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TAX REFORM PROPOSALS—IV

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

JUNE 17, 1985

(People Below Poverty Line)

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TAX REFORM PROPOSALS—IV

MONDAY, JUNE 17, 1985

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The committee met, pursuant to notice, at 9:30 a.m., in room SD-215, Dirksen Senate Office Building, the Honorable Bob Packwood (chairman) presiding.

Present: Senators Packwood, Danforth, Symms, Moynihan, and Baucus.

[The press release announcing the hearing and a report prepared by the Joint Committee on Taxation follows:]

[Press Release No. 85-033, May 30, 1985]

CHAIRMAN PACKWOOD ANNOUNCES FINANCE TAX REFORM HEARINGS

Senator Bob Packwood (R-Oregon), Chairman of the Committee on Finace, travelling in Oregon, today announced that the Committee will begin hearings in early June on President Reagan's tax reform proposal.

The Committee's work on the President's proposal will begin with Treasury Secretary Baker's testimony on June 11th, said the chairman of the Senate tax-writing committee, and will involve upwards of 30 days of hearings—3 or 4 days each week the Senate is in session during the months of June, July and September.

Chairman Packwood announced the first five days of hearings, as follows:

Secretary of the Treasury James A. Baker III will present the President's tax plan to the Committee on Tuesday, June 11, 1985.

Internal Revenue Service Commissioner Roscoe Egger will appear before the Committee to testify on Wednesday, June 12, 1985.

On Thursday, June 13, 1985, the Committee will receive testimony from invited national business leaders.

On Monday, June 17th, public witnesses will testify on the impact of the tax reform proposal on people below the poverty line.

On Tuesday, June 18, 1985, witnesses invited by the Committee will discuss the general issue of whether corporations ought to pay a higher percentage of the income tax burden.

All hearings will begin at 9:30 a.m. and will be held in Room SD-215 of the Dirksen Senate Office Building.

FEDERAL TAX TREATMENT OF INDIVIDUALS BELOW THE POVERTY LEVEL

SCHEDULE FOR A HEARING

BEFORE THE

SENATE COMMITTEE ON FINANCE

ON JUNE 17, 1985

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

INTRODUCTION

The Senate Committee on Finance has scheduled a public hearing on June 17, 1985, relating to the Federal tax treatment of individuals with income below the poverty level.

The first part of the pamphlet [1] compares the level of income below which a family is considered to live in poverty (the "poverty level") with the level of income at which a family begins to pay Federal income tax (the "tax threshold"). The second part describes provisions of present law affecting the tax threshold. The third part discusses the amount of Federal income tax payable, under present law, by individuals at the poverty level. The fourth part describes issues involved in proposals to alleviate Federal income tax burdens on low-income individuals. The final part summarizes certain provisions of the Administration's recent tax reform proposal and of Senate bills introduced to date in the 99th Congress intended to accomplish that objective.

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[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Federal Tax Treatment of Individuals Below the Poverty Level* (JCS-18-85), June 14, 1985.

I. COMPARISON BETWEEN POVERTY LEVEL AND INCOME TAX THRESHOLD

During the 1960's and 1970's, the Congress sought to eliminate any Federal income tax liability for families whose income was below the poverty level. The amount of income considered to mark the poverty level has been computed annually by the Federal Government since the 1960's. On the basis of data indicating that nonfarm families generally spend about one-third of their income for food, the poverty level originally was computed as three times the amount of money necessary to purchase the lowest cost "nutritionally adequate" diet calculated by the Department of Agriculture, with adjustments such as for family size and for farm families. The poverty level is now established simply by increasing the prior year's level by the change in the Consumer Price Index.

Several approaches were used in tax legislation enacted in 1969, 1975, 1976, 1977, and 1978 in seeking to increase the level of income at which a family begins to pay Federal income tax (termed the tax threshold or entry point) to a point at or above the poverty level. These approaches included increases in the personal exemption, increases in the standard deduction (now termed the zero bracket amount), and enactment of and increases in the earned income tax credit. In recent years, however, these provisions have not kept pace with inflation, and as a result, the income tax threshold has fallen well below the poverty level.

Table 1 below compares the poverty level and the Federal income tax threshold for a family of four for selected years between 1960 and 1988 (as estimated under present law). The tax computations in the table reflect assumptions that all family income consists of wages or salaries, that families of two or more include a married couple (rather than an unmarried head of household with one or more dependents), that all family members are under age 65, and that families of three or more persons are eligible for the earned income credit.

In 1960, the poverty level for a family of four was $3,022, but Federal income tax had to be paid on earnings above $2,667; this tax threshold was 11.7 percent below the poverty level. As a result of the 1964 tax cuts, this gap was narrowed to 6.9 percent by 1965. However, as a result of inflation by 1969, the tax threshold ($3.000) fell to 19.9 percent below the poverty level ($3,743). The Congress responded by enacting tax reductions in 1969 and 1971 which succeeded in eliminating the gap in 1972; i.e., no income tax was due unless earnings were greater than the poverty level amount.

The rapid inflation of 1973-74 caused the gap to reemerge for those years. Accordingly, in 1975 the tax cuts were so structured that the income tax threshold for a family of four ($6,692) was 21.7 percent above the poverty level ($5,500). The earned income tax credit, enacted that year, was designed not only to remove low-income individuals from the income tax rolls but also, because the credit is refundable, to offset some of the impact of the social security payroll tax on their earnings.

However, as a result of inflation in subsequent years, the tax threshold dropped to 11.5 percent below the poverty level in 1982, 13.6 percent below in 1983, and 17.2 percent below in 1984. It is estimated that in 1987 and 1988, the gap (under present law provisions) will increase to 18.8 percent and 20.7 percent, respectively, the largest gap since before 1960. For 1986, it is estimated that the poverty level for a family of four will be $11,502, but (under present law) the family will have to pay income tax beginning at $9,573. This shortfall is estimated to continue to grow for some families notwithstanding the impact of indexing of personal exemptions and the zero bracket amount, which took effect in 1985, since the earned income credit is not indexed.

Table 1.—Relationship Between Poverty Level and Income Tax Threshold for a Family of Four, 1960-1988

Year	Poverty level (family of four)	Income tax threshold	Percentage by which tax threshold falls below (exceeds) poverty level
1960	$3,022	$2,667	11.7
1965	3,223	3,000	6.9
1966	3,317	3,000	9.6
1968	3,553	3,000	15.6
1969	3,743	3,000	19.9
1970	3,968	3,600	9.3
1971	4,137	3,750	9.4
1972	4,275	4,300	(0.6)
1973	4,540	4,300	5.3
1974	5,038	4,300	14.6
1975	5,500	6,692	(21.7)
1976	5,815	6,892	(18.5)
1977	6,191	7,533	(22.0)
1978	6,662	7,533	(13.1)
1979	7,412	8,626	(16.4)
1980	8,414	8,626	(2.5)
1981	9,287	8,634	7.0
1982	9,862	8,727	11.5
1983	10,178	8,783	13.7
1984	[1] 10,612	8,783	[1] 17.2
1985	[1] 11,003	9,437	[1] 14.2
1986 (present law)	[1] 11,502	[1] 9,573	[1] 16.8
1987 (present law)	[1] 11,990	[1] 9,739	[1] 18.8
1988 (present law)	[1] 12,491	[1] 9,909	[1] 20.7

[1] Estimated. The table reflects assumptions that all family income consists of wages or salaries, that families of two or more include a married couple (rather than an unmarried head of household with one or more dependents), that all family members are under age 65, and that families of three or more persons are eligible for the earned income credit.

II. CODE PROVISIONS AFFECTING INCOME TAX THRESHOLD AND LOW-INCOME INDIVIDUALS

The principal provisions of the Internal Revenue Code that have determined the Federal income tax threshold over the last 20 years are listed in Table 3 below. These are the personal exemption and minimum standard deduction (now the zero bracket amount), both of which have been in the law for many years, and the earned income tax credit, enacted in 1975. (In addition, the general tax credit that was in effect between 1975 and 1978 affected the tax entry point in those years.) The child care credit and the credit for the elderly and disabled only affect taxpayers eligible for those credits.

Personal exemption

The personal exemption, which is subtracted as the final step in computing taxable income, is the principal tax law provision that differentiates tax burden by family size.

Each individual is entitled to one personal exemption (one for a single return and two for a joint return), and an additional exemption is allowed for each person who qualifies as a dependent of the taxpayer. (An unmarried head of household, like other unmarried individuals or a married person filing separately, has one exemption; however, the tax rates applicable to a head of household are lower than the rates for single persons or married persons filing separately.) Further, an extra exemption is allowed for a taxpayer age 65 or over, and for a taxpayer who is blind.

The personal exemption remained at $600 between 1948 and 1969, after which it was increased in stages to $750 for 1972-78. The Revenue Act of 1978 increased the exemption further to $1,000. Beginning in 1985, the personal exemption is indexed for inflation ($1,040 for 1985).

The present $1,040 exemption is much smaller, when adjusted for inflation, than was the $600 exemption in 1948; that is, the exemption today would have to be $2,614 to be equivalent in dollar terms to the $600 exemption in 1948. Also, the exemption has not kept pace with inflation since 1964; i.e., $600 in 1964 would be worth $2,009 in 1985. As a result of the erosion of the real value of the exemption, the extent to which the tax burden on large families is lower than the tax burden on small families at the same income level has gradually lessened. As a result, the current gap between the poverty level and the tax threshold is greater for large families than for small families.

Zero bracket amount (standard deduction)

The zero bracket amount (ZBA) originated as a standard deduction, designed to give taxpayers an alternative to itemizing their personal deductions. Prior to 1964, the standard deduction equaled

10 percent of adjusted gross income (subject to a maximum) and was subtracted by nonitemizers in computing taxable income.

Starting in 1964, the Congress began to target the standard deduction toward lower-income taxpayers. That year, the minimum standard deduction (also called the low-income allowance) was enacted and equaled $200 plus $100 for each personal exemption (i.e., $600 for a married couple with two children). In 1969, the minimum standard deduction was increased to $1,100 for 1970 and $1,050 for 1971. The 1971 and 1975 tax cut legislation increased the minimum standard deduction for joint returns to $1,300 and $1,900, respectively. Also, in 1975 the minimum standard deduction was established at a lower level for single returns ($1,600) than for joint returns ($1,900).

In 1977, the standard deduction was set at a flat amount for all taxpayers ($2,200 for single returns, $3,200 for joint returns, and $1,600 for married persons filing separate returns), built into the tax schedules as a tax bracket with a zero rate, and renamed the zero bracket amount (ZBA). Thus, the standard deduction amount is no longer actually deducted by the taxpayer in computing taxable income; instead, the taxpayer pays a zero tax on the amount of taxable income up to the ZBA. Itemizers must subtract their ZBA from their itemized deductions in order to avoid doubling the benefit of the ZBA.

For 1979-84, the ZBA was $2,300 for single returns and $3,400 for joint returns ($1,700 for married persons filing separate returns). Beginning in 1985, these amounts are indexed for inflation. The 1985 ZBA is $2,390 for single returns and $3,540 for joint returns ($1,770 for married persons filing separate returns). An unmarried head of household has the same ZBA as other unmarried individuals or a married person filing separately; however, the tax rates applicable to a head of household are lower than the rates for single persons or married persons filing separately.

For individuals who are not eligible for the earned income credit, the personal exemption and the zero bracket amount determine the tax entry point. Thus, for such a single taxpayer, the tax entry point for 1985 is $3,430 ($1,040 exemption plus $2,390 ZBA). For such a married couple, it is $5,620 ($2,080 exemption plus $3,540 ZBA). For such a married couple with two children, the tax entry point is $7,700 ($4,160 exemption plus $3,540 ZBA).

Earned income tax credit

The earned income tax credit was enacted in 1975 as a means of targeting tax relief to working low-income taxpayers with children, providing relief from the payroll tax for these taxpayers, and improving work incentives. (The credit is only available to a taxpayer living with his or her dependent child.) Unlike other tax credits, the earned income credit is refundable; i.e., the amount of the credit is paid to the taxpayer to the extent it exceeds tax liability. Also, under an advance payment system, eligible individuals may receive the credit with their paychecks, rather than waiting to claim a refund on their return filed for the year.

As originally enacted, the credit equaled 10 percent of the first $4,000 of earned income (i.e., a maximum credit of $400) and was phased out for adjusted gross income of $4,000 to $8,000. For 1979-

84, the maximum credit was increased to $500 (10 percent of the first $5,000 of earned income), and the phaseout was raised to income levels of $6,000 to $10,000.

Under the Deficit Reduction Act of 1984, the earned income credit was increased (beginning in 1985) to 11 percent of the first $5,000 of earned income, for a maximum of $550. The credit is now phased out for adjusted gross income of $6,500 to $11,000. Unlike the personal exemption and the zero bracket amount, the dollar limitations determining the amount of the earned income credit are not indexed for inflation.

The tax thresholds shown in Table 1 above include the impact of the earned income credit for years after 1974. Thus, for a four-person family for 1983, the tax entry point ($8,783) is the income level at which the tax before credits exactly equals the allowable earned income credit.

Table 2 below shows the total amount of earned income credits received for each of the calendar years since the inception of the program, the number of recipient families, the amount of the credits received as Treasury checks, and the average amount of the credit received per family. For 1983, approximately 45 percent of credit recipients were married couples filing joint returns and 55 percent were unmarried head of household returns.

Table 2.—Data Concerning Earned Income Credit, 1975–1986

Calendar year to which credit applies	Total amount of credit (in millions)	Number of families who received credit (in thousands)	Refunded portion of credit (in million [1]	Average credit per family
1975	$1,250	6,215	$900	$201
1976	1,295	6,473	890	200
1977	1,127	5,627	880	200
1978	1,048	5,192	801	202
1979	2,052	7,135	1,395	288
1980	1,986	6,954	1,370	286
1981	1,912	6,717	1,278	285
1982	1,775	6,395	1,222	278
1983 [2]	1,786	6,250	1,287	286
1984 [3]	1,643	NA	1,183	NA
1985 [3]	1,947	NA	1,460	NA
1986 [3]	1,791	NA	1,343	NA

[1] This is the portion of the credit that exceeds tax liability; it is treated as a budget outlay. All these credits were paid in the following year until 1979, when advance payments of the credit were permitted, by addition to the worker's paycheck.

[2] Preliminary.

[3] Estimated (under present law).

NA—Not available.

General tax credit (1975–1978)

Between 1975 and 1978, the Congress adopted a temporary general tax credit as an additional means of providing tax relief to lower-income persons. As enacted in 1975, the credit was $30 for each personal exemption. In 1977, it was increased to the greater of $35 per exemption or two percent of the first $9,000 of taxable income. The 1978 tax reduction legislation eliminated the general tax credit, replacing it with an increase in the personal exemption. Unlike the earned income credit, the general tax credit was not refundable.

Child care credit

A taxpayer who incurs child or dependent care expenses in order to work is entitled to a nonrefundable income tax credit equal to a stated percentage of those employment-related expenses. Such expenses must relate to the maintenance of a household for children under 15 or other qualifying individuals. Generally, the credit is not available to the extent such employment-related expenses exceed the earned income of the taxpayer, or for a married couple, the earned income of the lower-earning spouse; thus, if one spouse is not working, no credit generally is allowed. Married couples generally must file a joint return to claim the credit.

The maximum amount of employment-related expenses eligible for the credit is $2,400 for one qualifying individual, and $4,800 for two or more qualifying individuals. The amount of the credit is reduced as the adjusted gross income of the taxpayer rises. The credit equals 30 percent of qualified expenses for taxpayers with AGI of $10,000 or less, and decreases (by one percentage point per $2,000 of AGI) to 20 percent of qualified expenses for taxpayers with AGI over $28,000.

Although thought of in part as a credit to assist low-income persons, few such individuals use the credit. It is estimated that in 1983, only one percent of married couples who claimed the earned income credit also claimed the child care credit. This result probably occurs because married couples with income low enough to be eligible for the earned income credit are predominantly one-earner couples, who are not eligible for the child care credit. Even among working unmarried low-income persons with children, however, use of the child care credit is low; fewer than six percent of unmarried heads of households who claimed the earned income credit also claimed the child care credit.

Provisions for the elderly

Present law includes several provisions of particular benefit to low-income elderly individuals—a nonrefundable income tax credit for the elderly and disabled, an extra personal exemption for taxpayers age 65 or over, and tax exemption of social security benefits for taxpayers with income below $32,000 ($25,000 for unmarried taxpayers).

The credit for the elderly and disabled is computed as 15 percent of a defined base amount. This defined base amount is currently computed from an initial base amount of $5,000 for a single person over age 65 or for a married couple filing jointly where only one spouse is over age 65. If both spouses are over age 65, the amount is $7,500 if they file a joint return, and $3,750 if they file separate returns. These initial figures are reduced by the amount of certain nontaxable income of the taxpayer, such as social security benefits, and by one-half of the taxpayer's adjusted gross income in excess of $7,500 for single taxpayers, $10,000 for married taxpayers filing jointly, or $5,000 for married taxpayers filing separately. For disabled individuals, the defined base amount is limited to the amount of their disability income if it is less than their initial base amount.

As a result of these provisions, the tax threshold for elderly individuals is well above the poverty line under present law. For a single elderly taxpayer none of whose income consists of tax-free social security benefits, the tax threshold in 1986 is estimated to be $9,383, and for an elderly couple, the threshold is estimated to be $14,450. These are well above the estimated poverty levels for such an individual of $5,450 and $6,860, respectively.

Table 3.—Federal Income Tax Provisions Affecting Tax Threshold, 1948-1985

Year	Personal exemption	Minimum standard deduction (zero bracket amount) for joint returns	Earned income tax credit	General tax credit
1948-64	$600	10% of AGI	NA	NA.
1964-69	600	$200 plus $100 per exemption.	NA	NA.
1970	625	1,100	NA	NA.
1971	675	1,050	NA	NA.
1972-74	750	1,300	NA	NA.
1975	750	1,900	$400, phased out between $4,000-8,000 of AGI.	$30 per exemption.
1976	750	2,100	Same as 1975	$35 per exemption.
1977-78	750	3,200	Same as 1975	$35 per exemption.
1979-84	1,000	3,400	$500, phased out between $6,000-10,000 of AGI.	NA.
1985 and after (present law).	$1,000 adjusted for inflation ($1,040 for 1985).	$3,400 adjusted for inflation ($3,540 for 1985).	$550, phased out between $6,500-11,000 of AGI.	NA.

NA—Not applicable in that year.
AGI—Adjusted gross income.

III. AMOUNT OF TAX PAID AT THE POVERTY LEVEL

Table 4 below shows the poverty level and income tax threshold for families of one to six persons for 1978 and 1982-1986 (as estimated under present law). The tax computations in the table reflect assumptions that all family income consists of wages or salaries, that families of two or more include a married couple (rather than an unmarried head of household with one or more dependents), that all family members are under age 65, and that families of three or more persons are eligible for the earned income credit.

In 1978, the income tax threshold was below the poverty level only for single persons, and the maximum income tax paid by a single person at the poverty level was only $16. For three -and four-person families at the poverty line, the earned income credit offset a substantial part of the payroll tax.

In 1983, by contrast, the income tax threshold was below the poverty level for all family sizes except for three-person families. For four-person families, $1,395 in income below the poverty level amount was subject to tax; the corresponding figure for six-person families was $3,911. In 1985, after the first year of indexing and the increase in the earned income credit provided in the Deficit Reduction Act of 1984, the income tax thresholds for four -and six-person families were $1,567 and $4,314 below the poverty line, respectively. For 1986, the growth in these gaps is estimated to accelerate, making them $1,929 and $4,807, respectively. Even with indexing, and the increase in the earned income credit, the gap between the poverty level and the tax threshold grows faster than the rate of inflation for these families, because a taxpayer at the tax threshold is still eligible for the earned income credit and is affected by the fact that the credit is not indexed.

Table 4 also shows the amount of income tax and payroll tax paid by a family having income (all of which is includible in gross income) equal to the poverty level. While many low-income individuals also receive cash transfer payments that are excluded from gross income and, therefore, are not subject to the tax burdens shown in Table 4, other low-income individuals must rely on their earnings and thus are subject to these tax burdens under present law. For example, in 1985 it is estimated that a four-person family whose income is at poverty level ($11,003) could pay as much as $375 in Federal income tax, and a six-person family as much as $585.

In 1975, the Congress had sought to eliminate some of this burden by the refundable earned income credit, but since then inflation has raised tax liabilities and the poverty level so that the credit—which does not apply to families with income above $11,000—does not give any benefit to a significant number of low-income families. The table also shows the combined income and payroll tax burden at the poverty level as a percent of income. For

1985 and 1986, the table indicates that this burden could be as high as 11 percent of income.

Table 4.—Poverty Level, Tax Threshold, and Federal Tax Amounts for Different Family Sizes With Earnings Equal to the Poverty Level, 1978–1986 [1]

	Number of persons in family					
	1	2	3	4	5	6
Poverty level:						
1978	$3,311	$4,249	$5,201	$6,662	$7,880	$8,891
1982	4,900	6,280	7,690	9,860	11,680	13,210
1983	5,061	6,483	7,938	10,178	12,049	13,630
1984	5,277	6,759	8,276	10,612	12,562	14,211
1985	5,471	7,009	8,582	11,003	13,026	14,735
1986	5,719	7,326	8,971	11,502	13,617	15,403
Income tax threshold:						
1978	3,200	5,200	6,930	7,520	8,183	9,167
1982	3,300	5,400	8,237	8,727	9,216	9,706
1983–84	3,300	5,400	8,315	8,783	9,251	9,719
1985	3,430	5,620	8,943	9,436	9,929	10,421
1986	3,560	5,830	9,062	9,573	10,085	10,596
Income tax at poverty level:						
1978	16	0	−280	−134	−12	0
1982	202	106	−134	285	417	491
1983	207	119	−89	319	432	509
1984	226	149	−9	364	478	569
1985	233	153	−84	375	493	585
1986	246	165	−21	398	523	622
Payroll tax at poverty level:						
1978	200	257	315	403	477	538
1982	328	421	515	661	783	885
1983	339	435	532	682	808	913
1984	354	453	555	711	842	953
1985	386	494	605	76	918	1,039
1986	409	524	641	822	974	1,101
Combined income and payroll taxes at poverty level:						
1978	216	257	35	269	465	538
1982	530	527	381	946	1,200	1,376
1983	546	554	443	1,001	1,240	1,422
1984	580	602	546	1,075	1,320	1,521
1985	619	647	521	1,150	1,410	1,622
1986	655	689	620	1,221	1,497	1,723

Table 4.—Poverty Level, Tax Threshold, and Federal Tax Amounts for Different Family Sizes With Earnings Equal to the Poverty Level, 1978–1986 [1]—Continued

	Number of persons in family					
	1	2	3	4	5	6
Combined taxes as percent of income at poverty level:						
1978	6.5	6.0	0.7	4.0	5.9	6.1
1982	10.8	8.4	5.0	9.6	10.3	10.4
1983	10.8	8.6	5.6	9.8	10.3	10.4
1984	11.0	8.9	6.5	10.1	10.5	10.7
1985	11.3	9.2	6.1	10.5	10.8	11.1
1986	11.5	9.4	6.9	10.6	11.0	11.2

[1] Estimated for 1984, 1985, and 1986 (under present law). The tax computations in the table reflect assumptions that all family income consists of wages or salaries, that families of two or more include a married couple (rather than an unmarried head of household with one or more dependents), that all family members are under age 65, and that families of three or more persons are eligible for the earned income credit.

NOTE.—Negative figures in table reflect refundability of earned income credit.

Table 5 below illustrates the effect of filing status on the treatment of low-income individuals by the tax system. For a family size of two, as shown in the first two columns of the table, low-income unmarried heads of household with one dependent are treated more generously than married couples with no dependents. This result occurs because families with children are eligible for the earned income credit, while childless families are not.

The last two columns of Table 5 compare two different types of families of four with children—an unmarried head of household with three children and a married couple with two children. In this case, the unmarried taxpayer pays a higher tax at any given income level, although the difference is less than 1.5 percent of income for a family at the poverty level. In effect, the different treatment of the two types of families gives more relief when a larger number of adults is present in the family. Regardless of these differences, however, the table shows that the basic trends over the 1978 to 1986 period, described above in connection with Table 4, are similar regardless of filing status.

Table 5.—Tax Threshold and Federal Tax Amounts by Filing Status and Family Size, for Families with Earnings Equal to the Poverty Level, 1978–1986 [1]

	Family size			
	2 unmarried head of household	2 married couple	4 unmarried head of household	4 married couple
Income tax threshold:				
1978	$5,700	$5,200	$6,892	$7,520
1982	7,150	5,400	8,188	8,727
1983	7,293	5,400	8,269	8,783
1984	7,293	5,400	8,269	8,783
1985	7,859	5,620	8,891	9,436
1986	7,945	5,820	9,010	9,573
Income tax at poverty level:				
1978	−368	0	−60	−134
1982	−227	106	439	285
1983	−197	119	462	319
1984	−127	149	499	364
1985	−206	153	513	375
1986	−150	165	545	398
Payroll tax at poverty level:				
1978	257	257	403	403
1982	421	421	661	661
1983	435	435	682	682
1984	453	453	711	711
1985	494	494	776	776
1986	524	524	822	822
Combined income and payroll taxes at poverty level:				
1978	−111	257	343	269
1982	194	527	1,100	946
1983	236	554	1,144	1,001
1984	326	602	1,210	1,075
1985	288	647	1,289	1,151
1986	374	689	1,367	1,220
Combined taxes as percent of income at poverty level:				
1978	−2.6	6.1	5.1	4.0
1982	3.1	8.4	11.2	9.6
1983	3.6	8.5	11.2	9.8
1984	4.8	8.9	11.4	10.1
1985	4.1	9.2	11.7	10.5
1986	5.1	9.4	11.9	10.6

[1] Estimated for 1984, 1985 and 1986 (under present law). The tax computations in the table reflect assumptions that all family income consists of wages or salaries, that all family members are under age 65, and that families with children are eligible for the earned income credit.

NOTE.—Negative figures in the table reflect refundability of earned income credit.

IV. ISSUES IN REDUCING TAX BURDENS ON LOW-INCOME INDIVIDUALS

In terms of aggregate revenue loss per dollar of benefit to low-income taxpayers, the two most cost-effective tools to reduce tax burdens would be increases in the earned income credit and the zero bracket amount.

Earned income tax credit

Under present law, the earned income credit is phased out for income above $11,000. Therefore, unless the phaseout level is raised, the benefits from increasing the credit would be limited to individuals with income below the phaseout. Because the credit is not available to single persons or married couples without children, any increase in the credit would not raise the tax entry point for these taxpayers.

Also, the amount of the credit does not rise as the number of dependents increases; therefore, as presently structured, the credit does not serve to raise the tax entry point for very large families. There have been suggestions by some to vary the earned income credit by family size. This approach has been criticized by others who argue that such modifications would make the credit more of a welfare-type program and less of a way of alleviating the burden of the payroll tax on low-income individuals and less of a way of providing work incentives for low-income earners. In addition, such a proposal would present significant technical problems with respect to single parents who are maintaining a household.

Zero bracket amount (standard deduction)

Increasing the zero bracket amount also would be a relatively cost-effective way of providing tax relief to low-income individuals, because the tax reduction does not benefit taxpayers who itemize their deductions (since total itemized deductions are reduced by the ZBA before being subtracted from adjusted gross income). However, since married couples receive the same ZBA regardless of their family size, raising the ZBA does not serve to provide relatively greater relief to large families. On the other hand, consideration could be given to varying the ZBA by family size. In any case, sizable increases in the ZBA would be needed to raise the income tax thresholds of single persons and married couples up to the poverty level.

Another issue is the appropriate ZBA for heads of household. Although the personal exemption amount is uniform for all taxpayers, the ZBA varies according to filing status. Some argue that those unmarried individuals maintaining a household for dependents should be entitled to a higher ZBA than other unmarried individuals, on the ground that households with dependents may have extra costs not taken into account in the personal exemptions allowed for dependents. Others argue, however, that such a proposal would be unfair by creating a marriage tax penalty under which two unmarried individuals, each with children, would pay a substantially lower income tax than a married couple with the same number of children and the same combined income.

Personal exemption

Substantial increases in the personal exemption would be necessary to raise the tax threshold for large families up to the poverty level. The difference between the poverty levels for four- and five-person families is more than $2,000, and it is more than $1,700 between five -and six-person families. Therefore, a personal exemption of around $1,800 would be needed to provide the difference in tax entry points between four-, five-, and six-person families that would correspond to the respective poverty levels for such families.

Combined tax changes

It would be possible to enact one or a combination of these increases in the earned income credit, ZBA, and personal exemption.

V. PROPOSALS TO ALLEVIATE INCOME TAX BURDENS ON LOW-INCOME INDIVIDUALS

A. Administration Tax Reform Proposal

Overview.—The President's Tax Proposals to the Congress for Fairness, Growth, and Simplicity (May 1985) would modify the zero bracket amount (ZBA), the amount and number of personal exemptions, and the earned income credit. The net effect of these changes would be to exempt families (and single persons age 65 or over) below the poverty level from Federal income tax. The changes also would reduce the number of single taxpayers (below age 65) below the poverty level who pay Federal income tax. The proposed rate reductions could decrease tax liabilities for low-income taxpayers above the poverty level. Many other provisions of the proposal also could affect some low-income individuals, including provisions affecting itemized deductions and the partial taxation of employer-provided health insurance.

Zero bracket amount.—Under the Administration proposal, the ZBA would be increased from $2,390 to $2,900 for single taxpayers, from $2,390 to $3,600 for head of household returns, and from $3,540 to $4,000 for married individuals filing joint returns (from $1,770 to $2,000 for married individuals filing separately). These increases in the ZBA would be effective in 1986; the ZBA would continue to be indexed for inflation in future years under the Administration proposal, as under present law.

Personal exemption.—The Administration proposal would increase the personal exemption ($1,040 for 1985) to $2,000 per exemption, effective in 1986, and would continue to index the exemption amount to inflation in future years. Also, under the Administration proposal, the additional personal exemptions for the elderly and blind would be repealed in favor of an expanded credit for the elderly and disabled (described below).

Earned income credit.—The Administration proposal would increase the amount of the earned income tax credit to a maximum of $700 (i.e., 14 percent of the first $5,000 of earned income). This larger credit would be reduced by 10 percent of the excess of adjusted gross income (or earned income, if greater) over $6,500. Thus, the credit would not be totally eliminated until AGI or earned income reaches $13,500. Also, under the Administration proposal the maximum earned income credit and the income limitation would be adjusted annually, beginning in 1986, for inflation; e.g., the maximum of $700 would be adjusted for 1986 to reflect 1985 inflation. This adjustment would be tied to the consumer price index percentage increase for the previous fiscal year.

Provisions for the elderly.—Under the Administration proposal, the extra personal exemption for the elderly would be repealed, but almost all of the effect of this change would be offset by the proposed increase in the basic taxpayer exemption to $2,000. The proposal would not change the taxation of social security benefits.

Under the Administration proposal, an expanded tax credit for the elderly and disabled would be calculated in the same manner as current law with three changes. The proposal would increase the initial base amount to $7,000 for single individuals who are at least age 65 or blind or for married couples filing jointly where only one spouse is 65 or blind. The initial base amount for heads of households who are either age 65 or blind would be $8,750. Where both spouses are either over age 65 or blind, the initial base amount would be $11,500 if they file jointly or $5,750 each if they file separate returns. Also, the AGI phaseout level of the credit would be increased to $11,000 for single taxpayers, $12,500 for heads of households, $14,000 for married couples filing jointly, and $7,000 for married couples filing separately. As under current law, the initial base amount of the credit calculation would be reduced by one-half of the taxpayer's income in excess of these amounts. The third major change under the Administration proposal would be to index the credit for inflation in future years.

Child care credit.—The current credit for child and dependent care expenses necessary for gainful employment would be converted under the Administration proposal to an above-the-line deduction. Eligible expenses for the new deduction, like the current child care credit, would be limited to $2,400 for the expenses of one qualified individual and $4,800 for the expenses of two or more qualified individuals. Also, like the present law credit, the deduction would be limited by the amount of the taxpayer's earned income, or in the case of a married couple, by the earned income of the spouse with lower earnings.

B. Congressional Tax Reform Proposals

The following is a brief summary of provisions, contained in Senate bills introduced to date in the 99th Congress, that would alleviate Federal income tax burdens on low-income individuals by, for example, increasing the personal exemption or the zero bracket amount.

S. 321 (Senators DeConcini and Symms)

This bill would eliminate all tax credits and deductions while imposing a single tax rate of 19 percent. There would be a personal allowance of $4,500 for single returns, $8,000 for heads of households, and $9,000 for joint returns, plus $1,800 for each dependent; these amounts would be indexed for inflation in future years. The effective date of this legislation would be January 1, 1986.

S. 409 (Senator Bradley and others)

This bill (the "Fair Tax Act of 1985") would make several changes in the taxation of low-income individuals, effective January 1, 1987, in addition to making changes in tax rates and repealing various exclusions, deductions, and credits.

In lieu of a zero bracket amount, a standard deduction would be allowed to nonitemizers, equal to $6,000 for a joint return or $3,000 for single returns or a married individual filing a separate return.

The bill would not index these amounts, the personal exemption, or the rate brackets for inflation.

The size of the personal exemption would be increased to $1,600 for the taxpayer and for the taxpayer's spouse. The exemption for a head of a household would be increased to $1,800.

The bill would not modify the earned income credit. However, it would amend the child care credit by converting the credit to a deduction. The same restrictions as apply to the credit amount under present law also would apply to the deduction under the bill. The credit for the elderly or disabled would be repealed.

S. 411 (Senator Roth)

This bill (the "Broad-Based Enhanced Savings Tax Act of 1985"), in addition to changing tax rates, would change the zero bracket amount to $2,400 for unmarried individuals and heads of households and to $3,550 for married couples filing joint returns ($1,775 for separate returns). The personal exemption amount would be $1,050 in 1985. The ZBA and the personal exemption amount would be indexed for inflation in future years. Also, this bill would increase the maximum earned income credit to $676, increase the phaseout point of the credit, and index the credit for inflation in future years. The child care credit and the credit for the elderly or disabled would be repealed. The bill would be effective January 1, 1985.

S. 556 (Senator Chafee)

This bill (the "Base-Broadening Tax Act of 1985") generally would disallow 15 percent of itemized deductions, credits, and exemptions provided by current law, including the child care credit. However, there would be no reduction in the present-law credit for the elderly or disabled and the earned income credit. Neither the tax rates nor zero bracket amounts would be changed. The bill would be effective for tax years beginning on January 1, 1986, through December 31, 1989.

S. 888 (Senator Durenberger)

This bill (the "Economic Equity Act of 1985") would make changes to several tax provisions affecting low-income individuals. The zero bracket amount for heads of households would be increased to the amount of the zero bracket amount for joint returns. The bill also would increase the maximum amount of the child care credit from $1,440 to $2,400 and would make the credit refundable. In addition, the bill would make displaced homemakers one of the targeted groups under the targeted jobs tax credit. The effective date of the bill would be January 1, 1984.

S. 909 (Senator Quayle)

This bill (the "SELF-Tax Plan Act of 1985") would increase the zero bracket amount to $6,000 for unmarried individuals and heads of households, and to $10,000 for married individuals filing jointly ($5,000 if filing separately). The bill also would reduce the current 14 rate brackets to three brackets. Also, the earned income credit, the credit for the elderly or disabled, and the child care credit would be repealed. The effective date of the bill would be January 1, 1986.

S. 1006 (Senators Kasten and Wallop)

This bill (the "Fair and Simple Tax Act of 1985"), in addition to changing tax rates, would increase the zero bracket amount to $3,300 for a joint return ($1,650 for a married person filing separately), $3,200 for a head of household return, and $2,600 for an unmarried individual. The amount of the personal exemption would be doubled to $2,000. These provisions would continue to be indexed for inflation in future years. The effective date of the bill would be January 1, 1986.

The amount of the earned income credit would be changed from the current maximum of 11 percent of the first $5,000 of earned income. Under the bill, a percentage equal to the combined employer/employee social security payroll taxes would be applied to a base amount ($4,500 for a family of two, $5,000 for a family of three, and $5,500 for a family of four or more) to yield the earned income credit. This bill also would provide for a new phaseout of the credit at a rate of 15 percent of adjusted gross income (or, earned income, if greater) as exceeds the base amount. The credit for the elderly or disabled and the child care credit would be repealed.

S. 1194 (Senator Moynihan)

This bill (the "Family Economic Security Act of 1985") would increase the maximum earned income credit from $550 to $800 for 1986. The credit would be phased out at a rate of 16 percent for incomes between $11,000 and $16,000. Starting in 1987, the maximum credit and the phaseout thresholds would be indexed for inflation. Also, the bill would increase the zero bracket amount for heads of households to that of married couples filing jointly.

The CHAIRMAN. The committee will come to order, please. This morning is devoted to a hearing on the effects of the bill as introduced—and I emphasize that because we don't know what the bill may be by the time it gets to us from the House, and under the Constitution, the House must initiate and pass tax legislation before we can—but at least testimony on the bill as it has been introduced. And we have two panels this morning, and we will start with the first one. It is a panel consisting of Mary Bourdette, the director of government affairs for the Children's Defense Fund, the Reverend Charles Bergstrom, the executive director for governmental affairs of the Lutheran Council, Frederick C. Hutchinson, tax and domestic hunger policy analyst for Bread for the World, and Monsignor Jerome Boxleitner, the director of Catholic Charities of the Archdiocese of St. Paul and Minneapolis and president of the National Council of Catholic Charities. Does that panel want to come up first? Are the panelists here? Who is here from the second panel? Joseph Trevino? Stanley Hill? Robert Greenstein?

Senator MOYNIHAN. It is bad enough when no audience, but when even the witnesses don't come——

[Laughter.]

The CHAIRMAN. Monsignor, let's start with you, and if any of the other witnesses come in, if they will identify themselves, they may be seated. Ms. Bourdette? All right. Please be seated. While Ms. Bourdette is getting her papers ready, why don't you go ahead and start, Monsignor, and we will have her testify second.

STATEMENT OF REV. MSGR. JEROME BOXLEITNER, DIRECTOR, CATHOLIC CHARITIES OF THE ARCHDIOCESE OF ST. PAUL AND MINNEAPOLIS, AND PRESIDENT, NATIONAL CONFERENCE OF CATHOLIC CHARITIES, WASHINGTON, DC

Monsignor BOXLEITNER. Thank you, Mr. Chairman. Mr. Chairman, I am Jerome Boxleitner, president of the National Conference of Catholic Charities and director of Catholic Charities in St. Paul and Minneapolis. With me are Matthew Ahmann, our director for government relations, and Father Edward Ryle of our board and the executive director of the Arizona Catholic Conference. The poor are among the most vulnerable and powerless persons in our country. Of all the justice or fairness problems in tax reform, none is more pressing than to give relief to the poor. They have experienced a rapid tax increase in recent years. In 1978 the poverty line was at $858 below the income tax threshold. This year the line is $1,567 above the tax threshold. We evaluate tax reform proposals by two themes in Catholic social teaching: Distributive justice and the preferential option for the poor. Our concern for distributive justice was expressed in Pope John XXIII's statement that taxation according to ability to pay was fundamental to a just and equitable system. The U.S. Catholic bishops said the same thing in 1975 when they stated that a just and equitable system of taxation requires assessment according to ability to pay, and they repeated the same theme last year in their draft pastoral on our economic system. The concept of preferential option for the poor is grounded in Judeo-Christian tradition and was characterized by Jesus as the standard for judgment on the last day. These beliefs move us to the following comments on the President's treatment of fairness and of the poor. The proposal would reduce tax rates from the present 14 to 3. Such a reduction would severely reduce progressivity in our tax system. An emphasis on distributive justice leads us to oppose flat rate income tax proposals. It leads us to recommend two proposals to increase progressivity. First, the range of incomes encompassed in the 15 and 25 percent rates in the President's proposal have taxpayers of widely varying incomes paying taxes at the same rate. We urge redistributing these taxpayers into three brackets with separate applicable marginal tax rates. Second, adding another rate of 45 percent for taxpayers over $100,000 also would increase fairness and progressivity. When we remember that these same highest bracket taxpayers are also the chief beneficiaries of the 1981 tax cuts, the favorable treatment they receive here does not meet the test of distributive justice. The President's proposal does offer significant tax relief to the poor by increasing the zero bracket amount, doubling the personal exemption, and increasing and indexing the earned income tax credit. It is a definite improvement over present law. However, we hope you won't consider the President's bill the last word on these provisions. We urge several modifications. We recommend that a nonrefundable credit be provided in lieu of the personal deduction in order to treat very low income families as equitably as those who are better off. I note that this was an alternate recommendation of Dr. Martin Fieldstein in his op.ed. piece in the Washington Post yesterday. Also, we can see no reason to treat single heads of families differently than married couples with children. In justice, they should be accorded the same zero bracket amount as married couples filing jointly. The earned income credit proposal offers some relief to the working poor and indexing the credit will ensure its real value, but we urge the slightly higher credit in Senator Moynihan's Family Economic Security Act. This improved EITC would help families just above the poverty line by providing them with a better offset against payroll taxes and increasing the work incentive. Some of the President's proposals weaken the potential of his bill to help poor working families. Changing the dependent care tax credit to a deduction decreases its value to low income families, while increasing its value to higher income families. We urge equalizing the benefit by continuation of tax credit as in current law. Taxation of the first dollar amounts of fringe benefits would directly and adversely affect low income working families and individuals. We urge it be dropped. Finally, we hope the committee will examine carefully the proposal to remove the deduction for State and local taxes. Its implications are so far-reaching that it merits most careful study. In concluding, we thank you for an opportunity to testify on ways in which tax reform can provide tax justice for the poor and a more equitable tax system for all.

The CHAIRMAN. Thank you. Ms. Bourdette?

[The prepared written statement of Monsignor Boxleitner follows:]

TESTIMONY

ON THE PRESIDENT'S TAX PROPOSALS

BY

REV. MSGR. JEROME BOXLEITNER

PRESIDENT, NATIONAL CONFERENCE OF CATHOLIC CHARITIES

AND

EXECUTIVE DIRECTOR, CATHOLIC CHARITIES OF THE ARCHDIOCESE OF ST. PAUL AND MINNEAPOLIS

BEFORE THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

JUNE 17, 1985

Mr. Chairman, I am Monsignor Jerome Boxleitner, President of the National Conference of Catholic Charities and Executive Director of Catholic Charities in St. Paul and Minneapolis. With me are Mathew Ahmann, Associate Director for Governmental Relations of the National Conference and the Rev. Edward Ryle, a member of our Board of Directors and Executive Director of the Arizona Catholic Conference. The National Conference of Catholic Charities is the largest nonprofit human service delivery system in our country.

We are here to discuss tax proposals as they directly affect low income individuals and families. The poor represent some of the most vulnerable and powerless persons in our country. Of all the justice - or fairness - problems in tax reform, none is more pressing than to give relief to the poor. We are grateful that your committee has recognized this urgency by setting aside this special day of hearings.

The poor have experienced a rapid increase in their Federal taxes in recent years. In 1978, for example, a family of four with earned income at the poverty line paid $269 in income and payroll taxes. This year, the same family will pay almost 10% of its income, $1,075, in taxes to the government. In spite of the Economic Recovery Tax Act of 1981, the largest tax reduction act in the history of our country, families in poverty last year paid higher effective tax rates than they did in 1978.

In 1978, the poverty line was $858 below the income tax threshold. This year, the line is $1,567 above the tax threshold. Over the past few years, our income tax system has literally been driving poor working people deeper into poverty. In fact, in 1982, the last year for which the data are available, there were 3.2 million families whose gross income was above the poverty line but who were pushed below the line because of their federal tax obligation.

The perspective from which we evaluate tax proposals is that of Catholic social thought. Our focus, however, will not be narrowly sectarian since Catholic social thought relies heavily on concepts of justice and human rights, sources which are accessible to people working from other faith or ethical traditions. We believe such an approach is the unique way religious groups contribute to public policy development in our country.

In discussing the tax reform proposals as they impact on the poor, we shall attempt to bring two themes in Catholic social teaching to bear. One is the importance of distributive justice, the other the preferential option for the poor.

Catholic concepts of justice in general and distributive justice in particular go back to Aristotle.[1] The core of justice as a virtue has to do with giving people what is their due. Distributive justice, for Aristotle, is the species of justice that obliges those who have responsibility for the common good of society to distribute proportionately the burdens and benefits of that society for the sake of the common good. Distributive justice applied to taxation calls for progresssive taxes as most appropriate since they are levied proportionately, acording to ability to pay.

In the Middle Ages, St. Thomas Aquinas adopted and expanded Aristotle's concept of distributive justice.[2] It is from Aquinas that the concept of distributive justice entered modern Catholic social thought. Its influence can be seen in Pope John XXIII's straightforward statement that taxation according to ability to pay was "fundamental to a just and equitable system."[3]
The United States Catholic Bishops said the same thing in 1975 when they stated that "a just and equitable system of taxation requires assessment according to ability to pay."[4]

In 1977, the National Conference of Catholic Charities unanimously adopted a policy statement on "Distributive Justice and Taxation." I have attached a copy of this statement for the record. Like other Church statements on taxation, it calls for progressivity in taxation according to the canons of distributive justice.

Last year the Catholic Bishops spoke directly to the topic of these hearings in the first draft of their Pastoral Letter on "Catholic Social Teaching and the American Economy." They said that "reforms in the tax system should be implemented that would reduce the burden on the poor" and they pointed out that "in recent years the total amount of taxes has increased substantially for the poor, while those at the top of the income scales have received significant reductions."[5]

This statement leads me to the second concept that forms my stance in evaluating the tax reform proposal, namely what has come to be called in the Church, "The preferential option for the poor." This option is well grounded in the Judeo-Christian tradition. At the beginning of his public ministry, Jesus stressed his continuity with the the Jewish scriptures when he announced his mission by quoting Isaiah:

> The Spirit of the Lord is upon me; therefore he has annointed me. He has sent me to bring glad tidings to the poor, to proclaim liberty to captives.... Then, he went on to say, 'this Scripture passage is fulfilled in your hearing.'[6]

As the end of his life drew near, Jesus expressed the same concern for the poor. In his description of the Last Judgment, he said that the basis for reward or punishment was whether or not people had fed the hungry, gave drink to the thirsty, and clothed the naked.[7]

This idea of a special concern, a preferential option for the poor, is certainly not reserved to the churches or to people working from a Biblical perspective. A similar concern has often marked public policy in our country. Today we hear much criticism of public welfare programs like SSI, food stamps, and AFDC. Without them, the poor in our country would be in truly desperate straits. In 1983, food stamps and housing assistance lifted 3.3 million people out of poverty. This is a simple example of the fact that we do try, as a country, to have some special concern for the poor. Although we believe that we are not doing as much as could and should be done, we should not make the mistake of denying the value of the help that is being given the poor in our country. We help no one by being critical of the good that we are achieving.

That this Committee is having hearings on the impact of taxes on the poor is a good example of the fact that our country does have a special concern for the poor. The bottom line, of course, in this respect will be the final form the tax plan takes in its treatment of the poor. We would like, therefore, to move to some more specific comments on the tax reform proposal's treatment of fairness and of the poor.

The President's proposal and most others pending before your committee would reduce tax rates from the present 14 to three. We do understand that fewer rates help maintain confidence in our tax system, particularly in a period of high inflation. But such a reduction would severely reduce the progressivity in our tax system. From a Catholic perspective, our strong emphasis on distributive justice and progressivity in taxes would lead us to oppose flat rate income tax proposals. It also leads us to suggest that in at least two respects, greater progressivity is desirable in the tax reform proposal.

The range of incomes encompassed in the 15% and 25% rates in the President's proposal have families of widely varying incomes paying taxes at the same rate. We would suggest redistributing these income classes into three brackets with three separate applicable marginal tax rates.

Adding a fourth rate of 45% for taxpayers with $100,000 or more taxable income also would increase the progressivity of the proposal and, perhaps, make it more politically acceptable to the growing number of critics focusing on the large tax cuts the proposal offers high income taxpayers. It is, frankly, difficult to understand why the tax burden on taxpayers in the income class of $200,000 and over should see their taxes reduced 10.7% on the average, a greater reduction than scheduled for taxpayers in the income classes between $20,000 and $200,000. When one remembers that these same highest bracket taxpayers were also the chief beneficiaries of the Economic Recovery Tax Act of 1981, the favorable treatment they receive in the tax reform proposal is all the more questionable from the viewpoint of distributive justice.

We are not overlooking the fact that simplicity is one of the goals of tax reform. We would only comment that a fourth, or even a fifth tax rate, does not add undue complications since the arithmetic operations are the same whether there are three brackets or four. One finds one's bracket and multiplies taxable income by the rate that applies.

The President's proposal does offer significant tax relief to the poor. By increasing the zero bracket amount, doubling the personal exemption, and increasing and indexing the Earned Income Tax Credit, it is a definite improvement over both present law and Treasury I. However, we would hope the Committee would not consider the President's bill the last word regarding these provisions. Our nation's poor have been treated so unfairly that we urge several further modifications.

We would recommend that a nonrefundable credit be provided in lieu of the personal deduction in an effort to treat very low income families as equitably as those with better incomes.

We can see no reason to treat single heads of families differently than married couples with children. Women and children in these families are over 75% of all individuals living in poverty. We would urge, in justice, that they be accorded the same zero bracket amount as married couples filing jointly.

The President's proposal to raise the Earned Income Credit will help the near poor as well as the poor since it reaches more families. Indexing the credit will ensure the real value of the credit to people helping to reverse the deterioration of the value of the credit that resulted from past failure to adjust it for inflation.

We note the Family Economic Security Act of 1985 introduced by Senator Moynihan (and Representatives Ford and Rangel in the House) offers a more generous reform of the EITC. It calls for increasing the credit to 16% of the first $5,000 of earned income or $800. The credit wold be phased out at a rate of 16% for incomes between $11,000 and $16,000. As with the President's proposal, the credit would be indexed.

This approach to the Earned Income Credit improves somewhat the Administration plan since it would help families slightly above the poverty line. It does so by providing them with some offset against payroll taxes, which was the original purpose of the EITC and increasing the work incentive for poor families. We urge the Committee to give this proposal serious consideration.

While our basic position on the tax plan's general treatment of the poor is positive, some of its provisions do weaken its potential to help poor, working famillies. Changing the Dependent Tax Care Credit to a deduction decreases its value to low income, low tax bracket families, while increasing its value to higher income families. Given the economic pressures on women to work, whether they are married or single household heads, and given the continuing high poverty rates affecting women, we urge continuation of a tax credit to help with dependent care expenses.

Taxation of the first $120 in fringe benefits for a single person and $300 for a family would directly and adversely affect low income working families. We urge it be dropped.

We would like to ask the Committee to examine carefully the tax proposal to remove the deduction for state and local taxes. We are not now taking a position on this proposal, but its implications seem so far reaching that we believe it merits the most careful study. In this study, we believe it important that weight be given to the fact that state and local taxes tend to be less progresssive than Federal taxes. As a consequence, caution is in order in changes that would shift tax burdens significantly from the Federal to the State and local level. If it would have a disproportionate effect on states which have been generous in their public assistance programs (general assistance, AFDC and Medicaid), a change from current law could hardly be justified. Such a change would impact least the states making the smallest effort to help the poor.

From a historical perspective, it is interesting that a tax reform proposal even has to address reducing income taxes for poor people. We say this for two reasons, one having to do with the fact that the poverty line is based on pre-federal income and payroll taxes and the second relating to the fact that much of the debate about welfare reform in the past focused on a negative income tax to help the poor. Let us review some of this history since it may put the issue of tax treatment of the poor in a useful perspective.

The poverty line was developed by Mollie Orshansky of the Social Security Administration during the early 1960s as a tool to measure the economic status of the poor. With enactment of the Economic Opportunity Act of 1964 and establishment of the Office of Economic Opportunity, there was a need for some way of identifying or defining poverty. OEO's Research Division adopted the Orshansky measure, both as a tool for research and planning and as an administrative guideline for program purposes.[8] Refinements have been made in the poverty line since 1965, but it is still used essentially as developed by Ms. Orshansky for policy and program purposes by Federal agencies.

The poverty line reflects pre-tax, not post-tax, income. It reflects cash income, not the value of such in-kind benefits as food stamps or employer provided health insurance or a company car.[9]

The particular point, however, that we stress here is that one of the reasons the poverty line was based on pre-tax dollars was the simple fact that analysts did not expect to see a day when the income tax threshold would be significantly below the poverty line. In 1965, for instance, the year in which Orshansky published her detailed elaboration of the poverty line cutoffs, the line for a family of four receiving the earned income tax credit was only $223 above the income tax threshold.[10] This year, the line for the same family is projected to be $11,003, which is $1,566 above the tax threshold.

Fortunately, Congress did take note of the fact that our tax system was literally making the poor poorer aand took action several times to correct this situation. From 1975 through 1981, the income tax threshold was set above the poverty line to protect poor working people and their families from income tax liability. Today's hearing, with its focus on the poor, is consistent with earlier Congressional efforts to ensure that our income tax and proposals to reform it will not hurt the poor.

There is an irony in the fact that we are discussing tax reform in the context of not hurting the poor. In other years the tax system has been suggested as a vehicle to help the poor. In 1943 Milton Friedman, then working in the Treasury Department, conceived the idea of a negative income tax to assist people who had serious fluctuations in their income over a period of years. In a good year, the worker would pay taxes to the Treasury; in a bad year, Treasury would pay taxes to the worker. In the late

1940s, Friedman took the idea further, developing it into a proposal to help poor people whose income was not high enough to incur a positive tax liability through a negative income tax administered by the IRS.[11]

Several of the major efforts over the past twenty years to help the poor have been variants of a negative income tax though not necessarily labeled as such.[12] The Nixon Administration's Family Assistance Plan and the Carter Administration's Program for Better Jobs and Income both included elements of a negative income tax. The most carefully studied and prepared welfare reform proposal in our recent history was centered on a negative income tax proposal. We refer to the work of the Subcommittee on Fiscal Policy of the Joint Economic Committee of Congress. Chaired by Representative Martha Griffiths, its 1974 report entitled Income Security for All Americans: Recommendations of the Public Welfare Study set out a carefully constructed negative income tax to help all persons whose income failed to meet certain minimum standards.

The result of the Subcommittee's work is, we suspect, an instructive example of the lack of fit between diligent research, careful analysis, and creative planning on the one hand and political and financial realities on the other. The cost of implementing a negative income tax in the U.S. looked so high--and it was--that hearings were not held on the plan even though it was introduced several times in Congress. We hope that the solid work that has gone into the present tax reform propsal meets a happier fate than the Income Security for All Americans plan.

In concluding, Mr. Chairman, we would like again to thank you for an opportunity to testify on ways in which tax reform can provide tax justice for the poor and a more equitable tax system for all citizens. We urge your consideration of the recommendations we have made. We trust that you will find the Catholic Charities' agencies across the country, and the staff and volunteers associated with them, supporting these provisions and supporting your efforts to forge a fairer tax code for all Americans.

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[1] Nichomachean Ethics V, 1-4, 1129a-1132b.

[2] Summa Theologiae, II-II, 1-4 and Commentary on the Nichomachean Ethics.

[3] Mater et Magistra, n. 132.

[4] The Economy: Human Dimensions, 5.

[5] N. 211.

[6] Luke 4:18 and 21.

[7] Mt 25:13-41.

[8] The Measure of Poverty, A Report to Congress as Mandated by the Education Amendments of 1974, HEW, 1976, p. 6.

[9] This limitation has been offset in recent years by a Census Bureau series Characteristics of Households Receiving Noncash Benefits, which was developed by the Bureau in 1980. It collects data on public noncash benefits and employer or union-provided pension and group health insurance plan benefits.

[10] Joint Committee on Taxation, Federal Tax Treatment of Individuals Below the Poverty Level, 1985, p. 3.

[11] Daniel Patrick Moynihan, The Politics of Guaranteed Income, p. 50.

[12] For an instructive review of some of the history, Cf. Moynihan, op. cit., especially pp. 61-67 and 113-44.

POLICY STATEMENT ON DISTRIBUTIVE JUSTICE AND TAXATION (1977)

Background

(1) The National Conference of Catholic Charities adopted policy statements on income security and maintenance and on national health insurance at its 1976 Congress. Those statements reflect its conviction that the economic system of the United States has responsibilities, under the direction of the Government, for insuring a basic standard of decency and equity in meeting fundamental human needs for support of life and maintenance of health. In its statement on income security, the Conference affirmed that "the Federal Government has a planning and action responsibility to see that the economy of the nation is the servant of all" and that "Federal fiscal, budgetary, and monetary policies are essential tools, complementary to the private sector, to guarantee that the needs of all citizens are adequately met."

(2) In this affirmation of Federal responsibility, Catholic Charities was reaffirming the similar concern expressed by the Catholic Bishops of the United States in 1975 that "our economic life must reflect broad values of social justice and human rights." (The Economy: Human Dimensions, 3). With the Bishops, the National Conference further affirms that "economic prosperity is to be assessed not so much from the sum total of goods and wealth possessed as from the distribution of goods according to norms of justice" and that "a just and equitable system of taxation requires assessment according to ability to pay." (Ibid., 5c and f.)

(3) As long ago as 1956, Pope Pius XII took note of increased public expenditures by the nations of the world and the correlative increase in taxation entailed by such expenditures. ("Address to Members of the International Association for Financial and Fiscal Law," October 3, 1956.) In the United States, governmental expenditures at the Federal, State, and local levels increased from 27.8% of the Gross National Product in 1955 to 35.8% in 1975. (Gerard M. Brannon, *Tax Reform—Justice, Efficiency and Politics*, Mss., 1-7, Table 2.) Virtually all of these expenditures are financed by taxes and so taxation necessarily plays a large part in the distribution of wealth and income in our country. "Taxes take an average of $3.40 out of every $10 of income before it is used by private citizens." (Ibid., Introduction.)

(4) The tax systems in the United States, Federal, State, and local, carry out or contribute to a number of necessary functions in our country. The Federal system and, in varying ways and degrees, State and local systems:

A. Raise revenues.

B. Affect fiscal policies.

C. Redistribute income and wealth.

D. Achieve economic objectives, by encouraging or discouraging specific economic activities.

E. Affect specific social objectives, for example, promoting employment or housing.

F. Regulate certain activities, such as sales of alcohol or tobacco.

(Cf. Paul R. McDaniel, "Tax Reform at the Bicentennial: the Need for a Revolutionary Vision," *Journal of Current Social Issues*, 13 [Spring 1976]:43.)

(5) Though not all taxes are designed to carry out all these functions, and the nature and extent of their impact cannot always be precisely measured, it is nevertheless obvious that the tax system plays a large part in shaping the quality of life in our country.

(6) Since social and economic justice are influenced so greatly by the impact of tax burdens, as well as distribution of benefits, through income transfer programs, for example, or revenue sharing, or tax deductions, a comprehensive approach to human welfare and the common good in our country necessarily requires consideration of principles of tax justice and the implications of such principles. In approaching this subject, the National Conference of Catholic Charities wishes to make its own the words of Pius XII: "There can be no doubt that every citizen has the obligation to bear a part of public expenditures. The state, however, on its part, since it has responsibility to protect and promote the common good of the citizens, has the obligation to assess citizens only tax levies that are necessary and in proportion to their ability to pay ... It is essential, moreover, that the moral principles justifying taxes are clearly apparent both to governments and those governed and that they be effectively applied." (Op.cit.)

Principles

(7) The basic moral principle for judging taxes is that of distributive justice. In the recent social teachings of the Catholic Church, this type of justice has been understood to imply fair and proportionate assignment by the government of the burdens and benefits of the community to its members. As commonly presented in Catholic social thought, and as applied by the Popes to taxation, distributive justice calls for progressive taxation and assessment according to ability to pay. Pope John XXIII stated that this was "fundamental to a just and equitable system." (*Mater et Magistra*, 132).

(8) In tax language, distributive justice would relate to concepts of equity or fairness. (Brannon, 2, 1-4 and McDaniel, 43-44). This concern for fairness can be translated into the principle that: all things being equal, taxpayers with the same amounts of wealth or income should pay the same amount of tax and those with larger amounts should pay a proportionately greater tax than those with lesser amounts.

(9) Moreover, distributive justice is concerned with the responsibility of the state to avoid the social evils indicated by Vatican II when it pointed out that "excessive economic and social differences between the members of the one human family or population groups cause scan-

dal, and militate against social justice, equity, the dignity of the human person, as well as social and international peace." *(Pastoral Constitution on the Church in the Modern World,* 29) More directly, Pope John XXIII stated "all classes of citizens will benefit equitably from an increase in national wealth. Toward this end vigilance should be exercised and effective steps taken that class differences arising from disparity of wealth not be increased, but lessened so far as possible." *(Mater et Magistra,* 73) Thus, the tax system has a role to play in the distribution of wealth as well as of income.

(10) Since taxes serve as instruments of public policy, encouraging certain types of activity and discouraging others (e.g., giving to social service agencies or discouraging smoking) the principle of fairness in assessment of taxes must be complemented by one of efficiency and effectiveness in attaining the social goals desired in terms of the common good. It is important to note here the normative role of the common good, defined by Vatican II as "the sum of those conditions of social life which allow social groups and their individual members relatively thorough and ready access to their own fulfillment . . ." *(Pastoral Constitution on the Church in the Modern World,* 26.) To the extent, then, that tax incentives or exemptions efficiently contribute to the common good, they can be justified. For proportionately serious reasons, such exceptions from the "ordinary" tax structure and burdens can override considerations of strict progressivity. The words of Pius XII, however, should be recalled in this context: "Taxes should never become a convenient tool used by public authorities . . . to favor one industry or business sector at the expense of another equal utility." (Op. cit.)

(11) Simplicity, while not directly a moral principle, does have relevance for tax policy, since administrative complexities can increase costs of a tax program, lead to public confusion about its meaning and impact, and reduce public acceptance of the burdens it imposes. As Adam Smith, a one-time tax collector, pointed out in 1776, "every tax should be levied at a time, or in the manner, in which it is most likely to be convenient for the contributor to pay it" and taxes should not impose "unnecessary trouble, vexation, and oppression" upon the public. (Cf. William A. Klein, *Policy Analysis of the Federal Income Tax,* Mineola, N.Y., The Foundation Press, 1976, p. 103.) On the other hand, it must be recognized that the price of simplicity can be a diminution of the ability of a tax system to respond to differences in taxpayer circumstances and possible reduction in the progressiveness or equity of the system.

(12) Democratic participation and political acceptability are further factors relevant to judgments about tax justice. Pope Paul VI noted with approval the demand of men and women today for "a greater sharing in responsibility and decision-making" and went on to point out that "this legitimate aspiration becomes more evident as the cultural level rises, as the sense of freedom develops and as man becomes more aware of how in a world facing an uncertain future, the choices of today already condition the life of tomorrow." *(Octogesima*

Adveniens, 47). This would suggest the importance of reaching tax decisions in an open, democratic manner and avoidance of catering to special interest groups placing privilege above the common good.

(13) The realities of the democratic process require majority support for tax legislation as well as for other types of legislation. This suggests the importance of education about social justice and its implications for tax reform, and education that goes beyond general principles to specific issues and options for reform.

Concerns

(14) Our religious tradition, the principles enunciated above, our mission to serve the poor and our desire to improve living standards lead us to support the following general concerns in the field of taxation:

A. Improvements in the tax system to insure more equitable distribution of the gross national product and of the nation's wealth. Our concern arises from the fact that the poorest 20% of our families receive less than 6% of our nation's annual income, while the top 20% receive 41%—8 times as much. Further, the top 1.2% of U.S. households hold over 32% more investment assets than the bottom 60% of our households, while the wealthiest 20% own 75% of the nation's assets.

B. Efforts to stimulate forms of taxation which are progressive.

(15) Because of our concern for growth in the number of productive jobs in our economy, and the necessary requirement for growth in productive capacity to provide for those jobs, we support:

A. Appropriate encouragement of the accumulation of the capital needed for growth in our nation's econonomy; with

B. Attention to a wider distribution of the ownership of that capital; and with

C. Appropriate use of tax devices to assure that sufficient capital is assigned to maintain a high quality environment and reduce reliance on fossil energy resources.

(16) We have the following additional concerns:

A. The maintenance of a sound Social Security system. In the years to come our nation will have an increasing elderly population and relatively fewer persons in the work force. To improve the soundness of the nation's largest retirement program we support:

1) An extension of the wage-base to which the FICA tax is applied.

2) The introduction of additional general revenues into the Social Security trust fund.

Both of the above will help reduce the regressivity of the FICA tax which bears unduly heavily on low and moderate-income wage-earners.

B. Raising the earned income ceiling in the Social Security program for those who have reached retirement age and who are drawing Social Security benefits. An increased amount of earned income would be especially valuable for those whose retirement is largely sustained by Social Security benefits. Indeed, raising the earned income ceiling would have the additional benefit of increasing both Social Security and general tax revenues, since FICA tax would continue to be applied against earnings, as would the income or other taxes.

C. The past several years, the Internal Revenue Code has contained an "earned income credit" for low and modest wage-earners, and this credit, in order both to stimulate the economy and to help improve slightly the meager incomes of those who are unable to work, has been refundable to those with no earned income. We urge Congress to mandate a strong outreach program on the part of the Treasury Department to develop means for those eligible for the refundable credit to receive it.

D. Maintenance of the charitable deduction in the Internal Revenue Code. We urge this in recognition of the essential role of the voluntary, non-profit and religious sectors in the shaping of our nation's spirit and strength and in the delivery of human services. We urge this since the mediating role of these institutions and movements is essential to preserve the pluralism which makes our nation so vital a democracy. In addition, research seems to indicate that the deduction does produce more income for the voluntary sector of our nation's life than the tax revenues which would have been generated were the deduction not there. It would be disastrous for the future of our democracy if the government attempted to provide all services. Should this nation ever embark on such a course, the constant leavening and evolution of new thought and new services to meet deep human concerns and needs would be seriously weakened.

Conclusion

(17) As we express these concerns for tax reform in our country, we are not unmindful of the fact that tax questions have international implications. At the 1971 Synod in Rome, the Bishops in their statement on *Justice in the World* referred approvingly to aims of the Second Development Decade as first guidelines at the international level "for a graduated taxation of income as well as for an economic and social plan for the entire world." (#66) As research and reflection on international justice issues develop, it is our hope to relate issues of domestic economic justice to the interdependent world in which we live. At this time, however, we have limited ourselves to domestic issues of tax justice.

STATEMENT OF MARY BOURDETTE, DIRECTOR OF GOVERNMENT AFFAIRS, CHILDREN'S DEFENSE FUND, WASHINGTON, DC

Ms. BOURDETTE. Thank you. Mr. Chairman, Senator Moynihan, I am Mary Bourdette, the director of government affairs of the Children's Defense Fund, and I very much appreciate the opportunity to be here today to discuss the impact of tax reform on those below the poverty line. Because we are a children's organization, I would like to focus my remarks on the effect of taxes and tax reforms on low income working families, families that are struggling to support their children on poverty-level wages.

And in that regard, we recently issued a report entitled "The Impact of Federal Taxes on Poor Families," and I would appreciate it if that report could be entered in the record. It has been very helpful that a lot of attention has been paid in recent months to the large and growing tax burden on low-income working families because there has been a myth in this country that the poor pay little or no taxes. It used to be true, of course, that the poor paid little or no Federal taxes, thanks to the work of this committee. But now it is grossly incorrect. In fact, since 1979, the Federal tax burden on families in poverty has skyrocketed. The poverty level is no longer the point at which families begin to pay Federal taxes. Rather, the income tax threshold has dropped far below the poverty line. Estimates indicate that in 1984, the income tax threshold was more than 17 percent below the poverty line and, unless adjustments are made, it will drop to more than 20 percent below the poverty line in 1988. Social Security taxes, of course, have also gone up, and what this all means is that more and more families in poverty are paying a larger share of their meager incomes in Federal taxes. Now, our report indicates the Federal tax burden on various types of low income families these last 5 years, but it is fair to say that a typical two-parent family of four with poverty level wages saw its Federal tax burden increase fivefold between 1979 and 1984. This family was paying approximately 2 percent of its income in Federal taxes in 1979, but by 1984 this two parent family of four at poverty level income was paying more than 10 percent of its income in Federal taxes, and that is, of course, not to mention its State and local tax burden. Single parent families are burdened even more by our Federal tax system, so that in 1984 a single parent family of four with the same income and the same size family paid an even heavier tax burden—approximately 12 percent of its income in taxes. Therefore the poor obviously have an enormous stake in tax relief, whether it is accomplished through tax reform, which overhauls the entire system, or whether it is accomplished through specific legislative proposals that simply make adjustments in the various tax provisions that affect the poor. But whatever the route, the goal is clear—it is to restore the poor to their 1979 tax status and to repair the damage that our Federal tax system has imposed on working families in poverty since that time. We hope to accomplish this by exempting all families in poverty from Federal income taxes and to offset for them a substantial portion of their Social Security taxes as well. While not going all the way toward this goal, the President's plan takes a major step forward in relieving the Federal tax burden on low-income families, and we very much applaud this aspect of the President's tax reform proposal. Through a combination of doubling the personal exemption, raising the zero bracket amount—particularly for single heads of households—and most importantly, increasing and immediately indexing the earned income tax credit, the President's tax reform proposal goes a long way toward providing sufficient tax relief for working families in poverty. There are some aspects of the plan with which we disagree, however—the dependent care tax credit, which is proposed to be changed to a deduction. This change lessens the assistance—vital child care assistance—to moderate and low income families and actually increases it for higher income families at an overall cost to the Treasury of $300 million. We hope you will reject this proposal and build upon the President's plan through the tax proposals included in several legislative initiatives that are currently pending before this committee. I outlined them in my written testimony—S. 1169 by Senator Durenberger, the Economic Equity Act, Senator Moynihan's S. 1194, the Family Economic Security Act; and the Children's Survival Bill (S. 1237) introduced by Senator Chris Dodd—all outline a tax agenda that moves beyond the President's proposal. Senator Baucus' S. 1118 also targets tax relief to the poor. This can be done efficiently and at little cost. There are various ways to do it, including those ways proposed by Dr. Feldstein in his article this weekend, but we would propose focusing primarily on expanding the Earned Income Tax Credit as the way to most efficiently target tax assistance to working families in poverty. Thank you very much. I will be glad to answer your questions.

The CHAIRMAN. Thank you. We will take the entire panel, and then we will ask questions. Reverend Bergstrom.

[The prepared written statement of Ms. Bourdette and The Impact of Federal Taxes on Poor Families Report follow:]

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Statement of Mary Bourdette
Director of Governmental Affairs, The Children's Defense Fund
Before the Senate Committee on Finance
Concerning the Impact of Tax Reform on Those Below the Poverty Level

June 17, 1985

SUMMARY

Working families struggling to support their children on poverty level wages have a critical stake in tax reform. Federal taxes on working families in poverty have skyrocketed since 1979.

- A typical two-parent family of four with poverty level wages had its combined federal tax burden more than quintuple between 1979 and 1984, growing from 2 percent to over 10 percent of its income.
- A typical single parent family of four with the same poverty level wages paid an even larger share of its meager income in federal taxes in 1984.

Tax fairness and tax relief for families in poverty must be a central component of any tax reform plan.

- The Administration's Tax Reform Plan, as well as those proposed by Senator Bradley and Senator Kasten, provide some important tax relief to working families in poverty, but none repairs the tax damage imposed on these families, or fully restores them to their 1979 tax status.

The Committee on Finance is urged to build upon the Administration's tax proposals for working poor families by adopting several pending legislative initiatives to:

- Adequately expand and index the Earned Income Tax Credit.
- Add a children's allowance to the Earned Income Tax Credit.
- Increase the Zero Bracket Amount for single heads of household to the amount allowed for married couples filing jointly; and
- Retain and increase the Dependent Care Tax Credit for low and moderate income families.

My name is Mary Bourdette and I am the Director of Government Affairs of the Children's Defense Fund. I appreciate the opportunity to testify today concerning the impact of tax reform on those below the poverty line. Because we are a children's organization, I would like to focus my comments on the desperate need for tax relief for working families struggling to support their children on poverty level wages. The Children's Defense Fund recently released a White Paper, The Impact of Federal Taxes on Poor Families, which I would like to submit for the record, that details the increasing and substantial federal tax burden that has been imposed on these families since 1979. The paper also analyzes the impact of the major tax reform proposals on this most vulnerable segment of our population, and outlines a specific legislative agenda for tax relief for them.

Over 35 million Americans -- more than 15 percent of the population -- live in poverty. This is the highest poverty rate since 1965, and a rate that has increased in each of the last five years. The number of poor in America has grown by 6 million since 1980.

Families, especially female-headed families, make up a large proportion of the poverty population. Nearly half -- 48.2 percent -- of female headed families with children were poor in 1982, and the majority of children living in poverty in this country are part of female-headed families.

While some poor families have little or no earned income on which to pay income and Social Security taxes, many do. Nearly half of all poor single mothers with chilren attempt to support their families with their own wages, and three-quarters of all other poor families have income from earnings. In 1982, almost half of all individuals and families living in poverty paid federal taxes.

The 1984 poverty level for a family of four was $10,613. The poverty line is, however, intended to measure only consumption needs. It does not assume payment of taxes. A family with pre-tax income at or above the poverty line often will be living in poverty after taxes are paid. In fact, many families with income equal to or below the poverty line are further impoverished by taxes, and many with income above the poverty line are dragged into poverty by taxes. Census Bureau data reveal that the number of persons in poverty would have increased by 3.2 million in 1982 (from 34.4 to 37.6 million persons) if the counting of poor people were based on after-tax income.

I hope that, by now, the Members of this Committee and others have heard about Jane Doe, CDF's example of a working single mother with three children, who earned slightly above poverty wages but was taxed into poverty by the federal government, paying more federal taxes than Boeing, General Electric, Dupont, Texaco, Mobil and AT&T combined paid in federal income taxes in 1983, although these huge corporations earned $13.7 billion in profits. This example indicates perhaps better than any other the basic unfairness of our federal tax system -- both to low income families and to all taxpayers who must subsidize excessive tax breaks for the wealthy.

What happened to Jane Doe between 1979 and 1984 also illustrates what happened to millions of working poor familes with children under our federal tax system. In 1979, Jane Doe had an income from her job of $8,000 -- a little above the federal poverty line at that time. Jane, like most other low income workers, had no unusual tax deductions or tax "breaks", so her federal income and Social Security taxes were $481 in 1979 -- or about 6 percent of her income, leaving her family with an income still slightly above the official poverty line.

From 1979 to 1984 inflation increased the cost of living by 43.2 percent. Of course, the poverty line also rose at that rate. Despite the recession, Jane kept her job and received salary increases equal to the cost-of-living change. Her 1984 salary was $11,456, still slightly above the poverty line.

Jane would be in the same financial situation as she was during 1979, except for two things. First, many of the important federal benefits that used to go to some working poor parents and their children have been reduced or eliminated since then. Second, her taxes have skyrocketed. In 1984, her federal taxes were $1,384, or over 12% of her income. While Jane's salary went up 43.2 percent, her taxes increased by nearly 300 percent since 1979. Instead of being slightly above the poverty line, her 1984 after-federal-tax spendable income was cut by taxes to only 95 percent of the poverty level. Increases in her federal taxes literally impoverished Jane and her children.

Among the many myths surrounding the poor is that they pay little or no taxes. We hope this popularly held myth has finally been shattered, because since 1979, the federal tax burden on working families in poverty has shot up dramatically. Working families in poverty are paying more federal taxes than ever, and near poor families like Jane Doe's are being dragged into poverty by our federal tax system. Just a few statistics portray this quite vividly:

- The aggregate federal taxes paid by poor families increased 58 percent between 1980 and 1982 alone.
- The number of poverty level families paying federal taxes has more than doubled since 1980.
- A typical two parent working family of four earning poverty level wages paid approximately 2 percent of its income in federal taxes in 1979 and by 1984, this same two parent family of four with poverty line wages paid over 10% of its meager income in combined (income and Social Security) federal taxes.

Among families in poverty, single parent families -- primarily headed by women already suffering from higher poverty rates, disproportionately lower wages, and disproportionately greater need for child care services -- bear an even heavier federal tax burden than married two parent families of the same size with the exact same income.

Large poor families also suffer a heavier federal tax burden than other families in poverty. In fact, as family size grows, the federal tax threshold falls further and further below the poverty line -- meaning large poor families start paying federal taxes at relatively lower incomes (as a proportion of the poverty line).

Increasing taxes on the poor and near poor lessens the money available to families for supporting children, particularly young children. Americans' incomes normally start low when they are young workers, increase with age, and then drop again in old age. The elderly, however, have special rules giving them extra tax breaks. Substantially raising the taxes of the poor and near poor thus primarily increases the taxes of younger workers, those most likely to have young children and less income to support them. In this respect the tax policy of the last four years has virtually been a tax on childhood -- an anti-family tax policy that mirrors the budget cuts which have also disproportionately hurt children.

We must ask how this happened when Congress passed the largest income tax cut in history in 1981. The working poor are now paying a larger share of their earnings in income taxes not because of higher tax rates -- rates were in fact lowered in 1981 -- but because a much larger share of their earnings is being taxed. Inflation has driven up the wages on which the poor are taxed without giving them more real dollars in income or a higher standard of living, and without adjustments in the tax system to compensate. As a result, the income tax threshold -- the income level at which families begin to pay taxes -- which was above the poverty line in the late 1970's, is now well below the poverty line.

The income tax threshold for poor families is ultimately determined by the personal exemption, the zero bracket amount or standard deduction, and the Earned Income Tax Credit (EITC). For working families in poverty, and those just above the poverty line, the failure to adjust the personal exemption, the zero bracket amount or the EITC in 1981 more than offset any positive effect of the cut in income tax rates. As a result, we estimate that generally families earning below 160 percent of the poverty line paid higher effective tax rates in 1984 than in 1979. Moreover, the closer the family's earnings to the poverty line, the larger was the increase in effective rates since 1979.

Tax fairness and equity for the working poor are long overdue. We believe it is essential that Congress take immediate action to repair the damage imposed on the poor since 1979 by once again (1) exempting all working families in poverty from federal income taxes, and (2) offsetting for them a substantial portion of the highly regressive Social Security tax.

The chief proponents and sponsors of tax reform have indicated support for these basic tax objectives, and all of the major reform plans make some headway in providing tax relief to the working poor. None, however, comes close to fully restoring the working poor to their 1979 tax status, despite the fact that to do so is neither costly, nor difficult. Fairness and equity simply demand an immediate and sharp reduction in the federal tax burden on taxpayers struggling to support their families on low wages.

The President's new tax plan provides substantial relief to working families in poverty, and on behalf of the Children's Defense Fund, I want to applaud the Administration's proposal for the giant step forward it has taken for the poor. Under this plan, all families in poverty would be exempt from federal income taxes, and many working families in poverty would be provided some offset against their Social Security tax burden as well.

More than any other tax reform plan, the Administration's plan helps the working poor by doubling the personal exemption, substantially increasing the zero bracket amount, especially for heads of households, and most importantly, increasing and immediately indexing the Earned Income Tax Credit (EITC).

Under the Administration's plan, a married two parent family of four with a poverty income would be helped tremendously. As indicated in the attached chart, the percentage of its income paid in combined federal taxes drops by almost half -- from 10.1% of the total income in 1984 to 5.4% in 1986. Under this plan, this family would not only pay no federal income taxes, but 1.7% of the family's Social Security taxes would be offset as well.

Under the plan, a single parent family of four will be significantly helped as well. With the same poverty level income -- \$11,500 in 1986 -- the percentage of income taken in federal taxes from this family drops from 11.4 in 1984 to 5.7 in 1986 -- again below the 7.15% Social Security tax rate that will be imposed in 1986.

Our calculations indicate that all families in poverty gain under the plan and the current tax disparity among types of poverty families has been virtually eliminated.

There are, however, other aspects of the Administration's tax plan that seriously detract from its positive benefits for low income working families. First, the Administration's plan changes the Dependent Care Tax Credit to a deduction, thus limiting its value to low and moderate income working families and actually increasing its benefit to higher income families. Second, the taxation of the family's first $300 of health benefits and the inclusion of that amount as income in the Social Security tax base similarly hurts low income working families.

Currently, the Dependent Care Tax Credit is a critical source of child care assistance to low and moderate income working families. Available and affordable child care is essential to enable parents, particularly single parents, to work and remain self-sufficient. Yet study after study documents the great unmet need for child care in this country. The Administration's proposal to change the current Dependent Care Tax Credit to a deduction is a step backward, and departs from long standing Congressional and Administration policy in this area.

Under current tax law, the Dependent Care Tax Credit utilizes a sliding scale to target greater benefits to those most in need -- low and moderate income working families with dependents. The Administration proposal stands this policy on its head, by targeting greater benefits to high income families, and reducing the benefits to low and moderate income families. The value of the proposed deduction would depend on a taxpayer's marginal tax rate. Thus, the credit would be worth 35 cents per dollar spent on dependent care to taxpayers in the 35 percent tax bracket, and only 15 cents per dependent care dollar to those families in the 15 percent tax bracket. Families earning under $30,000 a year would receive less tax assistance than under current law, while upper income families would receive considerably more assistance. Moreover, by reversing the progressivity of the credit, and allowing those families who can afford to pay more for dependent care a larger tax benefit, the Administration's proposal would cost approximately $300 million in FY 1987. We believe the Administration's proposal to change the Dependent Care Tax Credit to a deduction should be rejected.

Other major tax reform proposals also make some progress in reducing the tax burden on low income working families. The Bradley-Gephardt FAIR plan reduces or eliminates federal income taxes for some families in poverty, particularly two-parent families. It does not, however, provide as much tax relief to those families, or to single parent families in poverty, as that provided under the Administration's tax reform plan. This is because of the FAIR plan's limited adjustments in the personal and dependent exemptions, its disparate treatment of the zero bracket amount for single heads of household and married two parent families, and its lack of adjustment or indexing of the Earned Income Tax Credit. FAIR's treatment of the Dependent Care Tax Credit will also mean less child care assistance for families most in need as well.

The Kemp-Kasten FAST plan also provides substantial tax relief to the working poor, but again that relief falls short of that provided in the Administration's plan, as well as that needed to restore the working poor to their 1979 tax status. This is primarily because of the plan's limited upward adjustment of the Earned Income Tax Credit. The repeal of the Dependent Care Tax Credit under this plan would also hurt these families with their child care expenses.

We believe it is incumbent on this Committee to move beyond the important steps proposed by the Administration's tax reform plan, as well as those plans proposed by Senator Bradley and Senator Kasten, to fully repair the tax damage imposed on the working poor since 1979. This can be accomplished simply and at little cost by more efficiently targeting the tax relief to those most in need.

Several pending legislative proposals provide the necessary tax relief to the working poor and should be incorporated in any final tax reform plan adopted by this Committee. The Economic Equity Act (S. 1169), sponsored by Senator Durenberger and other members of this Committee, as well as the Children's Survival Bill (S. 1237), introduced by Senator Dodd, include a tax agenda that fairly and effectively provides tax relief to working families in poverty. First, this legislation includes a provision to expand eligibility for the Earned Income Tax Credit (EITC) to families earning up to $16,000 per year, and increase the maximum credit itself on a sliding scale to $800. Building upon the Administration's helpful EITC initiative, this provision accomplishes several critical objectives: (1) It would exempt all families in poverty from federal income taxes and provide some tax relief for those slightly above the poverty line as well; (2) It would provide the working poor a more significant offset against Social Security payroll taxes than does the President's plan; (3) It would provide effective work incentives for lower income families; (4) Finally, it would end the impoverishment of these families as a result of federal tax policy. It is most important to note that this increase in the EITC would in essence do no more than compensate for its erosion by inflation since 1979, and by indexing the credit, would insure against future erosion. We would strongly urge that any tax bill reported from this Committee build upon the Administration's plan by including the provision to more adequately increase, and then index the Earned Income Tax Credit as included in S. 1169 and S. 1237.

Second, the Children's Survival Bill includes another change in the Earned Income Tax Credit beneficial to poor families with children. Currently, the EITC depends only on income, and is unrelated to family size. An eligible family of five receives the same credit as an eligible family of three. Therefore we recommend increasing the EITC with an allowance for each dependent child, and an additional allowance for each child under six. This would help large poor families, as well as families with young children and child care costs, and we urge this Committee to consider adding a dependent allowance to the EITC.

Third, the Economic Equity Act and the Children's Survival Bill also recognize the importance of significantly increasing the zero bracket amount for single heads of households. The Administration's plan makes major progress in this regard, and in so doing virtually closes the tax gap between single parent families and married two parent families of the same size and income. We recommend that the gap be eliminated entirely, however, by raising the zero bracket amount for single heads of households to the same level allowed for married couples filing jointly as included in these legislative proposals.

Fourth, both S. 1169 and S. 1237 retain and expand the current Dependent Care Tax Credit to provide additional child and dependent care assistance to low and moderate income working families. This positive approach has been favorably considered by this Committee several times, and should be included in any final tax reform package.

The current federal tax system is under attack on many fronts, not only because it produces insufficient revenues to reduce dangerously high budget deficits, but because it is perceived by citizens, tax experts and policymakers alike as overly complex, economically inefficient, and basically unfair. One of its most glaring inequities is the increasing burden on those least able to pay, those individuals and families with earnings at or below the poverty line. This inequity must be remedied, because the growing tax burden is an additional obstacle to such families' struggle to be self-sufficient and meet the needs of their children.

COMPARISON OF FEDERAL TAX COMPUTATION IN 1979 and 1984 AND UNDER PRESIDENT REAGAN'S PLAN IN 1986 FOR A TWO-PARENT FAMILY OF FOUR WITH POVERTY LINE WAGES

		1979	1984	1986 (Plan)
1.	Poverty Level Income, Family of Four	$7,412	$10,613	$11,508
2.	Personal Exemptions	$4,000	$4,000	$8,000
3.	Standard Deduction	$3,400	$3,400	$4,000
4.	Combined Personal Exemption & Standard Deduction (line 2 plus line 3)	$7,400	$7,400	$12,000
5.	Taxable Income (line 1 minus line 4)	$12	$3,213	0 */
6.	Income Tax Rates	14%, First $2,100 16%, Next $2,100 18%, Next $4,300 Etc.	11%, First $2,100 12%, Next $2,100 14%, Next $4,300 Etc.	15%
7.	Income Tax Liability Before EITC	$2	$365	0
8.	Earned Income Tax Credit	$322	0	$221 */
9.	Income Tax (line 7 minus line 8)	Minus $320	+ $365	Minus $221
10.	Social Security Tax Rate	6.13%	6.7%	7.15%
11.	Social Security Tax (line 1 X line 10)	$454	$711	$844 */
12.	Total Tax (line 9 + line 11)	$134	$1,076	$623
13.	After Tax Income (line 1 minus line 12)	$7,278	$9,537	$10,885
14.	After Tax Income as Percent of Poverty line	98.2%	89.9%	94.6%

*/ Taxable income base includes wages and $300 of employer-provided health insurance attributed as income.

COMPARISON OF FEDERAL TAX COMPUTATION IN 1979 and 1984 AND UNDER PRESIDENT REAGAN'S PLAN IN 1986 FOR A SINGLE PARENT FAMILY OF FOUR WITH POVERTY LINE WAGES

		1979	1984	1986 (Plan)
1.	Poverty Level Income, Family of Four	$7,412	$10,613	$11,508
2.	Personal Exemptions	$4,000	$4,000	$8,000
3.	Standard Deduction	$2,300	$2,300	$3,600
4.	Combined Personal Exemption & Standard Deduction (line 2 plus line 3)	$6,300	$6,300	$11,600
5.	Taxable Income (line 1 minus line 4)	$1,112	$4,313	$208 */
6.	Income Tax Rates	14%, First $2,100 16%, Next $2,100 18%, Next $2,200 Etc.	11%, First $2,100 12%, Next $2,100 14%, Next $2,200 Etc.	15%
7.	Income Tax Liability Before EITC	$156	$499	$31
8.	Earned Income Tax Credit	$322	0	$221 */
9.	Income Tax (line 7 minus line 8)	Minus $166	+ $499	Minus $190
10.	Social Security Tax Rate	6.13%	[illegible].7%	7.15%
11.	Social Security Tax (line 1 X line 10)	$454	$711	$844
12.	Total Tax (line 9 + line 11)	$288	$1,210	$654
13.	After Tax Income (line 1 minus line 12)	$7,124	$9,403	$10,854
14.	After Tax Income as Percent of Poverty line	96.1%	88.6%	94.3%

*/ Taxable income includes wages and $300 of employer-provided health insurance attributed as income.

STATEMENT OF REV. CHARLES V. BERGSTROM, EXECUTIVE DIRECTOR, GOVERNMENTAL AFFAIRS, THE LUTHERAN COUNCIL IN THE USA

Reverend BERGSTROM. I first of all want to join in the thanks for the opportunity of being here, Mr. Packwood and Mr. Moynihan. I would like to make one request on behalf of the three churches that I am representing that are listed in the testimony. We referred to three statements of the Lutheran Church—one, the American Lutheran Church, "Toward Fairness in Public Taxing and Spending," second, the Lutheran Church in America statement, "Economic Justice," and then our Lutheran bishops' statement, "The Poor and Our National Budget." I would like to have permission to have those entered into the record.

The CHAIRMAN. Those will all be in the record and the report that Ms. Bourdette asked to be entered in the record will be entered in the record and I see some of the other witnesses on the next panel have arrived. All of your statements in their entirety will be in the record. I would appreciate very much your getting them in early because it allowed me to read them over the weekend or this morning. I have read them all in their entirety, and so you don't have to read them in full.

Reverend BERGSTROM. Thank you, sir. I think either Monsignor Boxleitner heard some Lutherans in St. Paul, or they heard him, because much of what I would have said is exactly word for word in terms of the scripture admonitions of Christ and also the areas of justice. Let me just underscore a few facts that are included in our testimony. The emphasis again on the poverty line and the people who have suffered unfairly. We have seen statistics that show that even with the good things that are proposed in the administration's plan the working poor would still not be up to where they were in 1980 in terms of their net income. And at the same time, some of the benefits they depend upon, of course, have been cut.

I would like to underscore the word "justice." We are not talking about charity—we are talking about justice and fairness in terms of this distribution, and we are very appreciative of the fact that it is the direction tax reform seems to be going, and particularly in these kinds of hearings, to think about these people. I would again underscore the earned income tax credit and the indexing of that as a helpful way to reach the needs of these particular people; the child care credit rather than a deduction is also important to us; and to take a good look at single people who have families in terms of the deductions that are concerned; and also some concerns that we raised about the taxing of fringe benefits, where that again might affect the poor.

We all read the same newspapers over the weekend. My quotation was also going to be from Martin and Kathleen Feldstein, perhaps to say that sometimes clergy are considered the people who just dream. So it is good to hear an economist say the very same things that we have been saying this morning and therefore it has been helpful to us. Note particularly the last line of that article by the Feldsteins. In the June 16th edition of the Washington Post: "Rethinking the increased personal exemption should be a top priority for Congress." We certainly would agree with that. The 56 bishops of the Lutheran Churches I represent came together on a statement earlier this year concerning the poor, and it relates, of course, to taxes. We, the staff of the Lutheran Council here in Washington, visited some 25 cities across the country, and wherever we participated in discussions with these clergy and with lay people, there was shock on the part of every one of them to find out what truly had happened to the poor. I said in testimony last week in the House that it is unusual to get Lutheran bishops to agree on anything. We don't have quite the close organization that is true of the Roman Catholic bishops. One of the Lutherans said that either it is a miracle, or the statement wasn't strong enough; but in any case, you will find in our testimony that it strongly underscores our concern for fairness and justice, particularly related to those who are poor.

We hear constantly from the staff people at our Lutheran social service agencies across the country and could give story after story of immigrants and others who come, who need particularly the concern of people who are in Government and who are in the church, wherever we have an opportunity to do that. So, in every way possible, I would underscore this morning the fairness that we need to think about and our appreciation for hearings such as this that show that concern in Congress, and the opportunity in any way possible to be of assistance not only to this committee but to others. Thank you very much.

The CHAIRMAN. Thank you, sir. Mr. Hutchinson.

[The prepared written statement of Reverend Bergstrom and three Lutheran reports follow:]

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Statement of

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of the

Lutheran Council in the U.S.A.

Office for Governmental Affairs

on

TAX REFORM

before the

Committee on Finance

United States Senate

June 17, 1985

SUMMARY
STATEMENT OF CHARLES V. BERGSTROM

June 17, 1985

The American Lutheran Church, the Lutheran Church in America and the Association of Evangelical Lutheran Churches are deeply concerned that people further and further below the poverty line are being forced to pay a larger and larger share of their desperately needed income in taxes. This situation occurred when that same segment of the population, the "working poor," have seen the benefits which flowed to them through federal low-income programs curtailed or totally eliminated and most other Americans experienced a cut in their federal income taxes. As a matter of basic economic justice, we cannot support the shifting of the tax burden from more wealthy individuals and corporations to the working poor, who have, by definition, the least ability to bear that burden.

We have been encouraged by the Administration's stated commitment to the principle that "families with income at or below the poverty level should not be subject to income tax" and to the specific proposals--adjustments in the standard deduction, personal exemption and earned income tax credit--which it has advanced to accomplish that goal. We

***strongly support the expansion of the Earned Income Tax Credit found in the president's tax reform package, which goes a long way toward compensating for the recent inflation-related erosion in the credit. The proposed indexing of the credit is also absolutely necessary to prevent the current situation from recurring. However, given the tax cuts most other income groups have experienced in recent years, provision should be made to ensure that the poor and near poor pay no more in federal taxes than they did in the late 1970's. An additional increase in the credit and the level at which it is phased out would serve the purpose of more fully offsetting social security and income taxes and providing a stronger incentive to work. We also would urge that procedures for filing for such a credit be as simple as possible to ensure those eligible for the credit actually receive it.

***are concerned about the change from a child care credit to a deduction, which would result in substantially less favorable treatment for the poor and near poor than current policy.

***urge the committee to give careful consideration to ways that any effects of the elimination of the "two-earner deduction" on persons just above the poverty level can be ameliorated.

***object to the proposal to tax the first $120 per year in fringe benefits for individuals and the first $300 for families. This would make the tax system more regressive and would have a negative impact on many near poor families whose benefits would have remained exempt under the proposal in Treasury I.

We hope that the Senate Finance Committee and the Administration will work together to quickly remove the unfair tax burden from people who are working but not earning enough to provide an adequate living standard for themselves and their families.

My name is Charles V. Bergstrom and I serve as Executive Director of the Lutheran Council's Office for Governmental Affairs. I appreciate the opportunity to comment on measures which would improve the deteriorating tax situation of low income Americans. The following churches participate in the Office for Governmental Affairs:

The American Lutheran Church, with headquarters in Minneapolis, Minnesota, which has 4,900 congregations and approximately 2.3 million members;

The Lutheran Church in America, with headquarters in New York, New York, which has 5,800 congregations and approximately 2.9 million members in the U.S.; and

The Association of Evangelical Lutheran Churches, with headquarters in St. Louis, Missouri, which has approximately 270 congregations and 110,000 U.S. members.

As many witnesses at this hearing have underscored, the tax situation of the poor has eroded significantly since the late 1970's. People deeper and deeper in poverty are being forced to pay a larger and larger share of their desperately needed income in taxes. This situation has occurred just when the same segment of the population, the "working poor," have seen the benefits which flowed to them through such programs as Aid to Families With Dependent Children and Medicaid curtailed or totally eliminated. Caught in this two-sided squeeze, the poor are finding their already precarious standard of living declining--even as they expend the same, or greater, effort to work their way out of poverty. And the sad irony is that the increasing tax burden of the poor has occurred when the tax burden of moderate and wealthy taxpayers has declined as a result of the 1981 tax cut. As a matter of basic economic justice, we cannot support this shifting of the tax burden from more wealthy individuals and corporations to the working poor, who have, by definition, the least ability to bear that burden.

The 1982 national convention of the American Lutheran Church expressed its views in the statement, "Toward Fairness in Public Taxing and Spending," which I request be entered in its entirety into the hearing record. Of particular interest to our discussion here is the following:

> "Needed in a free society such as ours is a strong sense of elemental fairness in taxation and in the ways public revenues are distributed. Definitions of fairness will, of course, vary. We believe that to be fair means (1) taxing people in some relationship to their ability to pay, and (2) providing assistance when required in some relationship to need."

The Lutheran Church in America's 1980 convention statement on "Economic Justice" puts the apportioning of tax "burdens" in society within their broader context of work and provision of basic human needs:

> "Economic justice denotes the fair apportioning of resources and products, of opportunities and responsibilities, of burdens and benefits among the members of a community. It includes the provision for basic human need, fair compensation for work done, and the opportunity for the full utilization of personal gifts in productive living."

You will be debating what exact provisions most closely approximate the goal of fairness in the comprehensive tax reform measure your committee will be developing. One tax expert has somewhat cynically compared the quest for fairness in tax policy with the quest for the Holy Grail--one may embark upon the quest but will never achieve the goal. But the tax treatment of the poor in recent years is clearly unfair and unjust--and needs to be corrected, whether in the context of overall tax reform or as a separate legislative action.

THE ADMINISTRATION'S TAX REFORM PROPOSAL. We sincerely welcome the initiative of this committee in raising public concern about the tax situation of the poor and for calling this public hearing. It is particularly timely, given the recent release of the Administration's proposed tax reform plan. We have been encouraged by the Administration's stated commitment to the principle that "families with income at or below the poverty level should not be subject to income tax" and to the specific proposals it has advanced to accomplish that goal. The solid support of the Administration will be critical to ensuring that tax legislation in this area moves quickly through the Congress. The following are among the areas in which we have specific concerns:

***The Expansion of the Earned Income Tax Credit. Our staff talked recently with a local Lutheran pastor, whose congregation provides its low income neighbors with counseling and f^od/clothing services. This pastor also assists some of these low income people to file their tax returns. The Earned Income Tax Credit, to use his words, is a "lifesaver" for the working poor. One example he gave was of a woman he counseled this year whose refund was absolutely vital to help her pay back rent and buy needed food for her family. The recent erosion of this vitally important tax credit has meant that such poor families have less of their meager earnings available to them to pay for the necessities of life.

Thus, we strongly support the expansion of the earned income tax credit found in the president's tax reform package, which goes a long way toward compensating for the recent inflation-related erosion in the credit. The proposed indexing of the credit is also absolutely necessary to prevent the current situation from recurring.

However, it causes us concern that even with the proposed changes, some of the poor and near poor would continue to pay in federal income and payroll taxes a higher percentage of their income than they paid in 1978. Given the tax cuts most other income groups have experienced in recent years, provision should be made to ensure that the poor and near poor at least maintain their prior status. An increase in the credit and the level at which it is phased out would serve the purpose of more fully offsetting social security and income taxes and providing a stronger incentive to work.

The desire to simplify the tax code is a rationale for the Administration's proposal. Under the current system, many low income persons are not aware of the availability of an earned income tax credit or for other reasons do file for the credit. The Administration is proposing "return free filing" for many taxpayers. We would hope that the process for filing for the earned income tax credit would be as simple as possible--ideally, "return free"--to ensure those who are eligible receive the credit.

***Zero Bracket Amount. We appreciate the Administration's proposed increase in the Zero Bracket Amount for single heads of households. That proposal moves far in the direction of more equal treatment for households of the same number of members but with a different family structure. We would, however, push a bit further to provide for heads of households with dependents the same treatment as married couples with dependents. A mother with three dependent children, with income at the poverty threshold of $11,400, should not have a tax-free income level $240 lower than a couple with two children with income at the same level.

We appreciate the Administration's proposal to lower the tax threshold for single persons. However, we are concerned that almost one sixth of the income of single persons earning at the poverty level would still be subject to taxation. The Administration argues that such treatment is necessary because a "marriage penalty" would result if poor individuals married and that single people often live with others. However, taxing single persons with earnings well below the poverty level would result in serious instances of injustice for single individuals who may never marry or who do not have an extended family or others with whom they can share expenses. And it is these single non-aged individuals who are least eligible for various forms of federal assistance. The Administration's proposal, while an improvement over current law, does not fully comply with the principle that persons in poverty should not pay federal income tax. The rationale provided does not warrant such a deviation from this principle.

***<u>Change from Child Care Credit to Deduction</u>. The proposed change causes serious concern, since this would result in substantially less favorable treatment for the poor and near poor than current policy--and an accompanying better treatment for more affluent Americans. A tax credit targeted toward the poor provides for the allocation of resources where they are most needed--by persons with relatively low incomes who require child care to enable them to work. It just does not make good social sense for the wealthy to receive through the deduction twice as great a "dollar benefit" as a near-poor family for the same expenditure for child care--a reversal of current policy.

***<u>Elimination of the Two-Earner Deduction</u>. Because of the proposed flattening of the tax rates and lowering of marginal tax rates, the Administration argues for the repeal of the "two earner" deduction on the grounds that this repeal will not cause undue hardship--although it conceded that for some families, the so-called "marriage penalty" will continue. Two earner families with income just above the poverty line, who have to pay work-related expenses for two, could be effected negatively by this provision. We would urge the committee to give careful consideration to ways the effect of such a "penalty" on near poor taxpayers can be ameliorated.

***Taxation of Fringe Benefits. We have some serious concerns about the current proposal to tax as income the first $120 per year in fringe benefits for individuals and the first $300 per year for families--a major change from the original Treasury plan which would tax fringe benefits above certain levels. A measure which would make the tax system more regressive, the new proposal could negatively affect those working families whose relatively small benefits would have remained exempt under Treasury I.

A staff person of a Lutheran social service agency provided us with the following description of a person she serves who would be affected by this proposal. The man is a refugee from Ethiopia, living in Minneapolis, who has a strong desire to be financially independent. To support his wife and infant daughter, he works at two low-paying jobs. One of his employers recently provided health coverage for him--not an extensive plan but basic medical coverage. We would be seriously concerned that such families, who suddenly might have an additional $300 imputed to them as income for tax purposes, could have whatever federal or state benefits for which they are currently eligible reduced or eliminated. And there are serious questions of equity which must be raised when the extensive fringe benefits plans of more affluent workers remain for the most part exempt from taxation, while a much larger proportion of the dollar value of the "no-frills" plans of the working poor would become taxable.

<u>SUMMARY</u>. Earlier this year, staff of our office led forums in twenty five cities across the country on the effect of current and proposed legislation on the poor. During these discussions, the issue which actually shocked participants was the deterioration in the tax situation of the working poor which occurred at the same time the tax bills for many present at these forums had declined. People just could not believe this was happening, that the poor could be treated so unfairly under our tax system. In our meetings, a variety of opinions were expressed. But there was no dissension over the position that current tax policy must be changed to protect the working poor.

In February, 53 regional bishops and the three national leaders of the Lutheran churches listed above endorsed a statement on "The Poor and our National Budget." I request that this statement be included in the hearing record. The fact that this is the first time all of our bishops endorsed a statement on a public policy issue is evidence of a widely shared concern. One of their central points relates to our discussion here:

> "Persons with earnings at or below the poverty line should not pay federal income taxes. The 1981 cut in tax rates did little to address the specific needs of the working poor. Failure to adjust for inflation the earned income tax credit and other tax provisions means that the government is taxing away a greater and greater percentage of the dollars which the poor desperately need to provide a minimal living standard. This make little social sense and should be changed."

I hope your committee and the Administration will work together to quickly remove the unfair tax burden from people who are working but not earning enough to provide an adequate living standard for themselves and their families.

Social Statements

THE LUTHERAN CHURCH IN AMERICA

ECONOMIC JUSTICE

STEWARDSHIP OF CREATION IN HUMAN COMMUNITY

Adopted by the Tenth Biennial Convention, Seattle, Washington
June 24-July 2, 1980

INTRODUCTION

God wills humanity to exercise justice in its stewardship of creation. Holy Scripture declares that the earth is the Lord's, and that persons created in God's image are divinely authorized to care for this earth and to share in its blessings. Since human community is dependent on responsible stewardship, God commands that persons deal equitably and compassionately in their use of the earth's limited resources in order to sustain and fulfill the lives of others.

It is in obedient gratitude for all the gifts of God that we in the Lutheran Church in America commit ourselves in faithful love to struggle for economic justice as an integral part of the witness and work of God's People in the world.

ECONOMY IN SOCIETY

The word, "economy," is derived from the Greek words which mean the ordering of the household. In this basic sense, economy denotes the activity of persons in the management of all the resources (natural, human, and manufactured) of this world.

An economic system is the pattern of relationships, processes, institutions, and regulations, together with the values underlying them, by which the activities of production, distribution, and consumption are carried out in and among societies and cultures.

Economic policies and institutions develop through social custom and political decision. The allocation of the resources, burdens, and benefits of the economy is variously done: by traditional habits, by individual choice in the marketplace, by governmental regulation, by the action of corporations, or by all of these. Likewise the institutional constraints on economic activity are made by these means separately or in combination.

Economic activity is embedded in the total life of a society. Relations of production and distribution reflect the prevailing patterns of power as well as the values by which a society lives. The material allocations within a society are both an effect and a cause of the basic character of that society. The economic choices of the members and institutions of a society reflect what a society is and influence what it is becoming.

The fundamental questions underlying any economic system are therefore political and moral in nature. There are always technical questions that are peculiar to the operation of any given system, but the basic issues are not technical in character. For example, who may work? What should motivate our labors? By whom and how should it be decided what to produce, where to distribute, and how much to consume? Who determines, and how, the "fairness" of prices, profits, wages, benefits and strikes? How do we balance economic production and environmental protection? Do our economic practices reflect or reinforce child exploitation, sexism, ageism, racism, or anti-Semitism? The answers, never final, emerge qualified and compromised from the field of contending interests, powers, and moral claims.

The organization of economic life has undergone vast changes throughout the course of history, and no economic "system" has ever shown itself to be permanent. The appearance of new conditions, the development of new technologies, and the evolution of social values and political structures have all occasioned the alteration or replacement of economic institutions and relationships.

It is in such a world of continual change, amid graphic evidence of both progress and exploitation, that the Holy Spirit calls the church to bear witness to God's sovereign reign in our midst. As the Lord of history God acts in society to judge and fulfill the daily efforts of all people in their economic theory and practice.

THEOLOGICAL FOUNDATIONS

All persons are intended to respond in worship and work as one human family to the Creator's love: to propagate, nurture and extend human life and enhance its quality; to protect and use wisely the world's resources; to participate with God in the continuing work of creation; and to share equitably the product of that work to the benefit of all people.

In a world broken by sin the Creator lovingly enables the doing of justice. Into such a world God calls the redeemed in Christ to be advocates and agents of justice for all.

THE IMAGE OF GOD

Human life depends totally on a loving Creator. All persons are made in God's image for a life of trust, obedience, and gratitude.

Life under God is also meant to be life in community. There is no humanity but co-humanity, for one cannot be human alone. It is only together that persons can realize their creation in God's image. This image is reflected as persons respond in love and justice to one another's needs. Male and female persons are created equally in the image of God. (Gen. 1:27) It is in the basic human relationships of domestic, political, and economic life that persons share in their common humanity. God's love encompasses all people, and God intends that stewardship be practiced for the benefit of the entire human family.

Created in the image of God, persons are together stewards of God's bounty. They are accountable to God for how they use, abuse, or neglect to use the manifold resources — including their own bodies and capacities — which God has placed at their disposal. Reflecting God's cosmic dominion as Creator, they are called to care for the earth and "have dominion over," but not callously dominate, every living thing. (Gen. 1:28)

WORK

Work, the expending of effort for productive ends, is a God-given means by which human creatures exercise dominion. Through work, persons together are enabled to perpetuate life and to enhance its quality. By work they are both privileged and obligated to reflect the Creator whose work they are.

Although sinful rebellion issues in burdens of toil and alienation, the forgiving and renewing Lord holds out the possibility of work as useful and satisfying, prompting the Psalmist's prayer, "Establish the work of our hands." (Ps. 90:17)

Work is thus meant for persons in community, not persons for work. While participation in the community of work is meant to enhance personal well-being, the identity of persons created in God's image is neither defined by the work they do nor destroyed by the absence of work. What a person *does* or *has* does not determine what one *is* as the personal creature of a loving Creator.

Christian identity is also not to be equated with the work Christians do. As new persons in Christ, Christians have been set free and empowered to exercise their vocation through many roles, occupations among them. However, Christians do not equate baptismal vocation in God's kingdom with economic occupations in the world.

JUSTICE

Justice may be described as distributive love. It is what God's love does when many neighbors must be served with limited resources. Justice is the form of God's creating and preserving love as that love is mediated by reason and power through persons and structures in community life. Injustice dehumanizes life and prevents full participation in co-humanity. Justice is therefore viewed simply as that which people need to be human.

God mandates the doing of justice. (Micah 6:8) The specific content of that justice, however, is not directly revealed but is discovered as life is lived amid claim and counterclaim. The discernment of justice involves every aspect of the human being. It is a task of reason, requiring the counting, measuring and classifying of factors that admit to such analysis. It is intuitive, involving the capacity for empathy. It is political, involving the struggle for power among competing groups. Above all, it is moral, involving the fundamental human capacity to know what enhances and what destroys the being and dignity of the person. That capacity, conscience, grows and is nurtured in the creative interaction of persons and groups, in the recollection of and reflection on past experience, and in the confronting of new situations.

Therefore the doing of justice is the proper stewardship of the social and material resources of creation in which our co-humanity in God's image is being realized.

Social justice refers to those institutional and legal arrangements which promote justice for all the members of society.

In addition to being the way in which God's providential love is expressed socially, justice is also the way in which sinful persons are required to do for others what, in their self-centeredness, they would not otherwise do to meet their neighbors' collective needs.

Because human beings, both individually and collectively, are self-centered, self-serving, and self-justifying, their defining and doing of justice are inevitably tainted by the rationalization of special interest. This sinful rationalization often leads to such errors as the pitting of benevolence against justice and the confusion of justice with righteousness.

Social justice should not be pitted against personal benevolence (often called charity) or corporate benevolence (often called philanthropy); but neither should benevolence be substituted for justice. In its true sense, benevolence is the loving response directly to others in need; in its false sense, it is the vain attempt to purchase a good conscience and to avoid the demand for justice. Rightly understood, benevolence and justice complement each other as different forms of the Creator's providential love.

Neither personal nor corporate benevolence can accomplish what a society is required to do for its members under justice; but a society cannot remain sound if it leaves no room for benevolent acts.

Justice and righteousness, as these terms are used in this statement, are not to be confused or identified with each other. Righteousness denotes the redeeming activity of God in Christ which effects the forgiveness of sin, new life, and salvation. It frees and empowers God's faithful servants to act lovingly and justly in the world, not merely out of prudent self-regard, but also sacrificially for their neighbors' sake.

The attempt to equate human justice and divine righteousness distorts Christ's Gospel and undermines God's law. In the name of liberty, such self-righteousness enslaves; in the name of life, it kills; in the name of abundance, it lays waste. God's holy wrath is provoked when humans presume to rule society by a spurious "gospel," thereby weakening the possibility of realizing justice, peace, and civil order under God's law.

Justice takes place at the intersection of serving love and enlightened self-interest. All sinners, including Christians, are still able as the corrupted image of God to act justly out of such self-regard; and forgiven Christians are empowered to move beyond such self-regard. By the power of Christ working in them, they are freed to enlarge the conventional limits of justice.

While the advancement of justice involves the interplay of countervailing power, it depends finally upon the degree to which the members of a community are either willing or constrained to moderate their acquisitiveness in the interest of the common good.

Justice is a painful process, serving as both the prerequisite for and the fruit of civil peace. Although never fully completed, struggles for justice draw people into the ongoing work of approximating God's will in this sinful world.

ECONOMIC APPLICATIONS

God gives to human creatures the freedom and capacity to devise the means of exercising the stewardship that has been entrusted to them. They may therefore establish such social and legal institutions as will facilitate the life of mutual responsibility for which they have been created. Such humanly-devised means are legitimate so long as they do not usurp the place of God as Lord and owner of all things or thwart the will of God for the well-being of the whole human family.

THE STEWARDSHIP OF MEANINGS AND VALUES

God enables persons to employ ideas as tools of analysis and evaluation. The fashioning and use of conceptual tools is never finished. New historical situations may require new modes of diagnosis and prescription. The refinement of appropriate concepts is a vital part of the constructive work of seeking justice.

An ideology is a set of linked ideas by which a society, social movement or interest group seeks to explain, give coherence to, and justify a given pattern of behavior or a prescriptive vision for society. An ideology may be used to elicit commitment to preserving the social *status quo* or to changing it.

An ideology can be a useful means for the securing of political cohesion within a society or for mobilizing people in support of constructive change. It can also be used deceptively to mask injustice and to elicit an ultimate commitment which, besides being idolatrous, may make people insensitive to the violation of basic human rights.

No ideology can legitimately be held to be redemptive or represented as embodying God's saving righteousness.

Christians recognize stewardship as including the right use of meanings and values in the just ordering of society and economy. Such ideological stewardship must, however, prevent any system of values from laying an ultimate claim on persons as the bearers of God's image.

As part of the stewardship of meanings and values the following principles are offered as guidance for responsible action.

GOVERNMENT

In a sinful world God intends the institutions of government to be the means of enforcing the claims of economic justice. Government should neither stifle economic freedom through excessive regulation, nor abdicate its responsibility by permitting economic anarchy. Legitimate governmental activity normally includes such functions as: protection of workers, producers, and households from practices which are unfair, dangerous, or degrading; protection of the public from deceptive advertising and from dangerous or defective products or processes; encouragement and regulation of public utilities, banking and finance, science and education; environmental protection; provision for the seriously ill and disabled, needy, and unemployed; and establishment of an equitable system of taxation to support these functions. Compliance with these and other legitimate governmental activities should be affirmed, even as their improvement and correction are sought through appropriate political means.

In extreme situations, when governmental institutions or holders of political power engage in the tyrannical and systematic violation of basic human rights, and when the means of legal recourse have been exhausted or are demonstrably inadequate, then non-violent direct action, civil disobedience, or, as a last resort, rebellion may become the justifiable and necessary means of establishing those conditions within which justice can again be sought and enjoyed.

ECONOMIC JUSTICE

Economic justice is that aspect of social justice involving the material dimension of social relationships and the social activities of production, distribution, and consumption of goods and services. Economic justice denotes the fair apportioning of resources and products, of opportunities and responsibilities, of burdens and benefits among the members of a community. It includes the provision for basic human need, fair compensation for work done, and the opportunity for the full utilization of personal gifts in productive living.

Economic justice includes the elements of equity, accessibility, accountability, and efficiency.

Understood as equity or fairness, economic justice does not mean economic equality. It is rather the result of a discerning of, and response to, the various needs of the members of a society, respecting differences without being partial to power or special interest. Equity implies a sense of the common good and a care for the diversity of gifts and human resources that contribute to it. At the same time it provides for those minimal necessities which, in a given social and cultural setting, are prerequisites for participation in society; and it provides for those members of the society who, because of circumstances not of their making, cannot provide for themselves.

Accessibility includes both the formal entitlements to political participation and legal redress, and such substantive entitlements (e.g., nutrition, shelter, health care, basic education, minimum income and/or employment) as are needed for entrance into the social and economic community. It also includes the provision of the means by which the members of a community may participate in decisions which affect the quality of the common life and that of future generations.

Accountability implies that economic actors must be held answerable to the community for the consequences of their behavior. Government properly establishes the legal means whereby people may secure compensation for injury incurred, as a result of economic decisions which have not taken account of their likely impact on personal and community well-being.

Efficiency requires a responsible use of resources that is genuinely productive by minimizing waste. This productivity is conserving not only of material resources and time, but also of human resources and the environment. The economy should be structured to permit the calculation of efficiency so as to take account of social and ecological waste.

Persons should be permitted and encouraged to participate in fundamental as well as market decisions governing the economy. Members of a society should be co-determiners of the quality of their economic life. Such co-determination, requiring differing structures appropriate for differing situations, is the basic right of persons whom God has created in co-humanity as responsible stewards.

Stewardship requires careful forethought. Planning is vital to the stewardship of material resources at all levels of human life: personal, familial, communal, and political. Planning on economic matters is more than technical. Questions of basic human value are involved in both specifying economic goals and devising the means of achieving them.

Planning should therefore be sufficiently pluralistic in character to assure the possibility of self-correction and prevent domination by one or a few special interests. It should be done on a scale and level of social life which provide for the greatest practical degree of participation and co-determination.

God has implanted in the human creature the capacity and initiative to define the problems of material existence in community and to effect positive change. No person or community should relinquish that initiative or capacity, and social and political institutions should be designed to encourage such initiative at the local and intermediate levels of society. A society is healthier when its members are encouraged to participate responsibly in determining their own lives rather than being only the passive consumers of goods and services.

WORK

Even in the present state of sinful estrangement, God's intention remains that work be

IMPLEMENTING RESOLUTION

This church calls upon its ministers and congregations to engage in an intensive study over the next biennium of the social statement, "Economic Justice: Stewardship of Creation in Human Community," with a view to ascertaining the content of this church's corporate stewardship within the present historical setting. Such study is to consider both the institutional allocation of the material and human resources of this church internally and the work of public advocacy by this church externally.

This church directs its program agencies and offices to facilitate such study through programs appropriate to their several mandates. Such work should to the extent possible be planned and executed through such means as the Staff Team on World Hunger Concerns and the Staff Team on Fiscal Support. Each churchwide agency shall report to the 1982 convention of this church the results of its study and action, as well as its future intentions in the field of economic justice.

Efforts are to be made by appropriate agencies of this church to equip both the ministers and the laity to understand and apply the orientation and principles embodied in this statement through such means as:

1) Seminary and college curricula;
2) Continuing education for pastors;
3) Conferences for parish lay leadership;
4) Church school curricula; and
5) Faith and Life Institutes

The Division for Mission in North America shall advise this church as to appropriate ways of implementing this statement both through advocacy in the public sector and through consultation and shareholder action in the private corporate sector.

The administrative offices of this church, in consultation with the Division for Mission in North America, shall study this statement with a view to the application of its principles to this church as a manager of resources, employer, fund-raiser, investor, and purchaser and provider of goods and services.

The Division for Mission in North America shall continue the work of issue-clarification and the constructive criticism of ideology begun during the preparation of this statement. It shall continue to involve the lay persons of relevant expertise and experience who were engaged in the development of this statement as well as others whom it may identify.

The Division for Mission in North America, through its program, Advocacy for Global Justice, shall identify and act upon the global and domestic implications of this statement as they impinge on the reality of world hunger.

This church shall endeavor to implement this statement through its inter-Lutheran and ecumenical involvements, both in North America and worldwide.

Division for Mission in North America
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231 Madison Avenue, New York, N.Y. 10016

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done and its fruits be enjoyed by the whole human family. The division of labor according to efficiency and the diversity of human gifts, along with the social relations of productive activity, are means by which life in co-humanity may be both extended and enriched.

Work that is beneficial to society glorifies the Creator. Those who perform such work are to be esteemed for their contribution to the common good. They are not to be judged by whether or not the work is remunerative, or by the amount of remuneration. Vast disparities of income and wealth are both divisive of the human community and demeaning to its members.

Exclusion of persons from the community of work is a denial of the opportunity of realizing the divine intention for co-humanity.

Humanly-devised economic arrangements which, in their operation, tend both to exclude some persons from the community of work, and subsequently to stigmatize such persons for not working, constitute a double affront to the Creator and to persons created in God's image.

PROPERTY

The concept of property is a legal means of determining responsibility for the use of resources and humanly-produced wealth. Property may be held by individuals, by business corporations, by cooperative or communal self-help organizations, or by government. In whatever manner it is held, property is held in trust and its holder is accountable ultimately to God and proximately to the community through its constituted authorities for the ways in which the resource or wealth is, or is not, used.

While the holder of wealth-producing property is entitled to a reasonable return, as determined contextually by the society, the holder of such property may not assert exclusive claim on it or its fruits. Justice requires that wealth be both productive and contributory to the general well-being through both the provision of new opportunities and the alleviation of human need.

The private ownership of property is a humanly devised legal right which can serve as a means for the exercise of that responsible stewardship which constitutes the divine image. Private property is not an absolute human right but is always conditioned by the will of God and the needs of the community. The obligation to serve justifies the right to possess. The Creator does not sanction the accumulation of economic power and possessions as ends in themselves.

CONCLUSION

We affirm the inseparability of the economy from the whole of human life. The criticism and reshaping of economic relations and institutions is a fundamentally moral task in which Christians should be actively involved. Economy, rightly understood, is the God-given stewardship of life.

In Christ the People of God are freed and enabled individually and corporately to participate in the quest for greater economic justice and the achievement of the conditions of human well-being. As a worldwide community of brothers and sisters, the church can summon the human family to care for the earth responsibly while God yet gives us time.

TOWARD FAIRNESS in PUBLIC TAXING and SPENDING

Adopted Sept. 11, 1982, by the Eleventh General Convention of The American Lutheran Church as a statement of comment and counsel expressing the views of the convention to the member congregations and the units of The ALC for their consideration and such action as they deem appropriate (GC82.11.121). Ballot vote tally: Yes 716; No 29.

The American Lutheran Church welcomes the opportunity for national discussion of societal priorities in which our nation is now engaged. We encourage the members of our congregations to take full and informed part in that discussion. As a contribution to it, we offer the following observations.

1. Government and God's Justice. "Teach the king to judge with your righteousness, O God; share with him your own justice. . . . May the king judge the poor fairly; may he help the needy and defeat their oppressors" (Ps. 72:1, 4 TEV).

When we translate such a biblical word into the contemporary United States setting, we may think "government" in place of "king." And when we think "government" in our society we must think "all of us, collectively," because we, the citizens, are the ones who rule.

What *is* our responsibility as citizens, especially to those among us who are poor and needy? As a helpful contemporary response to that question, we affirm "The Needs of the Poor and the Proper Role of Government," a statement on the federal budget debate issued April 5, 1982, by four U.S. Lutheran leaders and, in particular, cite these excerpts as a basis for considering the matters discussed in the balance of this document.

THE NEEDS OF THE POOR AND THE PROPER ROLE OF GOVERNMENT

The Role of Government. Lutherans have important insights to contribute to the current public policy debate over the proper

drawings
by Wendy Brusick
from "Budget Choices,"
Lutheran Council USA;
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role of government. According to Lutheran theology, government is part of God's creating and sustaining order and plays a positive role by supporting the good and restraining evil. While specific governments may become instruments of evil, government under God is called to maintain peace, establish justice, protect and advance human rights, and promote the general welfare of all in society. Government's role includes more than simply providing for the common defense or using its coercive power to restrain lawbreakers. Government appropriately guarantees all citizens equal opportunity for self-development and upholds the rights of those who by reason of race, age, health, ability, or social standing are at the margin of our economic and social system.

All persons in society are entitled to that which is necessary to lead a healthful existence. Employment for all able to work, with remuneration sufficient to provide the minimum of what is needed for full participation in society, is essential to the well-being of the nation. When employment is not possible, society properly provides for individuals an income adequate to achieve at least a minimal living standard.

In our democratic society, ensuring that the basic human needs of children, the elderly, the disabled, and the poor are met requires the commitment of the community as a whole and the interaction of all institutions—government, churches, other voluntary agencies, and business. Government does not possess a monopoly on the provision of social services but rather seeks to establish the welfare of all citizens through the most effective and appropriate channels.

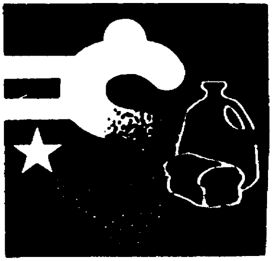
Church/Government Interaction. In response to the Gospel, churches play a vitally important role as they use their material and human resources to deal with the immediate needs of the poor, em-

power them to move from dependency to self-sufficiency, and address the root causes of economic deprivation. Hospitals, social service agencies, education institutions, and community organizations supported by Lutherans and other voluntary groups play an essential role as innovative providers, enablers, and advocates for those in need.

However, benevolence by persons, churches, and other voluntary organizations is limited and, *precisely because it cannot be compelled,* may be capricious and inconsistent. Voluntary agencies do not possess the power or the resources to address adequately the pervasive social problems which are the product of this highly mobile and rapidly changing society. Often they lack the structural mechanisms to deal with the complex needs of the poor and to ensure that individuals throughout the country do not slip into what can be major gaps in service.

In the face of continuing inequities of wealth and power, justice demands that the needs of the poor and others on the margins of society be consistently met. Since people do not always naturally seek what is best for their neighbor, the guarantees and enforcement of law in this area are necessary. The government is responsible for providing a basic floor of benefits at an adequate level for health and decency; it is to ensure that no one is forced to go hungry or homeless and none are deprived of adequate medical care. The benevolent activities of individuals and voluntary organizations *complement,* but in no way *replace,* the responsibility of government to establish social justice.

Lutheran Involvement. In this time of economic difficulty, we call upon Lutheran citizens, congregations, and agencies to redouble their efforts to address the very real needs of the poor in their com-



munities and to explore new ways of responding more creatively and effectively through programs which lead to economic self-sufficiency. Given our churches' historical involvement in this area, our churches and their members should be in the forefront of increased efforts to develop new models for improved delivery of services.

While our churches are meeting immediate human needs through direct services in their communities, they should also work with government to ensure that the unmet needs of the poor throughout the country are addressed and to eliminate root causes of poverty.

We call upon Lutheran citizens, congregations, and agencies to bring the wealth of their experience and insights to the federal budget debate.

Lutherans and others of good will may differ on economic assumptions, political positions, and specific ways of dealing with those in need. Yet we share a fundamental commitment to ensuring that the poor are dealt with justly by our society in its national budget decisions.*

2. Economic Health. As government seeks to ensure that the basic needs of the economically vulnerable are met, a complete set of factors must be addressed. Our nation needs an economy that can generate jobs and produce revenues to pay for public programs. We need an economy that has inflation under control. We need interest rates that are not usurious. And we need a federal budget that is normally in balance but that can quickly

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* Signers of the statement were James R. Crumley Jr., bishop, Lutheran Church in America; David W. Preus, presiding bishop, The American Lutheran Church; William H. Kohn, president, Association of Evangelical Lutheran Churches; John R. Houck, general secretary, Lutheran Council in the USA.

and effectively respond to changing economic conditions in the nation and the world.

3. **Fairness.** Also needed in a free society such as ours is a strong sense of elemental *fairness* in taxation and in the ways public revenues are distributed. Definitions of fairness will, of course, vary. We believe that to be fair means (1) taxing people in some relationship to their ability to pay, and (2) providing assistance when required in some relationship to need.

Those who pay taxes have a right to expect fairness in the tax system's rates, credits, exemptions, and deductions. Similarly, the public has a right to expect that public support payments or subsidies will go to those who qualify for them according to need (the economically exposed) or according to agreed social policy (such as benefits to military veterans in return for service rendered).

4. **The Vulnerable.** Public income-support programs should be designed to meet the needs of those citizens whose economic vulnerability is greatest. These Americans are found disproportionately in certain categories of the population: children, women, persons with disabilities, older Americans. Where the consequences of racism are present, the economic vulnerability is compounded. It does not help to tell Americans caught in such vulnerability to find jobs when (1) there are few jobs to be found, and (2) many of them are too young, too old, or too disabled to be able to work.

5. **Income Support.** Public income-support programs all share certain common features: they are transfer payments (funds transferred from the public as a whole to a specific body of citizens); they are paid from tax revenues (either general or designated); they are viewed as entitlements—benefits to which people have a right.

6. **Income-Tested or Not?** But in another respect income-support payments are of two kinds. Some are income- or means-tested, that is, one must be under a maximum income level to be eligible. Others, such as veterans benefits or Social Security payments, go to categories of persons on bases other than economic need.

It is regrettable that our public discussion separates income-tested programs (called "welfare") from the other income-support programs (considered "earned"). The fact is that most of our income-support programs —including Social Security, veterans benefits, and unemployment compensation—represent transfers from one set of taxpayers to another. They are not genuine insurance programs, wherein a recipient gets back only the recipient's and employer's payments, plus interest. At best, programs such as Social Security are but partially contributory on the part of the recipient.

7. Nearly All Give and Receive. Virtually all Americans, at some time in their lives, are on the receiving end of transfer payments. Virtually all Americans, through their lives as taxpayers, are on the paying end of transfer payments. If we could recognize that almost all of us, during a lifetime, are *both* payers and receivers of public transfer payments, the quality of our national discussion on public assistance would be upgraded significantly.

8. Share the Burden. The church is committed to the priority of meeting the needs of those who, through circumstances beyond their control, are living in economic distress. In a complex industrial society, public assistance is the primary means of addressing such needs. Church members are distressed when most of the burden of reductions in public spending is placed on programs which benefit primarily low-income people. In deciding where to reduce federal spending, the full range of programs should be reviewed, including transfer payments that are not means-tested and military spending.

9. Church Privileges. Certain tax advantages to churches, while not significant as a source of potential revenue, are of crucial importance as the churches make public witness on fairness in tax policy. These include (a) property tax exemptions on parsonages and other property not used for worship, education, and social services, in states where such prevail, and (b) the provision of income-tax-free allowances for the housing costs of ordained persons. Churches should show a willingness to have thorough examination of tax provisions or proposals which benefit them institutionally.

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THE POOR AND OUR NATIONAL BUDGET:

A Statement by 56 Lutheran Bishops

The nation's fundamental priorities are reflected in the budget choices it makes. This year, the soaring federal deficit makes particularly difficult the decisions on how much revenue our nation must raise and how that revenue is to be spent. Amid the clamor of various groups seeking to protect their own interests, the church must speak clearly on behalf of those at home and abroad whose pressing human needs require not only private charity but also government action.

Our deficit dilemma has no painless solutions. However, the sacrifice required must be distributed in accordance with the ability of individuals and groups to bear it. The allocation of limited resources should be based on a thorough evaluation of the utility and effectiveness of tax breaks, military spending and social programs.

In working for a fair "distribution of sacrifice," budget cuts and tax changes proposed for the 1986 fiscal year should be viewed in their broader context. Programs for the poor, which comprise approximately one-tenth of the federal budget, have been cut proportionately deeper than other programs benefitting all Americans. In addition, while the 1981 tax cut decreased the tax burden of many affluent Americans, persons at or below the poverty line have found themselves paying a greater percentage of their income in taxes. Due to these changes and to the effects of the recent recession, the standard of living of many poor Americans has deteriorated significantly and their numbers have grown. While voluntary organizations have responded to this increase in poverty, they have not been able to ensure that the needs of the poor—many of them children—are adequately met.

Given the high rate of both unemployment and poverty, we believe that a top budgetary priority should be securing adequate funding for human needs and income maintenance programs, with federal standards ensuring that such funds are targeted to persons in greatest need. We would assert-that:

***No one in this prosperous country should be forced by economic conditions to go hungry or homeless or lack adequate medical care. Even with current funding levels, federal benefits to poor families are often insufficient to provide adequately for their basic needs. We therefore oppose any further reductions in the programs—the so-called "social safety net"--which provide for the immediate needs of low-income Americans: Food Stamps, Aid to Families With Dependent Children, Medicaid, Supplemental Security Income for the elderly poor, and low-income housing and energy assistance programs. Eliminating cost-of-living adjustments or "freezing" funding levels for these programs will further depress the overall standard of living of low-income families. Given the cuts which have already been made in these programs in recent years, we cannot support such a strategy.

***Targeting special assistance to persons with special needs is good short- and long-term public policy. A dollar saved in program cuts today may result tomorrow in extended health care costs, disruptions in earnings, unemployment and other drains on our economy. For example, the WIC program provides special foods to certain low-income pregnant and nursing women, infants and children. However, even at current funding levels, many persons certified to be at nutritional risk are already being turned away, increasing the possibility of long-term damage to their health. Further cuts would exacerbate this situation. Social services to keep families intact, child nutrition efforts, and health programs addressing the specific needs of low-income children are a crucial investment in our nation's welfare.

***Persons with earnings at or below the poverty line should not pay federal income taxes. The 1981 cut in tax rates did little to address the specific needs of the working poor. Failure to adjust for inflation the earned income tax credit and other tax provisions means that the government is taxing away a greater and greater percentage of the dollars which the poor desperately need to provide a minimal living standard. This makes little social sense and should be changed.

***Programs which address some of the root causes of poverty should be strengthened and improved. These programs include education assistance for disadvantaged students and communities, job training and legal services. Efforts to reduce the unacceptably high level of unemployment, which is devastating to individuals and families, must be a major commitment of government.

***The needs of the poor abroad cannot be ignored. The African tragedy highlights the need for both direct food aid and development assistance in less developed areas throughout the world. The outpouring of donations to deal with famine indicates deep concern over the plight of the hungry abroad. However, the work of our voluntary agencies complements but cannot replace intentional government action in areas of aid, trade and development.

Our churches assert that the responsibility for addressing the needs of the poor is shared among individuals and institutions at every level of society. Private charity certainly plays an important role in this endeavor, and we encourage our own members to continue responding generously to the growing problems of poverty, both at home and abroad. But in our complex and highly mobile society, meeting the needs of the poor in all localities is beyond the capacity of charitable institutions. The federal government has an appropriate role in meeting immediate needs, as well as addressing the systemic causes of poverty. We value partnership between the voluntary and the government sectors in attempting to assist the poor to participate more fully in our economic life—but we strongly resist cuts in funding which undermine that partnership and seriously reduce the government's role in meeting pressing human needs.

Released February 14, 1985

STATEMENT OF FREDERICK C. HUTCHINSON, TAX AND DOMESTIC HUNGER POLICY ANALYST, BREAD FOR THE WORLD, WASHINGTON, DC

Mr. HUTCHINSON. Good morning, Mr. Chairman and Mr. Moynihan. As a representative of Bread for the World, we are very appreciative for the opportunity to come to give oral testimony before this committee. We would like to echo the analysis as well as the recommendations of the previous witnesses before this panel, but what we would like to do is focus in on the relationship between the Federal tax burden on families in poverty over the last few years and the epidemic proportions of hunger in this country. Also, we want to look briefly at the marginal approach to legislating tax relief for poor families that we feel has had a somewhat negative effect upon people at the lower end of the economic scale.

We would like to say first that it is public knowledge that over 35 million people in this country live in poverty, and 20 million of these people go hungry at least through some portion of every month. We feel that when Federal tax burdens reach the proportion of 10 percent of the income of these families, then obviously it takes away from the amount of money that could be used to contribute to the table. Families go hungry, children go hungry. Recent CBO and CRS reports indicate that 22 percent of our children are in poverty, that 37 percent of the poverty population are children, and we feel that when you combine all of these factors with a Federal tax burden of 10 percent and more of an income, it really contributes to the growing epidemic of hunger in this country. We feel that at one time our country was embarked upon a policy that would have eliminated this, and we were making great strides toward that end, but recently we find that there has been a resurgence of hunger. We think that by reducing the Federal tax burden and even eliminating this burden on families in poverty, we can make a major stride toward the recommitment to end hunger in this country. With respect to the President's proposal, we think it is a very positive step in the right direction in that it eliminates the Federal income tax burden on a family of four at the poverty level. It does this by significantly raising the personal exemption and the zero bracket amount.

We also think that it is positive in the sense that it closes the gap of the zero bracket amount between single heads-of-households and married couples, which afforded on a single-parent family of four a disproportionate tax burden. But there still remains a $569 payroll tax burden which concerns us, and the major question that our organization, as well as others who have met with Treasury Department officials has, is why do we not go a step further? We remember back in 1972, then-Governor Reagan came before this very committee and said that he felt that the poor should not shoulder an income tax nor a payroll tax burden. Fortunately, there is legislation now before this committee, as well as the Ways and Means Committee, that would eliminate this $569 payroll tax burden, and we urge that Congress enact this legislation. The only reason that we were able to glean from our discussions with Treasury Department officials of why the President's proposal did not go further was that to increase the Earned Income Tax Credit to reduce the rest of this payroll tax burden would increase the marginal tax rate at the lower end of the income scale, and this would serve as a disincentive for them to continue to work. But we find that through the data we have worked out, marginal tax rates don't have the effect on the people on the lower end of the scale that they do for middle income taxpayers and higher income taxpayers.

Looking at the data from the ERTA—the significant rate reductions that took place there—we find that after a 23-percent reduction over a 3-year period of time, the Federal tax burdens continued to rise, while inflation during that period was only moderate. Consequently, we feel that more substantial steps would have to be taken as is evidenced by the President's proposal. Also, when you compare the marginal rates of the various tax proposals at various increments of the poverty line, we find that there is just no relationship between marginal rates and effective tax rates for families near the poverty line. We would like to echo the recommendations of the previous panelists, the previous witnesses, and we would like to focus in on not only raising the earned income tax credit in accordance with a provision of the Economic Equity Act (S. 1169), but also the equalization of the zero bracket amount for single heads of households and married couples. We would also like to urge the committee to also consider making the child and dependent care credit not a deduction, but a refundable credit for families with incomes below $11,000. Thank you.

The CHAIRMAN. Thank you very much.

[The prepared written statement of Mr. Hutchinson follows:]

bread for the world
a christian citizens' movement in the usa

TESTIMONY OF
FREDERICK C. HUTCHINSON
TAX POLICY AND DOMESTIC HUNGER ANALYST
BREAD FOR THE WORLD

on behalf of
BREAD FOR THE WORLD

before the
COMMITTEE ON FINANCE,
UNITED STATES SENATE

JUNE 17, 1985

802 rhode island avenue n.e., washington, d.c. 20018 (202) 269-0200

"Rather than create a new category of welfare recipients, it is proposed that the situation of such low-income families be improved by providing automatic exemptions from state and federal income taxes and an automatic rebate of social security taxes including the employer's contribution thereto".

Ronald Reagan

Governor, California
Senate Finance Committee, February, 1972

"Low-income families face steep barriers that make hard lives even harder...To encourage opportunity and jobs rather than dependency and welfare, we will propose that individuals living at or near the poverty line be totally exempt from federal income tax ".

Ronald Reagan

President

State of the Union Address, February 6, 1985

Mr. Chairman and Members of the Committee, my name is Frederick Hutchinson, and I am a tax policy and domestic hunger analyst with Bread for the World. Bread for the World is most appreciative of the opportunity to come before this committee to testify on the impact of the tax reform proposal on people below the poverty line. Bread for the World is a Christian citizens' anti-hunger movement in the United States which works to influence public policy in ways that will eventually lead to the elimination of hunger in the U.S and abroad. We have been in existence for 10 years, and are 47,000 members strong across Congressional districts in the 50 states. We fully recognize that the hungry have a shortage of lobbying advocates in the Congress, and we work to help fill this void. One of the areas that we see as being an integral contributor to the increasing hunger epidemic in this country is the area of federal taxation. Poor families have been taxed in the last four years moreso than in any other period in our country's history. Part of the reason for this is that lobbying advocates for families in poverty have been conspicuously absent from previous Congressional debates on tax reform. As this Committee and the House Ways and Means Committee debate tax reform this time around, the Bread for the World membership intends to fully and vigorously participate in the debate through public testimony and letters to senators and representatives.

HUNGER IN AMERICA

Many recent studies have documented a dramatic increase in hunger in America. Studies by the U.S. Conference of Mayors, the U.S. Department of Agriculture, the Food Research and Action Council, the President's Task Force on Food Assistance, Bread for the World Hunger Watch Surveys, and most recently, the Physicians' Task Force on Hunger in America all confirm this embarrassing state of affairs. I say embarrassing because this condition exists in a country that pays farmers not to grow food, and that provides millions of dollars worth of food aid to the rest of the world. I say embarrassing because in spite of this, there are over 35 million people in this country living below the standard which society has determined as being minimum. I say embarrassing because 20 million of the 35 million people go hungry every month. I say embarrassing because the overwhelming majority of these 20 million persons who go hungry are children. And I say embarrassing and shameful because this country was once embarked upon a course that was making great strides toward eliminating this most dreaded of afflictions, but in recent years, has turned a callous shoulder toward those most helpless and least able to provide for themselves. It is in this context of increased hunger and poverty, as well as increased insensitivity, that salt has been poured onto the wound by the doubling of the federal tax burden on poor families.

TAXING THE POOR FEEDS THE HUNGER PROBLEM

Consider a family of four -- mother, father, and two children. Both parents work part-time because neither can find full-time work. Their combined income last year was roughly $10,600 -- right at the poverty line. Because they are in poverty, there are many hard choices to make about how to spend their meagre income. Reductions in benefits from antipoverty programs make these choices more difficult. Normally, they would allocate more money income to food purchases to compensate for reduced food stamp benefits, but their taxes have more than doubled in the last five years, from $450 to $1,152. This has more than eaten away the modest cost-of-living adjustment in the father's salary.

Instead of purchasing more food, they will have to reduce their food budget in order to pay the rent and utility increases. As the children's diets suffer, their performance in school declines. The parents see the cycle of hunger and poverty potentially repeating itself, in their children, right before their eyes. It seems that the harder they work and the more money they make, the poorer they get. How could this happen in America?

Much of their frustration can be traced to their increased federal tax burden. The ERTA in 1981, reduced income tax rates over a three-year period across income categories. But, for the poor, these rate reductions were more than offset by such factors as inflation and increased social security taxes. When all these factors were taken into account, taxpayers earning more than $30,000 per year experienced a reduction in taxes, while those earning less than $30,000 per year experienced a tax increase. In fact, the top 1.9 percent of all individual taxpayers -- those earning more than $80,000 -- received an approximate tax reduction of $17,433 through the years 1983 to 1985, while the bottom 34 percent of all individual taxpayers -- those earning less than $10,000 experienced a tax increase of $317 through the same time period.

This is an indication of two very unsettling trends. First, the tax position of the two most disparate income groups in this country are moving in opposite directions resulting in a rapidly deteriorating standard of living for the poorest of Americans. Now,the bottom fifth of the American population must share only 4.2 percent of the national income, whereas the top fifth of the American population shares 43 percent of the national income; more than ten times that of the lower fifth. And second, the income gap between the poorest and the most well-to-do segments of American society -- a gap that is more disparate than that of any other western country with the exception of France -- is widening.

Aside from the growing unequal distribution of the tax burden, when this increased tax burden is added to the definition of poverty, the number of people in poverty rises significantly. (See Table 1.) In 1982 -- the last year that

TABLE 1.

COMPARISON OF THE NUMBER OF PERSONS BELOW THE POVERTY LEVEL AND POVERTY RATES FOR SELECTED INCOME CONCEPTS BETWEEN 1980 and 1982

Income Concept	Year 1982	Year 1980	Increase Between 1980 and 1982
Number (In Thousands)			
Money Income Only--Official Definition	34,398	29,272	5,126
Money Income Less Federal and State Income Taxes and Payroll Taxes	37,573	31,561	6,012
Money Income and Food Stamps	32,952	27,421	5,531
Money Income, Food Stamps and Public Housing	31,599	25,934	5,665
Money Income, Food Stamps and Public Housing Less Federal and State Income Taxes and Payroll Taxes	34,768	28,158	6,610
Poverty Rate			
Money Income Only--Official Definition	15.0	13.0	2.0
Money Income Less Federal and State Income Taxes and Payroll Taxes	16.4	14.0	2.4
Money Income and Food Stamps	14.4	12.2	2.2
Money Income, Food Stamps and Public Housing	13.8	11.5	2.3
Money Income, Food Stamps and Public Housing Less Federal and State Income Taxes and Payroll Taxes	15.2	12.5	2.7

Source: Material sent to Subcommittee on Oversight of the Committee on Ways and Means, U.S. House of Representatives from the U.S. Bureau of Census, June 4, 1984.

such figures are available -- adding the tax burden to the definition of poverty increased the incidence of poverty by over one million persons above the official definition. Thus, focusing on the increased federal tax burden requires an adjustment in the traditional way poverty is determined.

Bread for the World sees the establishment of a floor of economic decency as an integral part of its fight against hunger in the United States. BFW believes that taxing those who have yet to achieve this floor of decency is contrary to the Christian concept of fairness.

PROVIDING EFFECTIVE TAX RELIEF TO LOW INCOME WAGE EARNERS REDUCING MARGINAL RATES VERSUS ADJUSTING LOW-INCOME PROVISIONS

In recent years, the approach to providing tax relief for citizens that has received the most attention is the process of lowering marginal income tax rates. The underlying assumption to this approach is that steeply progressive tax rates increase the marginal tax liability on a working individual, and thus, act as a disincentive to working people to increase work duration and intensity. By lowering and collapsing income tax rates, the marginal tax liability on working people would be significantly reduced, and citizens would tend to work more. This was the approach that guided the ERTA in 1981, and it still guides a significant segment of thinking on tax reform today.

This line of thinking has some validity for middle and upper income taxpayers. Once a person has acquired the basic necessities in life and has obtained some degree of security in holding on to these necessities, the decision of whether or not to work more becomes a cost-benefit decision, i.e., will the return from additional effort be worth the increase in income tax liability. Steeply progressive rates may have a bearing on this marginal decision, but in the case of the working poor, marginal decision-making is not a live option.

Working families in poverty are exclusively concerned with increasing their total amount of income. To these families, effective tax rates can make the difference between living in or escaping from poverty. For families who are at or below society's minimally designated standard of living (the poverty line), their major concern is to be able to utilize all that they earn. To the extent that they share a concern about taxes, it has to do with the percentage of their gross income that is taken away, not how much of the next dollar that could be earned would be kept.

A review of the federal tax status of a family of four at the poverty level since 1980 provides a clear picture of the effects that the marginal tax rate reductions contained in the ERTA had on its effective tax burden. (See Table 2.) The net effect was a $508 increase in federal taxes for this family between 1980 and 1984 in real dollar terms. Although most of the damage had been done before the ERTA took effect, even if all the low-income provisions of the tax code were indexed at its inception, a slight increase in the effective tax rate on this family still would have occured. The ERTA, as passed, significantly slowed the deterioration of the federal tax status of this family, and had the low-income provisions been indexed from the beginning, the tax status would have been held in check. But ERTA, as passed, is also a 23 percent reduction in marginal tax rates over a three year period versus the net effect of a .57 percent increase in payroll taxes. The first year of the rate reductions could not offset a modest increase in payroll taxes and 6.2 percent inflation. The second and third years could not offset more modest increases in inflation -- 3.0 percent and 4.5 percent respectively.

This is indicative of two very important factors. First, a substantial reduction in marginal tax rates has a very negligible effect on the federal tax position of low-income wage earners. In fact, without the indexation of

TABLE 2.

THE EFFECTS OF INDEXING ERTA ON THE FEDERAL TAX BURDEN
OF A TWO-PARENT FAMILY OF FOUR AT THE POVERTY LEVEL

YEAR	INFLATION	POVERTY LEVEL	INCOME TAX	PAYROLL TAX	EITC	TOTAL FED. TAX BURDEN	% INCOME IN FEDERAL TAXES
1980		8,414	134	514	202	450	5.3%
	10.4%						
1981		9,287	264	618	89	793	8.5%
	6.2%						
1982		9,862	285	661	28	918	9.3%
	3.0%						
1983	 4.5%	10,166 (10,166) (10,166)	318 (292) (292)	681 (681) (681)	0 (0) [29]	999 (973) [944]	9.8% (9.6%) [9.3%]
1984	 4.0%	10,626 (10,166) (10,626)	366 (302) (302)	712 (712) (712)	0 (0) [30]	1,078 (1,014) [984]	10.1% (9.5%) [9.3%]
1985		11,051 (11,051) (11,051)	369 (314) (314)	783 (783) (783)	0 (0) [31]	1,152 (1,097) [1,066]	10.4% (9.9%) [9.6%]

() Refers to the federal tax burden on this family if the ERTA had indexed the ZBA and the personal exemption at its inception.
[] Refers to the federal tax burden on this family if the ERTA had indexed the ZBA, the personal exemption, and the earned income tax credit.

the ZBA, the personal exemption, and the EITC, a substantial reduction in marginal tax rates cannot even hold the line against modest increases in inflation. And second, given the rapid increase in inflation in the late 1970s and up to 1981-82, a marginal tax rate reduction was the least effective way of legislating a tax cut for low-income wage earners. The net effect was a tax increase -- lower marginal rates and a higher tax bill. The low-income provisions in the tax code should have been substantially adjusted upward to compensate for inflation and to provide a real tax cut for low-income wage earners living in or near poverty.

MARGINAL TAX RATES AND TAX REFORM 1985: THE CASE OF THE EARNED INCOME TAX CREDIT

In the debate over the best way to provide tax relief for families living in or near poverty in the context of comprehensive tax reform, the marginal approach is at the center of the debate once again. Efforts to design a most appropriate relief package for low-income wage earners have been stymied by this factor. Bread for the World is very pleased with the fact that the President's proposal and the Kemp-Kasten proposal seek to permanently remove families in poverty from the income tax rolls. BFW is also pleased that Senator Bradley and Representative Gephardt have indicated a willingness to make substantial improvements in the low-income provisions of the Bradley-Gephardt proposal. But, BFW is still troubled by the way these proposals handle the payroll tax problem of low-income families, i.e., how these proposals seek to modify the earned income tax credit (EITC).

Under the President's proposal, the maximum EITC is increased substantially to $726 and eligibility for relief from the credit is extended to families with incomes up to $14,000. Thus, a family of four with an income at the poverty level would be eligible for a $253 EITC in 1986 as opposed to a zero EITC in 1985.

This is a significant step in the right direction, however, there is a remaining $569 payroll tax liability for this family. Families living in poverty should have more of their payroll tax burden offset.

Under the Kemp-Kasten proposal, the maximum EITC is increased substantially for some families living in poverty ($787 for a family of four), adjusted for family size, but phased out completely (at $10,750 for a family of four) for families living at the poverty level. The proposed rate for the credit is acceptable, but eligibility is not extended nearly enough. A family of four at the poverty line would receive no EITC and would have to shoulder a $783 payroll tax burden in 1986. This is too much of a federal tax burden.

In each case, the reason cited for not extending benefits further under the EITC is presence of a built-in marginal tax disincentive in the phaseout portion of the credit. The assumption is that because there is a significant increase in the marginal tax rate shouldered by low-income families with incomes in the phaseout range of the credit, this higher marginal rate would act as a disincentive to these families' efforts to extend employment; lower effective tax rates notwithstanding. Thus, it is further assumed that a family living in or near poverty would have a greater incentive to work if it had a lower marginal tax rate coupled with a higher tax bill, than if it had a higher marginal tax rate coupled with a lower tax bill. This is a kind of "corporation mentality" that has no place in the thinking of poor families.

Families living in or near poverty are concerned with acquiring every dollar that they possibly can in order to improve their lot in life. The more income they have at their disposal, the better -- marginal tax rates notwithstanding. That family is certainly not going to turn down a $1,000 increase in wages because it will incur a $150 income tax bill and a $100 reduction in EITC benefits.* That family is certainly not going~~ to turn~~ down a $1,000

* These numbers reflect the actual income tax rate and EITC phaseout rate schedules under the President' proposal.

increase in wages because they will have to begin paying income taxes and will lose all EITC benefits. That family will happily accept that $750 net increase in income and forgo the marginal cost associated with the $250 investment. To not accept this reality is to recommit the error of ERTA in 1981. Reducing marginal tax rates is not the most effective way to legislate tax relief for poor families.

There are several concrete examples which can vividly illustrate this point. (See Table 3.) First, by substantially expanding the EITC in accordance with the EITC provision of S.1169, and incorporating this into the President's tax reform proposal, the effective federal tax rate on a family of four at the poverty level is reduced to less than one (1%) percent of earnings ($101) as opposed to the 5.0 percent ($569) effective rate under the present version of the proposal. The EITC provision of S.1169 accomplishes this in the following manner:

1) increases the maximum benefit from $550 to $800 by increasing the rate of the credit from 11% to 16% on the first $5,000 in income;

2) extends maximum benefit eligibility to families with incomes up to $11,000 -- up from the current $6,500;

3) extends maximum income eligibility from $11,000 to $16,000 adjusting the phaseout rate from 12.22 percent to 16 percent; and

4) indexes the credit to keep its value from eroding due to inflation.

At the same time, the marginal tax rate on this family is six (6) percentage points higher under the expanded EITC version than it is under the current version.

Second, in the income range between $14,000 and $14,150, the President's proposal has a lower marginal tax rate than the Kemp-Kasten proposal or the President's proposal with the EITC provisions of S.1169. (See Table 4.) However, the effective rate under the President's proposal -- and thus, the total federal tax bill -- is a full 2.1 percentage points higher than the effective rates under the other two options. The very same condition exists at 125 percent of

TABLE 3.

THE IMPACT OF H.R. 2480 (EITC PROVISION OF S. 1169) ON THE FEDERAL TAX BURDEN OF A TWO-PARENT FAMILY OF FOUR WITH AN INCOME AT THE POVERTY LEVEL (1986)

TAX REFORM PROPOSAL	POVERTY LINE	INCOME TAX	PAYROLL TAX	EITC	TOTAL** FED. TAX BURDEN	% INCOME IN FEDERAL TAXES
PRESIDENT	11,493	0	822	253	569	5.0%
BRADLEY-GEPHARDT	11,493	41	822	0	863	7.5%
KEMP-KASTEN	11,493	0	822	0	822	7.2%
H.R. 2480/S. 1169	11,493	383	822	721	484	4.2%
PRESIDENT*	11,493	0	822	721	101	.9%
BRADLEY-GEPHARDT*	11,493	41	822	721	142	1.2%
KEMP-KASTEN*	11,493	0	822	721	101	.9%

*The various proposals with H.R. 2480/S. 1169 incorporated.

** Total federal tax burden equals (income tax + payroll tax) - EITC.

TABLE 4.

PERCENTAGE OF INCOME IN FEDERAL TAXES FOR A TWO-PARENT FAMILY OF FOUR AT VARIOUS PERCENTAGES OF THE POVERTY LINE (1986)

	PRESIDENT	TOTAL	PRESIDENT 1/	TOTAL	KEMP-KASTEN	TOTAL
100% of Poverty Level*	11,493		11,493		11,493	
% Income in Federal Taxes	(5.0%)	569	(.9%)	101	(7.2%)	827
Marginal Tax Rate	17.2%		23.2%		26.3%	
Income Tax Threshold**	12,800		14,060		14,125	
% Income in Federal Taxes	(6.2%)	794	(7.2%)	1,012	(7.2%)	1,017
Marginal Tax Rate	32.2%		38.2%		26.3%	
125% of Poverty Level	14,336		14,336		14,336	
% Income in Federal Taxes	(9.6%)	1,376	(7.7%)	1,104	(7.4%)	1,061
Marginal Tax Rate	22.2%		38.2%		26.3%	
Phaseout of EITC	14,000		16,000		10,750	
% Income in Federal Taxes	(9.3%)	1,302	(10.9%)	1,744	(7.2%)	774
Marginal Tax Rate	22.2%		22.2%		22.2%	
150% of Poverty Level	17,239		17,239		17,239	
% Income in Federal Taxes	(11.7%)	2,017	(11.7%)	2,017	(10.6%)	1,827
Marginal Tax Rate	22.2%		22.2%		26.3%	
175% of Poverty Level	20,113		20,113		20,113	
% Income in Federal Taxes	(13.2%)	2,655	(13.2%)	2,655	(12.9%)	2,595
Marginal Tax Rate	22.2%		22.2%		26.3%	
200% of Poverty Level	22,986		22,986		22,986	
% Income in Federal Taxes	(14.3%)	3,287	(14.3%)	3,287	(14.5%)	3,333
Marginal Tax Rate	22.2%		22.2%		26.3%	

* Poverty level assumes a four (4%) percent inflation rate between 1985 and 1986.

** Income Tax Threshold assumes the full use of the earned income tax credit.

1/ The President's proposal with the EITC provision of S.888 incorporated.

the poverty level ($14,336 for a family of four) with the President's proposal and that same proposal modified by the expanded EITC provision of S. 1169. In comparing the proposed modified version of the President's plan with Kemp-Kasten at 125 percent of the poverty level, the net difference in effective tax rates, and thus, total federal tax burden, is negligible (.3 percent and $43 respectively) although the marginal tax rate under Kemp-Kasten is almost 12 percent lower.

Third, from 150 percent of the poverty level ($17,239 for a family of four) to 200 percent of the poverty level ($22,986 for a family of four), marginal rates under Kemp-Kasten are higher than they are under the other two proposals although the total tax bill, and thus the effective tax rate, is lower. Only when income reaches 200 percent of the poverty level do the marginal tax rates under the various proposals reflect a direct relationship with the total tax bill. Only above the $16,000 income level, which is the phaseout point for the EITC under a proposed modified version of the President's proposal, do families near poverty fare equally well under the two proposals. Only above the $16,000 income level is the marginal tax rate under the modified version reduced on par with the marginal tax rate under the current version of the proposal.

The evidence is overwhelming that the marginal approach to legislating tax relief for families living in or near poverty is not the most effective approach to take. The evidence also suggests that this approach can be injurious to the federal tax status of low-income families if it is used exclusively as was the case with the ERTA in 1981. The features of the various proposals which make them attractive to low-income wage earners are the increase in the ZBA, the increase in the personal exemption, and the increase in the EITC. A higher marginal tax rate should not be used as an excuse for not substantially expanding the EITC according to the provisions of S. 1169.

THE ZERO BRACKET AMOUNT AND THE FEDERAL TAX BURDEN ON SINGLE-PARENT FAMILIES (HEADS-OF-HOUSEHOLDS)

Another area of concern has been the disproportionate income tax burdens shouldered by single-parent families living in or near poverty. Under current law in 1985, a single-parent family of four with an income at the poverty level will pay approximately $152 more in federal income taxes than a two-parent family with the same income and two children. This is unfair for that single-parent family which has the same number of family members, yet increased child care costs.

The reason for this discrepancy in tax burdens is that under current law, the ZBA for single heads-of-households is the same as it is for single taxpayers; more than $1,100 less than the ZBA for married couples filing jointly. The President's proposal, however, goes a long way towards closing the ZBA gap between heads-of-households and married couples filing jointly thereby reducing the difference in federal income taxes. The gap in the ZBA amounts is reduced to $400, and both amounts are raised significantly to points that when combined with the increase in the personal exemption, both family types are removed from the federal income tax rolls. This reduction is a significant step in the right direction.

Under the Bradley-Gephardt proposal, the plight of the single-parent family gets progressively worse vis-a-vis current law and dramatically worse vis-a-vis two-parent families. The situation gets progressively worse because the ZBA is not indexed for inflation and the personal exemption for the children remains the same as it is under current law. On the other hand, the situation gets dramatically worse because the bill practically removes a two-parent family of four with the same income completely from the federal income tax rolls ($41 in 1986). The net effect of the ZBA discrepancy on a single-parent family of four with an income at the poverty level under Bradley-Gephardt is a federal income tax bill of $517 in 1986 compared to $41 for their two-parent counterpart and $521 under current law for 1985. This is completely unacceptable.

Under Kemp-Kasten, the ZBA discrepancy is almost completely eliminated. It is raised to within $100 of the ZBA for married couples. When combined with the personal exemption increase and the twenty (20%) percent income exclusion, both family categories are removed from the federal income tax rolls until their income reaches $14,000 for a single-parent family of four and $14,125 for a two-parent family of four. This is a dramatic improvement over current law.

There is legislation before the Senate that would completely eliminate the discrepancy in income tax entry points for the two household types. The ZBA provision of S.1169 equalizes the ZBA for heads-of-households and married couples filing jointly. Bread for the World urges this Committee to incorporate this ZBA provision of S.1169 into its version of tax reform. Even though the ZBA provisions under the President's proposal and Kemp-Kasten are dramatic improvements over the current situation, when the Committee does comprehensive tax reform, it should do it correctly.

THE FEDERAL INCOME TAX STATUS OF A SINGLE-PARENT FAMILY OF FOUR UNDER THE VARIOUS TAX REFORM PROPOSALS (1986)

REFORM PROPOSAL	INCOME TAX* THRESHOLD	POVERTY LEVEL	INCOME TAX AT POVERTY LEVEL
PRESIDENT	12,575	11,493	0
BRADLEY-GEPHARDT	7,800	11,493	517
KEMP-KASTEN	14,000	11,493	0
PRESIDENT**	12,800	11,493	0
BRADLEY-GEPHARDT **	11,200	11,493	41
KEMP-KASTEN **	14,125	11,493	0

* Assumes full use of earned income tax credit to offset initial income tax liability.
** The various proposals with the ZBA provision of S.1169.

THE CHILD AND DEPENDENT CARE CREDIT

The final area of concern in the context of tax reform for low-income wage earners is the status of the child and dependent care tax credit. The child and dependent care credit provides relief to families from the exhorbitant costs of child and dependent care. Under current law, it is structured in a manner that targets the maximum benefits attainable under the credit to families in greatest need -- those families earning less than $10,000 per year. As family income rises, a smaller percentage of child care expenses is allowed, i.e., a smaller percentage of the uniform maximum allowable annual expenses. However, all of the major tax reform proposals now before Congress would effectively eliminate relief from child care expenses for poor families by changing the credit to a tax deduction. This would have a devastating effect on families living just above the poverty level because those families (who do not itemize deductions) would no longer get relief from child care expenses. This change would also add to the damage already done by the incorporation of Title XX into the Social Services Block Grant (SSBG).

Before 1981, Title XX of the Social Security Act provided funds to states to assist low and moderate income families with child care services and expenses. But, Title XX was incorporated into the SSBG as part of the Omnibus Budget Reconciliation Act of 1981. The result of this incorporation was a reduction by 21 percent and the elimination of $200 million in federal assistance to states for child care services. States have thus had to reduce these services to families.*

* The House Select Committee on Children, Youth, and Families, in a report entitled, "Families and Child Care: Improving the Options," found that 32 states provided Title XX child care to fewer children since 1981 and have cut Title XX expenditures. Sixteen states have cut Title XX expenditures by more than 21 percent. Nineteen states have increased fees for services. Twenty-four states reduced funds for training child care workers, and thirty-three states lowered their child care standards for Title XX programs.

Since then, families have had no other recourse except to turn to the child and dependent care credit as a source of relief from rising care costs. However, in spite of its structure and its increased use, two-thirds of the benefits under the credit provision go to families with incomes above the national median level. There are two basic reasons for this. First, relief under the credit comes after the expenses have been incurred and many low-income families cannot afford to forgo the initial costs in order to receive relief at a later date.* Only those families forgoing these expenses can position themselves for relief. And second, poor families with incomes below the income tax threshold receive no benefits because the credit is not refundable.

The impact of this on poor families has been devastating. It has had a tremendous negative impact on employment feasibility for parents of families in poverty. In a 1982 Census Bureau report, 36 percent of the women with children under five years of age and with incomes under $15,000 said they would look for work if child care were available at reasonable costs. Forty-five (45%) percent of the single mothers said that the lack of child care prevented them from working. Furthermore, it is estimated that families earning less than the Bureau of Labor Statistics (BLS) Intermediate Budget ($25,407 for a family of four in 1981) could only afford to pay five (5%) percent of their income for child care. With average costs running anywhere from $1,200 to $2,200 per year (11 percent to 20 percent of the poverty level wage), it becomes quite clear as to why exhorbitant child care costs act as a disincentive to parents'-in-poverty efforts to seek and maintain employment.

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* It is difficult to conceive of a family earning poverty level wages being able to afford an initial outlay of $2,400 to $4,800 for child care expenses. The report also cited the following examples: 1) Rhode Island reduced the number of children subsidized child care by 89 percent; 2) California provides child care for only one of three children eligible for such services; 3) Texas provides child care for only eight percent (16,000) of the 200,000 children deemed income-eligible while over 800,000 more children live in poverty; and 4) Michigan provides child care to about 7,000 children per month as opposed to 25,000 per month in 1981.

I go to these lengths to paint such a gloomy picture in order to underscore the ill-judgment in converting the child and dependent care credit to a deduction. This ill-judgment is further underscored by the fact that such a conversion would provide a windfall for taxpayers in the highest brackets -- those least in need of child care relief. The net effect of this conversion would be a loss of potentially $360 in tax credits for families with one qualifying individual and an income of $10,000 or less, and a $360 net gain in reduced taxes for one qualifying individual families with incomes in the top tax bracket. For more than one qualifying individual the respective losses and gains are $720.*

In order to reasonably improve this situation, Bread for the World recommends that the Committee incorporate the child and dependent care credit provision of S.1169 into its tax reform package. This provision would modify the child and dependent care credit in the following ways:

1) increase the maximum credit to 50 percent of eligible expenses for families with incomes of less than $11,000;

2) make the credit refundable;

3) expand the sliding scale of the credit so that it phases down to 20 percent for families earning $40,000 (this would increase the relief for families living slightly above the poverty level); and

4) index the income thresholds and the maximum expenditure amounts so that the value of the credit does not evaporate due to inflation.

SUMMARY OF RECOMMENDATIONS

Bread for the World sees the establishment of a floor of economic decency as an integral part of its fight against hunger in the United States. BFW believes that taxing those who have yet to achieve this floor of decency is contrary to the Christian concept of fairness. It is in this context that we

* The absolute maximum gain for taxpayers in the top tax bracket is $840 for one qualifying individual, and $1,680 for more than one qualifying individual.

strongly urge the Senate Finance Committee to make the elimination of federal income and payroll taxes on families in poverty a high priority of tax reform. BFW feels that this issue is bi-partisan in nature, and is fundamental to this country's conception of fairness and equity. BFW feels that the low income provisions of the President's tax reform proposal represent a solid starting point from which this goal can be achieved. However, Congress needs to go further by making the following modifications in the low-income provisions of the President's proposal:

1) The EITC provisions of the President's proposal should be changed to accomodate the EITC provision of S.[redacted]1169 This is the only legislative vehicle currently before the Congress that can virtually eliminate the federal payroll tax burden on families is poverty.

2) The ZBA for single heads-of-households should be raised an additional $400 so that it will become equal to the ZBA for married couples filing jointly. This is the best way to ensure that families in poverty of the same size but different type pay the same federal income tax bill. To the extent that families in poverty are exempt from federal income taxes, this will ensure that families with the same number of members begin to pay federal income taxes at the same income level. Incorporating the ZBA provision of S.[redacted] into the Committee's version of tax reform will achieve this goal. 1169

3) The provision that would change the child and dependent care credit to a deduction should be rescinded. The credit should not only be maintained, but should be made refundable in accordance with the child and dependent care provision of S.[redacted]1169 This will continue to provide low-income parents with positive incentives to seek and maintain full-time employment.

Bread for the World has faith that this Committee and the rest of the Congress will look favorably on these recommendations and adopt them. Bread for the World will continue to work on a bi-partisan basis to achieve these goals.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. Thank you, Mr. Chairman. It is very evident when you shoot deer in the hallways out there that we are dealing with problems of poverty and not intangible drilling costs, and there was a moment when it looked like nobody was going to show up, except Monsignor Boxleitner, who was here. This particular subject is poverty, and I congratulate Mr. Hutchinson for having retrieved President Reagan's testimony before this committee in 1972. It was the only time he appeared before a congressional committee while he was Governor, and he came here to oppose the family assistance plan and proposed instead something not unlike the earned income tax credit.

He was not alone in opposing the family assistance plan. Every liberal organization in the city was against it, the Catholic vote, NCWC excepted, and we had that moment. It passed the House twice. It will not come again in this century. It may never come again at all, but if we had adopted that legislation, we might have had other difficulties, but we would not be discussing this one. And it was not done because of spiritual pride because of some people—who incidentally are not here, they have all gone off to other pursuits—and we can do something important, though, in this legislation.

Mr. Sterley, who is either now at the Treasury or was, wrote a paper on the decline of the value of the personal exemption—income tax—in which he said if you—it was set in 1948 at $600. If that 1948 rate represented the same proportion of per capita income today, it would be $5,600. Just at CPI, it would be about $2,550. He said it is the largest single change that has taken place in the tax system in the post-war period, with the disappearance of the value—or the shrinking value—of the personal exemption. In 1948 we had an income tax system where a median income for a working family—they wouldn't start paying taxes until they were three-quarters through their income, and now they do it one-quarter. On the subject of poverty, however, we are not talking about working people in the main. The majority of the poor children in this country, as Ms. Bourdette said, are children in FEMA households and most of them are not working, and these are people outside the labor force and not assessible by normal means. But there is one thing that I would like to say, Mr. Chairman—I am making a speech here and not asking questions—it seems to me that the proposition that Monsignor Boxleitner made, and I believe Reverend Bergstrom referred to it, is that surely if we are going to deal with a poverty population, the majority of which are now and overwhelmingly the growing edge of is single family heads of households with children. They ought to have a zero bracket amount equal to husband and wife families. Do you not all agree with that and say that it is conspicuously illogical to give those who have the least less? If I hear you correctly on that, I would just like the record to show it. I think I know you agree.

Monsignor BOXLEITNER. Yes.

Ms. BOURDETTE. Senator, I would also agree that the zero bracket amount for single heads of households should be raised to that same amount allowed for married couples filing jointly in order to totally eliminate that disparity in our current Tax Code. And while the President's plan reduces that disparity, it doesn't eliminate it entirely, and the Economic Equity Act—and other legislation proposes to do that, and I think we should.

Senator MOYNIHAN. Mr. Hutchinson, do you agree?

Mr. HUTCHINSON. Yes, I agree. We think it is positive—to echo Ms. Bourdette's comments—that the President's proposal does narrow this gap, and that it raises the zero bracket amount to an extent that both types of families in poverty would no longer pay taxes. But the discrepancy begins to show itself at the threshold above the poverty level. A single-parent family of four would have to start paying taxes at $12,575, and a two-parent family of four would start at $12,800. There is still a discrepancy where they start paying taxes.

Senator MOYNIHAN. I think that is a point. I know, Mr. Chairman, that you recognized the anomaly, and if we do nothing else, we will tend to that, I think. Thank you, Mr. Chairman.

The CHAIRMAN. Let me ask Monsignor Boxleitner about your suggestion of raising the maximum tax to 45 percent. The House is apparently toying with 40 percent. When it comes to taxing the rich, there is a limit to the amount of money we can get. It may give our soul some satisfaction, but in terms of the quantity of money that it raises, there is neither a great deal of money to be raised by taxing the poor—those below the poverty line—there just isn't much to be raised, nor by taxing the very rich. And the figure I have used often is the one that if we were to confiscate all income above $100,000—and I don't mean taxable income, I mean gross income—we would raise about $100 billion once because no one would make over $100,000 after the first year. So, in a perfect world where we were setting the rate once—and assuming no tax shelters, because that is the way you avoid the high tax rate, by putting your money in municipal bonds or real estate or a variety of legal devices that Congress has passed to encourage what we regard as worthy social or economic behavior. Where would you put the rate—effective rate—of taxation on those who make above $100,000? Is 45 percent a fair amount? Would that have been an amount you would have argued for 3 years ago when the top rate was 70 percent and we dropped it to 50—to drop it to 45 or what?

Monsignor BOXLEITNER. First of all, Senator, let me confess I am basically a practitioner, so I may have to rely on my experts behind me. But I think we feel that the 45 percent at this point is equitable from out concept of distributive justice, in that people in this income bracket really can afford more taxes than they are paying, and I will defer to Mr. Ahmann if he has a comment on that.

The CHAIRMAN. For the purposes of the clerk, why don't you identify yourself so he will know who you are?

Reverend RYLE. Father Edward Ryle, executive director of the Arizona Catholic Conference. One of the fascinating things when you analyze the proposal is that the average tax reduction in the over $200,000 bracket, there is a little better than $9,000—way, way higher than the reduction in any other bracket. Second, in the $200,000 and above bracket, 71 percent of families get a tax reduction. That is a higher percent than in any of the lower brackets. Third, certainly you are absolutely right in suggesting there is not a lot of income to be recouped here. On the other hand, that doesn't necessarily exempt one from responsibilities in distributive justice. So, I think there are several reasons why a higher bracket is quite appropriate. The obligation, I would suggest, exists whether there is $30 or $3 billion of taxable income at that level.

The CHAIRMAN. And that is the question I was really asking. What is fair? Unfortunately, if we have to produce the revenues to run this country, we have to get the money from where the money is, and of course, that is in a great bulk of the middle income class because there are so many people in the middle income class. It is not for the sake of getting money that we tax the rich, as much as a sense of fairness or justice, as you call it. But do you think that 45 percent is a fair figure? Would that have been your figure 3 years ago when the rate was 70 percent and we were talking about tax reductions?

Reverend RYLE. I think historically it is fascinating that the Tax Reduction Act of 1981 was presented as an across-the-board tax reduction. I believe a 23 percent reduction took place after the top rate was lowered from 70 percent to 50 percent. So, the big gainers in 1981 were the highest taxpayers, at least in terms of the nominal tax rates. Certainly to give this bracket another big tax advantage after the Tax Reduction Act of 1981 flies in the face of a spirit of justice. A 45-percent rate, I think, is equitable if we consider that we are broadening the base in the President's recommendations. I think certainly that makes good sense. The thing that we do not deal with in our testimony and that you will be dealing with in these hearings later on is the question of the corporation rate reductions, and I realize the issues about who pays the corporations' tariffs, but given the fact that corporations work so hard to receive lower tax rates would suggest that at least they bear some part of the tax burden—the corporation tax. I think when you get into those issues—and I must admit that I realize the Democrats are the minority party in the Senate, but last night I read the report of the Democratic study group on the President's tax proposal. I thought its discussion of corporation taxes was quite fascinating and interesting, especially as it analyzed the President's version in comparision with Treasury I and examining some of the tax deductions—the oil and gas depletion allowances, for instance. That may be more of an answer than you were looking for.

The CHAIRMAN. I am just trying to find in a perfect world where the percentage is. I am always leary about taking percentages based upon last year's base. And we say the rich will get a disproportionate reduction. That may not be unfair if they were previously taxed disproportionately high. We are forever doing this on military versus social spending when it comes to the spending side. We say that the military went up *x* percent and social spending isn't going up at all or going up very slowly, but that discounts a tremendous change in our priorities from roughly about 1969 to 1977 or 1978, when the military spending went down every year as a proportion of real dollars, and social spending went up. At some stage, there is an end to any trend, and it would be, I think, unfair to say that the rich are getting too great a tax reduction if they were being taxed too highly to begin with. I am not sure that they were, but I am more curious to find out what you think is an ideal world because we may be in a position to set it, rather than is the rate reduction for the wealthy a higher percentage than the percentage rate reduction for the middle income brackets.

Reverend RYLE. I think that in answering that I would really want to look at some of the computer runs the Treasury Department did in developing the proposal for the President. I cited Aristotle in developing the written testimony. The concept of distributive justice developed by Aristotle was very strong in the Middle Ages and is in Catholic social thought. It makes much of the responsibility of the state to distribute both benefits and burdens of living in society on a proportionate basis. So, if one accepts conceptually the idea of distributive justice, then the prop rtionate allocations of the burdens of living in the United States and paying the expenses of doing business as a government, then I think the second job—and it is the job that you folks have—is translating the values of distributive justice into the numbers. Senator Moynihan, in his, I think, important Godkin lectures talks about the limits of social science in developing public policy. I think the role of policymakers like yourselves is to take the values and translate them into policy. I think much of what you are about in these hearings is making value judgments about distributive justice, and part of your success, I think, is going to be the extent to which you are virtuous people because making these value judgments——

The CHAIRMAN. You are the first witness that has ever even mentioned that possibility. [Laughter.]

Reverend RYLE. Well, I have been reading Aristotle and Aquinas lately, but the idea here would be that you can get these printouts from the Joint Committee on Taxation on the impact of the numbers on the different economic brackets. But making that judgment is going to be a function of the extent to which you internalize justice as well as your evaluation of the numbers.

The CHAIRMAN. Thank you. Senator Danforth?

Senator DANFORTH. Thank you, Mr. Chairman. I am sorry I wasn't here during your testimony. I got here a little bit late. If you were in the Senate and you were voting on the so-called Treasury II proposal, would you vote for it or against it?

Reverend RYLE. I would be selective. Certainly, I think on the issues of poverty, it is a major improvement. We have suggested in our testimony—all the witnesses have—a number of improvements. I think that there is basic concensus among all the witnesses on the panel that it is a major improvement over present law. I think it is also an improvement over Treasury I. So, in terms of the treatment of the poor, I think it is an improvement period. Does this sum up what the rest of your folks felt?

Reverend BERGSTROM. I would say, Senator Danforth, that if you tried everything else to balance off the kind of thing that Mr. Packwood was speaking about in terms of where were the poor and what happened to them in 1980 and 1981—not only in terms of taxes but programs that were cut out of the Federal budget which had a chance to earn money and participate in that—that if every effort was tried, then I think probably if I were sitting in your seat, I might vote for the plan, if it seemed that it was the best that could be secured. I wouldn't vote today.

Senator DANFORTH. Mr. Hutchinson?

Mr. HUTCHINSON. Senator Danforth, what we would look at is this: The President presented his proposal and said that this is the basis of a sound proposal. He urged the Senate Finance Committee and the Ways and Means Committee, as well as the American public, to shape the plan on the fringes. With respect to the low-income provisions, we feel that it is basically a good plan, but there are a number of modifications on the fringes that we have all suggested we would like to see take place. We must keep in mind that the President's proposal restores families in poverty to their 1980 tax status, essentially—a couple of hundredths of percentage points here and there, plus or minus, and as we realize that before 1981 the tax rate on the upper brackets was 70 percent and now would come in at 35 percent. Our question is: Where is the tax cut for poor families? If their position is going to be full circle from 1980 to 1986, then we think only in terms of equity and fairness that Congress needs to go a step further. He has provided us the direction. They have had their taxes doubled—more than doubled—since 1980 through inflation and the increase in payroll taxes. And now, we are just going to bring them back to where they are in the context of all of the cuts in social spending, etcetera, etcetera. So, I think that it is a good, sound program in terms of setting a direction, but as far as the low income provisions, we feel that they need to go a little further and give the poor its tax cut.

Senator DANFORTH. Would you vote for it or against it at this point? Ms. Bourdette?

Ms. BOURDETTE. I would certainly have to offer some amendments if I were on the Senate floor to improve it even further for low income families.

Senator DANFORTH. This is the final passage I am talking about. It has gone through all the amendments, and it is the third reading of the bill. You can either vote for it or against it. How would you vote?

Ms. BOURDETTE. I would have to study a lot of the other provisions, but certainly for low income families, it is a definite improvement, and we would favor those provisions in the President's tax plan. I am not in a position to comment on the corporate side or the high income side.

Senator DANFORTH. Let me ask you this. Treasury I had the effect of taxing some people into poverty or taxing people who were already in poverty. Does Treasury II move away from that? It is my understanding that, in this respect, people who are below the poverty line are not taxed. Is that correct?

Ms. BOURDETTE. Yes. Treasury II, or the President's plan, is an improvement even over Treasury I, and primarily that improvement focuses on the expansion of the earned income tax credit. Treasury I did not expand the EITC although it did index it. So, Treasury II—the President's plan—does move beyond the first proposal with respect to families in poverty. Also, the increase from Treasury I to Treasury II in the zero bracket amount is helpful for low income families.

Senator DANFORTH. But the effect, as I understand it, is that people who are below the poverty line would not be taxed if this proposal were put into law.

Ms. BOURDETTE. Families below the poverty line would be exempt from Federal income taxes under the President's proposal. It does not fully restore them to their previous position with respect to Social Security taxes, and they would still—many families—pay a hefty burden in Social Security taxes. One of the reasons we want to even expand the earned income tax a little further is to offset some more of their Social Security payroll taxes, but, yes, it does exempt families in poverty from income tax.

Senator DANFORTH. Thank you, Mr. Chairman. I have no further questions.

The CHAIRMAN. Senator Symms?

Senator SYMMS. Thank you very much, Mr. Chairman. I want to thank all the witnesses for their contribution to our hearings. I don't have any questions at this time.

The CHAIRMAN. Senator Moynihan?

Senator MOYNIHAN. Thank you, Mr. Chairman. Once again we appreciate the opportunity to hear from you and hear some positive statements about elements in the bill. I think it is fair to say that not since family assistance plans were proposed by Mr. Nixon, has a President come forward with as large a set of specific proposals that would change in a very dramatic way, the income of persons who are poor or near poor. May I ask if you would nod agreement?

[Whereupon, the witnesses nodded in the affirmative.]

Senator MOYNIHAN. And you also nod a measure of surprise, do you not?

[Whereupon, the witnesses nodded in the affirmative.] [Laughter.]

Senator MOYNIHAN. It is a pleasant surprise, is it not?

Reverend BERGSTROM. I would like to say one other word of unity about this panel, Mr. Chairman. We think there is just as much virtue behind that table of Senators as there is at this table, and we are here to share with you concern. We expect good action there, as we know has come in the past, especially when you have to disagree about the final vote that Mr. Danforth mentioned.

Senator MOYNIHAN. Reverend Danforth regularly prays for us, and it does show. [Laughter.]

The CHAIRMAN. I was struck by realizing that you did not prepare your testimony together—the striking similarity of the recommendations and the questions you had—all four of you. Almost any one of you could have testified for all four. Ninety percent of it was the same. It is most intriguing that you come from different backgrounds and different groups and come to the same conclusions.

Ms. BOURDETTE. Thank you, Mr. Chairman.

The CHAIRMAN. Are there any other questions?

[No response.]

The CHAIRMAN. Thank you very much. Next, we will take a panel of Joseph M. Trevino, the executive director of the League of United Latin American Citizens; Stanley Hill, the associate director of the District Council 37 of the American Federation of State, County, and Municipal Employees; and Robert Greenstein, the executive director of the Center on Budget and Policy Priorities. Unless you have objections, we will simply take you in the order that you appear on the witness list, and we will take Mr. Trevino first.

STATEMENT OF JOSEPH M. TREVINO, EXECUTIVE DIRECTOR, LEAGUE OF UNITED LATIN AMERICAN CITIZENS, WASHINGTON, DC

Mr. TREVINO. Thank you very much, Mr. Chairman. Good morning, Mr. Chairman and distinguished members of the committee. For the record, my name is Joseph M. Trevino. I am executive director of the League of United Latin American Citizens, the Nation's oldest and largest Hispanic membership organization in the country with over 110,000 members in 40 States. I am grateful for this opportunity to present LULAC's perspective on the issue of the impact of the present tax reform proposal on the poor, and I would like to thank the honorable chairman, Bob Packwood, for inviting LULAC to testify today on behalf of our constituents specifically and Hispanic Americans generally.

LULAC has a 56-year history of seeking equal educational, political, social, and economic opportunity for all Hispanic Americans. Through our own activities and joint efforts with civil rights, minority, and women's organizations, we are committed to advancing the cause of Hispanic Americans and other disenfranchised people.

Mr. Chairman, I will summarize the points in my testimony. They are included on the summary page. Apart from commending and applauding the President and Secretary Regan, whom we have had the opportunity to meet with over the last couple of months, I would just like to point out that we think it is an improvement over the present tax program, and we have applauded it, and we would just like to point out certain things—at least from our perspective—we think would improve it:

Persons under $10,000 per year would save $30. Persons earning $600,000 will save $59,000 or enough to fund a lifetime of free school lunches for 20 needy children.

Because capital gains will not be taxed if they are offset by inflation, the typical stock market or real estate speculator will never pay any tax. Inflation, for example, has easily outpaced stock market gains since 1970.

It is unfair to tax the first $300 per annum of families' health benefits. If we are to tax health benefits at all, it should only be the luxury, chief executive type health packages that have helped cause runaway medical costs.

There should be no deduction for business meals in excess of $50 a day, particularly when unemployment compensation, insurance, workmen's compensation, and health benefits are taxed.

The corporate tax should be revised so that corporations eventually contribute as much to the Treasury as Social Security payments. The President's proposed reform would allow corporations to contribute one-third as much as Social Security. Mr. Chairman, I welcome any questions. Thank you for the opportunity to testify.

The CHAIRMAN. Thank you, Mr. Trevino. Mr. Hill?

[The prepared written statement of Mr. Trevino follows:]

STATEMENT OF JOSEPH M. TREVINO, EXECUTIVE DIRECTOR
LEAGUE OF UNITED LATIN AMERICAN CITIZENS (LULAC)
ON THE IMPACT OF THE PRESIDENT'S TAX REFORM PROPOSAL ON THE POOR
BEFORE THE SENATE COMMITTEE ON FINANCE
JUNE 17, 1985

GOOD MORNING MR. CHAIRMAN AND DISTINGUISHED MEMBERS OF THE COMMITTEE. FOR THE RECORD, MY NAME IS JOSEPH M. TREVINO AND I AM EXECUTIVE DIRECTOR OF THE LEAGUE OF UNITED LATIN AMERICAN CITIZENS (LULAC), THE NATION'S OLDEST AND LARGEST NATIONAL MEMBERSHIP ORGANIZATION, WITH OVER 110,000 MEMBERS IN 40 STATES. I AM GRATEFUL FOR THIS OPPORTUNITY TO PRESENT LULAC'S PERSPECTIVE ON THE ISSUE OF THE IMPACT OF THE PRESIDENT'S TAX REFORM PROPOSAL ON THE POOR, AND I WOULD LIKE TO THANK THE HONORABLE CHAIR, BOB PACKWOOD, FOR INVITING LULAC TO TESTIFY TODAY ON BEHALF OF OUR CONSTITUENTS SPECIFICALLY AND HISPANIC-AMERICANS GENERALLY.

LULAC HAS A 56-YEAR HISTORY OF SEEKING EQUAL EDUCATION, POLITICAL, SOCIAL AND ECONOMIC OPPORTUNITY FOR ALL HISPANIC-AMERICANS. THROUGH OUR OWN ACTIVITIES AND JOINT EFFORTS WITH CIVIL RIGHTS, MINORITY AND WOMEN'S ORGANIZATIONS, WE ARE COMMITTED TO ADVANCING THE CAUSE OF HISPANIC-AMERICANS AND OTHER DISENFRANCHISED PEOPLE.

IN APRIL 1981, LULAC AND TEN OTHER HISPANIC ORGANIZATIONS WROTE SENATOR PETE V. DOMENICI, IN HIS CAPACITY AS CHAIRMAN OF THE SENATE BUDGET COMMITTEE. AT THAT TIME, THE HISPANIC COMMUNITY AGREED GENERALLY WITH THE PRESIDENT'S PROPOSED "ECONOMIC RECOVERY PACKAGE". WE DID, HOWEVER, VOICE OUR CONCERN THAT THE PRESIDENT'S ECONOMIC AND BUDGET PROPOSALS WOULD CAUSE OUR COUNTRY TO SUFFER ADDITIONAL ECONOMIC AND SOCIAL PRIVATIONS WHICH WOULD ONLY LEAD TO MORE FINANCIAL AND INTERNAL INSTABILITY.

TODAY, LULAC ASSERTS THAT AMERICA'S ALTRUISTIC CONSCIENCE HAS BEEN AWAKENED BY THE VISION OF SCORES OF HOMELESS PERSONS ON THE STREETS OF EVERY MAJOR URBAN CENTER, THE NEVER-ENDING LINES OF UNEMPLOYED AND UNDEREMPLOYED ADULTS, AND THE WASTE OF OUR NATION'S MOST PRECIOUS NATURAL NATIONAL RESOURCE -- THE CHILDREN.

LULAC MAINTAINS THAT REDUCTIONS CAN AND SHOULD BE MADE IN AREAS OF THE BUDGET WHICH, INDEED, REFLECT WASTEFUL EXPENDITURES AND DO NOT MAXIMIZE THE FEDERAL INVESTMENT. YET, WE CAN ILL AFFORD TO ADOPT ANY POLICY WHICH FAILS TO OPTIMIZE THE RESOURCES AND POTENTIAL OF ALL OUR PEOPLE, PARTICULARLY WHERE A LACK OF INVESTMENT IN HUMAN RESOURCES WOULD RESULT IN GREATER OVERALL SOCIO-ECONOMIC COSTS.

IT IS TO THIS GREATER OVERALL SOCIO-ECONOMIC COST THAT WE SPEAK THIS MORNING.

MR. CHAIRMAN, HISPANICS HAVE HAD AND CONTINUE TO HAVE SOME OF THE HIGHEST LEVELS OF POVERTY, UNEMPLOYMENT, AND SCHOOL DROP-OUT RATES. FOR EXAMPLE, IN 1979, 3,000,000 HISPANICS EXISTED ON INCOME LEVELS BELOW THE "POVERTY LINE". IN 1980, THAT FIGURE INCREASED BY 500,000 PERSONS. IN 1982, 28.4 PERCENT OF THE HISPANIC-AMERICAN POPULATION LIVED ON INCOMES BELOW THE POVERTY LINE. IN 1983, 4,249,000 HISPANIC-AMERICANS (ABOUT 30 PERCENT) LIVED BELOW THE POVERTY LINE.

FROM 1980 THROUGH 1984, UNEMPLOYMENT RATES FOR HISPANIC-AMERICANS HOVERED IN THE LOW TEENS (FROM 10.4 PERCENT TO 13.7 PERCENT).

ADMITTEDLY, THE MEDIAN INCOME OF HISPANICS HAS RISEN SLIGHTLY FROM $16,750 TO $16,956. BUT TAX RELIEF, IN THE FORM OF LARGER DEPENDENT DEDUCTIONS, MORE EQUITABLE TAX RATES, OR FREEDOM FROM EXCISE TAXES HAS NOT BEEN FELT.

MR. CHAIRMAN, OVER THE PAST FOUR YEARS LULAC HAS ASSESSED THE IMPACT OF BOTH EXECUTIVE BRANCH ECONOMIC POLICY AND SO-CALLED TAX REFORM MEASURES ON HISPANIC-AMERICA. I WILL SUBMIT THIS COMPILATION OF REPORTS FOR YOUR REVIEW AND FOR THE RECORD.

IN ADDITION TO THE ATTACHED TESTIMONY, LULAC WOULD LIKE TO POINT OUT THE FOLLOWING DEFICIENCIES IN THE PRESIDENT'S PLAN THAT MAKE IT UNFAIR TO MOST AMERICANS:

1. PERSONS EARNING UNDER $10,000 PER YEAR, WILL SAVE $30; PERSONS EARNING $600,000 WILL SAVE $59,000, OR ENOUGH TO FUND A LIFE-TIME OF FREE SCHOOL LUNCHES FOR 20 NEEDY CHILDREN.

2. BECAUSE CAPITAL GAINS WILL NOT BE TAXED IF THEY ARE OFFSET BY INFLATION, THE TYPICAL STOCKMARKET OR REAL ESTATE SPECULATOR WILL NEVER PAY ANY TAX. INFLATION, FOR EXAMPLE, HAS EASILY OUTPACED STOCKMARKET GAINS SINCE 1970.

3. IT IS UNFAIR TO TAX THE FIRST $300 PER ANNUM OF A FAMILY'S HEALTH BENEFITS. IF WE ARE TO TAX HEALTH BENEFITS AT ALL, IT SHOULD BE ONLY THE LUXURY CHIEF-EXECUTIVE TYPE HEALTH PACKAGES THAT HAVE HELPED CAUSE RUNAWAY MEDICAL COSTS.

4. THERE SHOULD BE NO DEDUCTION FOR BUSINESS MEALS IN EXCESS OF $50 A DAY, PARTICULARLY WHEN UNEMPLOYMENT INSURANCE, WORKMAN'S COMPENSATION, AND HEALTH BENEFITS ARE TAXED.

5. THE CORPORATE TAX SHOULD BE REVISED SO THAT CORPORATIONS EVENTUALLY CONTRIBUTE AS MUCH TO THE TREASURY AS SOCIAL SECURITY PAYMENTS. THE PRESIDENT'S PROPOSED REFORM WOULD ALLOW CORPORATIONS TO CONTRIBUTE ONE THIRD AS MUCH AS SOCIAL SECURITY.

THANK YOU VERY MUCH.

December 4, 1984

President Ronald Reagan
The White House
Executive Office
1600 Pennsylvania Avenue, N.W.
Washington, D.C. 20500

Re: Hispanics Support Tax Simplification and Reform

Dear Mr. President:

The League of United Latin American Citizens, this nation's largest Hispanic membership organization (109,000 members in 43 states), commends the Secretary of the Treasury Donald Regan for his recent tax simplification reforms and proposals.

In addition to our commendations and general support, we would like to urge some modifications consistent with the general objectives sought by tax simplification and fairness.

Tax All Social Security Earnings:

We believe that any tax reform is inadequate unless it deals with this nation's most regressive and inequitable tax, the $200 dollar a year social security tax. At present, the chief executive of a "Fortune 500" corporation is taxed for social security purposes at a rate just one-tenth that paid by the typical American earning $20,000. (That is, a chief executive earning $400,000 pays that same social security tax as a person earning one-tenth that amount.)

The fairest way to address this issue is to propose legislation that would tax all earnings at the same rate. According to a February 4, 1983, Social Security actuarial study, a tax on all earnings would generate $178 billion in additional revenue over the next six years and, it is estimated, would generate an additional $1.1 trillion over the next twenty years.

Such a flat tax generating $1.1 trillion in additional revenue would have three advantages:

1. It would avoid the need for cutbacks in Medicare and ensure that your pledge not to cut future social security benefits could, in fact, be honored by future Presidents.

2. It would create a surplus of social security revenue over expenses that could be used to help reduce federal budget deficits.

3. It is the key to implementation of true tax reform, since it is unfair to lower the maximum tax rate substantially (from 50 to 35 percent), while continuing to tax 90 percent of Americans at a social security rate 10 times higher than that paid by the wealthy.

Mortgage Deductions are Unfair to Renters, the Elderly and the Vast Majority of Homeowners:

At present, we lose $26 billion per year due to the home mortgage deductions. This deduction discriminates against the one-third of the nation that are renters and the elderly who have paid off their mortgages. It also provides windfall benefits to the wealthy with $400,000 mortgages.

In addition, home mortgage deductions artificially inflate the cost of homes, help maintain interest rates that are more than double the inflation rate, and increase environmentally expensive suburban sprawl at the expense of inner cities.

We therefore propose that the home mortgage deduction, in the interest of tax simplification and fairness, be eliminated.

Charitable Deductions Primarily Benefit Elite Institutions:

The Hoover Institute, an organization you are an honorary member of, contends that there would be no reduction in charitable giving if the charitable deduction were eliminated. We concur.

In any event, it is clear that contributions to religious institutions and most charities that assist the poor are unaffected by the charitable deduction. The primary beneficiaries, if any, of the charitable deduction are elite institutions, such as art museums and opera societies, that offer little benefit to the vast majority of Americans and are of no benefit to the poor.

Deductions Should Have the Same Tax Value for All:

In general, we oppose any deductions, no matter how laudable, including any interest deductions. However, if there are to be any deductions, we believe that the middle class should receive the same tax benefits as the wealthy for any particular deduction. Therefore, all deductions should be based on the same tax rate or 15 percent. It is unfair for a wealthy taxpayer in the proposed 35 percent bracket to receive more than twice as much in tax benefits for each dollar expended as a person in the 15 percent tax bracket.

Larger Dependent Deduction from Tax:

The proposed $2,000 per dependent deduction from tax should be raised to $3,000 per dependent. This is more in line with the actual minimal costs per annum per child.

Corporate Fair Share:

In 1950, the individual and corporate income taxes each contributed the same amount of revenue. (Each provided the federal treasury with $17 billion.) And during the Eisenhower years, the corporate tax constituted approximately 25 percent of all revenues. Today, the corporate tax is virtually non-existent. For the last year, corporations contributed less than 8 percent of all federal revenue, and almost one-third of the 250 largest corporations paid no federal corporate tax at all.

In general, we support proposals to increase the percentage of taxes paid by corporations. However, we believe the corporate tax rate should be structured so that on the average it contributes its historic Eisenhower years average of 25 percent of all federal revenue. The Treasury's proposal would only ensure that corporations contribute 10 to 12 percent of all federal revenue.

In summary, the Hispanic community applauds Secretary of the Treasury Donald Regan for his efforts, and hopes and expects to play a major role in further simplifying the tax system so that any tax reform can enjoy the widespread support of most Americans.

Sincerely,

MARIO OBLEDO
National President
League of United Latin
American Citizens

STATEMENT OF STANLEY HILL, ASSOCIATE DIRECTOR, DISTRICT COUNCIL 37, AMERICAN FEDERATION OF STATE, COUNTY, AND MUNICIPAL EMPLOYEES, NEW YORK, NY

Mr. HILL. Good morning, sir. I am Stanley Hill, the associate director of District Council 37 in New York of the American Federation of State, County, and Municipal Employees, representing 117,000 public employees in New York City. I want to thank you, Mr. Packwood, for giving me an opportunity to present my views, and I just want to say that we not only represent 117,000 public employees in New York City, but tens of thousands of our members are low income wage earners. They are hospital workers, school aids, crossing guards, food service workers, and clerks.

The CHAIRMAN. Let me ask you one quick question. You have 117,000 AFSCME employees in New York City?

Mr. HILL. That is correct, sir.

The CHAIRMAN. I am curious—is that one local?

Mr. HILL. No; it is a combination of 55 different locals within District Council 37. AFSCME wants reform of our loophole-ridden Federal income tax system. It is our members who are largely shut out of the 1981 tax cuts. The tax burden on our members has been rising. For these members, tax reform is a crying need, but the President's proposal taken as a whole is not a fair tax reform. It will increase the overall burden borne by low income wage earners and worsen the plight of the poorest citizens of this country. The President's plan would still leave many poverty level workers with a Federal tax burden that is three times what it was in 1979. We agree that an increase in the earning income tax credit and standard deduction must be part of any fair tax reform plan, but that isn't enough. It isn't enough because upper income taxpayers will be getting tax cuts that are nearly twice the average wage of our members.

Another fairness issue is the deduction for State and local taxes. We must consider the impact of this proposal on the total tax system and indeed on the total service delivery system of this country in order to fully understand its impact on low income families. Some States will gain, and some States will lose from the elimination of deductibility. The President wants us to believe that the States that will lose are spendthrifts. The President wants to pit one region of the country against another. After all, everyone knows that New Yorkers are strange folk, but there are very real differences in the way States treat their poorest citizens.

We see that 11 of the 17 losing States on deductibility provide maximum AFDC grants that are at least 90 percent of their own established standard of need. In contrast, 17 of the 34 States that are considered winners on deductibility pay AFDC recipients only 75 percent or less of their standard needs. New York, California, Delaware, Hawaii, Minnesota, New Jersey, Oregon, and Rhode Island all provide 100 percent of the standard of need and all will be penalized. At the other end of the spectrum, Alabama, Louisiana, Mississippi, and Texas all provide less than 40 percent of the standard of need, and they will be rewarded. Do we really want the entire country to go down to an AFDC payment of $120 a month? It may not happen today—after the President's tax bill is passed—

but I am sure that there would not be an AFDC inflation adjustment in New York for a very long time if deductibility is eliminated.

And eliminating deductibility will also hurt the working poor, low income taxpayers. These people are not Federal itemizers, but they pay Federal, State, and local taxes. The more regressive the State and local tax system, the greater the burden on low income wage earners. A married couple with two children and a $17,500 income level actually pays more State taxes in Alabama or West Virginia than New York. That family pays less State taxes in California, Michigan, or Delaware—all big losers from the elimination of deductibility—than in Mississippi or Arkansas. Even though the total taxes are lower in the regressive tax States, low income wage earners actually pay higher taxes.

If you eliminate deductibility, progressivity in State and local taxes will end. Upper income taxpayers will not accept the greater share of the burden if it cannot be offset against Federal taxes. The gains to low income wage earners under the President's plans have to be considered against the very real service cuts and higher State and local taxes that these same people will face. For a larger share of the tax burden, they will have poorer schools for their children, closing of public hospitals, reducing police and fire protection. For the neighborhoods, cutbacks in safe housing codes, less frequent trash collections, and unrepaired streets. If this is the way it is to be, then I think we should all pick up our pens and cross off the word "fairness" from the cover of the President's proposal.

I want to thank the committee. I also want to introduce Iris Lav, our Assistant Director of our Public Policy Department in AFSCME. Thank you very much.

The CHAIRMAN. It is good to have you with us. Mr. Greenstein?

[The prepared written statement of Mr. Hill follows:]

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STATEMENT OF

STANLEY HILL
ASSOCIATE DIRECTOR

DISTRICT COUNCIL 37
AMERICAN FEDERATION OF STATE,
COUNTY AND MUNICIPAL EMPLOYEES

ON

LOW INCOME ISSUES IN THE PRESIDENT'S
TAX REFORM PROPOSAL

BEFORE THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

JUNE 17, 1985

I am Stanley Hill, Associate Director of District Council 37 of the American Federation of State, County and Municipal Employees, representing some 117,000 public employees in New York City. D.C. 37 represents the gamut of public employees, but tens of thousands of our members are low-income wage earners; they are hospital workers and school aids and school crossing guards, and food service workers and clerks.

On behalf of D.C. 37 and our International Union, I want to thank you for this opportunity to present our thoughts today on how both the very poor and low-income wage earners will fare under the Administration's tax reform proposal.

For the sake of all of our members, AFSCME and District Council 37 have for many years favored reform of our loophole-ridden federal income tax. It is our members who were largely shut-out of the 1981 tax reductions. The combined federal income and Social Security tax burden on our members, and particularly on our low-income members, has been rising. For these members, tax reform is a crying need, and some of the provisions in the President's proposal speak commendably to that need. But I also am here today to sound a note of caution and concern, because I believe that the President's proposal, taken as a whole, is not fair tax reform. It will increase the overall burden borne by low-income wage earners and worsen the plight of the poorest citizens of this country.

I would first like to speak to the strong points of the President's proposal, those with which we wholeheartedly concur.

Poverty Level Workers

As I am sure you know, the income tax threshold -- the level below which our federal income taxes are paid -- has slipped well below the poverty line in recent years. From 1975 through 1980, a family of four with earnings at the poverty level owed no federal income taxes. By 1984, a family of four with earnings of just $8,783 -- 86% of the poverty level -- was subject to federal income taxes. At the same time, the Social Security burden on low-income families has been increasing. A two parent, two child family with the proverty level income of $10,613 in 1984 paid $1,076 in combined federal income and Social Security taxes, or 10.1% of its income. Five years before, that family with earnings at the 1979 poverty line paid less than 2 percent of its income in federal taxes -- all in Social Security. I think everyone agrees that this situation is totally inequitable and demands reform.

The two most efficient and cost effective ways of remedying this problem are increasing the refundable Earned Income Tax Credit (EITC) and increasing the Zero Bracket Amount (standard deduction). And the best way to keep federal income and Social Security taxes from increasing in the future, as the poverty level increases with inflation, is by indexing these two features. We support and endorse the increase and indexing of the EITC and ZBA in the President's proposal and believe that these two features must be part of any fair tax reform plan. And while I am on the subject, I would like to take the opportunity to thank this Committee for the expansion of the EITC enacted last year.

But in the same breath that I praise these provision, I have to be ungrateful enough to ask how good is good. I have to question whether they go far enough. If we ignore the admittedly flawed current tax system and look back to 1979, we find that the President's proposal does not nearly restore the tax treatment of a poverty level family at that time. Table 1 shows a single-parent family of four at poverty level income in 1979 under the existing law, and in 1986 under the President's proposal. If the family did not make use of the child care credit in 1979, its combined federal income and Social Security tax would have been $288, or 3.9% of its income. If it had used the 20% child care credit then available on, say, $1,000 of child care expenses, its combined tax would have been $132, or 1.8% of its income. Under the President's proposal, the combined federal income and Social Security tax on an estimated 1986 poverty level income would be $638, or 5.6% of income.

Surely the single parent (usually a mother) who is struggling to be independent rather than dependent, who works full-time just to earn a poverty level wage, deserves to keep all of that to support her family. This is especially true given what has happened to other aspects of the tax system between 1979 and now. Even without this latest tax reform proposal, upper-middle and upper income taxpayers have already received large to huge tax reductions from the 1981 Act. The maximum tax rate has already been cut from 70% to 50%. This proposal would reduce it to 35%, just one-half of what it was prior to 1981. If one considers the cut in the capital gains rate that favors upper income taxpayers, I don't think anyone would be too surprised to find upper income taxpayers whose taxes as a percentage of income would be cut in half by this proposal relative to their 1979 taxes. After all, the Administration's proposal is reported to give President Reagan a $30,000 tax cut, just from current level. Please compare that with the poverty level single parent, whose taxes as a percentage of income may be 3 times what they were in 1979 under this proposal. I think we should all be sorely disappointed if a tax reform proposal of such sweeping scope as this one cannot find more room for equity than that.

At this time, I would like to comment on just a few of the specific equity issues behind the problems I see with this proposal: the taxation of employer-paid health insurance, the elimination of the child care credit, and -- one that is not usually considered a low-income issue -- the deductibility of state and local taxes.

Health Insurance

The President's plan would include in a worker's gross income the first $10 per month for single coverage or $25 per month for family coverage of employer-paid health insurance. For families working at poverty level wages, this is a significant added burden. In the example I just used of the single-parent family of four, $45 of the $638 combined federal income and Social Security tax burden is attributable to this specific provision ($24 of income tax and $21 of Social Security). It is all well and good to say that this amounts to just 4/10 of one percent of this person's income in additional taxes, but at this level of income every dollar counts. For a similar family at 125% of the poverty level, it would add $66, or 5/10 of income, to the federal tax burden. This is a regressive proposal. For a $50,000 earner already paying the maximum Social Security, the bite is less than 2/10 of one percent of income, and it is 1/10 of one percent of income for a $100,000 earner, despite the higher marginal tax rates. At a poverty level income, it is a proposal that will take food out of the mouths and shoes off the feet of children.

Child Care Credit

The change in the President's proposal from the child care credit to a child care deduction defies rational explanation on the grounds of fairness or ability to pay. It is impossible for a single parent or both parents in a family to work without adequate child care -- and most often that means paid child care. Child care is an expense of working and thus an important element of ability to pay. The current law credit recognizes that child care consumes a greater proportion of the earnings of low income workers by providing a sliding scale from a 30% credit at the lowest income level, phasing down to a 20% credit at $28,000 and above.

Transforming the child care credit to a deduction eliminates this ability to pay feature of the tax code for all lower-income and most middle-income taxpayers. Realistically, only those taxpayers with high mortgage interest expense will be itemizers under the President's proposal. Only they will get a tax offset for child care expenses. Furthermore, high income taxpayers are getting a windfall from this change. Think of the two-worker upper-income professional family with children. The credit now gives them a tax reduction of 20% of expenses up to $4,800 or $960. If the family is in the 35% bracket under the proposal, their tax reduction will be increased by 75%, to $1680. Yet the single parent, the proverty level earner, and the family in which it takes two incomes to reach 150% or 200% of the poverty level

-- in which child care costs may make the critical difference between being able to work and not being able to work -- will get nothing.

The change from the child care credit to a deduction is listed in the President's proposal as a net revenue loser. It is worse than that. It is a direct income transfer from lower income to higher income taxpayers who don't need this tax break to be able to work. We are totally opposed to this change and support the retention of the child care credit.

State and Local Taxes

The federal deductibility of state and local taxes is not usually considered a low-income issue, but it is indeed. The deductibility of state and local taxes affects the level of income maintenance and services provided by state and local governments to low-income residents, and it affects the relative proportion of the state and local tax burden that is borne by low-income residents. Just as it was important to look at the combined federal income tax and Social Security burden to determine the impact of the President's proposal on the federal taxes of low-income families, so it is also necessary to consider the impact of this proposal on the total tax system of the country to fully assess its impact on low-income families. The federal income tax does not exist in a vacuum.

The Administration claims that the deduction for state and local taxes benefits only high income people in the Northeast and

Midwest. It therefore argues that the Sunbelt should not have to "subsidize" the frost belt. This line of reasoning overlooks some very critical points.

There are two important determinants of whether the residents of a state gain or lose from eliminating deductibility. The one most discussed is the level of taxation. Residents of states where there is a relatively higher tax level tend to lose. This is the point that the President wants to stress, implying that high state/local taxation ought to be a punishable offense -- and this is the punishment. But there is another determinant that is equally important. The residents of states where taxes are more progressive -- where higher income residents bear a greater share of the tax burden -- also come out losers. I would like to comment on both of these factors, because on both counts low-income people living in relatively high tax states and in states with progressive tax systems have a great deal to lose from the elimination of deductibility.

First, I would ask you to consider why certain state and local governments have higher relative tax levels than others. Among jurisdictions, there is a demographic-based difference in the need for services, and there is a difference in how they choose to deal with that need.

The difference in the need for services depends on several factors that have little element of choice attached to them. They include:

a) The incidence of poverty (and the corresponding need for social services)

b) The proportion of school age children in the population

c) The age and condition of the public infrastructure (and hence the cost of maintaining it)

d) Prevailing wages (which themselves primarily reflect the local cost-of-living)

e) Population density (which affects the number of needed police and fire personnel)

f) The incidence of crime (which affects the cost of police, court, and correctional services)

g) Patterns of commuting to work and shopping (e.g., city taxpayers must often subsidize the cost of roads, police protection, etc., enjoyed by commuting workers).

However, jurisdictions do make some choices with regard to how well they fulfill the responsibilities that circumstances have thrust upon them.

I would like to use just one example, AFDC payments. AFDC payments affect those who cannot work, but low-income wage earners are only one layoff away from AFDC dependency. AFDC payment levels are totally determined by each state. The federal government only matches, by formula, what states choose to spend. Thus it is instructive to compare AFDC levels in those states that the Advisory Commission on Intergovernmental Relations (ACIR) says will lose from the elimination of deductibility to those that are said to gain. There are 16 states and the District of Columbia that are identified as losers.

Each state determines its own AFDC "standard of need" -- a bare subsistence level. States then have the additional choice of what proportion of that standard of need they will set as a maximum grant.

Of the 17 states (including D.C.) that will lose from the elimination of deductibility, 11 provide AFDC maximum grants that are at least 90 percent of their AFDC "standard of need."

In contrast, 17 of the 34 states that are considered net gainers from the elimination of deductibility provide AFDC payments that are 75% or less of their "standard of need".

So New York and California and Delaware and Hawaii and Minnesota and New Jersey and Oregon and Rhode Island -- all of which have shouldered their responsibilities to provide 100% of the "standard of need" that they have established for those in their states who have no alternatives -- will be penalized. At the other end of the spectrum, Alabama, Louisiana, Mississippi and Texas all provide less than 40% of the "standard of need" -- and they will be rewarded. We are not talking about an abstraction. What we are talking about is a family of four trying to live on $147 per month in Alabama or $120 per month in Mississippi. We are talking about whether children literally have something to eat and something to wear. And I am only using AFDC payments as an easily measured-example. What is true for

AFDC is generally true across the board for means-tested entitlements and services.

The point I am trying to make is a simple one, but one that seems to be lost in the rhetoric of deductibility. It is true that the taxpayers who will initially be hurt by the elimination of deductibility are middle and upper income itemizers, not lower income non-itemizers or those too poor to pay taxes at all. But it is equally true that deductibility, within a moderately progressive state tax system, is a critically important factor in the willingness of middle and upper income taxpayers to bear taxes -- the kind of taxes necessary to support income maintenance and social services for those citizens who cannot provide for themselves. I do not think it is overstating the case to say that the days in which there are states providing adequate income maintenance and social services would end with the elimination of deductibility. I would venture to say that there would be no increase in AFDC payments for a decade in New York, no adjustments for inflation, if you allow deductibility to be eliminated.

So far I have been talking about the impact of elimination of deductibility on the very poor. But elimination of deductibility will also hurt the working near-poor -- lower income taxpayers. These people are not federal itemizers, but they pay federal, state and local taxes.

Lower income wage earners are hurt to the extent that tax systems are regressive -- whether federal, state or local -- and helped to the extent they are progressive. A progressive tax system, as you know, is one that places a greater proportion of the tax burden on higher income taxpayers, those best able to bear that burden. Deductibility provides a strong incentive for the maintenance of more progressive tax systems at the state/local level; the more progressive the tax system, greater the share of state/local taxes that is likely to be deducted by itemizers, and so the greater the share borne by the federal government.

One way to look at the progressivity of state/local tax systems is by considering the ratio of taxes paid by high income taxpayers to those paid by low income taxpayers. A 1984 ACIR working paper computed the 1982 tax burden for a family of four residing in the largest city in each state at varying income levels. If we look at the 10 cities where residents enjoy the most progressive state/local tax systems (measured by the ratio of taxes paid by $100,000 earners to $17,500 earners as a percentage of income), seven of those ten are in states identified as losers from the elimination of deductibility. The seven states in the top ten of progressivity that stand to be penalized for a well designed tax system are: Minnesota, California, Delaware, Hawaii, New York, South Carolina and the District of Columbia.

A less progressive tax system means a higher tax burden for lower income wage earners. If we look at state income and sales taxes paid (and it is at the state level where there is opportunity for progressivity; most local governments are dependent on the property tax), I think you will note some surprising results. A married couple with two children at a $17,500 income level actually paid more state taxes in Alabama or West Virginia than in New York. That family paid less state taxes in California, Michigan or Delaware -- all big losers from elimination of deductibility -- than in Mississippi or Arkansas.

There is one more point in connection with progressivity. The Administration's plan does nothing to improve the overall progressivity of federal taxes; by its own figures it maintains the distribution of the tax burden as it now stands. If regressivity in state/local tax systems is to be rewarded, if the incentive for progressivity that deductibiity provides is to be eliminated, then the combined tax system in this country will become more regressive.

In light of these considerations, I would ask that you seriously consider the flip side of the deductibility argument. If the federal deductibility of state and local taxes provides a cross-subsidy from some states to others, it is a well deserved subsidy. It rewards those states that have chosen to adequately provide for their least fortunate residents, and it rewards those states that have achieved a progressive and equitable distribution of the tax burden among their population, that have avoided placing an undue burden on low income wage earners. The Administration is saying that high, progressive, tax states have the choice to make their tax systems less adequate and more regressive. Should we not preserve deductibility and say instead that states not now benefitting from that deductibility should strive to close the gap, by moving their tax systems toward adequacy and progressivity.

If this Administration's model is a state where a family with an income of $100,000 pays a smaller proportion of that income as taxes than a family with $17,500 of income, if this Administration's shining image is a state that provides 40 percent or less of a subsistence level to its AFDC recipients, then I think this country -- and most particularly this country's poor and struggling low-income wage earners -- is in dire trouble. The gains to low income wage earners under this plan have to be considered against the very real service cuts and higher state and local taxes that these same people will face. For a larger share of the tax burden, they will have poorer schools for their children, closed public hospitals, reduced police and fire protection for their neighborhoods, cutback enforcement of safe housing codes, less frequent trash collection, and unrepaired streets. I would ask the Committee to weigh and study the total impact of the plan, the total trade-off, before taking action.

<u>Alternatives</u>

I have tried to focus my testimony exclusively on certain of the low income issues in this tax reform proposal. But in looking at the alternatives, one must go beyond those issues. Using the 1990 revenue estimates in the President's plan, I note that the elimination of deductibility of state and local taxes raises $40 billion and the taxation of health insurance $4 billion. In the first instance, I would ask you to compare that $44 billion with the difference in the depreciation revenue gain in the President's plan as compared to Treasury's original plan. The difference is $53 billion -- $15 billion revenue gain in the President's plan versus $68 billion in Treasury's.

Second, I would ask that you give consideration to changing the personal exemption to a credit. While the increase in the personal exemption does provide some low income relief, and does help large families, it is a very expensive way to do so. The value of the personal exemption, a deduction to the taxpayer, increases as the tax bracket increases. Even with the revised tax brackets, there is a big difference between 15 cents on the dollar and 35 cents on the dollar. If the personal exemption were changed to a credit, the relief would be channeled more efficiently, and at a lower cost, to low and middle income families.

Finally, I would seriously question whether the maximum individual tax rate should be brought down to 35%. Why should those taxpayers who are best able to bear the tax burden have their tax rate cut in half, compared to pre-1981 levels, while the federal tax burden on some proverty level families has increased three-fold. If this is the way it is to be, then I think we should all pick up our pens and cross off the word "Fairness" from the cover of the President's proposal.

Table 1

Federal Tax Burden on a Single Parent
Family of Four with Poverty Level Wages
1979 and 1986 President's Proposal

	1979 w/o child care credit	1979 with child care credit	1986
Poverty Level Income, Family of Four	$7,412	$7,412	$11,457
Employer-paid Health Insurance			300
Gross Income	$7,412	$7,412	$11,757
Less: Personal Exemptions	4,000	4,000	8,000
Standard Deduction	2,300	2,300	3,600
Taxable Income	$1,112	$1,112	157
Income Tax Liability Before Credits	156	156	24
Less: Child Care Credit		200	
Less: EITC	322	322	227
Income Tax	-166	-322	-203
Social Security Tax	454	454	841
Total Federal Tax	288	132	638
Federal Tax as Percent of Income	3.9%	1.8%	5.6%

Source: 1979 data from Children's Defense Fund, The Impact of Federal Taxes on Poor Families. 1986 data calculated by AFSCME.

Table 2

Examples of 1982 State Tax Burden
on $17,500 Income Family of Four

	State Individual Income Tax	State General Sales Tax	Total State Tax
Gainers from Elimination of Deductibility			
Mississippi	16	325	341
Alabama	268	226	494
Arkansas	184	186	370
West Virginia	252	202	454
Losers from Elimination of Deductibility			
New York	256	183	439
California	116	208	324
Michigan	-135	184	49
Delaware	321	0	321

Source: Advisory Commission on Intergovernmental Relations, "Tax Burdens for Families Residing in the Largest City in Each State, 1982." State Working Paper #3, April 1984.

STATEMENT OF ROBERT GREENSTEIN, EXECUTIVE DIRECTOR, CENTER ON BUDGET AND POLICY PRIORITIES, WASHINGTON, DC

Mr. GREENSTEIN. Thank you, Mr. Chairman. I am Robert Greenstein, Director of the Center on Budget and Policy Priorities, a nonprofit research and analysis organization. I appreciate the opportunity to be here today. Mr. Chairman, we believe that the extent to which any reform proposal addresses the increased tax burdens on the working poor must be one of the primary standards by which the entire proposal is judged. By this standard—although we have some concerns in other areas—the President's proposal is a distinctly positive one. To grasp how badly tax reform for the working poor is needed, I would like to briefly comment on how much the tax burdens of the poor have increased since the late 1970's.

A family of four with earnings equal to the poverty line paid $134, or 2 percent of its income, in Federal income and payroll taxes in 1979. Today, that family pays $1,147, or more than 10 percent of its income. Adjusting for inflation, this means that the total Federal tax burden on these families is more than five times what it was just 6 years ago. The Federal Government is taxing away a significant amount of income from people who, by its own definition, don't have enough to live on. As you know, people below the poverty line also are taxed at present. In 1979, the tax threshold for a family of four was over $1,200 above the poverty line. Today, it is $1,500 below the poverty line. For a family of six, the tax threshold today is $4,000 below the poverty line. We see the same kind of story if we look at Census data. In 1982, the latest year for which the data are available, there were 3.2 million families whose gross incomes were above the poverty line, but who were pushed into poverty by their Federal tax obligations. From 1980 to 1982, the number of families below poverty that had to pay Federal income tax more than doubled. The amount of income taxes collected from this group rose over 100 percent just in that 2-year period. The President's proposal addresses this problem through its changes in the Zero Bracket Amount, the Earned Income Tax Credit, and the personal exemption. We have some analysis of how this would work in our testimony, which I will pass over for the oral statement. The relief is very substantial, very important, very welcome, and very overdue. I would mention, however, the Federal tax burdens for large numbers of working families would still remain somewhat above the levels of the late 1970's. For example, a family of four at the poverty line would pay about 5 percent of its income in Federal income and payroll taxes in 1986, which is above the 4 percent in 1978, or the 1.8 percent it paid in 1979. By contrast for most taxpayers, the cuts embodied in the proposal would be on top of previously enacted cuts and they would be paying lower percentages of income than in the late 1970's. The working poor would be one of the few groups still paying a slightly higher percentage.

While we are strongly supportive of the overall treatment of low income persons in the plan, we do want to raise a few concerns. First, the relief appears to be inadequate to those of the working poor who don't qualify for the Earned Income Tax Credit, such as single individuals and married couples without children. Senator

Danforth asked a minute ago if everyone below poverty would be exempt from income tax. They would not. Single individuals who are not elderly or disabled would still have to start paying Federal income taxes at a point $800 below the poverty line. Poor people without children, already suffer from relatively harsh treatment by Federal and State governments since they don't qualify for AFDC or SSI or Medicaid or any Federal cash assistance. The Tax Code ought not to exacerbate the difficult situation they face. Single persons ought not to be the one group of the poor taxed deeper into poverty despite the fact that they are working. We suggest the committee explore the possibility of tailoring some type of tax credit to relieve the undue tax burden on working poor individuals to ensure that they won't have to pay taxes if they are below the poverty line. It is not easy to tailor such a credit, but if it could be properly tailored and targeted, it would have a very small revenue effect.

Second, we are concerned about large working poor families. If you are a family of six or more, you can be below the poverty line but not qualify for the Earned Income Tax Credit under the President's plan because the tax credit isn't family-size adjusted. As a result, those families would still be paying over 7 percent of income in payroll taxes, and we think it would be consistent with the overall profamily thrust of the reform if the committee could explore modifying the EITC to make it sensitive to family size. We would also hope the committee might look at scheduling an increase in the EITC to correspond with the scheduled increases in Social Security payroll taxes for later in the decade. One final point we would make—is that we are concerned, as were the other witnesses, about the effect on lower income workers of the fringe benefit proposal. Without going into the details, let me add an additional point. We are concerned about the possible interaction of that proposal with means tested benefit programs. It would depend on how that change was written into the law and administered. We would hate to see the imputed $300 of fringe benefits counted as $300 of income as regards public assistance—housing and things of that sort—and thus lower families' benefits from means tested programs. I will close by saying we also have some analysis which I will just submit in the testimony of the impact on the wealthiest families. Our analysis, using Treasury data, shows that the reduction in taxes would be over $9,000 apiece, and that while it is true that as a percentage reduction in taxes, this is comparable to some other income groups, as a percentage of income, the reduction would be four to five times larger than for any other group. It is also interesting to note that in dollar terms the tax cuts for those above $200,000 a year is more than 13 times the cut for those in the nearest group—from $100,000 to $200,000 a year—and that warrants some investigation. Thank you.

The CHAIRMAN. Thank you.

[The prepared written statement of Mr. Greenstein follows:]

TESTIMONY OF ROBERT GREENSTEIN

DIRECTOR, CENTER ON BUDGET AND POLICY PRIORITES

before the

SENATE COMMITTEE ON FINANCE

June 17, 1985

Mr. Chairman and Members of the Committee, I'd like to thank you for the opportunity to testify before the Committee today on the subject of federal tax treatment of low income persons. I am Robert Greenstein, director of the Center on Budget and Policy Priorites, a non-profit research and analysis organization that focuses on federal policies affecting low and moderate income persons. With me today is David Kahan, who specializes in the area of taxation at the Center.

No segment of the population is more deserving of tax reform, nor in more dire need of it, than the working poor. The extent to which any reform proposal addresses the problem of the increased tax burdens on the working poor must be one of the primary standards by which the entire proposal is judged.

By this standard, President Reagan's proposal is a distinctly positive one. It significantly reduces the tax burden on poor working families, and it accomplishes most of the goals that are necessary to offset the massive tax increases imposed on low income working families in recent years. While we do have some concerns about certain aspects of the Administration's proposal, both in its treatment of certain groups of the working poor and in several other areas, we are, on the whole, favorably impressed by the President's proposal. We regard this proposal as the most significant piece of anti-poverty legislation that President Reagan has submitted to Congress.

To grasp how badly tax relief for the working poor is needed, one need only examine how much tax burdens on the poor have increased since the late seventies. As the Committee knows, taxes for poor working families have increased dramatically over the last several years. No other group of taxpayers had its taxes increase so much over this period.

For example, a family of four with earnings equal to the poverty line paid 134 dollars -- or 2 percent of its income -- in federal income and payroll taxes in 1979. By 1985, a family of four with earnings equal to the poverty line[1] will pay 1,147 dollars in federal income and payroll taxes. This amount is more than 10 percent of that family's income and the total federal tax burden on these families, after adjusting for inflation, is more than five times what it was just six years ago. The federal government is taxing away a significant amount of income from people who, by its own definition, do not have enough to live on.

Families with gross incomes well below the poverty line have also been affected. As recently as 1979, the income tax threshold, the point at which a family of four began to pay federal income tax, was over 1,200 dollars above the poverty line. By 1985 the tax threshold for a family of four has slipped to over 1,500 dollars below the poverty line. For larger familes the situation is even worse and a family of six now begins to pay federal income taxes at a point over 4,000 dollars below the poverty line. Further, poor families have been affected by the erosion of the

[1]Treasury Department inflation assumptions are used to project the poverty lines for 1985 and 1986. Using Congressional Budget Office assumptions, as does the Joint Committee on Taxation, would yield numbers that differ by less than $10 or one-tenth of one percent.

Earned Income Tax Credit due to inflation.

Census data reveal that in 1982 (the latest year for which these data are available) there were 3.2 million families whose gross income was above the poverty line but who were pushed into poverty by their federal tax obligations. Further, from 1980 to 1982 the number of families below the poverty line who had to pay federal income tax more than doubled and the amount of income taxes collected from this group rose over 100 percent. As the position of the tax threshold relative to the poverty line has deteriorated even further since 1982, I have little doubt that as more recent data become available, they will show that the effects of rising tax burdens on the poor have been even sharper.

The President's proposal addresses this problem. By increasing the personal exemption and the zero bracket amount and by increasing and indexing the Earned Income Tax Credit, the proposal would end income tax liability for most poor families. The poor family of four in our example would owe no federal income taxes in 1986 and would have recent increases in its payroll tax partially offset, if the proposal were enacted. The result is that instead of paying 1,212 dollars in federal income and payroll taxes in 1986, a family of four at the poverty line would pay 565 dollars, a reduction of over 50 percent. The following table illustrates the extent of the reduction for a variety of poor and near-poor families under the administration proposal.

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REDUCTION IN TAX LIABILITIES FOR WORKING POOR FAMILIES UNDER ADMINISTRATION PROPOSAL*

Federal Tax Burdens in 1986

	Earnings	Taxes Under Current Law	Taxes Under New Proposal	Change in Taxes
Earnings at 75% of poverty				
Family of 3 - single-parent	$6,706	$62	-$247	-$309
Family of 3 - married	6,706	-46	-247	-201
Family of 4 - single-parent	8,593	517	99	-418
Family of 4 - married	8,593	386	99	-287
Earnings at 100% of poverty				
Family of 3 - single-parent	8,941	751	133	-618
Family of 3 - married	8,941	610	133	-477
Family of 4 - single-parent	11,457	1,358	565	-793
Family of 4 - married	11,457	1,212	565	-647
Earnings at 125% of poverty				
Family of 3 - single-parent	11,176	1,450	753	-697
Family of 3 - married	11,176	1,288	693	-595
Family of 4 - single-parent	14,321	1,982	1,432	-550
Family of 4 - married	14,321	1,797	1,372	-425

*Note: Federal tax payments include both federal income and payroll taxes. Examples assume no itemized deductions. Minus sign indicates a refund. Poverty levels were computed by adjusting 1984 poverty levels by Treasury assumptions for changes in the Consumer Price Index for 1985 and 1986.

While this tax relief is substantial, it is important to note, however, that federal tax burdens for large numbers of working poor families would still remain above the levels of the late seventies. The family of four at the poverty line would pay 4.9 percent of its income in federal income and payroll taxes in 1986, which is significantly more than the 4 percent this family paid in 1978 or the 1.8 percent it paid in 1979. (Since this figure measures taxes as a per ent of income, it fully controls for inflation which affects the value of both taxes and income equally.) The following table shows that many poor and "near poor" families would still face tax burdens above the 1978 level.

Federal Taxes as a % of Income - 1978 vs. 1986

	1978	1986 Under Administration Plan
Family of three (married)		
100% of poverty	0.7%	1.5%
125% of poverty	4.0%	6.2%
Family of four (married)		
100% of poverty	4.0%	4.9%
125% of poverty	7.8%	9.6%

Thus, while for most taxpayers the cuts embodied in the President's proposal come on top of previously enacted cuts, and they would be paying lower percentages of income in taxes than they did in the late 1970's, the working poor would be one of the few groups still paying a higher percentage of income in taxes than it did in the late 1970's.

While we are strongly supportive of the overall treatment of low income persons in the President's plan, I do want to raise several concerns about the proposal as currently structured. First, this proposal offers modest -- and in some cases inadequate -- relief to those of the working poor who do not qualify for the Earned Income Tax Credit, such as single individuals or married couples without children. Though it removes nearly all other people below the poverty line from the income tax rolls, a poor single person who is not elderly or disabled would still need to pay federal income taxes at a point starting 800 dollars below the poverty line. Federal income and payroll taxes would consume 528 dollars from a modest 5,700 dollar income for a single individual in 1986 under the President's plan. This individual would pay over 9 percent of his income in total federal taxes, even though his or her income was at the poverty line.

Poor people without children already suffer from relatively harsh treatment by federal and state governments. They do not qualify for any federal cash assistance (such as SSI or AFDC), and they are not covered under the Medicaid program. The tax code ought not to exacerbate the already difficult situation they face. These persons ought not to be the one group of the poor who are taxed deeper into poverty despite the fact that they are working. We suggest that the Committee explore the possibility of tailoring some type of tax credit to relieve the undue tax burden on these working poor individuals and to ensure that they will not be subject to federal income tax if they fall below the poverty line. Such a credit, if properly targeted, would likely have very modest revenue effects.

One other group of poor persons who would receive somewhat inadequate relief are large working-poor families. Under the President's plan a family of six with earnings equal to the poverty line in 1986 would still pay nearly 1,100 dollars in total federal taxes as opposed to the 1,711 dollars that they would pay under current law. Although this tax relief of over 600 dollars is substantial, it still leaves this family paying 7.2 percent of its income in total federal taxes. This is because the Earned Income Tax Credit is not adjusted for family size and, as a result, large families have little or none of their payroll taxes offset. We suggest that it would be consistent with the overall pro-family thrust of this reform for the Committee to explore modifying the Earned Income Tax Credit to make it sensitive to family size.

We would also suggest that the Committee schedule an increase in the Earned Income Tax Credit to correspond with the scheduled increases in Social Security taxes in coming years. Absent such an expansion, all of the working poor will experience a tax increase in 1988.

We are also concerned that the proposal to tax as income the first 120 dollars a year in fringe benefits for an individual and 300 dollars a year for a family may affect a significant number of low and moderate income families. The original Treasury tax plan ("Treasury I") proposed to tax fringe benefits above specified levels. This proposal, though somewhat troublesome, would have left most of the working poor unaffected.

Instead, it would have primarily affected higher salaried employees who have extensive fringe benefit plans, and would have addressed the trend of employees' receiving an increasing share of their income in non-cash compensation. The fringe benefit provision contained in the new Administration plan does the reverse: It has little effect on those with extensive fringe benefit plans since most of their benefits would remain exempt from taxation, but it would affect many lower income working families whose benefits would have remained exempt under "Treasury I." This proposal would, in essence, erode the value of the personal exemption by increasing the taxable income of many working families. Taxing fringe benefits in this manner is regressive. Further, the additional payroll tax levied on these benefits would again disproportionately affect low and moderate income persons.

In addition, we are concerned about the interaction of this proposal with means-tested benefit programs. Depending on how this change in the tax laws is written and administered, poor people could suddenly have an additional 300 dollars of income imputed to them and could find their benefits for some social programs, from subsidized housing to public assistance, negatively affected. We urge the Committee to explore this possible interaction.

We also ask the Committee to carefully scrutinize what effect the proposal to end the deductability of state and local taxes would have on the provision of basic services to low and moderate income families at the state and local level.

While the President's proposal does provide substantial relief to poor working families, we should note that they are not the biggest gainers under the plan. To the contrary, it is the very richest members of society who would gain the most.

Those families whose economic incomes are above 200,000 dollars a year would receive an average tax reduction of 9,250 dollars apiece under the new plan. This stands in sharp contrast to the treatment of persons with less income. Persons with incomes below 30,000 dollars a year would realize average gains of less than 150 dollars a year. Middle class Americans in the 30,000 - 50,000 dollar range would receive average tax reductions of a little more than 200 dollars a year.

The Administration has noted that low income taxpayers will have their income taxes reduced by a larger percentage than taxpayers at higher income levels. While correct, this point masks another fundamental point: measured either in dollars or as a percentage of income, the tax cuts for the wealthiest taxpayers dwarf those for all other groups, including the poor. The following table shows the projected effect of the tax plan on various income classes.

Income Class	Average Income Tax Cut*	Average Income Tax Cut as % of Income	Average % Reduction in Income Taxes
Under $10,000	$ 104	0.5%	-35.5%
$10,000-$15,000	$ 128	0.7%	-22.8%
$15,000-$20,000	$ 132	0.6%	-13.5%
$20,000-$30,000	$ 149	0.6%	-8.7%
$30,000-$50,000	$ 211	0.5%	-6.6%
$50,000-$100,000	$ 252	0.4%	-4.2%
$100,000-$200,000	$ 686	0.5%	-4.1%
Over $200,000	$ 9,254	2.3%	-10.7%

*These figures represent average tax cuts by income class if the plan were in full effect for 1983. Treasury data on the effects of the tax proposal by income class are based on 1983 data. Income classes, as defined by Treasury and shown here, reflect income from virtually all sources whether currently taxable or not, including the imputed income value of certain assets. For the bottom five income classes, the figures shown here may slightly overstate the size of the average tax cut. As a result, this table provides a conservative estimate of the gap between average tax cuts for the lowest and the highest income groups.

The fact that the largest cuts go to those with the most income is not simply due to the fact that these people pay more in taxes to begin with, despite President Reagan's claim to the contrary at a press briefing on June 7th. Measuring the tax cut as a percent of income controls for the differing amounts of income. This measure shows that the cut for those earning above 200,000 dollars a year is four to five times greater than the cut for any other income group, including those earning under 10,000 dollars a year. It is also interesting to note that in raw dollar terms, the average tax cut to those earning above 200,000 dollars a year is more than 13 times the cut for those in the nearest income class, those earning between 100,000 and 200,000 dollars a year.

This represents a substantial shift toward the wealthy since the Treasury Department unveiled its initial tax proposal last November. The average taxpayer over 200,000 dollars a year will receive a 2,400 dollar larger tax cut under the final Administration proposal than under the original Treasury plan, while the average low income taxpayer would receive an additional tax cut of less than 40 dollars, and the average middle-income taxpayer would actually receive a smaller tax cut than under the original Treasury plan.

In testimony before the House Committee on Ways and Means on May 30th, Treasury Secretary Baker cited as a major shortcoming of the current tax system the fact that many wealthy individuals now pay relatively small percentages of their income in taxes. "Fewer than half" of all families and individuals with incomes of more than 250,000 dollars a year "report tax liabilities that most people would consider a fair share at this income level -- 20 percent or more of positive-source income," Baker stated.

Our analysis suggests that the provisions of the new tax plan that confer such large tax breaks on the wealthy could aggravate this problem, although further study of this issue is needed. We would note that Treasury's own figures show that the average percent of income that families in this income class would pay is 18.7 percent -- below the 20 percent threshold that Secretary Baker himself set as a measure of fairness.

The large drop in tax liabilites for the highest income group is due primarily to the reduction in the tax rate for upper income taxpayers from 50 to 35 percent, coupled with the retention in whole or in part of many preferences disproportionately directed to high income individuals. In particular, the fact that the final Administration proposal contains substantially larger reductions than the original Treasury plan for the highest income group appears to be due to a number of concessions that the Administration made in recent weeks, such as dropping the top tax rate on capital gains profits to 17.5 percent.

Other aspects of this plan cause us concern. We question whether it is essential to reduce the top rate all the way to 35 percent -- half its pre-1981 level -- for individuals in the very highest income brackets. We would particularly question the highly preferential treatment accorded to capital gains at the same time that the top rate is being halved. The benefits of continuation of accelerated depreciation would also accrue disproportionately to those at the top. In addition, we are troubled by how far the Administration has backed down from Treasury's earlier proposals to restrict wasteful tax-sheltering. A recent Wall Street Journal article by Alan Murray, which is attached, explains just how far the Administration has retreated on this important area. We suggest that the goals of fairness, growth and simplicity could be better served by modifying the President's proposals in these areas.

Finally, we are very concerned about the plan's potential impact on the federal deficit. While the effects may be small over the next five years, they could grow larger after 1990 when the corporate "recapture" provisions end. Treasury's forecast that the plan will eventually reduce individual taxes by 7 percent while raising corporate taxes 9 percent implies that the total reduction in revenues could be substantial. (The corporate tax base is less than one-fourth the size of the individual tax base, so a 9 percent corporate tax increase would not come close to offsetting a 7 percent individual tax reduction.) We urge the Committee to request that the Treasury Department and the Congressional Budget Office estimate the impact of this tax reform proposal on the deficit over a much longer period than just the next five years. We also urge that the Committee make the necessary modifications in the plan to prevent further swelling of the large deficits we already face.

Reagan's New Tax-Overhaul Plan Retreats From Attacks on Shelters

YOUR MONEY MATTERS

By Alan Murray
Staff Reporter of The Wall Street Journal

WASHINGTON – Tax-shelter buyers and promoters should take heart from the changes being made in the administration's tax-overhaul plan. Unlike the original proposal the Treasury Department unveiled last November, the new plan, details of which will be released tomorrow, will still allow ample opportunity to protect income from taxation.

The Treasury's original plan was designed to tax nearly all income the same, regardless of where it comes from or how it is used. That would have eliminated many tax shelters, which exploit differences in the ways income and expenses are treated under the tax code.

The plan the Reagan administration will release tomorrow, however, departs from that simple principle in the name of political expediency. After announcing its blueprint – so-called Treasury I – last fall, the White House began to modify it in response to complaints from interest groups. As a result, plenty of opportunities for exploiting the tax system will remain.

"I think it's very discouraging," says David Bradford, professor of economics and public affairs at Princeton University, and an advocate of the original Treasury plan. "To me (the administration) is abandoning much of the fundamental appeal of the plan."

Charles Hulten, senior research associate at the Urban Institute, says, "The genius of the original plan was that the provisions were deduced from principle, and the principle was that taxable income should conform to economic income. If you retreat too much from principle, it's hard to justify the other changes."

Although White House officials decline to discuss the changes in advance of the plan's release, Treasury Secretary James Baker has said: "We feel sure that once they (in Congress) see the president's overall package, they will be pleased."

The administration believes that by lowering tax rates, the new plan will decrease the incentive to avoid taxes. Taxpayers will presumably be less anxious to escape a top rate of 35% than they are a top rate of 50%.

But Treasury I would have attacked the tax-shelter problem on at least six other fronts. The plan to be released tomorrow retreats from four of those.

Economic depreciation. Despite a reduction in the top personal-tax rate to 50% from 70% in 1981, tax-shelter sales have boomed since then. The reason is the sharp acceleration of depreciation. Rapid write-offs for investment in plant and equipment combined with the 6% or 10% investment-tax credit enabled investors in everything from boxcars to office buildings to enjoy significant tax breaks. Treasury I would have eliminated the investment tax credit and drastically altered the depreciation rules, making write-offs correspond more closely to the actual rate at which machinery or buildings depreciate. The move to such economic depreciation would have taken away much of the incentive to invest for tax reasons alone.

The plan to be released tomorrow, however, would continue to allow substantially accelerated depreciation write-offs for investors, although it would eliminate the investment tax credit.

Interest indexing. Leverage is the key to many lucrative tax shelters, which give investors tax write-offs of two to five times the amount they actually invest in the shelter. By using borrowed money, investors can commit a limited amount of their own funds to a project, yet still deduct their full share of the partnership's interest payments. "The current treatment of interest is a big subsidy to borrowers, especially when inflation gets high," says John Makin, a resident scholar at the American Enterprise Institute in Washington.

> 'POLITICS is driving (the tax plan) now,' says one tax expert. 'People thought about the economics . . . and then said let's cut some deals.'

Treasury I would have limited the interest deduction by indexing it for inflation. Only the portion of interest that isn't due to inflation would have been deductible. The plan to be released tomorrow, however, won't include interest indexing.

Thirty-five partner rule. Tax shelters are usually arranged in limited partnerships. That means the tax "losses" created by large tax deductions can be used by the individual partners to offset their taxable income from other sources. Treasury I would have required that any limited partnership with more than 35 partners be taxed as a corporation, and therefore would have prevented large partnerships from passing tax losses on to investors.

The plan to be released tomorrow, however, won't include a 35-partner rule.

Capital gains. Many tax shelters play on the tax advantage provided for long-term capital gains. Under current law, gains are taxed at a maximum 20% rate, compared with the 50% top rate on ordinary income. Shelter schemes often enable investors to convert ordinary income into capital gains. The original Treasury plan would have eliminated that opportunity by taxing capital gains as ordinary income and allowing an adjustment for inflation.

The administration, however, bowed to those who argue that a lower capital gains tax is needed to enable small entrepreneurs to raise funds. The plan to be released tomorrow will lower the top rate on capital gains to 17.5% for many assets, including stocks and bonds. And the value of other assets, such as developed real estate, would be adjusted for inflation before being taxed.

The only provisions to combat tax shelters that survived intact in the revised plan are:

At-risk rules. The greatest tax-shelter growth in recent years has been in real estate, when investors can invest in heavily leveraged projects, face limited liability and claim large tax losses. Treasury I, as well as the plan to be announced tomorrow, would prohibit taxpayers from claiming losses that are larger than the amount they have invested plus any additional amount for which they are personally liable.

Shelter promoters could circumvent that rule by changing the type of financing they use, but this would increase the personal liability of investors. That might discourage some investors from tax shelters, but even Treasury estimates show the effect wouldn't be great.

Interest deduction limits. Both the original Treasury proposal and the plan to be released tomorrow restrict an individual's interest deductions, other than those for interest paid on a mortgage for a principal residence, to \$5,000 plus a person's "passive investment earnings," such as interest, dividends and earnings from limited partnerships. That could put a damper on some shelter schemes that rely heavily on interest deductions. But for investors who already have large amounts of investment income, the limit would have little bite. For example, a person with annual investment income of \$50,000 would have a \$55,000 limit on interest deductions.

The final administration tax plan will also include a new proposal for a "minimum tax," which could prove an obstacle to people who use shelters to dramatically reduce or eliminate their tax liabilities. But while the minimum tax might stop some of the worst abuses of tax shelters, it wouldn't eliminate shelters.

Many tax experts lament the administration's move away from a plan that would attempt to tax all income equally, and thus remove the temptation for tax sheltering.

"Politics is driving it now," says Mr. Makin of the American Enterprise Institute. "People thought about the economics for about 10 days, and then said: 'OK, let's cut some deals.' "

But while tax experts regret the lost opportunity to create a more consistent tax system, they generally agree that lowering tax rates and broadening the tax base are worthy goals in themselves. Says Mr. Makin: "The bottom line is that Treasury II will probably still be better than the current system."

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THE IMPACT OF THE ADMINISTRATION'S TAX PROPOSAL ON LOW INCOME AMERICANS

The new Administration tax proposal unveiled yesterday would provide long overdue tax relief and reduce tax burdens for most of the nation's poorest working families. This feature of the Administration plan is designed to help compensate for the striking increases in federal tax burdens that have been imposed on the working poor in recent years.

Since 1978, tax burdens on the working poor have soared -- more than doubling in many cases and rising over 150% for a family of four with earnings at the poverty line. While taxes for more affluent Americans were cut in recent years, the taxes of the working poor rose at record rates.

The new tax plan would roll back most of the increase in federal tax burdens imposed on low-income working families over the past seven years. Many of the working poor would still be paying modestly higher percentages of their income in federal taxes than in 1978 -- and would be one of the few groups of taxpayers paying more in taxes than in the late 1970's. Still, low income working families would pay significantly less in taxes under the new plan than they will if the current law remains in place.

Two other factors should also be noted. First, the plan provides limited relief for single low income individuals. Persons living alone with incomes above $4,900 a year would (unless they are elderly and disabled) still have to pay federal income tax, despite the fact that their incomes fall as much as $800 below the poverty line.

Secondly, the biggest gainers under the new plan would not be the poor, but rather the very affluent. Average low-income working families would receive tax reductions of several hundred dollars under the new plan. Similarly, the average middle income taxpayer would receive a tax cut in the $200-$300 range. By contrast, taxpayers with incomes over $200,000 a year would receive average tax cuts of $9,250 a year under the new proposal.

I. <u>The Administration's Tax Proposal Provides Tax Relief to the Working Poor</u>

- The Administration's new proposal would provide substantial tax relief to working poor families. Federal income taxes would be eliminated for most families below the poverty line.

- As a result, federal tax burdens would drop for most of the working poor. A married family of four with earnings equal to the poverty line would owe $1,212 in income and payroll tax in 1986 under current law. Under the new Administration plan this family would owe $565 instead.

- This low-income family would thus have its federal taxes reduced by $647, or 53%.

- A single-parent family of four with earnings equal to the poverty line would also benefit significantly. Such a family would owe $1,358 in federal income and payroll taxes under current law next year. Under the Administration proposal, its taxes, too, would drop to $565 -- for a tax reduction of $793, or 58%.

- Federal taxes would take 4.9% of the income of 4-person families at the poverty line under the Administration plan. Under current law, federal taxes would consume 10.6% of the income of married families of four at the poverty line and 11.9% for single-parent families of four next year.

REDUCTION IN TAX LIABILITIES FOR WORKING POOR FAMILIES UNDER ADMINISTRATION PROPOSAL*

Federal Tax Burdens in 1986

	Earnings	Taxes Under Current Law	Taxes Under New Proposal	Change in Taxes
Earnings at 75% of poverty				
Family of 3 - single-parent	$6,706	$62	-$247	-$309
Family of 3 - married	6,706	-46	-247	-201
Family of 4 - single-parent	8,593	517	99	-418
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Family of 4 - married	14,321	1,797	1,372	-425

*Note: Federal tax payments include both federal income and payroll taxes. Examples assume no itemized deductions. Minus sign indicates a refund. Poverty levels were computed by adjusting 1984 poverty levels by Treasury assumptions for changes in the Consumer Price Index for 1985 and 1986.

II. Tax Burdens for Many Working Poor Families Would Still Remain Above 1978 Levels

- Although the tax relief provided to the working poor would be substantial, it would still leave federal tax burdens for large numbers of these families above 1978 levels.

- For example, a married family of four at the poverty line paid 4% of its income in federal taxes in 1978. Under the new plan, it would pay 4.9% of income in taxes in 1986. A "near-poor" family of four with earnings equal to 125% of the poverty line paid 7.8% of income in federal taxes in 1978 but would pay 9.6% in 1986. (Since these figures measure taxes as a percentage of income, they take into account the impact of inflation on taxes and income both).

- Similarly, a family of three at 100% of the poverty line paid 0.7% of income in taxes in 1978. It would owe 1.5% of its income in taxes next year under the Administration plan. For a family of three at 125% of the poverty line, federal taxes would be 6.2% of income in 1986, compared to 4.0% in 1978.

Federal Taxes as a % of Income - 1978 vs. 1986

	1978	1986 Under Administration Plan
Family of three (married)		
100% of poverty	0.7%	1.5%
125% of poverty	4.0%	6.2%
Family of four (married)		
100% of poverty	4.0%	4.9%
125% of poverty	7.8%	9.6%

- It should also be noted that the proposal to tax as income the first $120 a year in fringe benefits for an individual (and $300 for a family benefit plan) would affect a significant number of low income working families. The original Treasury tax plan ("Treasury I") proposed to tax fringe benefits above specified levels. This proposal would have affected more affluent salaried employees who have extensive fringe benefit plans, while leaving most of the working poor unaffected. The fringe benefit provision contained in the new Administration plan does the reverse, however -- it has little effect on those with extensive fringe benefit plans (since most of their benefits will remain exempt from taxation) but it would affect many low income working families whose benefits would have remained exempt under "Treasury I."

- For low income families with fringe benefits of any magnitude and with incomes above the new income tax thresholds, tax relief will be diminished to some, modest degree by the new fringe benefit provision. The figures in this background paper do not take the taxation of fringe benefits into account. Consequently for some low income workers, the amount of tax relief would actually be somewhat less than is reflected here.

- In addition, some other low income families would have tax relief diminished by the proposals to convert the child care tax credit to a deduction and to count unemployment insurance benefits as taxable income for lower income workers (under current law, unemployment insurance benefits are taxed for single filers with incomes over $12,000 and joint filers with incomes over $18,000; the new plan would repeal the exemption for taxpayers below the $12,000 and $18,000 limits and count unemployment insurance as taxable income for lower income families as well).

- Nevertheless, many low income families that now benefit from the child care credit and the lower income exemption for unemployment insurance would still have their taxes reduced rather than increased under the new plan. For many of these families, the increases in the personal exemption, the earned income tax credit, and the zero bracket amount (also known as the standard deduction) would more than balance out the effects of the child care and unemployment insurance changes. For every household with income below $10,000 a year that would face a tax increase, there would be seven households whose taxes would be reduced. For every household in the $10,000-$15,000 range that would have its taxes increased, there would be five households receiving tax cuts.

III. Poor Individuals Would Still Owe Income Tax

- While families with children who live in poverty would generally be exempt from federal income tax under the new plan, poor individuals living alone would not be helped to the same degree.

- A person living alone who is not elderly or disabled would have to start paying federal income tax when his or her income passed $4,900 -- which is $800 below the poverty line.

- For a non-elderly or disabled person with earnings equal to the poverty line, federal income and payroll taxes would consume $528, or 9.3% of a modest $5,700 income. In 1978, a person living alone at the poverty line paid 6.5% of income in federal taxes, or nearly a third less.

- Still, these persons, too, would receive some tax relief under the Administration plan. Under current law, federal taxes for a single individual at the poverty line would rise to $653, or 11.5% of income, in 1986. Such a person would have taxes reduced $125 next year by the new plan.

IV. Largest Tax Gainers Would Be Very Wealthy, Not the Poor

- While low income working families would be helped substantially under the new tax proposal, the very affluent would be helped more. The Administration has correctly noted that low income families would receive a larger percentage reduction in tax liabilities than families in higher income groups. However, when the tax cuts are looked at in actual dollar terms, the very wealthy are by far the largest gainers.

- Taxpayers above $200,000 a year would receive an average reduction of $9,250 apiece under the new plan. By contrast, taxpayers with incomes below $10,000 a year would receive an average reduction of about $100, and most taxpayers right at the poverty line would receive reductions in the $100-$800 range.

- In addition, taxes would drop an average of 0.5% of income for those below $10,000 a year, 0.7% of income for those in the $10,000-$15,000 range, and 0.6% of income for those in the $15,000-$20,000 range. But taxes would fall an average of 2.3% of income -- or about 4 times as much -- for those over $200,000 a year (see separate analysis on the impact of the new plan on the wealthy).

V. The Historical Background: Dramatic Rises in the Tax Burdens of the Working Poor in Recent Years

- Since 1978, federal tax burdens for the working poor have soared. A family of four with earnings at the poverty line paid $269 in federal income and payroll tax in 1978, $459 in 1980, and $1,147 in 1985. If the tax code is not changed, this family will pay $1,212 in federal income and payroll tax next year (1986).

- Measured as a percentage of income, this family's taxes have jumped from 4% of income in 1978 and 5.5% in 1980 to 10.4% in 1985. After adjusting for the increased income due to inflation, the family's taxes have still gone up by 158% from 1978 to 1985 (and 91% just since 1980).

- For a single-parent head of a household of four with earnings at the poverty line, the rise in tax burdens has also been sharp -- from $343 in 1978 and $614 in 1980 to $1,285 today. This family saw its taxes jump by over 125% since 1978, after adjusting for inflation. As a percentage of income, this family's federal tax burden has risen from 5.2% in 1978 and 7.3% in 1980 to 11.7% in 1985.

- Families with gross incomes below the poverty line have also been heavily affected. In 1978 and 1980, most families below the poverty line did not pay federal income tax. Today a married family of four with gross income $1,500 below the poverty line must pay income tax. A family of six with gross earnings $4,300 below the poverty line must pay federal income tax.

- As a result, Census data show that in the two years from 1980 to 1982 (the latest year for which Census has issued these data), the number of families below the poverty line who had to pay income tax more than doubled. Census data also show that the total amount of federal income taxes paid by families below the poverty line rose 114% from 1980 to 1982.

- In addition, the Census data show that in 1979, there were 1.9 million persons in families who had gross incomes above the poverty line, but who were pushed below the poverty line when federal and state income and payroll taxes were taken out of their paychecks. By 1982, the Census data reveal, this number had climbed sharply -- and 3.2 million persons were pushed below the poverty line due to their income and payroll tax obligations.

- The bulk of this increase in the tax burdens of the working poor has come from increased federal income tax burdens rather than from Social Security payroll tax increases. While the percentage of income a family of four at the poverty line had to pay in combined income and payroll taxes rose more than six percentage points over the past seven years, from 4% of income in 1978 to 10.5% in 1985, the Social Security payroll tax was rising one percentage point, from 6.05% of income in 1978 to 7.05% in 1985.

- In addition, the fact that the federal income tax threshold (the point at which families have to start paying income tax) has dropped well below the poverty line has nothing to do with social security tax burdens.

May 30, 1985

CENTER ON BUDGET AND POLICY PRIORITIES

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Robert Greenstein
Director

VERY AFFLUENT ARE LARGEST GAINERS UNDER NEW TAX PLAN

TAXPAYERS OVER $200,000 A YEAR TO RECEIVE AVERAGE GAIN OF $9,250 APIECE

The biggest gainers under the Administration's new tax plan are America's wealthiest individuals -- those with incomes over $200,000 a year. The 441,000 taxpayers in the $200,000+ income bracket would receive an average tax reduction of $9,254 apiece under the new tax plan.

By contrast, persons with incomes below $30,000 a year would realize average gains of less than $150 a year.

Middle class Americans in the $30,000-$50,000 range would receive average tax reductions of a little more than $200 a year.

In releasing the new tax plan, the Administration has noted that low income taxpayers will have their income taxes reduced by a larger percentage than taxpayers at higher income levels. This is correct, but there is another fundamental point -- when measured either in dollars or as a percentage of income, the tax cuts for the wealthiest taxpayers dwarf those for all other groups, including the poor.

Income Class	Average Income Tax Cut*	Average Income Tax Cut as % of Income	Average % Reduction in Income Taxes
Under $10,000	$ 104	0.5%	-35.5%
$10,000-$15,000	$ 128	0.7%	-22.8%
$15,000-$20,000	$ 132	0.6%	-13.5%
$20,000-$30,000	$ 149	0.6%	-8.7%
$30,000-$50,000	$ 211	0.5%	-6.6%
$50,000-$100,000	$ 252	0.4%	-4.2%
$100,000-$200,000	$ 686	0.5%	-4.1%
Over $200,000	$ 9,254	2.3%	-10.7%

*These figures represent average tax cuts by income class if the plan were in full effect for 1983. Treasury data on the effects of the tax proposal by income class are based on 1983 data. Income classes, as defined by Treasury and shown here, reflect income from virtually all sources whether currently taxable or not, including the imputed income value of certain assets. For the bottom five income classes, the figures shown here may slightly overstate the size of the average tax cut. As a result, this table provides a conservative estimate of the gap between average tax cuts for the lowest and the highest income groups (see methodology section).

This reflects a substantial shift toward the wealthy since the Treasury Department unveiled its initial tax proposal last November. Under the November plan, income taxes for families below $200,000 a year would have been cut 8.5% on average. Taxes for those above $200,000 a year would have been reduced by a slightly lesser percentage -- 8.0%. Now, taxes for those under $200,000 a year would drop 6.3% on average, while those in the $200,000-and-above bracket would receive an average 10.7% reduction (or 70% more than for the below-$200,000 group).

The average taxpayer over $200,000 a year will receive a $2,400 larger tax cut under the final Administration proposal than under the original Treasury plan.

Low income families also do better under the final proposal than under the original proposal, but the added gains here (as compared to the original proposal) are much smaller -- less than $40 a year for the average low income taxpayer.

The large reductions in tax liabilities for the wealthiest group appear to be due primarily to the reduction of the tax rate for upper income taxpayers from 50% to 35%. The added $2,400 tax cut under the new plan (as compared to the earlier Treasury proposal) stems from a number of concessions made by the Administration in recent weeks, such as the decision to lower the maximum tax rate of profits from capital gains to 17.5%.

May 30, 1985

Methodology

This analysis of the dimensions of the tax cuts by income class is based on data supplied by the Treasury Department and published in The President's Tax Proposals to the Congress for Fairness, Growth, and Simplicity, May 1985 and in Tax Reform for Fairness, Simplicity, and Economic Growth: The Treasury Department Report to the President, November 1984, and on data from the Joint Congressional Committee on Taxation:

- Chart 8 on page 16 of the The President's Tax Proposals to the Congress shows the average tax reduction as a percentage of income for each income class. This chart also lists the average percentage reduction in income taxes by income class.

- The dollar figures for the size of the average tax cut for each income class are derived from a series of tables and charts in these publications. Chart 17 on page 25 shows the percentage of income taxes paid by each income class under current law. These percentages are multiplied by estimates of total individual tax liabilities under current law (as published, from Treasury data, by the Joint Congressional Committee on Taxation) to determine the tax liabilities in dollars (under current law) for each income class. These tax liabilities by income class are then multiplied by the percentage reduction in taxes for each income class under the new plan, as reported by Treasury in chart 8 on page 16. The result is the aggregate dollar reduction in taxes by income class.

  The dollar reductions by income class are then divided by the number of families in each income class to find the average tax cut per family in each income class. The number of families in each income class is provided in Table 4-4, page 54, of Tax Reform for Fairness, Simplicity, and Economic Growth: The Treasury Department Report to the President, Volume I, November 1984.*

  Following this derivation of the average tax cut for each income class, one further adjustment is made so as not to understate the dimensions of the tax cuts that lower income families would receive. If the total tax cut for each income class is divided by the total number of families in the income class, the results show very small average tax cuts for families in the poorest income classes -- for example, an average tax cut of less than $35 per family in the under-$10,000 category. The reason the average tax cut appears so

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*Note: The data used in these computations (for the number of families in each income class, for total individual tax liabilities under current law, and for total tax liabilities by income class under current law) are for 1983. This is the latest year for which Treasury has compiled data on the distribution of families by income class. Treasury's own analysis on the impacts of the new proposal by income class is similarly based on 1983 data.

small in these income classes is that substantial numbers of low income families in these income classes are families where no one is employed and where the family is not actually in the income tax system. Such families could not, of course, be expected to benefit from a tax cut. However, by virtue of their being included in the total number of families in these income classes, these families make the average tax cut per family in these incomes categories appear uncharacteristically small.

To take this problem into account, and to better determine the average tax cut for low income families who work, an adjustment has been made to the Treasury estimates of the number of families in the various income classes. This adjustment is based on data provided in Chart 14, page 22 of The President's Tax Proposals. This chart shows the percentage of families in each income class who would have "no change in tax" under the new tax plan. Since "no change in tax" is defined as a change in tax of less than 0.05% of income -- and since this amounts to no more than $5 in the under-$10,000 bracket and no more than $25 in the $30,000-$50,000 bracket -- those families in the bottom five income classes (income classes up to $50,000 a year) who would experience "no change in tax" are assumed to be families who lack earnings and are outside the tax system. (Treasury confirms that this assumption is correct and that most of these families are not in the tax system). Consequently, the total number of families shown by Treasury as being in each of these bottom four income classes is reduced to exclude the families in the "no change" category. The resulting, lower number of families in each of these four income classes is then divided into the aggregate tax cut for each of these income classes in order to determine the average tax reduction per working family for these income classes.

There is likely to be a small number of families in the "no change" category who are actual working families (and who are in the "no change" category because after the various changes in the tax code are factored in, their overall tax burdens would remain unchanged). As a result, the true average tax cut for each of the bottom four income classes will be somewhat smaller than is shown in this analysis. This analysis therefore somewhat understates the gap in the size of the average tax cut between the top and bottom of the income scale.

No similar adjustment (to exclude families in the "no change" category) was made for income classes over $50,000. Unlike poorer families, most families in these income classes who are listed as having "no change in tax" are unlikely, due to the size of their incomes, to be outside the tax system. Moreover, as income gets higher, the amount that a family's taxes can increase or decrease with the family still being listed as having "no change in tax" mounts substantially.

- As noted, the data used throughout these computations are for 1983, the latest year for which Treasury has actual data on tax receipts by income class. As a result, the figures shown here represent what the average tax cut by income class would be if the new proposal had been in full effect in 1983. Due to increases in individual tax receipts from 1983 to 1986 as a result of inflation and other factors, these figures understate the average tax cut that families in the various income classes would receive if the new proposal were in full effect for all of 1986.

The CHAIRMAN. Mr. Trevino, let me ask you a specific question on the deduction of business meals because you recommend totally eliminating the deduction. Of course, you know the argument that is used by those on the other side is that these are providing jobs for low-income Americans, many of whom are probably members of your organization, and they are talking about job losses of 150,000 if we limit it to $25, plus half of the above. I would appreciate it if you would comment on that.

Mr. TREVINO. Yes, sir. Thank you, Mr. Chairman. A couple of weeks ago when I had the pleasure of testifying before Chairman Rangel and the Subcommittee on Select Revenue in the House, Congresswoman Kennelly asked me the same question. And my response was the same response that I will give you today, Senator, that it is true. We have advocated the elimination of the business lunch, but we have set a ceiling at $50. I think that is realistic. We have been told, as Congresswoman Kennelly commented to me, that this could well mean that more people would be unemployed. Well, it seems to me that the Department of Labor laws establish the salaries and wages of employees, and not the menu, but I do understand that there may be some threat or potential for layoffs. But as I explained to her then, if we view fairness and justice as a rose, then we note that roses come with thorns. We are prepared to suffer the consequences. I believe that $50 is a fair ceiling. If $50 is not sufficient, then I could only say that either there is something wrong with the product or something wrong with the sales pitch. I just think that that is a fair ceiling, and we would stand by it, Senator.

The CHAIRMAN. That is a very specific and direct answer. I appreciate it. Let me ask each of the three of you, and I will start with Mr. Hill.

Do you have any studies at all as to how the tax reform proposal, as it is now before the Ways and Means Committee—not Treasury I, but as it has been before the Ways and Means Committee—how it might affect jobs for the low-income people? I don't know, and I don't know if any of you have any studies or not.

Mr. HILL. Yes; our research department here in Washington and also in New York are very concerned that it would have a tremendous impact on jobs, as well as on the level of services provided by New York City, as well as by New York State. We are very concerned that the elimination of deductibility will hurt us tremendously. We feel very strongly that there is a good possibility that jobs definitely could be lost.

The CHAIRMAN. Now, you are not just talking about your members now? You are talking about low income——

Mr. HILL. I am talking across the board, yes. We have, as I said before, tens of thousands of low income members, but I am talking across the board, in the public sector as well as the private sector. And as the plan stands right now, there stands a good chance—not only in New York City and New York State, but also nationwide—of hurting the poor.

The CHAIRMAN. Do you think that would be true if the deductibility of State and local tax was not in the bill?

Mr. HILL. Absolutely. Yes.

The CHAIRMAN. Then, where do you think it would be on job creation, absent that particular provision?

Mr. HILL. If deductibility remains in the bill——

The CHAIRMAN. If it is out of the bill?

Mr. HILL. If it is out of the bill, it would hurt tremendously.

The CHAIRMAN. I am not asking it right. If the deduction is left—if you can continue to deduct State and local taxes—that was the change made in the bill now before Ways and Means—how would it affect job creation for the poor?

Mr. HILL. Well, it would help. It would help, of course, in this way not only in terms of jobs, but also it would still give the people who are paying for the services—like in New York City—an incentive to continue funding the services and keep jobs in New York City and New York State. I must point out that the Port Authority of New York, which is a tripartide agency that comes out with figures on a yearly basis—they see some good trends in the years ahead, but if deductibility is eliminated, it would hurt tremendously in New York State and in New York City.

The CHAIRMAN. Mr. Greenstein.

Mr. GREENSTEIN. I think one has to distinguish between what would happen to jobs in particular areas, particular industries, particular locations and what would happen to jobs in the economy as the whole. There is no question that there would be certain areas where jobs would be lost. That is not the same thing as saying that jobs would be lost in the economy as a whole. Low-income people are helped by economic growth. When the economy grows, it creates more jobs, and low-income people are helped. But it seems to me the bottom line question is: Is the plan promoting enough economic growth to offset the individual dislocations in particular areas and end up a net positive? Now, as you know, Treasury has argued that it might increase growth by as much as 1½ percent of the GNP. I think that most people agree that that estimate is too optimistic, but in general, we subscribe to the school of thought that anything that reduces the distortions in incentives for allocating capital—anything that reduces the distortions in the current code which causes capital to be allocated where the tax writeoff is the biggest, rather than where the profit and productivity are greatest—is in the long run going to make the economy more competitive, and is going to create jobs. In that sense, our view is that Treasury I, because it was more neutral in that regard, would have created more economic growth and more jobs. And if one is concerned about economic growth—which I think we all are—than we would hope the Congress would look toward removing some additional tax shelters and, tax preference opportunities that remain from the current code and which crept back into the President's proposal. The more you go in the direction of removing preferences, the more capital will get allocated more efficiently, and the more growth we will have in the long run and more jobs for low income people and everyone else.

The CHAIRMAN. Mr. Trevino.

Mr. TREVINO. Senator, we don't have a research department as some of these folks do, but I would just say that at this point, we do not have sufficient information to give a response to your question, sir.

The CHAIRMAN. Senator Baucus?

Senator BAUCUS. I would like to follow up on the question the chairman asked. What pockets of the population would be adversely affected by this bill? Mr. Greenstein, you were saying that, even though the economy is generally better off with the bill, that there are some pockets of people who will be worse off.

Mr. GREENSTEIN. We haven't studied that in detail, but anything that makes the kinds of changes a plan like this does will create some winners and some losers. For example, there is the issue Mr. Hill raised, which we haven't studied, as to what the impact might be on State and local public employees' jobs. Some people raise concerns about impacts on some of the smokestack industries. There are areas where particular industries may have had more capital directed to them in the past than the economy economic efficiency might merit. The industries might get somewhat less capital directed to them, and they might have somewhat fewer jobs. But I think we need to understand that, where that is the case, that means that another economic sector that didn't get as much capital allocated to it in the past as the economic merits would indicate, because it didn't get such a large tax writeoff, is likely to get more capital allocated to it and to create more jobs.

Senator BAUCUS. It seems to me that even though the solutions we are talking about this morning, particularly the earned income tax credit, are very helpful to low income people in America, to some degree we are addressing the symptoms rather than the actual problem. In this last round of questioning, please address the actual question, namely a more prosperous economy so that more jobs are created. In what way would you change the administration's proposal to generally have a healthier country, that is, a country where there are more jobs, more growth, more development?

Mr. HILL. Again, Senator, there is a large school of thought among many economists, conservative and liberal alike—that the more neutral we make the code, the better that is for the economy in the long run. I call your attention to an article—we have attached it to our testimony—in the May 28 Wall Street Journal that discusses the administration's retreat from Treasury I in closing of tax shelters—covering a number of areas on partnerships, capital gains, risk rules, and others. And we would urge that some of those areas be looked at again. I think one particular thing that we would be concerned about, too, is that the justification for lowering the top rate to 35 percent is that that is supposed to be a tradeoff for closing a lot of shelters and loopholes and so forth. In the current plan, so many shelters have been put back in that it is not clear that we would get any significant reduction of capital being misallocated to shelters—just like in the 1981 tax bill. We lowered the top rate from 70 to 50 and tax shelters boomed. They didn't go down because they weren't closed.

I think the bottom line here is whether we can tighten what I think are still overly generous depreciation rules in the new plan. I don't think there is a justification for further lowering capital gains to 17.5 percent. Partnership rules, oil and gas rules, and some of the others—as much as can be done to move the provisions back toward neutrality in dealing with different kinds of investments would, I think, promote economic growth and jobs.

Senator BAUCUS. Mr. Trevino?

Mr. TREVINO. Sir, I think that what we are looking for here is a little bit of fairness, and it does seem that, when corporate America paid 8 percent of all taxes last year, we would like to see that go back to the Eisenhower years where it was almost 25 percent. I think that that would be a little bit more equitable and that some of the problems and concerns that we now express today, would be alleviated by taking that measure.

Senator BAUCUS. Mr. Hill?

Mr. HILL. Basically, I would start with retaining the deductibility and retaining the State and local taxes.

Senator BAUCUS. I gathered that one. I got that pretty loud and clear.

Mr. HILL. OK. [Laughter.]

I would also deal with the child care credit where the proposal has what is now called a deduction instead of the earned credit. I would also deal with the issue, based on the Treasury I plan, of tightening the depreciation proposals. I also—Mr. Packwood asked the question about the business lunches—I would favor the President's cap on that. I wouldn't eliminate it totally. I would retain the current spousal limits on IRA's. I would also take a look at how the overall proposal impacts on American families. As drafted, currently it seems to only favor the wife who stays home, not the wife who works. So, these are some of the proposals that I would deal with.

Senator BAUCUS. Thank you very much. I have no further questions, Mr. Chairman.

The CHAIRMAN. I have no other questions. Again, your answers are very good. Your testimony is very good. I appreciate very much your taking the time. We are adjourned.

[Whereupon, at 10:40 a.m., the hearing was adjourned.]

[By direction of the chairman the following communication was made a part of the hearing record:]

COALITION ON BLOCK GRANTS AND HUMAN NEEDS

Testimony Submitted to: Senate Finance Committee
Hearing on: The impact of the tax reform proposal on people below the poverty line.
Date: June 17, 1985

Mr. Chairman, I am Susan Rees, Executive Director of the Coalition on Block Grants and Human Needs. The Coalition consists of over 100 national organizations concerned about the impact of federal policies, including taxes, on low income, minority, and other disadvantaged groups. I appreciate this chance to address the Senate Finance Committee on the impact of the tax reform proposal on people below the poverty line.

The Coalition advocates a tax system which promotes economic justice and allows all people to retain the earnings they need to sustain themselves. In the past four years, the tax burden of lower income Americans has increased dramatically. For example, a family of three at the poverty level paid 8.2% of its income in federal taxes in 1984, compared to 0.7% six years ago. This jump represents nearly a twelvefold increase in tax rates, despite the general rate cut in 1981. At the same time, taxes paid by the affluent and by large corporations have decreased. As a result, moderate and low income tax payers carry too heavy a share of the load, and the revenue yield has been sharply reduced.

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The Coalition on Block Grants and Human Needs is deeply concerned about these regressive trends. We believe we must

1) ease the tax burden of low income workers;

2) expand and index the Earned Income Tax Credit (EITC);

3) restore progressivity; and

4) raise the Zero Bracket Amount (ZBA).

Lastly, the Coalition is in strong opposition to consumption taxes because they violate the basic concept of tax fairness.

The rationale for untaxing individuals and families living at or near the poverty line is that the poverty line defines a minimum subsistence level of income. People should not have to pay taxes when they are living in poverty and cannot meet their basic needs.

The EITC is the single most important federal tax provision for families in poverty. Available only to working low income families with annual earnings up to $11,000, the EITC is a work incentive. The maximum credit is currently $550. A sliding scale based on income determines each family's eligibility. Since 1981, the value of the EITC has eroded substantially as a result of inflation. In real terms, it is now worth only half of what it was in 1978. This decline must be reversed.

The Coalition believes that expansion and indexing of the EITC is necessary to restore tax fairness to families in poverty. The Coalition recommends that the EITC be extended to working families earning up to $16,000 a year, and the maximum credit be increased to $800. Similar to the personal exemption, the zero bracket amount and tax rates, the EITC must be indexed for inflation to maintain its real value.

Progressivity must be restored. The "pay-by-ability" principle has been increasingly undermined in recent years. Since 1980, the poor, who have the least ability to pay taxes, have seen their taxes more than double as a share of their meager income. This is primarily due to inflation-caused erosion in the value of the standard deduction(ZBA), the personal exemption and the EITC. Despite tax cuts, most middle income taxpayers are paying more of their income in taxes because of bracket creep. Meanwhile, taxes on the best-off taxpayers have declined by more than a third and corporations' share of taxes has dropped due to loopholes.

The Coalition supports tax rates that rise with taxable income so that low and middle income families pay significantly lower effective tax rates than the wealthy. Furthermore, the tax entry point should be moved above the poverty line by adjusting the ZBA, the EITC and the personal exemption. Lastly, taxable income should be broadly defined. Upper income individuals and corporations should not be able to shelter large portions of income from taxation, thereby shifting the burden onto lower income families.

The zero bracket amount must be increased for all persons. A sufficient ZBA (standard deduction) guarantees that people below the poverty line pay no taxes and that poor people do not shoulder a disproportionate tax burden. The ZBA has not been increased since 1978. Between 1980 and 1984, the value of the ZBA in real dollars dropped 21%. Raising the ZBA to $4,150 for all households would return the value to its 1977 level and equalize the burden on single parent families.

The Coalition opposes any form of consumption taxes - whether a value-added tax, a sales tax or a consumed income tax. Flat taxes levy the same burden on all people regardless of income, thereby violating the notion of tax fairness and "pay-by-ability." Since the poor consume a high percentage of their income (sometimes borrowing to make ends meet), consumption taxes shift the tax burden away from upper income taxpayers and onto middle and lower income tax payers. Consumption taxes also permit the distribution of wealth in our nation to grow less fair by breaking the link between income earned and taxes paid, and by eliminating the direct taxation of capital income.

In conclusion, while the Coalition on Block Grants and Human Needs commends President Reagan's attempt at tax reform for the poor, we encourage this committee to go one step further to ease the tax burden on low income workers. This could be done by expanding and indexing the EITC, restoring progressivity, raising the ZBA and by opposing all forms of consumption taxes.