

**EFFECTS OF CHANGES IN TAXES AND BENEFIT PAYMENTS
RESULTING FROM THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982,
FOR HOUSEHOLDS IN DIFFERENT INCOME CATEGORIES**

Staff Memorandum

July 1982

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Human Resources and Community Development Division
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Congressional Budget Office

**Pursuant to the Request of
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 proposed in the Tax Equity and Fiscal Responsibility Act of 1982, as reported out by the Senate Committee on Finance.¹ 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 for individuals are estimated for households in various income categories, changes in business taxes and in federal expenditures other than for benefits to households are not considered. 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 proposed tax and benefit changes.

1. These estimates are based on the bill as reported to the Senate by the Committee on Finance on July 19, 1982. The provisions estimated here were the same in that version of the bill and in the version passed by the Senate on July 22, however.

REVENUE INCREASES

The Senate Finance Committee bill includes numerous revenue-raising measures. The total increase in tax revenues contemplated by the bill is \$99.7 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; the shorter six-month holding period for capital gains; and the excise taxes on cigarettes, air travel, and telephone services.

The alternative minimum tax would broaden and combine two current individual minimum taxes. Its revenue yield would be \$227 million in fiscal year 1984, all of which would come from taxpayers with incomes of at least \$100,000.

The present medical and casualty deductions would both be made more restrictive under the bill as reported. Medical expenses would be deductible only if they exceed 7 percent of adjusted gross income, and the cap on the deduction for one-half of medical insurance premiums would be lowered to \$100 from \$150. The casualty-loss deduction would be subject to a floor of 10 percent of adjusted gross income. The additional revenue resulting from the medical expense and casualty-loss provisions would be \$2.3 billion and \$666 million, respectively, in fiscal year 1984.

One of the few tax reductions in the bill would shorten the minimum holding period for long-term capital gains from one year to six months. That provision would reduce revenues by \$219 million in fiscal year 1984.

Three excise tax increases would have measurable revenue implications for identifiable households. Airline ticket taxes would be increased from 5 to 8 percent, and a \$3 international departure tax would be imposed; the combined revenue yield from these changes would be \$2.6 billion. The current 1 percent excise tax on telephone service would be

increased to 2 percent for calendar year 1983 and to 3 percent for 1984 and 1985, and would fall to 2 percent thereafter; the revenue gain from these changes would be \$881 million in fiscal year 1984. For the purposes of this memorandum, it is assumed that one-half of the air travel and telephone taxes would be paid by businesses; that portion of these taxes is therefore not distributed among households. The bill would also raise 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 that would result 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 are included in the bill reported by the Committee on Finance. Reductions would be largest for the Medicare program, but would also affect Medicaid, Aid to Families with Dependent Children (AFDC), Supplemental Security Income (SSI), and Unemployment Insurance. The CBO estimates that the proposed reductions in outlays for benefit payments

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 dollars)

	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1983-85</u>	Percent of Total Allocated to Individuals ^a
Total, All Provisions	20,948	34,207	43,894	99,049	14
Individual Income Tax	240	2,984	3,261	6,485	100
Business Taxes	5,927	12,755	18,162	36,844	0
Compliance Provisions	6,698	7,056	8,646	22,400	0
Pension Provisions	211	588	673	1,472	0
Life Insurance and Annuities	1,487	1,510	2,183	5,180	0
Employment Tax	1,814	3,104	3,869	8,787	0
Excise Taxes	2,509	3,847	4,734	11,090	70
Miscellaneous Taxes	-38	-37	-34	-109	0
Enforcement Personnel	2,100	2,400	2,400	6,900	0

SOURCE: Congressional Budget Office

NOTE: Table describes provisions of bill as reported to the Senate by the Committee on Finance on July 19, 1982.

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

would total about \$4.2 billion in fiscal year 1983, and would grow to about \$7.2 billion in 1985.²

Not all reductions in benefit payment programs have been included in these estimates, since changes that would not directly affect the benefits received by individuals have been excluded. In AFDC and Medicaid, for example, the bill would reduce federal payments to the states resulting from erroneous benefit payments made by the states. In addition, federal matching would be eliminated for some state Medicaid expenditures. Although the enactment of these proposals could substantially increase states' costs, they would 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 distributed by program.)

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2. The estimates of outlay savings presented here are the differences attributable to proposed 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.

Cuts in the Medicare program account for more than three-fourths of the savings from the proposed benefit reductions. However, only about 45 percent of the Medicare savings can be distributed across income categories. Proposed Medicare reductions include both benefit changes affecting covered services and patient liability, which are included in this analysis, and reductions in hospital reimbursement, which have been excluded.

The Medicaid and AFDC programs would account for most of the remaining reductions in spending. Proposed Medicaid cuts include: allowing states to apply liens on patients' property to cover the costs of long-term care; allowing states to impose co-payments for some services; and changing the matching rate and error-rate provisions as discussed above. Some Medicaid savings would also result from AFDC changes that would remove some current recipients from the AFDC program, thereby reducing the number eligible for Medicaid.

A number of comparatively small changes have been proposed for AFDC. In addition to changes in error-rate tolerances, these include counting the income of unrelated adults who are part of the household in determining AFDC benefits; counting all minor children in the household in the AFDC unit; repealing emergency assistance; eliminating parents' benefits when the youngest child reaches 16; permitting states to pro-rate

TABLE 2. REDUCTIONS IN OUTLAYS FOR PROGRAMS PROVIDING BENEFIT PAYMENTS TO INDIVIDUALS RESULTING FROM THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982, BY PROGRAM: FISCAL YEARS 1983-1985 (In millions of dollars)

	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>Total, 1983-85</u>	<u>Percent of of Total Allocated to Individuals^a</u>
Total, All Programs ^b	4,217	5,958	7,207	17,382	50
Medicare	3,020	4,599	5,760	13,379	45
Medicaid	588	638	786	2,012	57
AFDCC ^c	472	563	474	1,509	78
SSI	137	148	168	453	75
Unemployment Compensation	--	10	19	29	100

SOURCE: Congressional Budget Office.

NOTE: Table describes provisions of bill as reported to the Senate by the Committee on Finance on July 19, 1982.

- a. Only those reductions directly affecting individual benefits have been distributed by income class. (See Tables 3 and 4.)
- b. Excludes interest on the public debt and employers' share of employee retirement (function 950).
- c. Includes child support enforcement.

shelter expenses if the AFDC unit is part of a larger household; and requiring AFDC parents who are minors to reside with their parents or guardians in order to maintain their eligibility for benefits.

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

Tax increases would be greater than the spending reductions resulting from this bill in all income categories except the lowest, as Tables 3 and 4 show.³ About two-thirds of the revenues generated by the tax increases would come from taxes affecting households in the third and fourth income categories. On a per-household basis, however, the impact of the tax increases would rise with income, and would be 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 would primarily affect households in this category.

The effect of spending reductions would be largest in the lowest income category, and reductions in benefits going to this category would account for 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 would be some reductions in benefits in every income category.

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

TABLE 4. CHANGE IN AVERAGE TAXES AND BENEFITS PER HOUSEHOLD RESULTING FROM THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 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
1983						
Benefit Reductions	30	60	20	20	10	30
Tax Increases	<u>70</u>	<u>20</u>	<u>40</u>	<u>80</u>	<u>100</u>	<u>900</u>
Total	100	80	60	100	110	930
1984						
Benefit Reductions	40	80	30	20	20	50
Tax Increases	<u>80</u>	<u>20</u>	<u>50</u>	<u>90</u>	<u>110</u>	<u>980</u>
Total	120	100	80	110	130	1,030
1985						
Benefit Reductions	50	90	40	30	20	50
Tax Increases	<u>90</u>	<u>30</u>	<u>50</u>	<u>100</u>	<u>120</u>	<u>1,080</u>
Total	140	120	90	130	140	1,130

SOURCE: Congressional Budget Office.

NOTE: Table describes provisions of bill as reported to the Senate by the Committee on Finance on July 19, 1982.

TABLE 3. TOTAL CHANGE IN TAXES AND BENEFITS RESULTING FROM THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 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	2,440	1,210	510	500	210	30
Tax Increases	<u>5,870</u>	<u>360</u>	<u>830</u>	<u>2,300</u>	<u>1,370</u>	<u>940</u>
Total	8,310	1,570	1,340	2,800	1,580	970
<u>1984</u>						
Benefit Reductions	3,260	1,520	750	670	270	50
Tax Increases	<u>6,940</u>	<u>480</u>	<u>1,040</u>	<u>2,830</u>	<u>1,580</u>	<u>1,060</u>
Total	10,200	2,000	1,790	3,500	1,850	1,110
<u>1985</u>						
Benefit Reductions	4,070	1,850	980	860	340	60
Tax Increases	<u>7,720</u>	<u>550</u>	<u>1,160</u>	<u>3,130</u>	<u>1,750</u>	<u>1,180</u>
Total	11,790	2,400	2,140	3,990	2,090	1,240

SOURCE: Congressional Budget Office.

NOTE: Table describes provisions of bill as reported to the Senate by the Committee on Finance on July 19, 1982.

The average impact of the tax and spending changes considered together would be much larger for households in the highest income bracket than for those in any other category. Households with incomes below \$80,000 would lose about \$100 on average in 1984. Households with incomes over \$80,000, however, would lose more than 10 times as much--over \$1,000 on average in 1984. Most of this loss would 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 would not necessarily be the same. Further, within each category some households would experience substantial changes in tax liabilities, while others would be relatively unaffected.

