

**EFFECTS OF MAJOR CHANGES IN INDIVIDUAL INCOME AND
EXCISE TAXES ENACTED IN 1981 AND 1982
FOR HOUSEHOLDS IN DIFFERENT INCOME CATEGORIES**

(An Update of Earlier Analyses)

Staff Memorandum

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Chairman James R. Jones
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Chairman Pete V. Domenici
Senate Budget Committee

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This memorandum is a companion to the recent Congressional Budget Office (CBO) memorandum, "Major Legislative Changes in Human Resource Programs Since January 1981" (August 1983), which estimates the effects on budget outlays of policy changes since 1981.¹ It revises the revenue estimates provided in the CBO memoranda of February 1982 and November 1982,² which respectively estimated the distributional effects of the tax and benefit reductions enacted in 1981 and 1982. In order to be consistent with the estimates of benefit reductions contained in the

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1. The budget outlay estimates presented in the August 1983 memorandum are calculated on a fiscal year basis. The estimates presented here are on a calendar year tax liability basis. The basic data used for this analysis are tax returns grouped by expanded income categories. (Expanded income is defined as adjusted gross income plus excluded capital gains and certain tax preference items, less investment interest to the extent of investment income.) These return data are reorganized to form households using the results of a procedure developed by the U.S. Bureau of the Census (see After-Tax Money Income Estimates of Households: 1981, Current Population Reports, Special Studies Series, P-23, No. 132). To conform with most other tax distribution studies, movement over time by taxpayers into higher tax rate brackets is simulated by adjusting the number of households in each income category each year. Previous CBO studies have assumed the share of households contained in each income group is relatively constant year after year.

To consider the combined effects of the outlay and revenue changes CBO has examined, adjustment of both sets of estimates is necessary. A forthcoming CBO report will sum the individual estimates and outline the resulting effects on different income groups.

2. See CBO, "Effects of Tax and Benefit Reductions Enacted in 1981 for Households in Different Income Categories," Special Study (February 1982), and CBO, "Effects of Changes in Taxes and Benefit Payments Enacted in Fiscal Year 1982 for Households in Different Income Categories," Special Study (November 1982). (A detailed presentation of general definitions and limitations, along with further discussion of the methodological problems associated with such estimates, may be found in the February 1982 memorandum.)



August 1983 memorandum, the revenue estimates presented here are based on the CBO economic assumptions of February 1983.

The revenue estimates presented here reflect actual economic conditions since 1982—the signal feature of which, for this analysis, was the effect of the recession in depressing personal income growth. In particular, the estimates of the revenue effects (in dollars) of the Economic Recovery Tax Act of 1981 (ERTA) across-the-board rate cuts presented here are smaller than those provided in February 1982.

These revenue estimates, however, are static estimates: they are based on the somewhat arbitrary assumption that such changes in the tax code do not have significant effects on general taxpayer behavior or otherwise on the economy at large, and that they do not have significant effects on other budget policies or on the stance of monetary policy. These assumptions limit the value of the revenue estimates for assessing the ultimate effects of such fiscal policy initiatives; however, they facilitate the comparison of these estimates with other budget estimates, which are generally calculated in the same manner.³

3. The likely behavioral responses of both taxpayers and the monetary authority to such tax law changes are subjects of considerable controversy. If such static assumptions are not employed, a wide range of behavioral responses should be assessed.



INTRODUCTION

This memorandum discusses the effects on households in different income categories of significant changes in income and excise taxes enacted in 1981 and 1982. These changes were included in the Economic Recovery Tax Act of 1981 (ERTA) and the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). The results of the analysis indicate that the distributional effects of the ERTA individual income tax cuts dominate those of the TEFRA income and excise tax increases, because the ERTA cuts are so much larger. The ERTA individual income tax cuts range from \$41 billion dollars in 1982 to \$136 billion in 1985 (relative to projected revenues under prior law).

Taken as a share of the gross national product (GNP), ERTA as a whole reduced federal government revenues by 1.3 percentage points in 1982 and by 3.5 percentage points in 1985, from a post-World War II high of 20.8 percent of GNP in 1981. The tax burden had been rising steadily during the high-inflation years of the late 1970s, and some form of tax reduction would likely have been enacted anyway in the early 1980s, if only to provide relief from inflation-induced bracket creep.

In terms of total dollar volume, the bulk of the net revenue reduction from the ERTA and TEFRA provisions examined was experienced by households with annual incomes between \$20,000 and \$80,000, the group of households paying the bulk of total taxes. Measured in terms of total dollars per household or as a percentage of

income, the effects are greater for households with annual incomes of more than \$40,000. This is an expected outcome of the common across-the-board reduction in rates when applied to the progressive income tax system in which the more affluent pay more tax. The share of total taxes paid by those with incomes of more than \$40,000, however, increases over the 1982 to 1985 period, for the most part because income growth over the period pushes a greater proportion of households above this income.⁴ Taxpayers with incomes above \$40,000 will pay about 65 percent of total taxes in 1985 compared with 56 percent in 1982.

The analysis that follows considers first the effects of the major ERTA tax cuts (relative to continuation of prior law). Next, it considers the effects of significant TEFRA tax increases (relative to continuation of prior law including ERTA). Then it considers the combined effects of all these provisions.

This memorandum considers only major changes in taxes that have directly affected household incomes. Thus, it includes estimates of changes in personal income and excise taxes, but it does not consider changes in business taxes. Although business tax changes do affect household incomes, their impact is more difficult to estimate. In addition, as mentioned above, no attempt has been made to take into account the possible macroeconomic effects of the tax changes examined here.

4. As incomes grow, reflecting both real economic growth and inflation, the proportion of the total population with income above any specified dollar bracket amount also rises.



DIFFERENCES FROM EARLIER ANALYSES

Estimates of the distribution of tax changes in this study are based on CBO economic projections of February 1983. These projections were chosen for compatibility with the outlay estimates provided in the August 1983 CBO study.

Earlier (1982) analyses were based on projections at the time they were prepared, which differed significantly from subsequent economic conditions. Actual rates of growth of both real incomes and prices proved to be sharply lower than had been anticipated. As a result, the amount of income subject to the individual income tax—in both nominal and real terms—was substantially less than projected in the February 1982 CBO memorandum estimating the effects of the ERTA tax cuts. Because 1982 and 1983 taxable incomes were lower than projected, the revenue loss due to the 1981 tax rate reductions was also lower (as was the amount of revenue collected). Also, because of the lower-than-projected income growth, fewer households moved from lower to higher income levels over time as a result of bracket creep. The discrepancy was not as great in the estimates of the effects of the 1982 tax legislation. The economic projections used at the time of the enactment of TEFRA (September 1982) included more of the effects of the recession than in progress.

The TEFRA changes affecting individuals that are analyzed here are mostly excise tax increases, which are less sensitive to the state of the economy than are

across-the-board income tax rate reductions and the indexing of tax brackets and exemptions.

ECONOMIC RECOVERY TAX ACT OF 1981

The ERTA provisions for which distributional effects are estimated in this study comprise the across-the-board tax rate reductions (including the reduction in the top marginal rate to 50 percent), the special deduction for two-earner married couples, and indexing. When taken together, these provisions account for approximately 90 percent of the ERTA individual income tax reductions in 1982-1985.

ERTA Changes Examined

ERTA cut marginal individual income tax rates below pre-1981 levels by 1.25 percent in 1981,⁵ 10 percent in 1982, 19 percent in 1983, and 23 percent in 1984. Withholding rates applied to wages and salaries were first reduced 5 percent on October 1, 1981. This reduction increased to 14 percent on July 1, 1982, and to 23 percent on July 1, 1983--resulting in reductions in withholding rates that equal the tax rate cuts in each calendar year. The marginal tax rate on the wages and salaries of the highest-income taxpayers was not reduced by the across-the-board cuts, because the maximum tax rate on earned income had been limited to approximately

5. The tax reduction for 1981 actually took the form of a tax credit equal to 1.25 percent of regular tax liability before other credits.

50 percent since 1969 through a complex legal provision known as the maximum tax. However, effective January 1, 1982, the maximum statutory tax rate on all income was reduced to 50 percent; and so taxpayers in the very highest brackets, who received no marginal rate reduction for earned income (although they received a reduction in their average tax rate), received immediate and larger than average reductions for income from property. CBO estimates all of these rate cut provisions reduced tax liabilities by about \$35 billion in 1982, increasing to about \$105 billion in 1985. (All revenue estimates are CBO February 1983 estimates and refer to calendar years, unless otherwise specified.)

The second major individual income tax provision was the introduction of a special deduction for two-earner married couples. Such couples received a deduction in 1982 equal to 5 percent of the earnings of the lesser-earning spouse up to a maximum deduction of \$1,500. The deduction increases to 10 percent (up to a \$3,000 maximum) for 1983 and later years. The second-earner deduction reduced tax liabilities by about \$3 billion in 1982, with the tax loss increasing sharply to about \$7 billion in 1985 as the provision phases in.

The third major individual income tax provision is indexing. Beginning on January 1, 1985, the zero bracket amount, personal exemptions, and tax rate brackets will be increased each year according to the rate of inflation as measured by the Consumer Price Index. This change is intended to eliminate the increase in effective tax rates caused by inflation eroding the value of exemptions and zero bracket



amounts and pushing taxpayers into higher tax brackets. CBO projects the tax loss due to indexing at about \$11 billion in 1985.

The combined distributional effects of the ERTA tax changes are shown in Tables 1 and 2. The largest tax cut in dollar terms goes to the \$40,000 to \$80,000 upper-middle-income group (see Table 1). The \$20,000 to \$40,000 class, the group containing the most households and the most income, receives the next largest reduction. On a per household basis, the tax cuts increase sharply with income, because those who pay the most taxes benefit the most in dollars from an across-the-board rate cut (Table 2). The higher-income groups also benefited most from the reduction in 1982 in the top marginal rate on property income.

When measured as a percentage of income, the ERTA tax cuts also rise with income. This occurs in a progressive tax structure because higher-income persons pay a higher proportion of income in tax, and the effects of an across-the-board rate cut will mirror this progression. As income increases, the tax cuts will represent larger shares of income because the underlying tax liabilities do. (The combined effects of the ERTA and TEFRA individual income tax changes on the percentage of total income tax liabilities owed by income category are shown in Table 8.)

TABLE 1. INDIVIDUAL INCOME TAX CHANGES RESULTING FROM ERTA BY INCOME CATEGORY, CALENDAR YEARS 1982-1985^a (In billions of current dollars)

Calendar Year	Household Income (In current dollars) ^b					
	All Households	Less Than \$10,000	\$10,000-20,000	\$20,000-40,000	\$40,000-80,000	\$80,000 and Over
1982	-37.8	-0.3	-2.9	-13.2	-14.3	-7.1
1983	-74.1	-0.5	-5.1	-25.9	-29.7	-12.9
1984	-99.9	-0.6	-6.1	-32.8	-41.5	-18.9
1985	-122.3	-0.7	-6.8	-37.8	-52.3	-24.6

SOURCE: Congressional Budget Office. Based on CBO economic projections of February 1983.

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

- a. Individual income tax cuts from ERTA included in this table are the rate cuts, the deduction for two-earner married couples, and indexing.
- b. Household income bracket boundaries are expressed in nominal dollars. Taxpayer incomes in each year are assumed to grow reflecting real economic growth and inflation ("bracket creep"). Income growth is assumed to be the same for all income groups. Bracket creep causes taxpayers (and households) to be pushed into higher income categories over the 1982-1985 period, and thus can affect the total amount of taxes paid by each income group differently.

TABLE 2. INDIVIDUAL INCOME TAX CHANGES PER HOUSEHOLD RESULTING FROM ERTA BY INCOME CATEGORY, CALENDAR YEARS 1982-1985^a (In current dollars)

Calendar Year	Household Income (In current dollars)					
	All Households	Less Than \$10,000	\$10,000-20,000	\$20,000-40,000	\$40,000-80,000	\$80,000 and Over
1982	-450	-10	-130	-460	-1,170	-5,100
1983	-880	-20	-240	-910	-2,260	-7,510
1984	-1,160	-30	-290	-1,130	-2,870	-8,750
1985	-1,390	-40	-320	-1,290	-3,320	-9,430

SOURCE: Congressional Budget Office. Based on CBO economic projections of February 1983.

- a. Individual income tax cuts from ERTA included in this table are the rate cuts, the deduction for two-earner married couples, and indexing.



ERTA Provisions Affecting Individuals Not Included in the Distributional Analysis

Income Tax Provisions. This analysis does not include the effects of other smaller ERTA provisions such as a liberalization of the child and dependent care credit, a broadening of the charitable contributions deduction to apply to non-itemizers, an increase in the exclusion of capital gains from the sale of a principal residence, liberalization of the tax treatment of foreign earned income, broadening of the Individual Retirement Account (IRA) and liberalization of the Keogh retirement saving provisions, establishment of the "All Savers" certificates, and the 15 percent net interest exclusion. All of these provisions are much smaller in revenue impact, and the distributional effects of most are difficult to estimate. Accordingly, these provisions were omitted from the quantitative analysis above. Since the revenue effect of these provisions, taken together, totals less than 10 percent of the effect of the provisions examined here, it is reasonable to assume that their inclusion would not significantly change the results seen in Tables 1 and 2. All but one of these provisions--the charitable deduction for non-itemizers, would tend to marginally increase the relative tax deductions received by middle- and higher-income groups.

Business Tax Cuts. Some ERTA tax cuts were aimed primarily at businesses, including more rapid depreciation due to the Accelerated Cost Recovery System (ACRS) and larger investment credits, and other provisions that benefit businesses making research and development expenditures, rehabilitating structures, or producing oil. Even though businesses are owned by people, attributing business tax cuts to



individuals is theoretically and practically difficult. There is no general agreement on who actually pays the corporate income tax--whether it is borne by shareholders out of profits, or passed on to consumers through higher prices or to workers through lower wages. Consequently, the effects of the ERTA business provisions are not analyzed here.

Estate and Gift Tax Reductions. ERTA also included substantial reductions in the estate and gift taxes. The most important provisions in terms of revenue loss were an increase in the unified credit phased in from 1982 through 1987, a four-year phased-in reduction in the maximum rates of tax, an unlimited marital deduction, and an increased permissible reduction in valuation due to current use. The estate and gift tax cuts clearly benefit persons with relatively large amounts of wealth, simply because under prior law these taxes touched only the 3 percent of all households with the greatest wealth. Attribution of the tax cuts in this analysis could be misleading, however, because the association between wealth and income, while strong, is not perfect; and because these tax cuts are received mostly on the occasion of death, when financial affairs are disrupted, making a ranking of tax cuts by current income difficult to interpret. Therefore, these tax reductions are not included in the estimates presented here.

TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982

The TEFRA provisions examined in this memorandum are the tightening of the medical and casualty loss deductions, and the increases in excise taxes on cigarettes, air travel, and telephone services.

TEFRA made both the medical and casualty deductions more restrictive effective January 1, 1983. Medical expenses are deductible only if they exceed 5 percent (previously 3 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 now 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 TEFRA air travel, cigarette, and telephone service excise tax increases have significant revenue implications for households. Airline ticket taxes were increased from 5 percent to 8 percent, a \$3 international departure tax was reimposed, and taxes were imposed and increased on fuels and freight waybills. The current 1 percent excise tax on telephone service was increased to 3 percent for calendar years 1983-1985, and terminated thereafter. 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; therefore, only the remaining one-half of the gross revenue effect is distributed among households. TEFRA also temporarily (until September 30, 1985) raised cigarette excise taxes from 8 to 16 cents per pack for small cigarettes, and from 16.8 to 33.6 cents per pack for large cigarettes. The entire gross revenue effect of this tax increase is distributed among households.

The greater part of the TEFRA revenue increase is collected from businesses, and is not analyzed in this memorandum. Also not included are the compliance measures, including withholding on interest and dividends, which was repealed; the changes in the tax treatment of pensions and life insurance; changes to the alternative minimum tax; changes to employment taxes; 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 revenue increases resulting from all of the tax provisions of the bill and the shares of these revenue increases included in this distributional analysis are shown in Table 3.

TABLE 3. INCREASES IN TAX LIABILITIES RESULTING FROM THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982, BY TYPE: CALENDAR YEARS 1982-1985 (In billions of dollars)

	1982	1983	1984	1985	1982-1985	Percent of Total Allocated to Individuals ^a
Individual Income Taxes	---	3.1	3.1	3.3	9.5	100
Business Taxes	0.7	8.4	12.9	19.1	41.1	0
Compliance Provisions	0.1	4.0	7.2	8.8	20.2	0
Pension Provisions	---	0.8	0.8	1.0	2.6	0
Life Insurance and Annuities	1.2	1.5	2.8	3.0	8.6	0
Employment Taxes	---	3.0	3.2	3.0	9.1	0
Excise Taxes (Net)	0.4	3.8	4.1	4.4	12.7	90
Miscellaneous Taxes	b	b	b	b	-0.1	0
Enforcement Personnel	<u>0.7</u>	<u>2.5</u>	<u>2.5</u>	<u>2.0</u>	<u>7.7</u>	0
Total, All Provisions	3.0	27.0	36.6	44.6	111.3	

SOURCE: General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982, Joint Committee on Taxation (December 31, 1982).

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

- a. Only those increases directly affecting individual incomes have been distributed by income class. (See Tables 4 and 5.)
- b. Between \$0 and -\$50 million.



Impact of TEFRA Changes on Households In Different Income Categories

As a group, households in the \$20,000 to \$80,000 income range pay two-thirds of the TEFRA tax increases analyzed here (see Table 4). On a per-household basis, however, the dollar amounts of the tax increases generally rise with income, and are much greater for those in the highest income category than in any other (Table 5). When measured as a percentage of income, the tax increases also are largest for the highest income group.

ERTA AND TEFRA PROVISIONS COMBINED

When the results of the analysis of the ERTA and TEFRA provisions are combined, the larger ERTA effects predictably dominate. The combined effects of the provisions examined here follow the same general division among income groups as do the ERTA provisions alone (Table 6). Net tax reductions, measured per household, rise with household income, even though TEFRA raised taxes per household more for upper-income households (Table 7). Measured as a percentage of income, the net tax reductions also increase as income rises.

While ERTA and TEFRA combined result in net tax reductions per household which rise with household income, income growth over the period will push many households into higher tax brackets, partially offsetting the effects of the rate cuts. As a result, higher-income households, as a group, will actually pay a larger



TABLE 4. CHANGE IN TAX LIABILITY RESULTING FROM TEFRA, BY INCOME CATEGORY: CALENDAR YEARS 1982-1985^a (In billions of current dollars)

Calendar Year	All Households	Household Income (In current dollars)				
		Less Than \$10,000	\$10,000-20,000	\$20,000-40,000	\$40,000-80,000	\$80,000 and Over
1982	0.3	b	b	0.1	0.1	b
1983	6.1	0.5	0.9	2.4	1.7	0.6
1984	6.3	0.5	0.9	2.5	1.7	0.7
1985	6.4	0.5	0.9	2.3	1.9	0.8

SOURCE: Congressional Budget Office. Based on CBO economic projections of February 1983.

NOTE: Details may not sum to totals due to rounding. Tax increases include only selected large changes affecting households.

a. Individual income tax increases from TEFRA included are the tightening of the medical and casualty loss deductions. The effects on households of TEFRA increases in cigarette, air travel, and telephone service excise taxes are also included.

b. Less than \$50 million.

TABLE 5. NET CHANGE IN AVERAGE TAX LIABILITY PER HOUSEHOLD RESULTING FROM TEFRA, BY INCOME CATEGORY: CALENDAR YEARS 1982-1985^a (In current dollars)

Calendar Year	All Households	Household Income (In current dollars)				
		Less Than \$10,000	\$10,000-20,000	\$20,000-40,000	\$40,000-80,000	\$80,000 and Over
1982	b	b	b	b	b	20
1983	70	30	40	90	130	340
1984	70	30	40	80	120	300
1985	70	30	40	80	120	290

SOURCE: Congressional Budget Office. Based on CBO economic projections of February 1983.

NOTE: Tax increases include only selected large changes affecting households.

a. Individual income tax increases from TEFRA included are the tightening of the medical and casualty loss deductions. The effects on households of TEFRA increases in cigarette, air travel, and telephone service excise taxes are also included.

b. Less than \$5.



TABLE 6. COMBINED TAX CHANGES RESULTING FROM ERTA AND TEFRA BY INCOME CATEGORY, CALENDAR YEARS 1982-1985^a (In billions of current dollars)

Calendar Year	All Households	Household Income (In current dollars)				
		Less Than \$10,000	\$10,000-20,000	\$20,000-40,000	\$40,000-80,000	\$80,000 and Over
1982	-37.5	-0.3	-2.8	-13.1	-14.2	-7.1
1983	-68.0	b	-4.2	-23.5	-28.0	-12.4
1984	-93.6	c	-5.1	-30.4	-39.8	-18.3
1985	-115.9	-0.2	-6.0	-35.4	-50.5	-23.9

SOURCE: Congressional Budget Office. Based on CBO economic projections of February 1983.

- a. Individual income tax cuts from ERTA included in this table are the rate cuts, the deduction for two-earner married couples, and indexing. Individual income tax increases from TEFRA included are the tightening of the medical and casualty loss deductions. The effects of TEFRA increases in cigarette, air travel, and telephone service excise taxes are also included.
- b. Between \$0 and \$50 million.
- c. Between \$0 and \$-50 million.

TABLE 7. COMBINED TAX CHANGES RESULTING FROM ERTA AND TEFRA PER HOUSEHOLD BY INCOME CATEGORY, CALENDAR YEARS 1982-1985^a (In current dollars)

Calendar Year	All Households	Household Income (In current dollars)				
		Less Than \$10,000	\$10,000-20,000	\$20,000-40,000	\$40,000-80,000	\$80,000 and Over
1982	-450	-10	-130	-460	-1,160	-5,080
1983	-810	b	-200	-820	-2,130	-7,170
1984	-1,090	c	-240	-1,050	-2,750	-8,450
1985	-1,320	-10	-280	-1,210	-3,200	-9,140

SOURCE: Congressional Budget Office. Based on CBO economic projections of February 1983.

- a. Individual income tax cuts from ERTA included in this table are the rate cuts, the deduction for two-earner married couples, and indexing. Individual income tax increases from TEFRA included are the tightening of the medical and casualty loss deductions. The effects of TEFRA increases in cigarette, air travel, and telephone service excise taxes are also included.
- b. Between \$0 and \$5.
- c. Between \$0 and \$-5.



percentage of total income taxes by 1985 than they would have paid in 1982 under pre-ERTA tax law (Table 8). The percentage of income taxes paid by households in the \$80,000 and over category was reduced in 1982 largely by the ERTA reduction in the maximum statutory tax rate on all income from 70 percent to 50 percent. However, after 1982, all households with incomes of \$40,000 and over pay a progressively larger share of total income taxes each year as more households both cross the \$40,000 threshold and move into the top marginal tax bracket.

MORE RECENT CHANGES IN THE TAX LAW

The Social Security Amendments of 1983. The Social Security Amendments of 1983 (P.L. 98-21), enacted on April 20, 1983, increased payroll and income taxes. Because data on the distributional effects of this piece of legislation are incomplete, it is not analyzed here.

The most significant revenue provision of the Social Security legislation, in terms of numbers of dollars raised, is the acceleration of two already scheduled payroll tax rate increases. The first moves 0.3 percentage points of a 0.35 percentage point tax rate increase from January 1, 1985, to January 1, 1984; the second moves 0.36 percentage points of a 0.5 percentage point increase from January 1, 1990, to January 1, 1988. The latter acceleration thus occurs beyond the time horizon of this analysis. The employee portion of the first acceleration in the scheduled rate increases (in 1984) is totally offset by a 0.3 percent payroll tax credit

TABLE 8. PERCENTAGE OF TOTAL INCOME TAX LIABILITY PAID
BY INCOME CATEGORY, CALENDAR YEARS 1982-1985

Percentage of Total Income Tax Liability	All Households	Household Income (In current dollars)				
		Less Than \$10,000	\$10,000- 20,000	\$20,000- 40,000	\$40,000- 80,000	\$80,000 and Over
<u>Under Prior Law:</u>						
1982	100.0	0.6	7.6	36.0	38.4	17.5

<u>After ERTA and TEFRA:</u>						
1982	100.0	0.6	7.6	36.1	38.5	17.3
1983	100.0	0.5	6.9	33.8	39.4	19.3
1984	100.0	0.5	6.1	31.5	40.7	21.3
1985	100.0	0.4	5.2	29.2	42.0	23.2

ADDENDUM

Adjusted Gross Income (AGI) of
Households in Each Income Group As a
Percent of Total AGI

	All Households	Household Income (In current dollars)				
		Less Than \$10,000	\$10,000- 20,000	\$20,000- 40,000	\$40,000- 80,000	\$80,000 and Over
1982	100.0	2.5	13.4	42.0	32.6	9.6
1983	100.0	2.3	12.5	40.3	34.1	10.8
1984	100.0	2.1	11.5	38.3	35.9	12.2
1985	100.0	1.9	10.5	36.4	37.6	13.5

SOURCE: Congressional Budget Office. Based on CBO economic projections of February 1983.

- a. The individual income tax cuts from ERTA included in these estimates are the rate cuts, the deduction for two-earner married couples, and indexing. The individual income tax increases from TEFRA included are the tightening of the medical and casualty loss deductions (which went into effect in 1983). (The effects of TEFRA increases in cigarette, air travel, and telephone service excise taxes, included in Tables 6 and 7, are not included here because the liabilities presented here are individual income tax liabilities only.)

in that year, so the tax increase affects only employers. Assigning payroll taxes paid by employers to households is always problematic from a distributional point of view, because it is unclear whether the taxes would be passed along through lower wages or higher prices, or would affect employers by reducing profits. In the short term, the outcome of a payroll tax increase such as this one is even more uncertain, because firms may not be able to pass the tax increase along immediately; the increase might in fact be paid out of profits. Therefore, this tax increase could not be ascribed to household income groups with any confidence.

The second largest revenue provision is the taxation of up to one-half of Social Security benefits of persons with adjusted gross incomes over \$25,000 (\$32,000 for couples), effective with calendar 1984. Because there has been no linking of Social Security benefit data with federal income tax returns in any recent year, the distributional effects of this provision are somewhat uncertain, and it cannot be included in the analysis. Most of this tax will rest on households defined for purposes of this analysis to have over \$20,000 of income.

Another large revenue provision is the taxation of the earnings of self-employed persons at the combined employer/employee payroll tax rate, with a payroll tax credit for a fraction of the self-employment tax paid. For 1984 and 1985, the payroll tax credit cancels out much of the tax increase for individuals (even though the Social Security trust funds are augmented as though there were no credit), and so the net tax increase for the self-employed is relatively small. In later years,



however, the rate of the credit declines (and is replaced by an income tax deduction in 1990); so while the tax increase is small over the time horizon of this analysis and can reasonably be omitted, it will become more significant in later years.

Surface Transportation Assistance Act of 1982. The Surface Transportation Assistance Act of 1982 (P.L. 97-424), enacted on January 6, 1983, raised federal excise taxes on gasoline, diesel, and special motor fuels from 4 cents to 9 cents per gallon, effective April 1, 1983. The effects of this tax increase on households are not included in the estimates shown above.

Attributing gas taxes to households in different income groups is troublesome. Although it may be possible to determine the share of these taxes paid by individuals generally, relating this information to incomes would be unreliable. Available data on households' consumption patterns predate the 1973 oil crisis which significantly altered gas usage by individuals. In the absence of more up-to-date information, these tax increases have not been analyzed.

