

Although economic efficiency would improve as a result of base broadening because current biases favoring certain kinds of investment would be eliminated, it could worsen because the repeal of tax preferences for saving would make saving less attractive.⁵⁰ Moreover, efficiency gains would be lost if tax subsidies were replaced by new direct spending programs subsidizing the same activities.

Equity

Under the current income tax, individuals with equal incomes pay markedly different rates of tax according to their willingness and ability to take advantage of deductions and credits or to receive their income from tax-free sources like fringe benefits, transfer payments, and interest on tax-exempt bonds.⁵¹ Much of the current dissatisfaction with the income

⁵⁰ A recent study that attempted to take both factors into account concluded that the current income tax is more efficient overall than one with the base broadened somewhat and marginal tax rates reduced across the board to preserve the current yield of the individual income tax. The study did not compare the current tax to a completely comprehensive income tax, but to a tax with no preferences for saving and investment and with its base broadened to include all real capital gains and imputed income on owner-occupied housing. Integration of the corporation income tax with this broader-based individual income tax would require higher marginal tax rates to preserve the current combined yield of the corporation and individual income taxes. According to this study, such an integrated and broader-based income tax would about equal the current income tax on economic efficiency grounds. Unfortunately, the results of this study must be considered tentative, since they are based on very strong simplifying assumptions, as explained in footnote 31. (Don Fullerton, John Shoven, and John Whalley, "Replacing the U.S. Income Tax with a Progressive Consumption Tax: A Sequenced General Equilibrium Approach," National Bureau of Economic Research Working Paper No. 892 (May 1982), pp. 19, 21.)

⁵¹ Nearly all taxpayers who take deductions, credits, and exclusions do not gain dollar for dollar of tax reduction. Rather, they pay an implicit tax that leaves them better off by less than a dollar per dollar of tax reduction. For instance, suppose that an employee is offered a choice of a pay increase of \$200 or dental insurance coverage which would also cost the employer \$200. If the employee is in the 50 percent tax bracket, he would owe \$100 tax on the pay increase (and no tax on the insurance coverage), so he would choose the dental

tax derives from the perceived violation of horizontal equity that arises from the wide variation in effective rates of tax within income groups.⁵²

On the other hand, the Congress enacted many tax preferences specifically to account for differences among individuals in their financial status. For example, special provisions were enacted because it was felt that two taxpayers of equal income are not in equivalent positions if one has large and unavoidable medical expenses or if one is blind, elderly, or disabled. Eliminating the deductibility of medical expenses, the extra personal exemptions of the blind and elderly, or the exclusion of Social Security benefits and disability pay might therefore lessen perceived horizontal equity.⁵³

Tax base broadening would also affect the fairness of the income tax by changing the distribution of the tax. Most people believe that wealthy taxpayers make disproportionately heavy use of deductions, exclusions, and

coverage even if it was worth only \$110 to him. Although he had saved \$100 of tax, he would consider himself better off by only \$10 (compared to having chosen the pay increase), so the implicit tax is \$90. For further discussions of implicit taxes, see Department of Treasury, Blueprints for Basic Tax Reform, pp. 152-153; and Harvey Galper and Eric Toder, "Transfer Elements in the Taxation of Income from Capital" (1982).

⁵² For evidence on the wide dispersion in effective tax rates (not taking into account implicit taxes) see Benjamin Okner, "Distributional Aspects of Tax Reform During the Past Fifteen Years," National Tax Journal (March 1979), pp. 11-27.

Milton Friedman scorned the net result of a highly progressive statutory tax rate schedule coupled with a vast array of deductions and exclusions: "The effect has been to make the actual rates imposed far lower than the nominal rates and, perhaps more important, to make the incidence of the taxes capricious and unequal. People at the same economic level pay very different taxes depending on the accident of the source of their income and the opportunities they have to evade the tax." (Milton Friedman, Capitalism and Freedom (University of Chicago Press, 1962), pp. 172-173.)

⁵³ Some argue that the elimination of these preferences would enable the substitution of large enough personal exemptions to ensure that the neediest would pay no tax; others argue that even large personal exemptions cannot differentiate among taxpayers' economic circumstances the way the current preferences do.

credits so that extensive base broadening would shift the burden of the tax more toward high-income taxpayers. Very high-income taxpayers do in fact derive almost all of the benefit from certain deductions and exclusions, such as the deduction for charitable contributions and the exclusions for capital gains and interest on municipal bonds. But other deductions and exclusions, such as the exclusions for transfer payments and Social Security benefits, benefit primarily lower-income taxpayers. When tax liabilities for the 1976 tax law were compared by income group with a fairly comprehensive tax base using the same 1976 rates, the tax liabilities of those with incomes below \$15,000 increased by the greatest percentages--by between 91 and 323 percent. (These percentages represent small dollar amounts, since tax liabilities of these taxpayers were low.)⁵⁴ Tax liabilities of those with incomes between \$15,000 and \$50,000 increased by percentages varying between 66 and 74 percent, those with incomes between \$50,000 and \$500,000 by percentages of between 56 and 67 percent, and those with incomes above \$500,000 by percentages of between 59 and 82 percent.⁵⁵

Substitution of Spending for Tax Subsidies

Under the most comprehensive, broad-based income tax, subsidies would not be delivered through the tax code. If the Congress wanted to encourage people to buy state and local bonds, save for retirement, or install solar heaters or windmills, for instance, it would have to appropriate funds directly for those purposes. Subsidies delivered through spending programs are generally subject to closer budgetary scrutiny than those delivered through the tax code. Spending programs are reviewed more frequently than the tax code, and tax subsidies, like entitlements, are available to all who meet eligibility requirements, without any limit on aggregate use. Because of interactions among tax subsidies and with the

⁵⁴ Joseph Minarik, "The Yield of a Comprehensive Income Tax," in Joseph Pechman, ed., Comprehensive Income Taxation (1977), p. 285.

⁵⁵ Ibid. Of the additional tax that would be collected from broadening the tax base but leaving rates unchanged, 18 percent would be paid by those with incomes below \$15,000, 56 percent by those with incomes between \$15,000 and \$50,000, and 26 percent by those with incomes above \$50,000. This compares to the distribution of total tax paid under 1976 tax law for the same income groups of 11, 59, and 30 percent, respectively.

standard deduction, it is often extremely difficult to determine the true cost of tax subsidies.⁵⁶

If the Congress chose to eliminate all tax preferences in favor of a comprehensive income tax base, it would probably replace some eliminated preferences with direct spending. To the extent that this was done, the tax rate reduction that could be accomplished with base broadening would be lessened commensurately, unless other spending was curtailed or the budget deficit increased.

GENERAL CONCLUSIONS ABOUT BASE BROADENING AND RATE REDUCTION

Some Problems Would Remain

Although base broadening and rate reduction would greatly decrease distortions now imposed by the income tax, some difficult problems would remain. The theoretically ideal tax treatment of certain kinds of income is not practically feasible. In some cases, such as with capital gains and pension income, income is earned over a long period of time and should, in theory, be taxed as it accrues, but the difficulty and costliness of determining the amount of such income in the absence of monetary transactions would almost certainly prove insurmountable. Similarly, imputing dollar figures to the income from home production and owner-occupied housing and other consumer durables is probably not feasible (see Chapter III). As discussed above, a flat-rate tax would eliminate nearly all inflation-caused bracket creep, but it would not solve the mismeasurement of the income tax base that occurs because of inflation.

Business Taxation

Unless enactment of a broad-based individual income tax was accompanied by reform of the corporate income tax, the income tax overall would still exert a large role in business investment decisions. This would result from the combination of corporate tax preferences and the failure to integrate the corporate and individual income taxes. (For an explanation of integration, see Chapter III.)

⁵⁶ See Congressional Budget Office, Tax Expenditures: Current Issues and Five-Year Budget Projections for Fiscal Years 1982-1986 (September 1981), pp. 46-63.

Even if a comprehensive individual income tax were adopted and no personal income tax deductions were allowed, the legitimate costs of earning partnership and sole proprietorship income would be deductible under the individual income tax. There is no clear line separating legitimate business expenses from personal expenses, so abuses would continue as taxpayers deducted as business expenses the costs of such things as cars, vacations, and restaurant meals.⁵⁷ In addition, most so-called tax shelters, such as those for real estate and oil and gas, benefit individuals who organize limited partnerships and take advantage of lucrative business tax provisions, such as deductions that are more generous than the deductions that would be allowed for the true costs of earning income. Unless these business tax preferences were repealed, opportunities for tax shelters would remain, although, as mentioned above, tax shelters would be less lucrative at the lower tax rates made possible by base broadening.

As long as the tax rate on corporate income differed from that on individual income, taxpayers would reshuffle their affairs to some extent to have their income taxed at whichever rate was lower. Some of the bills for flat-rate individual income taxes would solve this problem, since they call for elimination of the individual taxation of dividends and for a reduction in the rate of tax on corporate income, so that all income--corporate and individual--would be taxed at the same flat rate.⁵⁸ Together these two changes would very nearly accomplish the integration of the two taxes.⁵⁹

⁵⁷ The deductibility of certain expenses, such as those for restaurant meals and travel, could be limited by allowing only a percentage of the expense to be deducted, on the theory that a portion is actually an untaxed fringe benefit enjoyed by employees. Since any such rule would necessarily be arbitrary, its effect would be to disallow the deductibility of some expenses that are purely business related and to allow the deductibility of some personal expenses.

⁵⁸ The Hall-Rabushka plan (S. 557), described in Chapter VII, would integrate the corporate and individual income taxes completely by eliminating taxes on capital gains and dividends and imposing the same flat tax rate on businesses and individuals.

⁵⁹ Even these proposals do not accomplish complete integration, since individuals would still pay tax on retained corporate earnings that increased stock prices and thus created capital gains. Individuals with incomes so low that they would be exempt from the flat-rate

Difficult Transition

The transition to a broad-based individual income tax of any sort would be difficult. Even with phase-ins or grandfathering, a new tax system would bring with it large windfall losses in the values of many assets. Even if home mortgage interest deductions were phased out over several years, for instance, homeowners might still suffer an immediate drop in the value of their houses. There would, of course, be windfall gains in the value of assets that are taxed heavily under current law. In any case, if any windfall losses or gains proved too inequitable, the Congress could attempt to rectify the problems through further changes in the tax code, as discussed in Chapter VII.

Winners and Losers. Even if graduated tax rates were adopted so that each income group paid about the same average tax as under current law, a comprehensive income tax would leave many individuals paying lower taxes than they do now and others paying more. The winners would be those who currently make less use of tax deductions, exclusions, and credits than is average for their income group, and the losers would be the current heavy users of tax preferences.

Earlier in this chapter, results were cited from a study that estimated the tax increases that would result from broadening the base of the individual income tax in 1976 without changing the rates. The same study then estimated the differences in tax burdens that would result if the rates were reduced so as to hold revenues constant and preserve the overall progressivity of the tax. Moving from the 1976 income tax to such a hypothetical broad-based tax would have increased the taxes of about 30 million taxpayers, with the average increase being about \$650. About 45 million taxpayers would have received tax decreases, with the average decrease being about \$500.⁶⁰ Of those paying more taxes, roughly 23 million would have had increases greater than both \$100 and 10 percent of their actual 1976 tax liability.⁶¹ These figures are an upper bound for the

individual income tax would be overtaxed on their corporate-source income under these proposals, unless the individuals were refunded the corporate tax paid on their behalf.

⁶⁰ These numbers are the rough averages for changes to two different, but essentially similar in scope, comprehensive income tax bases. The actual differences between the two are small. (Minarik, "The Yield of a Comprehensive Income Tax", p. 290). A similar exercise with similar results was reported in Blueprints for Basic Tax Reform, pp. 162-167.

⁶¹ Minarik, "The Yield of a Comprehensive Income Tax," p. 292.

losses in net income that would be experienced from the change, however, because they assume no change in taxpayer behavior, even though under the new tax taxpayers would almost certainly spend their money with less thought to tax consequences and reduce costly efforts to lessen their taxes.⁶² For example, an individual who currently pays \$2 to a tax shelter syndicator in exchange for a \$3 tax savings would not be worse off by \$3 if the shelter were eliminated, but only by \$1.

Hypothetical Broad-Based Tax System

A variety of approaches could be used to broaden the individual income tax base and, depending on the comprehensiveness, any number of flat-rate taxes could raise the same amount of revenue as the current tax. The lowest tax rate could be achieved by broadening the tax base as much as possible and eliminating the personal exemption and zero bracket amount (standard deduction).

Even assuming no behavioral changes on the part of taxpayers, it is difficult to determine precisely the single tax rate that would raise the equivalent of current revenues for any specified personal exemption and tax base. The Joint Committee on Taxation estimated that a flat tax rate of 11.8 percent would raise the same amount of revenue in 1984 as the current tax system if the tax base were expanded by taxing all nominal capital gains in full and eliminating all personal exemptions, tax credits, and personal deductions, including the standard deduction (zero bracket amount).⁶³ A much higher flat tax rate--about 18.5 percent--would be needed to raise this amount of tax without eliminating any deductions, exemptions, or credits or in any other way changing the current tax base.⁶⁴

⁶² See, for example, Milton Friedman, "How Flat is Flat?," Newsweek (August 2, 1982), p. 52.

⁶³ This rate would raise the same amount of revenue as the current income tax would in 1984 if incomes were at 1981 levels. See Testimony of Joseph Minarik, Congressional Budget Office, before the Subcommittee on Monetary and Fiscal Policy, Joint Economic Committee (July 27, 1982), pp. 14-15.

⁶⁴ See Minarik testimony of July 27, 1982. Another study examined flat-rate taxes with different tax rates and exemption levels to find the tax that preserved the 1982 tax yield while coming closest to the distribution of tax burdens in 1982. The tax that minimized the sum of changes in individual tax burdens had a marginal rate of 25 percent, allowed nonrefundable tax credits of \$1,000 per return and \$500 per

Distribution of the Tax by Income Group. The current individual income tax is progressive, with average tax rates projected for 1984 rising from about 5 percent for those with incomes from \$5,000 to \$10,000 to about 25 percent for those with incomes above \$200,000.⁶⁵ No flat-rate

person, and did not allow any deductions. (Joel Slemrod and Shlomo Yitzhaki, "On Choosing a Flat-Rate Income Tax Schedule" (National Tax Journal, March 1983), pp. 42-43.)

- 65 The average tax rate for those with income below \$5,000 is projected to be -1.4 percent, reflecting tax refunds received under the earned income credit. These statistics and those reported in the text are preliminary and are based on expanded income, which is adjusted gross income plus certain tax preference items and excluded capital gains. (Joint Committee on Taxation, "Analysis of Proposals Relating to Broadening the Base and Lowering the Rates of the Income Tax" (September 24, 1982), p. 16.) The Treasury Department recently projected average tax rates for 1984 using somewhat different concepts of income and tax. Allocating corporation income tax to shareholders and using a broader definition of income that includes the currently untaxed income that would be taxed under a comprehensive income tax, the Treasury Department projected average tax rates for 1984 ranging from 3 percent for those with incomes below \$5,000 to 34 percent for those with incomes above \$200,000. (Statement of John Chapoton, Assistant Secretary of the Treasury for Tax Policy before the Senate Finance Committee (September 28, 1982), p. 26.)

Although federal, state, and local taxes taken as a whole are roughly proportional, the individual income tax is itself progressive. (See Joseph Pechman and Benjamin Okner, Who Bears the Tax Burden (The Brookings Institution, 1974).) Recent work by Hausman, Galper, Toder, and Browning suggests that the individual income tax may be more progressive than previously believed. (See Hausman, op. cit.; Galper and Toder, op. cit.; and Jacqueline Browning, "Estimating the Welfare Cost of Tax Preferences," Public Finance Quarterly (April 1979), p. 212.)

Two summary statistical indexes have been devised recently to measure the overall progressivity of a tax such as the individual income tax, but they do not produce the same results in any given year and over some periods they move in opposite directions. (See John Formby, Terry Seaks, and W. James Smith, "A Comparison of Two New Measures of Tax Progressivity," Economic Journal (December 1981), pp. 1015-1019; Nanak Kakwani, "Measurement of Tax Progressivity: An International Comparison," Economic Journal (March 1976), pp. 71-80; and Daniel Suits, "Measurement of Tax Progressivity," American

tax system would replicate this degree of progressivity. Since the flat tax rate would probably be between 15 and 20 percent, those high-income taxpayers who now pay average rates far above those levels would get big tax cuts, and some of those currently paying less would incur sizable tax increases. Table 7 shows the distribution of the flat-rate income taxes just described, with rates ranging from 11.8 percent to 18.7 percent. The tax with the broadest base and no personal exemptions, zero bracket amount, tax credits, or personal deductions appears as System 1. Under this plan, taxpayers in the highest income group would pay roughly half the tax that they now pay, while those in the lowest income groups would pay considerably more tax than currently. Basically the same result would hold under System 2, with tax imposed at the flat rate of 18.5 percent on the current tax base, although taxes of the lowest income groups would not increase by as much as under the most broadly based flat rate tax of System 1.

In order to provide relief to taxpayers in the lowest income groups, most proposals for flat-rate taxes would provide personal exemptions and zero bracket amounts at least as large as those provided under current law. Systems 3 and 4 in Table 7 are designed to show the effects of allowing personal exemptions under the same broad-based tax as System 1. The personal exemptions and zero bracket amount of System 3 are those of current law: a \$1,000 exemption and zero bracket amounts of \$2,300 for single taxpayers and \$3,400 for married couples. The larger allowances of System 4 are: a \$1,500 personal exemption and zero bracket amounts of \$3,000 for single taxpayers and \$6,000 for married couples. Even with these more generous allowances, taxes would increase on average for those with incomes below \$50,000 and decrease considerably for those with incomes above \$50,000, with those with incomes above \$200,000 receiving tax cuts of about \$28,000 on average.

A broad-based tax with graduated rates could be devised to replicate the current degree of overall income tax progressivity, but within each income group many individuals would still get large tax cuts or increases, as discussed above. The Treasury Department estimated that the combined yield of the current individual and corporate income taxes would be replicated by a broad-based income tax with three rates--10 percent on the

Economic Review (September 1977), pp. 747-752.) Indeed, some people even question the usefulness of distributional data based on annual income, on the basis that lifetime income is a superior measure of ability to pay. (See David Davies, "Measurement of Tax Progressivity: Comment," American Economic Review (March 1980), pp. 204-7; and Thomas Mayer, "The Distribution of the Tax Burden and Permanent Income," National Tax Journal (March 1974), pp. 141-146.)

TABLE 7. DISTRIBUTION OF TAX LIABILITIES UNDER ALTERNATIVE FLAT-RATE TAX SYSTEMS COMPARED TO 1984 TAX LAW^a AT 1981 INCOME LEVELS

System 1					
(11.8 percent tax on adjusted gross income, with no personal exemption, zero bracket amount, tax credits, or personal deductions, and with long-term capital gains included in full)					
Expanded Income ^b (in thousands of dollars)	Number of Taxable Returns (in thousands)	Tax Liability 1984 Law (in millions of dollars)	Tax Liability (in millions of dollars)	Change in Tax (in percents)	Change in Tax (dollars per return)
0 - 5 ^c	6,482	403	5,479	1,259.5	783.07
5 - 10	15,057	5,772	14,280	147.4	565.04
10 - 15	13,092	12,526	19,700	57.3	547.99
15 - 20	10,737	17,462	22,496	28.8	468.88
20 - 30	16,800	44,080	49,701	12.8	334.58
30 - 50	13,568	63,833	60,579	-5.1	-239.82
50 - 100	3,580	38,687	27,389	-29.2	-3,155.74
100 - 200	631	18,656	9,872	-47.1	-13,920.58
200 and above	164	16,385	7,675	-53.2	-53,107.15
Total or Average	80,110	217,803	217,172	-0.3	-7.87

(Continued)

SOURCE: Joint Committee on Taxation, May 18, 1982.

- a. To facilitate comparison, 1984 law in this table does not include the earned income credit, the two-earner married couple deduction, or the IRA or Keough provisions. The flat-rate tax systems similarly do not include those provisions.

TABLE 7. (Continued)

Expanded Income ^b (in thousands of dollars)	Number of Taxable Returns (in thousands)	Tax Liability 1984 Law (in millions of dollars)	System 2 (18.5 percent tax on 1984 taxable income less zero bracket amount)		
			Tax Liability (in millions of dollars)	Change in Tax (in percents)	Change in Tax (dollars per return)
0 - 5 ^c	6,482	403	1,574	290.7	180.71
5 - 10	15,057	5,772	8,752	51.6	197.91
10 - 15	13,092	12,526	17,610	40.6	388.31
15 - 20	10,737	17,462	22,665	30.0	484.54
20 - 30	16,800	44,080	52,871	19.9	523.28
30 - 50	13,568	63,833	66,419	4.1	190.61
50 - 100	3,580	38,687	30,486	-21.2	-2,290.90
100 - 200	631	18,656	10,743	-42.4	-16,540.20
200 and above	164	16,385	7,129	-56.5	-56,438.05
Total or Average	80,110	217,803	218,249	0.2	5.57

(Continued)

- b. Expanded income is a broader concept of taxpayer income than adjusted gross income. In addition to adjusted gross income, it includes the excluded part of capital gains, percentage depletion in excess of cost depletion, and other tax preferences subject to the minimum tax. At the same time, it excludes the deduction of investment interest to the extent it exceeds investment income. The differences between adjusted gross income and expanded income occurs mainly in the higher income classes.

TABLE 7. (Continued)

System 3					
(15.7 percent tax on 1984 law taxable income less zero bracket amount, with long-term capital gains included in full, and no itemized deductions)					
Expanded Income ^b (in thousands of dollars)	Number of Taxable Returns (in thousands)	Tax Liability 1984 Law (in millions of dollars)	Tax Liability (in millions of dollars)	Change in Tax (in percents)	Change in Tax (dollars per return)
0 - 5 ^c	6,482	403	2,232	453.7	282.10
5 - 10	15,057	5,772	7,854	36.1	138.26
10 - 15	13,092	12,526	15,720	25.5	243.97
15 - 20	10,737	17,462	20,778	19.0	308.88
20 - 30	16,800	44,080	49,978	13.4	351.06
30 - 50	13,568	63,833	66,466	4.1	194.08
50 - 100	3,580	38,687	32,658	-15.6	-1,684.20
100 - 200	631	18,656	12,459	-33.2	-9,821.59
200 and above	164	16,385	10,050	-38.7	-38,630.67
Total or Average	80,110	217,803	218,194	0.2	4.88

(Continued)

57

- c. Outcomes under the flat-rate tax for tax returns of under \$5,000 of income would be highly uncertain. Some taxpayers at that income level currently make use of tax preferences that would be terminated under the flat-rate tax, and those taxpayers would thus face tax increases. Many households with very low incomes who would not have to file tax returns under the 1984 law and are therefore not represented in the table would have to file returns and pay taxes under System I in which all income would be subject to tax without exemption or deduction. The impact of this factor on the table would likely be small, though it would significantly change administrative burdens under the tax system.

TABLE 7. (Continued)

System 4					
(18.7 percent tax on taxable income as in System 3, with \$1,500 personal exemption and \$3,000 (\$6,000) zero bracket amount for single (joint) returns)					
Expanded Income ^b (in thousands of dollars)	Number of Taxable Returns (in thousands)	Tax Liability 1984 Law (in millions of dollars)	Tax Liability (in millions of dollars)	Change in Tax (in percents)	Change in Tax (dollars per return)
0 - 5 ^c	6,482	403	1,996	395.2	245.71
5 - 10	15,057	5,772	5,345	-7.4	-28.33
10 - 15	13,092	12,526	12,698	1.4	13.11
15 - 20	10,737	17,462	18,802	7.7	124.76
20 - 30	16,800	44,080	48,170	9.3	243.45
30 - 50	13,568	63,833	68,804	7.8	366.41
50 - 100	3,580	38,687	36,104	-6.7	-721.60
100 - 200	631	18,656	14,344	-23.1	-6,833.56
200 and above	<u>164</u>	<u>16,385</u>	<u>11,843</u>	<u>-27.7</u>	<u>-27,692.33</u>
Total or Average	80,110	217,803	218,106	0.1	3.78

first \$19,000 of income; 25 percent from \$19,500 to \$75,000; and 39 percent over \$75,000.⁶⁶ This tax would provide \$1,000 personal exemptions for each dependent and a \$3,000 exemption for married couples and would represent a comprehensive income tax that also eliminated the double taxation of dividends. Even though the tax was designed to replicate the progressivity and yield of the current income tax, its enactment would raise taxes for about 55 percent of taxpayers and correspondingly lower them for the other 45 percent.⁶⁷

Less Than Fully Comprehensive Base Broadening. Base broadening need not be so extensive as to involve the repeal of all tax preferences. The Congress might want to preserve preferences that reflect differences in economic circumstances or that subsidize activities that the Congress wants to encourage or whose elimination would represent such a dramatic departure from current law as to cause economic dislocation.

The revenue losses from selected tax preferences (also called tax expenditures) are shown in Tables 8 through 11, along with the distributions of the losses by income groups.⁶⁸ Elimination of the deduction for charitable contributions, for instance, would increase revenues by \$8.8 billion, based on 1981 income levels, with nearly all of the increased revenue coming from those with incomes above \$30,000.

The estimates in Tables 8 through 11 were provided by the Department of the Treasury, Office of Tax Analysis. The Treasury cautioned that the estimates reprinted in Table 9 are less reliable than those in Table 8, since the Table 9 estimates are based on information from sources other than income tax returns. The Treasury also listed a number of tax expenditure items for which there was not enough information to make reasonable distribution estimates. These items appear in Table 10.

The Treasury Department did not attempt to allocate corporate tax expenditures to individuals, mainly because of the difficulty in determin-

⁶⁶ Statement of John Chapoton, Assistant Secretary of the Treasury for Tax Policy, before the Senate Finance Committee (September 28, 1982), p. 5.

⁶⁷ Ibid.

⁶⁸ The distributions are shown by adjusted gross income groups. Adjusted gross income does not include the sixty percent of capital gains that is untaxed or other items subject to the minimum tax. The differences between adjusted gross income and the broader concept of expanded income occur mainly in the higher income classes.

TABLE 8. REVENUE LOSS FROM TAX EXPENDITURES FOR INDIVIDUALS, DISTRIBUTED BY ADJUSTED GROSS INCOME CLASS ON THE BASIS OF TAX RETURN DATA, 1982 LAW AND 1981 INCOME LEVELS (In millions of dollars)

Adjusted Gross Income Class (In thousands of dollars)	Exclusion of Income Earned Abroad by U.S. Citizens	Investment Credits Other Than Energy Credits ^{a,b}	Capital Gains, Excluding Home Sales ^c	Residential Energy Credits		Alternative Conservation and New Technology Credits-- Supply Incentives ^a
				Supply Incentives ^a	Conservation Incentives ^a	
Less than 10	4	75	428	17	28	--
10 - 15	14	199	384	7	38	e
15 - 20	21	249	308	19	48	e
20 - 30	53	557	1,140	43	124	e
30 - 50	158	744	2,564	68	130	5
50 - 100	385	745	3,179	34	39	8
100 - 200	221	414	2,148	8	7	12
200 and over	<u>74</u>	<u>454</u>	<u>3,081</u>	<u>2</u>	<u>2</u>	<u>13</u>
Total	930	3,439	13,231	199	415	38

Adjusted Gross Income Class (In thousands of dollars)	Jobs Credit ^a	Deductibility of Medical Expenses	Additional Exemption for the Blind	Additional Exemption for the Elderly	Tax Credit for the Elderly ^a
10 - 15	1	190	1	407	37
15 - 20	1	299	10	260	21
20 - 30	8	827	2	360	19
30 - 50	5	1,201	8	374	16
50 - 100	10	614	2	225	3
100 - 200	6	150	1	76	e
200 and over	<u>3</u>	<u>56</u>	<u>2</u>	<u>23</u>	<u>e</u>
Total	35	3,422	28	2,131	135

(Continued)

SOURCE: Department of the Treasury, Office of Tax Analysis, September 23, 1982.

NOTE: Details may not add to totals because of rounding.

a. Based on 1980 distributions.

b. Includes the investment credits for increasing research activities, the rehabilitation of structures, and other investment.

TABLE 8. (Continued)

Adjusted Gross Income Class (In thousands of dollars)	Dividend and Interest Exclusion	Deductibility of Mortgage Interest on Owner-Occupied Homes	Deductibility of Property Tax on Owner-Occupied Homes	Deductibility of Charitable Contributions ^d	Child and Dependent Care Credit ^a	Work Incentive Program Credit ^a
Less than 10	24	220	109	36	92	--
10 - 15	28	343	198	129	218	2
15 - 20	30	892	374	249	188	e
20 - 30	87	3,633	1,429	985	382	2
30 - 50	170	8,639	3,252	2,550	364	4
50 - 100	128	4,672	2,291	2,109	62	7
100 - 200	33	979	725	1,126	7	2
200 and over	<u>8</u>	<u>225</u>	<u>302</u>	<u>1,652</u>	<u>1</u>	<u>e</u>
Total	506	19,602	8,679	8,836	1,314	17

Adjusted Gross Income Class (In thousands of dollars)	Deductibility of Casualty Losses	Earned Income Credit	Credit for Political Contributions ^a	Deductibility of Nonbusiness State and Local Taxes Other than on Owner-Occupied Homes
Less than 10	8	533 ^f	8	118
10 - 15	21	--	9	230
15 - 20	41	--	9	497
20 - 30	109	--	18	2,276
30 - 50	249	--	21	6,289
50 - 100	178	--	21	5,050
100 - 200	52	--	11	2,032
200 and over	<u>37</u>	<u>--</u>	<u>1</u>	<u>1,352</u>
Total	695	533 ^f	80	17,844

- c. Includes capital gains treatment of coal royalties, iron ore, certain timber and agricultural income, and other income.
- d. Includes the deductibility of charitable contributions for education, health, and other. The estimates exclude amounts claimed by nonitemizers, estimated to total \$180 million.
- e. Less than \$500,000.
- f. The effect of the credit on receipts. The effect on outlays equals \$1,283 million, all of which is claimed by individuals with less than \$10,000 adjusted gross income.

TABLE 9. REVENUE LOSS FROM TAX EXPENDITURES FOR INDIVIDUALS, DISTRIBUTED BY ADJUSTED GROSS INCOME CLASS ON THE BASIS OF DATA FROM SOURCES OTHER THAN TAX RETURNS, 1982 LAW AND 1981 INCOME LEVELS (In millions of dollars)

Adjusted Gross Income Class (In thousands of dollars)	Exclusion of Veterans' Preferences ^a	Exclusion of Interest on State and Local Bonds ^b	Deductibility of Interest on Consumer Credit	Deferral of Capital Gains on Home Sales	Exclusion of Capital Gains on Home Sales for Persons Age 55 and Over	Exclusion of Employer Contributions for Medical Insurance Premiums and Medical Care
Less than 10	858	4	9	8	3	888
10 - 15	520	5	98	4	1	1,191
15 - 20	482	7	332	52	9	1,464
20 - 30	815	25	1,566	146	79	3,851
30 - 50	504	230	3,606	341	183	4,470
50 - 100	176	2,019	1,888	294	60	1,450
100 - 200	37	1,441	549	90	30	252
200 and over	<u>8</u>	<u>868</u>	<u>199</u>	<u>34</u>	<u>15</u>	<u>53</u>
Total	3,400	4,599	8,246	967	380	13,619

(Continued)

SOURCE: Department of the Treasury, Office of Tax Analysis, September 23, 1982.

NOTE: Details may not add to totals because of rounding.

a. Includes the exclusion of benefits and allowances to Armed Forces personnel, military disability pensions, veterans' disability compensation, veterans' pensions, and GI bill benefits.

TABLE 9. (Continued)

Adjusted Gross Income Class (In thousands of dollars)	Exclusion of Social Security and Railroad Retirement Benefits ^c	Exclusion of Workers' Compensation Benefits	Exclusion of Untaxed Unemployment Insurance Benefits	Exclusion of Disability Pay	Net Exclusion of Pension Contributions and Earnings ^d	Exclusion of Insurance Premiums ^e
Less than 10	5,029	786	1,073	127	964	83
10 - 15	1,787	444	560	22	1,371	112
15 - 20	1,254	314	205	1	1,893	163
20 - 30	1,822	664	272	3	5,495	444
30 - 50	1,278	345	9	---	8,306	642
50 - 100	731	93	---	---	4,345	282
100 - 200	209	20	---	---	1,463	89
200 and over	<u>55</u>	<u>8</u>	<u>---</u>	<u>---</u>	<u>513</u>	<u>36</u>
Total	12,165	2,674	2,119	153	24,350	1,851

- b. Includes the exclusion of interest on pollution control bonds, industrial development bonds, housing bonds for owner-occupied homes and rental housing, student loan bonds, hospital bonds, and general purpose state and local debt.
- c. Includes the exclusion of disability insurance benefits, OASI benefits for retired workers, benefits for dependents and survivors, and railroad retirement system benefits.
- d. Includes the exclusion of contributions and earnings for employer plans and plans for the self-employed and others.
- e. Includes premiums for group-term life insurance and accident and disability insurance.

TABLE 10. TAX EXPENDITURES FOR INDIVIDUALS FOR WHICH DISTRIBUTION DATA ARE UNAVAILABLE

Expensing of research and development expenditures

Expensing of exploration and development costs, fuel and nonfuel minerals

Excess of percentage over cost depletion, fuel and nonfuel minerals

Tax incentives for preservation of historic structures

Cash accounting for agriculture

Exclusion of interest on life insurance savings

Expensing of construction period interest and taxes

Carryover basis of capital gains at death

Amortization of start-up costs

Exclusion of interest on certain savings certificates

Five-year amortization for housing rehabilitation

Exclusion of employee meals and lodging (other than military)

Employer educational assistance

Exclusion of contributions to prepaid legal plans

Exclusion of income of trusts to finance supplementary unemployment insurance benefits

Deductibility of certain adoption expenses

Deferral of interest on savings bonds

Parental personal exemption for students age 19 and over

Exclusion of special benefits for disabled coal miners

SOURCE: Department of the Treasury, Office of Tax Analysis, September 23, 1982.

TABLE 11. DISTRIBUTION OF TAX RETURNS AND TAX LIABILITY BY ADJUSTED GROSS INCOME CLASS, 1982 LAW AND 1981 INCOME LEVELS

Adjusted Gross Income Class (In thousands of dollars)	Total Number of Returns (In thousands)	Total Number of Taxable Returns (In thousands)	Tax Liability ^a (In millions of dollars)
Less than 10	34,366	17,207	6,600
10 - 15	13,457	13,226	14,582
15 - 20	10,936	10,832	20,394
20 - 30	17,254	17,176	52,815
30 - 50	13,538	13,498	77,958
50 - 100	3,384	3,375	46,379
100 - 200	549	549	21,288
200 and over	<u>116</u>	<u>116</u>	<u>16,093</u>
Total	93,600	75,979	256,109

SOURCE: Staff of the Joint Committee on Taxation.

- a. Tax liabilities do not include the refundable (outlay) portion of the earned income credit. Liability reflects major Economic Recovery Tax Act (ERTA) and Tax Equity and Fiscal Responsibility Act (TEFRA) provisions except Accelerated Cost Recovery System (ACRS), All Savers, IRA, and Keogh provisions.

ing which individuals benefit from particular reductions in corporate income taxes. The Treasury noted that "this omission is extremely important and means that the tables should not be used to indicate the distribution of all tax expenditures by income class." In order to give some perspective on the estimates, Table 11 shows total tax liability by adjusted gross income class, plus the total number of returns filed and the total number of taxable returns.

The models from which the tax expenditure estimates are taken undergo continual updating and improvement, so all of the estimates should be viewed as preliminary and subject to change. This is especially true for those estimates for which no tax return data are available. The estimates nonetheless serve as a useful guide to the approximate distribution by income class of a large number of existing tax expenditures.

Because of interactions among provisions and with the zero bracket amount, it is not possible to calculate the amount of revenue that would be raised from repeal of two or more provisions simply by summing the revenue losses of each of the provisions. Such a simple summing gives a rough idea of the potential revenue gain, however. The rate reductions would have to be tailored to the distribution of revenue gain by income group if the ultimate goal was preservation of both the yield and the distribution of the current tax.