

EFFECTS OF CHANGES IN TAXES AND BENEFIT PAYMENTS
ENACTED IN FISCAL YEAR 1982,
FOR HOUSEHOLDS IN DIFFERENT INCOME CATEGORIES

Staff Memorandum

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Senator Ernest F. Hollings
Ranking Minority Member
Senate Committee on the Budget

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INTRODUCTION

This memorandum discusses the impact on households in different income categories of the changes in personal income and excise taxes and in benefit payments for individuals enacted in fiscal year 1982. Most of these changes were included in the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). The analysis closely resembles that in a Congressional Budget Office (CBO) memorandum dated February 1982, which estimated the distributional impact of the tax and benefit reductions enacted in 1981. A more detailed presentation of general definitions and limitations, along with further discussion of the methodological problems associated with such estimates, may be found in that memorandum.

Like the earlier one, this memorandum concentrates on those changes in taxes and benefits that would directly affect household incomes. Thus, while proposed changes in the personal income tax, in excise taxes, and in benefit payments received directly by individuals are estimated for households in various income categories, changes in business taxes and in federal expenditures other than for direct benefits to households are not considered.¹ Although these changes will eventually affect household incomes, their immediate impact cannot be estimated based on the data available. In addition, no attempt has been made to take into account the possible macroeconomic effects of the tax and benefit changes.

1. Some payments from programs categorized as "benefits for individuals" are made on behalf of individuals, for example, Medicare payments to hospitals for services received by beneficiaries. Reductions in payments to providers are not analyzed here since they have no direct impact on individuals.

REVENUE INCREASES

Changes in taxes affecting individuals were enacted in 1982 as part of the Tax Equity and Fiscal Responsibility Act, which included numerous revenue-raising measures. The total estimated increase in tax revenues is \$98.3 billion through fiscal year 1985.

The greater part of the revenue increase is to be collected from businesses, and is not analyzed in this memorandum. The revenue-raising provisions not included here are the taxes on businesses; the compliance measures, including withholding on interest and dividends; the changes in the tax treatment of pensions and life insurance; the employment tax; and various miscellaneous provisions. Although the compliance provisions might affect some individuals, they are omitted here because there are no accurate data identifying those who have failed to comply with the law, and because it might be misleading to label as tax increases those liabilities that are rightfully owed but that would not have been paid without more thorough enforcement.

The tax provisions included in this memorandum are the individual alternative minimum tax; the tightening of the medical and casualty loss deductions; and the excise taxes on cigarettes, air travel, and telephone services.

The alternative minimum tax broadens and combines two current individual minimum taxes. Its revenue yield is \$659 million in fiscal year 1984, virtually all of which is expected to come from taxpayers with incomes of at least \$80,000.

The present medical and casualty deductions are both made more restrictive effective January 1, 1983. Medical expenses are deductible only if they exceed 5 percent of Adjusted Gross Income (AGI), and the separate deduction for one-half of medical insurance premiums up to \$150 is repealed. Deductibility of drug expenses is restricted to prescription drugs and insulin, but the separate 1 percent of AGI floor for drug expenses is eliminated. These latter provisions are effective January 1, 1984, later than the other provisions. The casualty-loss deduction is subject to a floor of 10 percent of adjusted gross income. The additional revenues resulting from the medical expense and casualty loss provisions are \$1.8 billion and \$0.7 million, respectively, in fiscal year 1984.

Three excise tax increases will have measurable revenue implications for identifiable households. Airline ticket taxes are increased from 5 to 8 percent, a \$3 international departure tax is imposed, and new taxes and tax increases are imposed on fuels and freight waybills; the combined revenue yield from these changes is \$1.0 billion. The current 1 percent excise tax on

telephone service is increased to 3 percent for calendar years 1983-85, and terminated thereafter; the revenue gain from these changes is \$1.1 billion in fiscal year 1984. For the purposes of this memorandum, it is assumed that one-half of the gross (i.e., before the revenue effect of deductibility on business income tax returns) air travel and telephone taxes would be paid by businesses; that portion of these taxes is therefore not distributed among households. The bill also temporarily raises cigarette taxes from 8 to 16 cents per pack for small cigarettes, and from 16.8 to 33.6 cents per pack for large cigarettes, resulting in a total revenue increase of \$1.8 billion in 1984.

The revenue increases resulting from all of the tax provisions of the bill, and the shares included in this memorandum, are shown in Table 1.

REDUCTIONS IN BENEFIT PAYMENTS

Reductions in several programs that provide benefits directly to individuals were enacted in 1982. Reductions are largest for the Medicare program, but also affect Medicaid, Aid to Families with Dependent Children (AFDC), Supplemental Security Income (SSI), food stamps, subsidized housing, and veterans benefits. Unemployment benefits will increase in 1983, followed by slight decreases in 1984 and 1985. The CBO estimates

TABLE 1. INCREASES IN REVENUES RESULTING FROM THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982, BY TYPE: FISCAL YEARS 1983-1985 (In millions of current dollars)

| | <u>1983</u> | <u>1984</u> | <u>1985</u> | <u>1983-85</u> | Percent of Total Allocated to Individuals ^a |
|------------------------------|-------------|-------------|-------------|----------------|--|
| Total, All Provisions | 17,959 | 37,664 | 42,698 | 98,321 | 16 |
| Individual Income Tax | 272 | 3,113 | 3,106 | 6,491 | 100 |
| Business Taxes | 5,422 | 13,292 | 16,497 | 35,211 | 0 |
| Compliance Provisions | 3,365 | 8,869 | 8,660 | 20,894 | 0 |
| Pension Provisions | 194 | 780 | 870 | 1,844 | 0 |
| Life Insurance and Annuities | 1,942 | 2,155 | 2,920 | 7,017 | 0 |
| Employment Tax | 1,904 | 3,083 | 3,577 | 8,564 | 0 |
| Excise Taxes | 2,798 | 4,009 | 4,702 | 11,509 | 79 |
| Miscellaneous Taxes | -38 | -37 | -34 | -109 | 0 |
| Enforcement Personnel | 2,100 | 2,400 | 2,400 | 6,900 | 0 |

SOURCE: Congressional Budget Office

- a. Only those increases directly affecting individual incomes have been distributed by income class. (See Tables 3 and 4.)

that the proposed reductions in outlays for benefit payments will total about \$2.6 billion in calendar year 1983, offset by a one-year increase in unemployment insurance benefits of \$920 million. Benefit reductions will grow to about \$3.5 billion in 1985.²

Not all reductions in benefit payment programs have been included in these estimates, since changes that will not directly affect the benefits received by individuals have been excluded. In Medicaid, for example, the bill will reduce federal payments to the states resulting from erroneous benefit payments made by the states. Although these proposals could substantially increase states' costs, they will not directly affect benefit payments to individuals. Similarly, the impact on particular beneficiaries of proposals to limit reimbursements to hospitals under Medicare cannot be estimated. (See Table 2 for a breakdown of total expenditure reductions affecting individuals distributed by program.)

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2. The estimates of outlay savings presented here are the differences attributable to legislative changes relative to the level of spending that would otherwise occur. The "baseline" from which the savings are measured assumes that program authorizations would be extended into the future and that, in the case of entitlement programs (encompassing most benefits for individuals), spending would otherwise have risen consistent with current CBO economic assumptions and with anticipated demographic changes. In the case of appropriated accounts, the baseline assumes that, except where capped by legislation, appropriations would otherwise have risen at the rate necessary to provide the base year's level of services for each year thereafter.

TABLE 2. REDUCTIONS IN DIRECT BENEFIT PAYMENTS TO INDIVIDUALS ENACTED IN FISCAL YEAR 1982, BY PROGRAM: CALENDAR YEARS 1983-1985 (In millions of current dollars)^a

| | 1983 | 1984 | 1985 | Total, 1983-85 |
|----------------------------------|-------------------|-------|-------|-------------------|
| Total, All Programs ^b | 1,700 | 3,060 | 3,460 | 8,230 |
| Medicare | 800 | 1,170 | 1,490 | 3,450 |
| Medicaid | 230 | 250 | 280 | 760 |
| Food Stamps | 550 | 600 | 680 | 1,820 |
| Housing | 690 | 670 | 640 | 2,000 |
| Veterans | 170 | 190 | 170 | 530 |
| AFDCC | 100 | 80 | 90 | 270 |
| SSI | 90 | 90 | 100 | 280 |
| Unemployment Insurance | -920 ^d | 10 | 20 | -890 |

SOURCE: Congressional Budget Office.

NOTE: Preliminary estimates, subject to change.

- a. Total reduction in outlays for these programs was approximately \$20 billion over the 1983-85 period. About half directly affects beneficiaries and is shown in the table. The remaining savings is largely from reduced reimbursements to hospitals by Medicare.
- b. Excludes interest on the public debt and employers' share of employee retirement (function 950), but includes benefit increase in unemployment insurance.
- c. Includes child support enforcement; adjusted to reflect offsetting cost increases in other programs such as food stamps and offsetting cost reductions in other programs such as Medicaid.
- d. Unemployment insurance benefits will increase in 1983.

Reductions in Medicare benefits affecting individuals account for about 40 percent of the total savings from changes in benefit payments for individuals. However, direct benefit cuts account for only about 26 percent of all reductions in Medicare expenditures. Since most Medicare reductions affect providers of services, rather than beneficiaries, they cannot be distributed across income categories. Changes in Medicare that directly affect beneficiaries include making coverage for the working aged secondary to private insurance coverage, and raising part B premiums enough to cover 25 percent of the cost of Supplementary Medical Insurance (SMI) services for aged beneficiaries in each year through 1985.

The food stamp and subsidized housing programs account for most of the remaining reductions in spending. Changes in the food stamp program include redefining some households to consolidate them, rounding benefit amounts down to the nearest whole dollar, and eliminating the standard utility allowance for households that do not incur utility expenses. In subsidized housing, the most important change affecting benefits is the requirement that the entire premium for mortgages insured by the Federal Housing Administration (FHA) be paid up front, rather than in installments.

Smaller changes were also enacted in the SSI and AFDC programs. The most important change affecting SSI benefits is the coordination of the cost-of-living adjustment (COLA) with other programs. In AFDC, states are now permitted to pro-rate shelter expenses if the AFDC household is part of

a larger household. AFDC error rate tolerances were also reduced. Both AFDC and SSI benefits will be reduced by pro-rating the first month's benefit, and by rounding benefit amounts down to the next whole dollar.

Small benefit reductions result from rounding unemployment insurance benefits down to the next whole dollar, but these are more than offset by the addition of a federal supplemental compensation program for 1983.

IMPACT OF TAX AND SPENDING CHANGES FOR HOUSEHOLDS IN DIFFERENT INCOME CATEGORIES

Tax increases are greater than the spending reductions resulting from these changes in all income categories except the lowest, as Tables 3 and 4 show.² About half of the total revenues generated by the tax increases comes from taxes affecting households in the third and fourth income categories. On a per-household basis, however, the tax increases generally rise with income, and are much greater for those in the highest income category than in any other. Both the new minimum tax provisions and the medical expense and casualty loss provisions will primarily affect households in this category.

2. Note that Table 1 is on a fiscal year basis, whereas Tables 2, 3 and 4 are on a calendar year basis, because the information needed to allocate the tax increases to households in different income categories is available only on a calendar year basis.

TABLE 3. TOTAL CHANGE IN TAXES AND BENEFITS ENACTED IN FISCAL YEAR 1982, BY INCOME CATEGORY: CALENDAR YEARS 1983-1985 (In millions of current dollars)

| | All Households | Household Income (in 1982 dollars) | | | | |
|--------------------|----------------|------------------------------------|-------------------|-------------------|-------------------|-------------------|
| | | Less than \$10,000 | \$10,000-\$20,000 | \$20,000-\$40,000 | \$40,000-\$80,000 | \$80,000 and over |
| <u>1983</u> | | | | | | |
| Benefit Reductions | 1,700 | 950 | 100 | 330 | 290 | 30 |
| Tax Increases | <u>5,340</u> | <u>310</u> | <u>700</u> | <u>1,940</u> | <u>950</u> | <u>1,440</u> |
| Total | 7,050 | 1,260 | 810 | 2,270 | 1,250 | 1,470 |
| <u>1984</u> | | | | | | |
| Benefit Reductions | 3,060 | 1,270 | 510 | 790 | 460 | 40 |
| Tax Increases | <u>6,560</u> | <u>440</u> | <u>930</u> | <u>2,440</u> | <u>1,120</u> | <u>1,630</u> |
| Total | 9,630 | 1,720 | 1,440 | 3,230 | 1,580 | 1,670 |
| <u>1985</u> | | | | | | |
| Benefit Reductions | 3,460 | 1,470 | 600 | 870 | 480 | 40 |
| Tax Increases | <u>6,990</u> | <u>510</u> | <u>1,020</u> | <u>2,590</u> | <u>1,140</u> | <u>1,730</u> |
| Total | 10,450 | 1,980 | 1,620 | 3,460 | 1,620 | 1,770 |

SOURCE: Congressional Budget Office.

NOTE: Details may not sum to totals due to rounding. Tax and benefit amounts include only those changes affecting households.

TABLE 4. NET CHANGE IN AVERAGE TAXES AND BENEFITS PER HOUSEHOLD ENACTED IN FISCAL YEAR 1982, BY INCOME CATEGORY: CALENDAR YEARS 1983-1985 (In current dollars)

| | All Households | Household Income (in 1982 dollars) | | | | |
|--------------------|----------------|------------------------------------|-------------------|-------------------|-------------------|-------------------|
| | | Less than \$10,000 | \$10,000-\$20,000 | \$20,000-\$40,000 | \$40,000-\$80,000 | \$80,000 and over |
| <u>1983</u> | | | | | | |
| Benefit Reductions | 20 | 50 | 0 | 10 | 20 | 30 |
| Tax Increases | <u>60</u> | <u>20</u> | <u>30</u> | <u>60</u> | <u>70</u> | <u>1,370</u> |
| Total | 80 | 70 | 30 | 70 | 90 | 1,400 |
| <u>1984</u> | | | | | | |
| Benefit Reductions | 30 | 60 | 20 | 30 | 30 | 30 |
| Tax Increases | <u>70</u> | <u>20</u> | <u>40</u> | <u>80</u> | <u>80</u> | <u>1,520</u> |
| Total | 100 | 80 | 60 | 110 | 110 | 1,550 |
| <u>1985</u> | | | | | | |
| Benefit Reductions | 40 | 70 | 30 | 30 | 30 | 40 |
| Tax Increases | <u>80</u> | <u>20</u> | <u>50</u> | <u>80</u> | <u>80</u> | <u>1,580</u> |
| Total | 120 | 90 | 80 | 110 | 110 | 1,620 |

SOURCE: Congressional Budget Office.

NOTE: Tax and benefit amounts include only those changes affecting households.

The effect of spending reductions is largest in the lowest income category, and reductions in benefits going to this category are almost half of the total benefit cuts. However, because the Medicare program, which is not means-tested, accounts for such a large proportion of the total savings, there are some reductions in benefits in every income category.

The average impact of the tax and spending changes considered together is much larger for households in the highest income bracket than for those in any other category. Households with incomes below \$80,000 will lose about \$90 on average in 1985. Households with incomes over \$80,000, however, will lose more than 17 times as much--over \$1,600 on average in 1985. Most of this loss will result from the relatively large tax increases for households in this category.

In assessing these findings, it should be remembered that averages over entire income categories may not be representative of the experience of specific households in each category. In particular, the households affected by the tax increases and the spending reductions will not necessarily be the same. Further, within each category some households will experience substantial changes in tax liabilities, while others will be relatively unaffected.

