needed to increase the income level at which people begin to pay income tax (the tax threshold) to offset its erosion by inflation.

The extent to which the standard deduction (which becomes a zero rate bracket in the House bill) determines a tax-free income level and how the tax-free level compares to projected poverty levels for various taxpayers is shown in table 9, below. For example, under present law, the tax-free income level for a single person is $2,700. With the "flat standard deduction" of $2,400, the tax-free income level would be $3,400 in 1977. (The $3,400 is the sum of the $2,400 "standard deduction," the $750 personal exemption, and $250 of income, the tax on which is offset by the $35 per capita tax credit.) This compares with the projected poverty levels of approximately $3,100 in 1977 and $3,400 in 1979.

Table 9.—Tax-Free Income Levels Under Present Law and House Bill Compared to Projected Poverty Levels

	Tax-free levels		Projected poverty levels [1]	
	1976 law	H.R. 3477 for 1977 and thereafter [2]	1977	1979
Single person	$2,700	$3,400	$3,107	$3,439
Couple without dependents	4,100	5,000	4,018	4,448
Family of 4	6,100	7,000	6,110	6,763

[1] Applicable to nonfarm families. Projections assume consumer price indexes of 179.11 in 1977 and 198.26 in 1979.

[2] Assumes extension of the $35 per capita tax credit.

Source: Treasury Department.

Some tax reduction, it is argued, is needed to offset the effects of inflation in raising tax rates. Table 10 shows an estimate of the tax increase in 1976 that resulted from the 5.8 percent increase in the price level in 1976 compared to 1975. This tax increase from inflation amounted to $5.1 billion, or 3.6 percent of individual income tax liabilities.

Table 10.—1976 Tax Increase Caused by Inflation

[Dollars in millions]

Adjusted gross income class	Total taxes under present law	Inflation induced tax increase [1]	Percentage distribution
Under $5,000	$660	$166	3.2
$5,000 to $10,000	10,194	664	13.0
$10,000 to $15,000	19,971	760	14.9
$15,000 to $20,000	23,767	831	16.3
$20,000 to $30,000	33,682	1,177	23.0
$30,000 to $50,000	22,512	823	16.1
$50,000 to $100,000	16,700	514	10.0
$100,000 and over	13,600	179	3.5
Total	141,087	5,113	100.0

[1] Staff estimate of the excess of actual taxes in 1976 over what taxes would have been had the tax brackets, the personal exemption, and the minimum and maximum standard deduction been adjusted upward by the 5.8 percent increase in the consumer price index for 1976 over 1975.

Note.—Details may not add to totals because of rounding.

Marriage penalty

There has been much concern about the difference in the tax liabilities which single and married individuals must pay. Two single individuals with relatively equal incomes filing single returns pay less tax as single people than they would pay if they married each other. This larger liability is partly attributable to the loss of one standard deduction and is often called the "marriage penalty." When one spouse's income is approximately one-fourth or less than the other's at average income levels, however, there is a tax benefit to marriage because of income splitting. It has been suggested that some "marriage penalty" may be appropriate to take into account any economies of scale enjoyed by married couples sharing a single household compared to single individuals maintaining separate households. In any event, the existence and size of this "marriage penalty" has affected the development of the Administration's proposal and is relevant to the consideration of changes in the standard deduction.

The amount of the marriage penalty, in this case the loss of one standard deduction when two single taxpayers marry, differs under present law, the House bill and the Administration proposal. Under present law, the penalty ranges between $1300 and $2000, because the amount of the standard deduction varies. For example, at the low end of the income scale two single taxpayers each receive a minimum standard deduction of $1700, or a total of $3400. For married couples, the minimum standard deduction is $2100, so that the two single taxpayers would lose $1300 of standard deduction if they marry. Under the present maximum standard deduction, singles may claim $2400

..d joint returns, $2800. Thus, the maximum present penalty is $2000. Under the House bill, the standard deduction levels for single and joint returns are $2400 and $3000, respectively, and the penalty is $1800. Under the Administration proposal, the levels are $2200 for singles and $3000 for joint returns, and the penalty is $1400.

The Administration originally proposed that the present standard deduction be replaced with a flat deduction of $2,400 for single individuals and $2,800 for married couples. These dollar limits are equal to the maximum standard deduction now permitted. However, the Administration subsequently recognized that this change would increase the marriage penalty for those who now take the minimum standard deduction from $1,300 under present law to $2,000. Under the original Administration proposal, if two single individuals get married their combined standard deduction would decrease from $4,800 ($2,400×2) to $2,800, or a decline of $2,000. Because of this increase in the marriage penalty, the Administration modified its position to favor a flat standard deduction of $2,200 for single individuals ($200 less than the current maximum standard deduction) and $3,000 for joint returns. This would increase the marriage penalty for those presently using the minimum standard deduction to $1,400 and would reduce it for most taxpayers who claim the percentage or maximum standard deduction. The $2,200 standard deduction for single individuals would result in 2.1 million single individuals paying more tax under the proposed law than they presently pay. The tax increase would average $52 per return.

The House bill provides a flat standard deduction of $2,400 for single individuals and $3,000 for married couples filing jointly. This insures that no taxpayer has a tax increase. While it increases the marriage penalty from $1,300 to $1,800 for taxpayers now entitled to the minimum standard deduction, it decreases the marriage penalty from $2,000 to $1,800 for taxpayers now entitled to the maximum standard deduction. The House provision (setting the "standard deduction" for single people at $2,400 instead of $2,200) increases the permanent tax cut by $800 million per year compared to the Administration's proposal.

Itemizers

A question could also be raised as to whether a tax reduction which goes only to standard deductors and provides nothing to itemizers is appropriate.

If the committee wants to provide tax relief focused on itemizers, the proposed floor on itemized deductions provides a mechanism for doing it. Tax reduction for itemizers could be provided by reducing the floor on itemized deductions by some amount, but including the full standard deduction in the tax tables.

Charitable contributions and the standard deduction

Organizations receiving charitable contributions contended in testimony that increases in the standard deduction affect them adversely. They believe that when itemizers switch to the standard deduction (as 5½ million would do under the House bill) their incentive to make certain deductible expenditures, such as charitable contributions is reduced and such expenditures decrease.

Because the changes in the standard deduction in both the House bill and the Administration proposal mainly benefit lower-income taxpayers, the adverse impact on charities may be small. The average marginal tax rate of taxpayers who would switch to the standard deduction in response to the House bill is only 17.8 percent. Thus, the average tax benefit for a charitable contribution made by these taxpayers is only about 18 cents for every dollar of the contribution; that is, it costs them about 82 cents for each deductible dollar. Clearly, the charitable contribution deduction is far less an incentive or benefit for them than for taxpayers with 50 or 70 percent marginal tax rates.

Under the House bill, an estimated 5.5 million taxpayers will no longer itemize their deductions. The total amount of charitable contributions claimed by these switchers is $1.78 billion annually. Studies conducted for the Filer Commission on Private Philanthropy and Public needs suggest that the reduction in contributions by this group as a result of the change in the standard deduction in the House bill should be no more than $200 to $300 million, out of total charitable contributions in the U.S. of $27 billion in 1975 and an estimated $30 billion in 1977, or less than one percent of the total.

The Coalition of National Voluntary Organizations recommended that a deduction for charitable contributions be allowed for those who do not itemize their deductions. The review cost in calendar year 1977 would be approximately $2 billion.

Simplification—revision of tax tables

The proposal to return standard deductors to a tax table based on AGI and the number of exemptions rather than the present taxable income tables, which require taxpayers to make several computations, seems desirable. The present forms 1040 and 1040A are too long and complex: their many computations, elections and instructions are a source of taxpayer confusion and error. For example, the presentation of the standard deduction on the forms requires printing five numbers just for single and joint returns (two minimums, a percentage of income and two maximums).

The way in which a taxpayer determines his tax also needs to be simplified. Under the present system, both standard deductors and itemizers are required to make too many computations to obtain their tax. (See illustration of computations in table 6, above.)

Including itemizers in the tax tables would simplify the tax computation for itemizers. However, placing a floor equal to the standard deduction on itemized deductions, as the House bill does, might confuse itemizers who might not understand the purpose of such a floor. This confusion might be avoided by including an explanation at that point on the form stating that they are not losing itemized deductions because the amount of the standard deduction is being built into the tax tables and rate schedules. (This suggestion for an explanation on the form was made by the Administration.)

Under both the Administration's proposal and the House bill, taxable income is redefined as present law taxable income plus the new standard deduction, so that the standard deduction could be incorporated into the rate schedules. The change in the definition of taxable income may create difficulties with State income taxes which are based on the Federal definition of taxable income. Eight States would need to change their tax laws to conform to the new Federal definition or to adjust Federal taxable income on their forms in order to avoid an automatic tax increase for their residents.

E. Alternative Proposals

One alternative to the standard deduction changes under the House bill would be to set the levels of the standard deduction at $2,200 for single persons (as in the Administration proposal) and $3,200 for married couples. This would reduce the marriage penalty relative to the House bill and relative to existing law. (The marriage penalty would be $1,200 compared to $1,800 under the House bill, $1,400 under the Administration proposal and between $1,300 and $2,000 under existing law.) It would involve a revenue loss that is $200 million more than the House bill. Also, it would cause 1.2 million more people to switch to the standard deduction than in the House bill.

Another alternative would be to set the standard deduction for heads-of-households at the level available to married couples ($3,000). This would involve an additional revenue loss of $363 million. This, however, will create a tax advantage for divorce similar to the "marriage penalty."

III. EXTENSION OF 1977 INDIVIDUAL TAX REDUCTIONS THROUGH 1978

A. Present Law

Two individual income tax reductions, enacted in the Tax Reduction Act of 1975 and subsequently enlarged and extended in the Revenue Adjustment Act of 1975 and the Tax Reform Act of 1976, are scheduled to expire at the end of 1977. These are the general tax credit and the earned income credit.

General tax credit.—The general tax credit equals the greater of (1) $35 for each taxpayer, spouse or dependent or (2) 2 percent of the first $9,000 of taxable income. It is a nonrefundable tax credit; that is, it is limited to the amount of tax liability.

Earned income credit.—The earned income credit equals 10 percent of the first $4,000 of earned income. The credit is reduced by 10 cents for each dollar of earned income or adjusted gross income (AGI) above $4,000, which generally means that the credit is phased out as AGI rises from $4,000 to $8,000. It is available only to persons who maintain a household for a child who is under 19, is a student or is a disabled adult dependent. The earned income credit is a refundable credit; that it, it can exceed tax liability. To be eligible for the earned income credit, a person must "maintain a household" for a child who is under 19, a student or a disabled dependent. "Maintaining a household" means providing more than one-half the support for that household, and AFDC and other payments with respect to children are support for those children not provided by the parents. This has the effect of making ineligible for the earned income credit most parents receiving AFDC or other aid or assistance in the same way as other parents are not eligible for the credit if they do not provide at least one-half the support for their household.

B. House Bill

General tax credit

The bill extends the general tax credit through 1978. (In addition, as discussed above, the bill modifies the general tax credit for the aged and the blind and for married persons who file separate returns.) The bill provides that the general tax credit be reflected in lower withheld taxes through 1978 in the same manner that it has been reflected in withholding rates in 1977.

Earned income credit

The bill extends the earned income credit through 1978. There is a technical amendment to the Tax Reform Act of 1976 making the credit available to 1977–78 fiscal year taxpayers, since that Act inadvertently denied the credit to these persons.

The bill also extends the credit to persons receiving aid to families with dependent children (AFDC) and other aid or assistance from Federal, State or local income maintenance programs by providing that, for purposes of the earned income credit, "maintaining a household" is to be defined by not taking into account any aid or assistance for any child under any Federal, State or local program. This includes aid or assistance provided directly for the child and also that based on the needs of the child.

Revenue effect

The extension of the general tax credit will reduce budget receipts by $6.8 billion in fiscal year 1978 and $3.9 billion in fiscal year 1979. The extension of the earned income credit will reduce receipts by $1.3 billion in fiscal year 1979. It is not known what the cost will be of the modification in eligibility for the earned income credit.

C. Administration Position

The Administration supports the extension of the general tax credit and earned income credit through 1978 and the modification extending the earned income credit to AFDC recipients who are excluded under present law.

D. Staff Analysis

The current economic situation is such that it would be inappropriate to withdraw from the economy the fiscal stimulus provided by the 1977 individual income tax reductions. Allowing these tax cuts to expire at the end of 1977 would more than counteract the additional fiscal stimulus provided by the other sections of this bill.

In deciding the duration of this tax cut extension, the committee may want to take into account the possibility of comprehensive tax reform legislation during the 95th Congress. The role of both the general tax credit and the earned income credit will probably be reconsidered as a part of such legislation, and extending these tax cuts beyond 1978 could, in effect, predetermine part of the appropriate tax reform package.

The House bill includes an authorization for appropriation for the amount of the earned income credit for 1978 which exceeds tax liability. Since the third concurrent budget resolution considers the earned income credit to be a reduction in revenues and not an outlay, the committee may want to delete this authorization as unnecessary.

The provision in the House bill extending the earned income credit to AFDC families where the parent provides less than half the support for the child has the advantage of making additional persons eligible for the work incentive effect of the credit; however, it does provide an income disregard for AFDC recipients not available to other families. The IRS has had difficently enforcing this provision. The committee may wish to examine this provision of the House bill.

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