NLWJC - Kagan
DPC - Box 057 - Folder-015

Tax Proposals

Family-child care policy - stay-at-home parents

and

Tax proposals

Summary of Proposals that Target Marriage Penalties and Stay-at-Home Parents			
Proposal	Preliminary Cost /1	Description	Brief Comments
Marriage penalty proposals that might affect stay-at-home parents			
Single Filer Option (H.R. 2456)	$22 billion per year (in 1999 income levels)	Married couples could continue to file a joint return, or elect to file two separate returns as if each were a single individual. On separate returns, each spouse would report their own earnings. Unearned income could be reallocated by shifting assets. Rules specify how deductions, exemptions, and credits split.	Would significantly reduce marriage penalties, but would also increase some marriage bonuses. Provides only limited or even no benefit to stay-at-home parents. Would substantially increase filing burdens.
Income Splitting (Ashcroft and others)	$36 billion per year (in 1999 income levels)	Single filing, with half of a couple's income, including earned income, attributed to each spouse.	Would significantly reduce marriage penalties, but also greatly increase marriage bonuses. Would help stay-at-home parents. Adds some complexity to filing.
Make Joint Tax Parameters Double Singles	Roughly $36 billion per year (in 1999 income levels) /2	The standard deduction and rate brackets for joint filers would be made twice the corresponding amounts for single filers.	Basically equivalent results to income splitting, but much simpler since no additional computations are required.
Two-Earner Deduction	$12 billion per year (in 1999 income levels)	Couples with two earners would be allowed a deduction for 10 percent of the first $30,000 of the earnings of the lower-earning spouse.	Would reduce marriage penalties significantly, but would also increase some marriage bonuses and convert some penalties into bonuses. Provides no benefits to stay-at-home parents.

Targeted Two-Earner Deduction	$5 billion per year, but could be larger or smaller /3	Couples with two earners would be allowed a deduction (or a credit) for some percentage of the amount by which the earnings of the lower-earning spouse exceeded, say, 20 percent of the couple's total income.	Would reduce marriage penalties significantly, with little of the benefits "wasted" on those already receiving marriage bonuses. Provides no benefits to stay-at-home parents.
Proposals targeted to stay-at-home parents			
Expand CDCTC to stay-at-homes no phase-out → floor = 1200-1 2400-2+ (instead of curr 5.1)	$11.4 billion to $13.4 billion over 5 years Obviously could be altered to fit revenue constraints	Variant 1: Parents with children under age 3 would be deemed to have spent $1,200 ($2,400 for two or more under age 3 children) plus actual child care expenses, up to current limit of $2,400 ($4,800 for two or more children) for purposes of the CDCTC. Variant 2: Same as variant 1, except parents would be deemed to have spent $1,200 (or $2,400), or, if more, actual child care expenses up to current limits for purposes of the CDCTC.	Proposals cost between $6.5 billion and $8.5 billion over five years more than the President's Budget proposal for expansion of the CDCTC (which would not benefit stay-at-home parents). The policy rationale for targeting scarce public resources to families with stay-at-home parents is dubious. already receive the marriage bonuses through tax code.
Expand child credit for young children Under age 1	roughly $4 billion over 5 years /4	The child credit would be increased for young children, irrespective of the work status or actual out-of-pocket child care expenses of the parent(s). how young?	The policy rationale for targetting scarce public resources to families with stay-at-home parents is dubious. This is a relatively straightforward administrative mechanism.

both to stay-at-home + others.
↕
(e.g. people w/ illegal child care who are not reporting — grandparent care)

/1 These are preliminary estimates, in 1999 income levels. Estimates would presumably grow in the out-years.
/2 This can be dialed down, by reducing single filer parameters to half the current joint parameters, though doing so would hurt single taxpayers at the expense of married taxpayers with two earners.
/3 This allows a ten percent deduction for the amount by which the second earner's earned income
/4 The revenue estimate is for increasing the child credit for children under age 1 by $500, to $1,000, beginning in 1999.

Variant 3 - impute $1200 [illegible] (Under 4)

Marriage Penalties and Bonuses, and Stay-At-Home Parents

Overview

- o These are overlapping, but distinct, issues.
  - Marriage penalties and bonuses affect most married couples as well as many currently unmarried individuals. The tax treatment of marriage is a very broad issue.
  - The concern about the child care costs of stay-at-home parents is a narrower issue of primary concern to couples with young children.
- o This memo has three sections:
  - The first describes marriage penalties, why they arise, and provides examples.
  - The second describes and analyses options for reducing marriage penalties.
  - The third describes and analyses a few additional options specifically aimed at stay-at-home parents.

I. What Are Marriage Penalties?

- o A couple that owes <u>more income tax by filing a joint return</u> than they would pay if they were unmarried and each filed separate returns has a <u>marriage penalty</u>.
- o Conversely, a couple that owes <u>less income tax by filing a joint return</u> than they would pay if they were unmarried and each filed separate returns has a <u>marriage bonus</u>.
- o In general, couples with a stay-at-home spouse receive marriage bonuses, whereas two-earner couples in which spouses have similar earnings face marriage penalties.

Why Do Marriage Penalties and Bonuses Arise?

- o Marriage penalties and bonuses generally arise because the standard deduction and rate brackets for joint filers are less than twice the corresponding amounts for single filers.
- o For couples with children, marriage penalties may arise because a spouse could file as a head of household if the couple were not married.
  - The head of household standard deduction and rates are more generous than corresponding amounts for single filers.

- Marriage penalties and bonuses also arise because of other tax provisions, such as the EITC, the taxation of Social Security benefits, and the AMT exemption for which the parameters for joint filers are less than twice the corresponding amounts for single filers.

Examples

- Consider four couples, each with $60,000 of earnings (and no other income).
  - Couples A and B have no children, Couples C and D each have one child.
  - Couples A and C have two earners, each with $30,000 of earnings.
  - Couples B and D have one earner with $60,000 of earnings.
- The details of the tax computations for these couples are shown in the attachment.
- In summary, here is what the examples show:
  - Two-earner Couples A and C have marriage penalties, whereas one-earner couples B and D have marriage bonuses.
  - The marriage penalties and bonuses for the couples with a child are smaller than for the couples without a child. However, this would not be true in all circumstances.
  - Having a child reduces Couple C's and D's tax liability significantly relative to Couples A and B, because of the additional exemption for the child, the child credit, and (for Couple C) the child and dependent care tax credit (CDCTC).

How Large Are Aggregate Marriage Penalties and Bonuses?

- There are approximately **$30 billion per year** of marriage penalties and **$34 billion per year** of marriage bonuses according to a recent CBO study.
- More taxpayers have bonuses than penalties, with marriage bonuses predominating for low income families, and marriage penalties predominating for high income families, especially when there are two high earners.

II. Options for Addressing Marriage Penalties

Five options for addressing marriage penalties have been discussed: a single filer option, an income splitting option, making joint tax parameters double single parameters, a two-earner deduction, and a targeted two-earner deduction or credit.

- o Treasury is doing more analytical work on these options.

Single Filer Option (H.R. 2456 with 218 cosponsors)

- o Under this option, a married couple could continue to file a joint tax return, or could elect to file two separate returns, as if each were an unmarried individual.
  - H.R. 2456 would combine separate filing on one tax return form and lessen some of the inherent complexity of separate filing by arbitrarily prorating deductions and by retaining a joint computation of the EITC and other credits.
  - Each spouse would report their own earnings, but could reallocate their unearned income by shifting assets.
  - Dependent exemptions would be allocated in proportion to each spouse's share of their total income (AGI).
- o As the examples illustrate, optional single filing would significantly reduce marriage penalties. In the examples marriage bonuses are unaffected, but in some circumstances marriage bonuses would be increased.
- o The examples also illustrate that married couples with identical total incomes and taxes under current law could pay quite different taxes under optional single filing (compare Couples A and B).
- o This option would be very expensive, costing roughly **$22 billion** (in 1999 income levels) per year.
- o This option would provide only limited or even no tax benefit to stay-at-home parents, since each spouse would report their own earned income.
- o Optional single filing would also substantially increase the burdens of the income tax system. Many, if not most, married couples would have to make three, rather than one, tax computation (joint, his, and hers) in order to determine the filing method that results in the least tax liability.
  - Currently, couples who pool their resources need not keep separate records by spouse. Under optional separate filing, separate income and deduction records could be necessary and complex rules would be needed to allocate income, deductions, credits and exemptions.

Income Splitting

A number of Republicans who originally supported H.R. 2456 are now advocating an even more costly approach, which would allow single filing combined with "income splitting." The motivation for this option is specifically to provide tax benefits to stay-at-home parents. (Senator Ashcroft's proposal includes this provision.) Under income splitting, half of a couple's income, including their earnings, would be attributed to each spouse.

- o As the examples illustrate, this option would allow two-earner couples to compute their tax as if they were single individuals, reducing their marriage penalties, as under the single filing option. Some two-earner couples would receive a larger tax cut (and reduction in marriage penalties) under income splitting, however, because both earned and unearned income could be split.

- o Income splitting would greatly increase marriage bonuses.

- o This option would cost roughly **$36 billion** (in 1999 income levels) per year.

- o Income splitting would add computational complexity to income tax filing, although it would not be as onerous as single filing since income would simply be split irrespective of which spouse earned the income or owned the underlying asset.

Make Joint Tax Parameters Double Single Parameters

Marriage penalties could be substantially reduced by making the standard deduction and rate brackets for joint filers twice the corresponding amounts for single filers.

- o One approach would be to increase the joint parameters to twice the current single parameters.

- o As illustrated by the examples, this option is basically equivalent in effect to income splitting, so would be just as expensive (**$36 billion** per year), and have the same effect on marriage penalties and bonuses.

- o However, this option would be much simpler than income splitting, since no additional computations would be required.

- o An alternative approach would be to reduce the single parameters to half the current joint parameters.

  - This approach would <u>raise revenue by increasing taxes on most single filers</u>, without reducing taxes paid by married couples.

- o The Treasury reform option adopts an intermediate approach to addressing marriage penalties, but also makes several other significant changes to the tax code.

- Tackling marriage penalties as part of a broader reform package ameliorates the stark tradeoff between two-earner couples and single taxpayers that a low-cost marriage penalty solution along these lines would require.

Two-Earner Deduction (H.R. 2593, sponsored by twenty-two mostly Republican Ways and Means Committee members)

This proposal would resurrect the second earner deduction that existed between 1982 and 1986. The deduction is for 10 percent of the first $30,000 of the earnings of the spouse with lesser amount of earnings.

- o As the examples illustrate, this option can reduce marriage penalties significantly.
- o This option can also increase the marriage bonuses of those already receiving marriage bonuses, or change current marriage penalties into marriage bonuses
- o However, this option provides no tax benefits to stay-at-home parents.
- o Our very preliminary revenue estimates are that this proposal would cost approximately **$12 billion per year**.

A Targeted Two-Earner Deduction or Credit (A less expensive two-earner deduction)

Better targeting of a second earner deduction can be achieved by setting a percentage floor, say, 20 percent, of combined total income (not only earnings) on the second earner deduction. A tax deduction or credit could then be provided for some percentage of the amount by which the earnings of the lower-earning spouse exceed 20 percent of the couple's total income. The size of the deduction or credit can be capped, if there is a resource constraint.

- o Compared with a simple second earner deduction, very little of the benefits of a targeted deduction or credit are "wasted" on those already receiving marriage bonuses.
- o As with the previous proposal, limited deductions (or credits) address the problem by providing only incomplete relief to those with very large penalties.
- o One variant we have examined costs roughly **$5 billion** per year, though this cost could be dialed up or down depending on revenue targets.

III. Options for Helping Stay-At-Home Parents

Two options specifically designed to help stay-at-home parents have been discussed:

extending the CDCTC to stay-at-home parents, and providing an additional child credit for young children. Before describing and analyzing these proposals, the President's Budget proposal to expand the child and dependent care tax credit (CDCTC) is described.

President's Proposal to Expand the CDCTC

- Under the President's Budget proposal, the credit rate would be raised to 50 percent for parents with incomes (AGIs) of $30,000 or less. This rate would phase down by one percentage point for each $1,000 of income above $30,000 until it reached 20 percent for parents with over $59,000 of income.

    - The President's proposal retains the requirement that both parents (the parent, in single-parent households) must work (or attend school or be fully disabled) in order to be eligible for the CDCTC.

    - The President's proposal (including a simplification provision) would cost **$5.1 billion over five years.**

- Under this proposal, couples with incomes over $59,000 would have the same CDCTC as under current law.

- However, because the credit rate is increased for incomes below $59,000, some couples would have larger marriage penalties under the President's proposal than under current law.

- The President's proposal provides no tax benefits to stay-at-home parents.

Extend the CDCTC to Stay-At-Home Parents

- Senator Chafee has introduced a bill that would deem taxpayers with one or more children under the age of four to have incurred child care expenses of $150 per month ($1,800 per year) for purposes of the CDCTC.

    - As under the President's proposal, the credit rate would be raised to 50 percent for parents with incomes (AGIs) of $30,000 or less.

    - However, the 50% rate would phase down more slowly under the Chafee proposal, by one percentage point for each $1,500 of income above $30,000, until it completely phased out.

- Under the Chafee proposal, couples with a stay-at-home parent could receive a CDCTC.

- However, many single parents and two-earner couples with children under the age of four would also benefit from the Senator Chafee's proposal, either because they work but do not pay for child care, or pay for child care but do not claim as much credit as they would be eligible for under the proposal.

- o We have prepared preliminary revenue estimates for two variants of the Chafee proposal.
  - Both variants differ from the Chafee proposal in two respects: they would apply to children under age three (rather than age four), and both would deem minimum expenses on a per-child basis (up to two or more children).
  - One variant would allow parents of children under the age of three to claim a deemed amount of annual child care expenses of $1,200 ($2,400 for two or more children under age three) plus actual child care expenses, up to the current law limit of $2,400 ($4,800 for two or more eligible children) for purposes of the CDCTC.
  - This variant would cost **$13.4 billion over five years** ($8.5 billion more than the President's Budget proposal).
  - A second variant would allow parents of children under the age of three to claim a deemed amount of annual child care expense of $1,200 ($2,400 for two or more children under age three), or, if more, actual child care expenses (up to the current law limit of $2,400 ($4,800 for two or more eligible children)) for purpose of the CDCTC. It would also phase the credit out at $103,500 of AGI.
  - This second variant would cost **$11.4 billion over five years** ($6.5 billion more than the President's Budget proposal).

Provide an Additional Child Credit for Young Children

- o The child credit could be increased for young children, irrespective of the work status or out-of-pocket child care expenses of the parent(s).
  - For example, the child credit could be doubled for children under the age of one.
  - This would make the credit for these children $1,000 beginning in 1999.
  - This option would cost roughly **$4 billion over five years**.

Attachment

Examples of Marriage Penalties and Bonuses

Measuring Marriage Penalties and Bonuses

- o For purposes of measuring marriage penalties and bonuses, it is assumed that if a couple were unmarried each spouse would retain their earnings and would each file a separate return.
  - If the couple has no children, the separate returns would be filed using the standard deduction and rates for single taxpayers.
  - If the couple has one or more children, it is assumed that the spouse with higher earnings would provide a home for the child(ren) and file using the standard deduction and rates for head of household taxpayers. The other spouse would file as a single taxpayer.

Couple A (Two-Earners, No Children)

- o Two earners, each with $30,000 of earnings, and no other income.
- o No children.

	Filing Joint Return	Filing Separate Returns Spouse 1 Single Filer	Filing Separate Returns Spouse 2 Single Filer
Total Earnings	$60,000	$30,000	$30,000
Standard Deduction	7,100	4,250	4,250
Exemptions	5,400	2,700	2,700
Taxable Income	47,500	23,050	23,050
Tax (before credits)	7,794.50	3,457.50	3,457.50
Credits	0	0	0
Tax (after credits)	7,794.50	3,457.50	3,457.50

- o Couple A has a marriage penalty of $879.50. If they were unmarried and each spouse filed a separate return, their combined tax liability would be $3,457.50 + $3,457.50 = $6,915.00 which is $879.50 less than their tax on a joint return ($7,794.50 - $6,915.00 = $879.50).

Couple B (One Earner, No Children)

- One earner with $60,000 of earnings, other spouse is stay-at-home, no other income.
- No children.

	Filing Joint Return	Filing Separate Returns: Spouse 1 Single Filer	Filing Separate Returns: Spouse 2 Single Filer
Total Earnings	$60,000	$60,000	$0
Standard Deduction	7,100	4,250	0
Exemptions	8,100	2,700	0
Taxable Income	47,500	53,050	0
Tax (before credits)	7,794.50	11,558.50	0
Credits	0	0	0
Tax (after credits)	7,794.50	11,558.50	0

- Couple B has a marriage bonus of $3,764.00. If they were unmarried, Spouse 2 would have no tax liability, but Spouse 1 would pay $11,558.50 which is $3,764.00 more than their tax on a joint return ($7,794.50). Note that Couple B pays the same amount of tax as Couple A.

Couple C (Two-Earners, One Child)

- Two earners, each with $30,000 of earnings, and no other income.
- One child, and child care expenses of $200 per month ($2,400 per year).

	Filing Joint Return	Filing Separate Returns: Spouse 1 HH Filer	Filing Separate Returns: Spouse 2 Single Filer
Total Earnings	$60,000	$30,000	$30,000
Standard Deduction	7,100	6,250	4,250
Exemptions	8,100	5,400	2,700
Taxable Income	44,800	18,350	23,050
Tax (before credits)	7,038.50	2,752.50	3,457.50
Child Credit (1998)	400.00	400.00	0
CDCTC (current law)	480.00	480.00	0
Tax (after credits)	6,158.50	1,872.50	3,457.50

- o <u>Couple C has a marriage penalty of $828.50</u>. If they were unmarried and Spouse 1 filed as a head of household and Spouse 2 filed as single, their combined tax liability would be $5,330.00 (= $1,872.50 + $3,457.50), which is $828.50 <u>less</u> than their tax on a joint return ($6,158.50 - $5,330.00 = $828.50).

- o Couple C's marriage penalty is $51 less than if they did not have a child (Couple A).

  - Some couples, however, face larger marriage penalties with a child than without.

- o Although Couple C still faces a marriage penalty, having a child reduces their joint return tax liability by $1,636.00.

  - The additional exemption for the child has a tax value of $756.00, since Couple C is in the 28% bracket (28% x $2,700 = $756.00).

  - The child-related credits reduce Couple C's tax liability by $880.00.

<u>Couple D (One Earner, One Child)</u>

- o One earner with $60,000 of earnings, other spouse is stay-at-home, no other income.

- o One child.

	Filing Joint Return	Filing Separate Returns	
		Spouse 1 HH Filer	Spouse 2 Single Filer
Total Earnings	$60,000	$60,000	$0
Standard Deduction	7,100	6,250	0
Exemptions	8,100	5,400	0
Taxable Income	44,800	48,350	0
Tax (before credits)	7,038.50	9,124.50	0
Child Credit (1998)	400.00	400.00	0
CDCTC (current law)	0	0	0
Tax (after credits)	6,638.50	8,724.50	0

- o <u>Couple D has a marriage bonus of $2,086.00</u>. If they were unmarried and Spouse 1 filed as a head of household (Spouse 2 would not have to file a return), their combined tax liability would be $8,724.50, which is $2,086.00 <u>more</u> than their tax on a joint return ($8,724.50 - $6,638.50 = $2,086.00).

- Couple D's marriage bonus is $1,678.00 less than if they did not have a child (Couple B).
  - This is because if Couple D had no children, filing separately would require Spouse 1 to file as single, which has a less favorable standard deduction and rates than for a head of household.
- Although Couple D has a smaller marriage bonus than if they were childless, having a child reduces their joint return tax liability by $1,156.00 ($756.00 for the additional exemption and $400.00 for the child credit).
- The difference in Couple C's and Couple D's joint return liability ($480.00) is due entirely to the CDCTC.

Examples of Proposals to Address Marriage Penalties

Single Filer Option

- Under this option, a married couple could continue to file a joint tax return, or could elect to file two separate returns, as if each were an unmarried individual.
  - Each spouse would report their own earnings.
- This option would change marriage penalties and bonuses as follows:

	Childless Couples		Couples with One Child	
	Couple A (Two Earners)	Couple B (One Earner)	Couple C (Two Earners)	Couple D (One Earner)
Current Penalties (Bonuses)	$879.50	($3,764.00)	$828.50	($2,086.00)
Option Penalties (Bonuses)	0	($3,764.00)	300.00	($2,086.00)
Change	-879.50	0	-528.50	0

- The option would eliminate Couple A's marriage penalty and reduce, but not eliminate Couple C's marriage penalty (because the option would not allow any spouse to compute their tax using the head of household standard deduction and rates).

Income Splitting

- This option would allow separate filing, as in the preceding option, but in addition would attribute half of a couple's total earned income to be attributed to each spouse.

- This option would change marriage penalties and bonuses as follows:

	Childless Couples		Couples with One Child	
	Couple A (Two Earners)	Couple B (One Earner)	Couple C (Two Earners)	Couple D (One Earner)
Current Penalties (Bonuses)	$879.50	($3,764.00)	$828.50	($2,086.00)
Option Penalties (Bonuses)	0	($4,643.50)	300.00	($2,614.50)
Change	-879.50	+879.50	-528.50	+528.50

Make Joint Tax Parameters Double Single Parameters

- Marriage penalties could be substantially reduced by making the standard deduction and rate brackets for joint filers twice the corresponding amounts for single filers.

- One approach would be to increase the joint parameters to twice the current single parameters.

- This approach would give the following results for the above examples:

	Childless Couples		Couples with One Child	
	Couple A (Two Earners)	Couple B (One Earner)	Couple C (Two Earners)	Couple D (One Earner)
Total Earnings	$60,000	$60,000	$60,000	$60,000
Standard Deduction	8,500	8,500	8,500	8,500
Exemptions	5,400	5,400	8,100	8,100
Taxable Income	46,100	46,100	43,400	43,400
Tax (before credits)	6,915.00	6,915.00	6,510.00	6,510.00
Child Credit (1998)	0	0	400.00	400.00
CDCTC (current law)	0	0	480.00	480.00
Tax (after credits)	6,915.00	6,915.00	5,630.00	6,110.00

- The changes in marriage penalties and bonuses are as follows:

	Childless Couples		Couples with One Child	
	Couple A (Two Earners)	Couple B (One Earner)	Couple C (Two Earners)	Couple D (One Earner)
Current Penalties (Bonuses)	$879.50	($3,764.00)	$828.50	($2,086.00)
Option Penalties (Bonuses)	0	($4,643.50)	300.00	($2,614.50)
Change	-879.50	+879.50	-528.50	+528.50

Two-Earner Deduction

- This proposal would resurrect the second earner deduction that existed between 1982 and 1986. The deduction is for 10 percent of the first $30,000 of the earnings of the spouse with lesser amount of earnings.

- This proposal would only affect two-earner Couples A and C.

	Couple A (No Child)	Couple C (One Child)
Total Earnings	$60,000	$60,000
Second Earner Deduction	3,000	3,000
Standard Deduction	7,100	7,100
Exemptions	5,400	8,100
Taxable Income	44,500	41,800
Tax (before credits)	6,954.50	6,270.00
Child Credit (1998)	0	400.00
CDCTC (current law)	0	480.00
Tax (after credits)	6,954.50	5,390.00

- This option would change marriage penalties and bonuses as follows:

	Childless Couples		Couples with One Child	
	Couple A (Two Earners)	Couple B (One Earner)	Couple C (Two Earners)	Couple D (One Earner)
Current Penalties (Bonuses)	$879.50	($3,764.00)	$828.50	($2,086.00)
Option Penalties (Bonuses)	39.50	($3,764.00)	60.00	($2,086.00)
Change	-840.00	0	-768.50	0

Do we deserve
what we just
got?

And which of us?

Budget - tax proposals

Agenda for White House Meeting with Chief of Staff Erskine Bowles
10 a.m., Wednesday, February 18, 1998

1. **Options for Enactment of Initiatives**

   (a) Micro Strategy: move individual bills, possibly on one of the pending revenue measures in Senate (technical corrections, line-item veto substitutes, Coverdell, or IRS restructuring);

   (b) Budget Reconciliation;

   (c) New Tax Bills from the House: Chairman Archer may have a bill that reduces revenues as a percentage of GDP. He may also move an extenders bill. The tobacco settlement, if moved, will undoubtedly include a tax section;

   (d) Internal Administration Coordination of Tax Initiatives.

2. **Republican Initiatives**

   (a) Marriage Penalty;

   (b) Coverdell Education;

   (c) Estate Tax Repeal;

   (d) Sunset Tax Code/Tax Limitation Amendments;

   (e) IRS Restructuring;

3. **Clinton Initiatives**

   (a) Child Care (including stay-at-home moms);

   (b) Climate Change;

   (c) Low-Income Housing Tax Credit;

   (d) School Construction;

   (e) Pensions.

Tax issues - generally

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

January 30, 1998

MEMORANDUM FOR SECRETARY RUBIN

FROM: DONALD C. LUBICK
ACTING ASSISTANT SECRETARY (TAX POLICY)

SUBJECT: Agenda for Your Monday Meeting With Chief of Staff Bowles

Your meeting Monday afternoon with Erskine Bowles is to discuss tax legislative strategy: how to move forward the Administration's proposals and defeat the Congressional proposals. A suggested agenda for the meeting, listing the key issues, is attached. This memorandum provides brief comments on each of those issues.

1. **Congressional proposal to sunset the tax code.** Administration strategy options:

- (a) Oppose. The proposal would create great uncertainty, thus likely inhibit business investment until an alternative tax system were enacted, adversely affecting the economy.

- (b) Develop an alternative proposal to sunset only upon enactment, without gap, of a replacement tax system that is fair, promotes economic growth, provides the revenue needed to maintain budgetary discipline, and simplifies the tax system for average Americans. This will require that the Congress develop a better system than the current one before it can be repealed. This will allow members who don't think a better system can be adopted by the Congress to vote for sunset. An alternative approach is to require the sunset proposal to include a number of "poison pills" (such as retaining home mortgage interest deduction, charitable deduction, etc.), or possibly linking to increase in minimum wage or campaign finance reform. Both of these approaches will also generate uncertainty (but because a shift in the tax system will be perceived as less likely, the adverse impact on the economy would be less severe).

- (c) Develop an alternative proposal for return-free filing or other major simplification of the present tax system (apparently House Democrats are exploring such options). A return-free systems raise many administrative problems (such as how to handle two-earner couples, how to provide EITC, etc.) and either places additional burden on IRS when it is facing other problems (reorganization, year 2000 problem, etc.) or places additional burden on employers, or both.

2. **Our strategy for enactment of our initiatives:**

- (a) Micro strategy: move individual bills, possibly on one of pending revenue measures in Senate (Coverdell, technical corrections, line-item veto substitutes, or, less probably, IRS restructuring). This approach requires Administration acceptance of the (possibly modified) Congressional bill (which is most troublesome in the case of the Coverdell bill, which provides tax credits for sending children to private schools) and offers the opportunity for a major Congressional tax bill.

- (b) Budget reconciliaton. (Alan Cohen will supply material)

3. **Congressional initiatives:**

- (a) Marriage penalties. This is a sympathetic issue, but is costly ($29 billion is one measure of penalties) and administratively complex to completely solve, though less costly targeted options providing limited relief can be designed.

  -- Tax incentives for "stay-home moms". This issue has been raised in response to the Administration's proposal to expand the child and dependent tax credit. This will bias the tax system even more strongly against working mothers (who need the credit to offset actual out-of-pocket expenses), while defining "stay-at-home moms" in an administratively acceptable manner will be very difficult.

- (b) Estate tax repeal. TRA 97 provided significant immediate relief to owners of businesses, but provided a lengthy schedule (through 2006) for an increase in the estate tax deduction from $600,000 to $1 million, which might be accelerated if necessary to retain the estate tax (which is needed as backstop to income tax);

- (c) Flat Tax or National Sales Tax. These proposals have strong advocates (who greatly overstate resulting benefits of simplicity and economic growth), but as proposed have many problems, including failure to provide adequate revenue and failure to provide adequate transition relief while significantly shifting burden of tax from high-income taxpayers to others.

- (d) Cap tax revenues as a fixed percent of GDP. This proposal may have superficial appeal, but could set the stage for runaway deficits and an increase in Federal mandates on States and local governments in lieu of Federal programs. It might best be fought by getting out the correct facts (average tax rates on most families have gone down, actual tax/GDP ratio is much lower than suggested, etc.).

- (e) Coverdell. This proposal, which provides tax credits to parents for the cost of their children's private elementary and secondary education, could erode support for high quality public education and will disproportionately favor higher-income families, who are far more able to afford private schooling for their children (even with the tax credit). To somewhat mask the unfairness, the proposal would also cover "supplemental educational expenses", which are ill-defined, will thus generate administrative difficulties, and will do little to reduce the bias in favor of higher-income families.

- (f) IRS restructuring. The House bill meets most of our concerns, and is preferable to earlier (Kerrey-Portman) versions and to Roth's likely proposals. The only negatives in the House bill concern inadequate personnel flexibilities and burden of proof and accountant-client privilege issues.

- (g) Deduction for payroll taxes. This proposal is very expensive (about $65 billion annually), and would disproportionately benefit high-income taxpayers (both because they have adequate taxable income against which the deduction may be offset, and because of the higher tax rate to which the income being shielded would otherwise have been subject).

Process for Enacting the President's Targeted Tax Cuts This Year

The process for enacting one or many of the President's targeted tax cuts this year comes down to a question of what the possible tax vehicles are this year. There are a number of possibilities:

1. **Reconciliation**. The Budget Resolution could call for a reconciliation bill. Reconciling any paid-for tax cuts is dangerous because the reconciliation bill could also be used as a vehicle for tax cuts that use up some or all of the surpluses -- although if tax cuts that are not paid for are included, they should subject this year's Budget Resolution to a 60-vote point-of-order in the Senate. Nonetheless, to protect against reconciliation becoming a vehicle for big tax cuts, we should consider opposing having any reconciliation bill at all this year.

2. **Tax bills that are already in the Senate**. There are several tax bills that have already come over to the Senate from the House. This is important because, of course, a new tax bill cannot originate in the Senate. The bills that have already come over include technical corrections, the Coverdell bill, and one or two bills that undo the line-item veto of certain tax provisions in the last tax bill. These bills could be amended in the Finance Committee or on the floor to include some or all of the President's targeted tax cuts, and then be sent back to the House for conference. Keep in mind that such a tax bill would not have the protections of reconciliation on the floor e.g. non-germane amendments can be added. This could be helpful in adding provisions we like, but it could be harmful if provisions we don't like are added or if the bill gets bogged down with a lot of controversial amendments.

3. **New tax bills originating in the House**. Chairman Archer may try to move a bill with provisions that reduce revenues as a percentage of GDP. Most likely, these would be mostly provisions which we don't like. Once again, if this bill got to the Senate floor, it would not have the protections of reconciliation. Democrats could bottle it up there.

   There are two bills that Chairman Archer may consider must-pass this year, however. One is an extenders bill. This would be a good bill to which to try to attach the President's tax cuts.

   Second, if there is a tobacco settlement bill, it will have some tax components -- aside from the payments required of the tobacco companies. For example, the tax treatment of such payments would have clarified in legislation. Thus a tobacco settlement bill could include a tax section to which other tax-related provisions could be attached. The tobacco settlement bill -- IF IT MOVES, AND THAT IS A BIG IF --could be an ideal vehicle for targeted tax cuts because we are already advocating using the tobacco settlement to pay for a number of popular spending initiatives. Thus the bill could develop an omnibus character with something for everyone.

Budget materials - tax proposals

Rec'd 7/23/97

COMPARISON OF TAX LIABILITIES OF WORKING FAMILIES
(1999 Tax Law Parameters

Two-Earner Couple with $50,000 of Earnings and Two Young Children

	Current Law	President's Proposal	House Tax Bill	Senate Tax Bill
Adjusted Gross Income (AGI) [All earnings]	$50,000	$50,000	$50,000	$50,000
Standard Deduction	$7,300	$7,300	$7,300	$7,300
Personal Exemptions	$11,200	$11,200	$11,200	$11,200
Taxable Income	$31,500	$31,500	$31,500	$31,500
Income Tax Before Credits	$4,725	$4,725	$4,725	$4,725
Employee Payroll Tax (7.65% of earnings)	$3,825	$3,825	$3,825	$3,825
Child Credits	$0	$1,000	$1,000	$1,000
Income Tax After Credits	$4,725	$3,725	$3,725	$3,725
Income and Employee Payroll Taxes After Credits	$8,550	$7,550	$7,550	$7,550
Tax Savings Compared to Current Law	N.A.	$1,000	$1,000	$1,000
Spendable Income	$41,450	$42,450	$42,450	$42,450

One-Earner Couple with $25,000 of Earnings and Three Young Children

	Current Law	President's Proposal	House Tax Bill	Senate Tax Bill
Adjusted Gross Income (AGI) [All earnings]	$25,000	$25,000	$25,000	$25,000
Standard Deduction	$7,300	$7,300	$7,300	$7,300
Personal Exemptions	$14,000	$14,000	$14,000	$14,000
Taxable Income	$3,700	$3,700	$3,700	$3,700
Income Tax Before Credits	$555	$555	$555	$555
Employee Payroll Tax (7.65% of earnings)	$1,913	$1,913	$1,913	$1,913
Child Credits	$0	$1,222	$0	$0
Earned Income Credit (Refundable)	$1,246	$1,246	$1,246	$1,246
Income Tax After Credits	($691)	($1,613)	($691)	($691)
Income and Employee Payroll Taxes After Credits	$1,222	$0	$1,222	$1,222
Tax Savings Compared to Current Law	N.A.	$1,222	$0	$0
Spendable Income	$23,778	$25,000	$23,778	$23,778

Tax proposals

PRESIDENT CLINTON'S CHILD TAX CREDIT

Working families
who pay taxes and play by the rules
deserve a tax cut too

July 10, 1997

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President Clinton's Child Tax Credit
A Fact Sheet
July 10, 1997

The President's child tax credit includes the following features:

Age:

- Covers children under 17 through 2002.
- After 2002, covers children under 19.

Amount per-child:

- $400 in 1998
- $500 in 1999 and then indexed for inflation.

Income Limits:

- Phased out for families with incomes between $60,000 and $75,000 until 2000.
- After 2000, the phase-out range is raised to between $80,000 and $100,000 and then indexed for inflation.

Refundability to Cover Out-of-Pocket Income and Payroll Taxes:

- Working families who pay out of pocket federal taxes would benefit from the child tax credit. The child tax credit is calculated before the EITC and will be partially refundable. A family will get a child credit for their income taxes plus the extent to which their out-of-pocket (employee share) payroll taxes exceed their EITC.

Savings Incentive Feature:

- Taxpayers who are entitled to a child credit would have the opportunity to contribute their child tax credit plus an additional $500 per-child each year to a Kidsave Account for the child's education, first time home purchase, or the taxpayer's retirement. Earnings would accumulate tax-free in the account and no taxes would be due upon withdrawal for these purposes.

Cost:

- $70.2 billion over 1997-2002.
- $176.1 billion over 1997-2007.
- $22.0 billion in 2007.

Working Families Who Pay Taxes and Play by the Rules Deserve a Tax Cut Too

Compared to the President's proposal, the Senate bill denies the child credit to 3.8 million families who make less than $30,000. The House bill denies the child tax credit to 4.8 million of these families. The President strongly believes families who work hard, pay taxes, and play by the rules deserve a tax cut too.

Examples of working families who receive a tax cut under President Clinton's plan but are shortchanged by Congressional plans:

Example #1: A Family Like Police Officer Daniel Mercado's

Consider a family like Police Officer Daniel Mercado's of Savannah, Georgia. A family like his with two parents, four children, and an income of $26,000 would receive a $1,238 child tax credit under President Clinton's proposal, but would not receive a child tax credit under the House or Senate bills.

Federal Tax Situation Before Any Child Tax Credit/1:	
Income taxes owed before EITC	$285
Payroll taxes (just employee share)	$1,989
Excise taxes/2	$400
Federal out-of-pocket taxes owed before EITC	$2,674
Employer share of payroll taxes	$1,989
Federal taxes before EITC	$4,663
Benefit from EITC	$1,036

	President Clinton's Proposal	**House Bill**	**Senate Bill**
Child Tax Credit for family with two parents and four kids and income of $26,000	**$1,238**	**$0**	**$0**

Notes:
1: Source: U.S. Department of Treasury. Assumes 1999 tax parameters.
2: Estimate calculated from Congressional Budget Office Data. CBO estimates that in 1998, families with incomes between $20,000 and $30,000 would pay 1.54 percent of their income in federal excise taxes.

Example #2: A Family Like Michelle Orticke's

Consider a family like Michelle Orticke's, a receptionist from Springfield, Virginia. A family like hers with a mother and two children and an income of $24,000 would receive a $1,000 child tax credit under President's Clinton's proposal. A family like this one would receive a smaller $651 child tax credit under the Senate bill and would receive no child tax credit under the House bill.

Federal Tax Situation Before Any Child Tax Credit/1:

Income taxes owed before EITC	$1,380
Payroll taxes (just employee share)	$1,836
Excise taxes/2	$370
Federal out-of-pocket taxes owed before EITC	$3,586
Employer share of payroll taxes	$1,836
Federal taxes before EITC	$5,422
Benefit from EITC	$1,457

	President Clinton's Proposal	House Bill	Senate Bill
Child Tax Credit for family with one parent and two kids and income of $24,000	**$1,000**	**$0**	**$651**

Notes:
1: Source: U.S. Department of Treasury. Assumes 1999 tax parameters.
2: Estimate calculated from Congressional Budget Office Data. CBO estimates that in 1998, families with incomes between $20,000 and $30,000 would pay 1.54 percent of their income in federal excise taxes.

State-by-State Analysis of Working Families Shortchanged by Congressional Tax Cut Plans

PRESIDENT CLINTON STRONGLY BELIEVES FAMILIES WHO WORK HARD, PAY TAXES, AND PLAY BY THE RULES DESERVE A TAX CUT TOO:

- ✔ Compared to President Clinton's tax cut proposal, the House bill denies the child tax credit to 4.8 million working families who make less than $30,000.

- ✔ Compared to President Clinton's tax cut proposal, the Senate bill denies the child tax credit to 3.8 million working families who make less than $30,000.

State	*Compared to President's Plan Number of Working Families Who Make Below $30,000 Denied the Child Credit under the Senate Plan*	*Compared to Presidents Plan Number of Working Families Who Make Below $30,00 Denied the Child Credit under the House Plan*
Alabama	82,659	104,411
Alaska	6,323	7,987
Arizona	68,517	86,548
Arkansas	49,268	62,233
California	447,915	565,788
Colorado	50,160	63,360
Connecticut	27,150	34,294
Delaware	10,038	12,679
Florida	222,038	280,469
Georgia	130,635	165,013
Hawaii	13,203	16,678
Idaho	19,334	24,421
Illinois	155,667	196,632
Indiana	78,566	99,241
Iowa	36,093	45,591
Kansas	35,135	44,381
Kentucky	57,021	72,026
Louisiana	80,628	101,846
Maine	16,949	21,409
Maryland	71,351	90,128
Massachusetts	54,677	69,066
Michigan	104,371	131,837
Minnesota	50,043	63,213
Mississippi	61,474	77,651
Missouri	78,557	99,230

State	***Compared to President's Plan Number of Working Families Who Make Below $30,000 Denied the Child Credit under the <u>Senate</u> Plan***	***Compared to Presidents Plan Number of Working Families Who Make Below $30,00 Denied the Child Credit under the <u>House</u> Plan***
Montana	13,400	16,926
Nebraska	23,648	29,872
Nevada	26,709	33,737
New Hampshire	12,794	16,161
New Jersey	96,681	122,124
New Mexico	31,716	40,063
New York	237,157	299,567
North Carolina	134,793	170,265
North Dakota	8,756	11,060
Ohio	135,211	170,792
Oklahoma	54,046	68,269
Oregon	41,077	51,886
Pennsylvania	141,976	179,338
Rhode Island	10,915	13,787
South Carolina	71,580	90,417
South Dakota	11,719	14,804
Tennessee	94,790	119,735
Texas	354,927	448,328
Utah	27,212	34,373
Vermont	7,887	9,963
Virginia	86,986	109,877
Washington	61,630	77,848
West Virginia	25,255	31,901
Wisconsin	56,208	71,000
Wyoming	6,623	8,366
District of Columbia	11,147	14,081
United States	**3.8 million**	**4.8 million**

Methodology of State-by-State Analysis

Using the Treasury individual income tax model, an estimate was generated for the aggregate numbers of taxpayers in 1998 with Adjusted Gross Income below $30,000 who receive the child tax credit under President Clinton's proposal but not under the House and Senate bills. These aggregates were distributed across states in proportion to the fraction of EITC recipients nationwide in 1995 with incomes between $15,000 and $30,000 who reside in the particular state. EITC recipients with incomes between $15,000 and $30,000 form the group primarily affected by the differences in the child tax credit proposals.

Child Tax Credits for Families With Incomes Between $18,000 and $30,000

Families of Four: Two Parents and Two Children

Family Income	President's Proposal	House Bill	Senate Bill
$18,000	$0	$0	$0
$20,000	$225	$0	$0
$22,000	$330	$0	$0
$24,000	$1,000	$0	$96
$26,000	$1,000	$89	$607
$28,000	$1,000	$810	$1,000
$30,000	$1,000	$1,000	$1,000

Source: U.S. Department of Treasury. Figures for 1999.

Tax proposals

PRESIDENT CLINTON'S HIGHER EDUCATION TAX CUTS

The President's Hope Scholarship and Tuition Tax Credit Help 12.6 Million Students -- 7 Million More Students than Congressional Versions

SUMMARY DOCUMENTS

July 8, 1997

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President Clinton's Higher Education Tax Cut Proposal
A Fact Sheet

President Clinton's HOPE Scholarship and 20% Tuition Tax Credit help 12.6 million students and their families -- *seven million* more students than under Congressional versions. While all of the plans encourage saving and help with student loan payments, only the Administration's proposal provides tax credits to working families who use their earnings to pay for college beyond the first two years, for part-time study to improve or acquire job skills, or graduate study. The higher education tax cut plans passed by the House and Senate are limited in their scope, providing some of the largest benefits to higher-income families who can afford to save large amounts.

- ***HOPE Scholarship.*** A maximum $1,500 credit for the first two years of postsecondary education. Students attending on at least a half-time basis would receive a 100% credit for the first $1,000 of tuition and required fees and a 50% credit for up to the next $1,000. For example, a student attending a community college with tuition costs of $1,400 would receive a $1,200 HOPE Scholarship. Scholarships would be phased out for joint filers with income between $80,000 and $100,000, and for single filers with income between $50,000 and $70,000. After 2002, the HOPE Scholarship increases to a 100% credit for the first $1,500 and a 50% credit for the next $1,000 of tuition and required fees.

- ***20% Tuition Tax Credit.*** Undergraduates beyond their first two years, graduate students, plus working people going to school part-time to improve or acquire job skills, would benefit from a 20% tax credit on the first $5,000 of tuition and required fees through the year 2000 and after 2000 a 20% tax credit on the first $10,000 of tuition and required fees. The credit would be phased out at the same income levels as HOPE.

- ***Education and Retirement Savings Accounts.*** Allows penalty-free IRA withdrawals for undergraduate, post-secondary vocational, and graduate education expenses. Additionally, taxpayers eligible for the child tax credit are given the opportunity to deposit their child tax credit plus an additional $500, in a Kidsave Account for the child's education, first-time home purchase or the taxpayer's retirement. Earnings would accumulate tax-free in the Kidsave Account and no taxes would be due upon withdrawal for an approved purpose.

- ***Employer-Provided Education Benefits.*** Extends permanently Section 127 of the tax code, which allows people to exclude $5,250 of employer-provided education benefits from their taxable income. Eligibility for graduate education benefits would be reinstated retroactively back to June 30, 1996, with both undergraduate and graduate education eligible in the future. Additionally, a 10% employer credit for small business training is included. This credit would apply to payments made to third parties to cover expenses of education for employees under employer-provided education assistance programs. The credit would be available to employers with average annual gross receipts of $10 million or less for the prior three years.

- ***Student Loan Interest Deduction.*** Allows a deduction for up to $2,500 per year of interest on education loans for expenses of students enrolled at an institution of higher education. The deduction would be allowed for the first 60 months interest is due on a loan. The deduction would phase out for taxpayers making between $45,000 and $65,000 ($65,000 and $85,000 for married taxpayers filing jointly). This deduction would be available even if the taxpayer does not itemize deductions.

- ***Community Service Loan Forgiveness.*** In most circumstances, a loan that is forgiven is considered income and is therefore taxable. To encourage programs that offer loan forgiveness to borrowers who take lower-paying, community-service jobs, loan amounts forgiven through programs run by nonprofit tax-exempt charitable or educational institutions, and loans forgiven under the Direct Loan Program's income-contingent repayment program, would be excluded from income. Currently, the exclusion generally covers only certain forgiveness arrangements between students and government entities.

- ***Repeal Cap on Tax Exempt Bond Issuance by Colleges and Universities.*** Repeals the $150 million bond cap that affects private higher education institutions and certain other charitable institutions. The repeal would apply to tax-exempt bonds issued by these institutions to finance new capital expenditures.

A Comparison: Higher Education Tax Cuts

HOPE Scholarship and Tuition Tax Credit	President	House	Senate
Students in their first two years of college, attending at least half-time	100% tax credit on the first $1,000 of tuition and required fees, 50% on next $1,000. After 2002, a 100% credit on first $1,500 and 50% on the next $1,000.	50% tax credit on up to $3,000 on tuition, required fees, books, and supplies.	75% tax credit on up to $2,000 for community colleges; 50% tax credit on up to $3,000 for other institutions for tuition, required fees, books, and supplies.
Students beyond the first two years, enrolled at least half-time	20% tax credit on up to $5,000 in 1998 and up to $10,000 starting in 2001.	None	None
Graduate students	20% tax credit on up to $5,000; up to $10,000 starting in 2001.	None	None
Part-time (less than half-time) students seeking to acquire or improve job skills	20% tax credit on up to $5,000; up to $10,000 starting in 2001.	None	None
5-year revenue cost:	$35 billion	$22 billion	$20 billion
Estimated number of beneficiaries in 1999	**12.6 million**	**5.6 million**	**5.6 million**

Other provisions	Administration	House	Senate
Employer-provided education assistance (Section 127)	Permanent extension for graduate and undergraduate courses. 10% Small Business Credit.	Six month extension, only for undergraduates.	Permanent extension for graduate and undergraduate courses.
Student loan interest deduction	Up to $2,500 may be deducted each year for five years of repayment.	None	Up to $2,500 may be deducted each year for five years of repayment.

Other provisions	Administration	House	Senate
Savings incentives	Penalty-free IRA withdrawals for higher education. Optional Kidsave education accounts. Maximum per-child contribution of child credit plus $500 each year. Earnings free from tax if used for various purposes including child's postsecondary tuition and fees.	Penalty-free IRA withdrawals for higher education. Education investment accounts and new qualified tuition programs. Maximum per-child contribution $5,000 each year, $50,00 total. Earnings used for higher education not taxed (subject to limits).	Penalty-free IRA withdrawals for higher education. Requires contributions to Educational IRAs or qualified tuition plans for parents to obtain the child credit for children 13 and over. Education IRAs and expanded qualified tuition programs; tax-free distributions for educational expenses. Maximum per-child contribution $2,000 plus child credit each year (no limits on State-sponsored plans).

Distribution of Higher Education Tuition Tax Credits by Student's State of Legal Residence 1/
(Beneficiary Calculations FY 1998/Dollar Amounts FY 1999)

	Number of Beneficiaries 2/ (in thousands)			Dollar Amounts of Benefits (in millions)			Dollar Difference: (in millions) President Compared to	
	President	House/Senate	Difference	President	House	Senate	House	Senate
Alabama	195	87	108	$111.6	$78.2	$72.3	$33.4	$39.3
Alaska	27	12	15	15.4	10.6	9.8	4.8	5.6
Arizona	244	108	136	139.4	97.0	89.6	42.4	49.8
Arkansas	79	36	43	45.3	32.0	29.5	13.4	15.8
California	1,654	733	922	944.9	655.9	605.8	289.0	339.1
Colorado	219	97	122	125.0	86.7	80.0	38.3	44.9
Connecticut	149	66	83	85.1	58.8	54.2	26.3	30.9
Delaware	42	18	23	23.8	16.4	15.2	7.4	8.7
District of Columbia	74	32	41	42.0	28.9	26.7	13.1	15.3
Florida	553	246	306	316.1	220.6	203.8	95.5	112.3
Georgia	266	119	147	152.0	106.3	98.2	45.7	53.8
Hawaii	61	27	34	35.0	24.1	22.2	10.9	12.8
Idaho	51	23	28	29.3	20.6	19.0	8.8	10.3
Illinois	669	296	374	382.2	264.6	244.4	117.6	137.8
Indiana	259	115	144	148.2	103.1	95.3	45.1	52.9
Iowa	150	67	83	85.9	59.9	55.4	25.9	30.5
Kansas	151	67	84	86.5	60.2	55.6	26.3	30.9
Kentucky	154	69	85	88.3	61.9	57.2	26.3	31.0
Louisiana	166	75	91	94.9	67.0	62.0	27.9	33.0
Maine	50	22	28	28.7	20.0	18.5	8.7	10.3
Maryland	243	108	136	138.9	96.2	88.9	42.7	50.1
Massachusetts	383	169	214	218.4	151.2	139.6	67.3	78.9
Michigan	493	219	274	281.4	195.6	180.7	85.8	100.7
Minnesota	258	115	143	147.4	102.5	94.7	44.9	52.7
Mississippi	97	44	53	55.4	39.3	36.3	16.2	19.1
Missouri	259	115	144	148.3	103.3	95.4	45.0	52.9
Montana	32	15	18	18.6	13.1	12.1	5.4	6.4
Nebraska	104	46	58	59.2	41.1	38.0	18.0	21.2
Nevada	61	27	34	34.5	23.8	22.0	10.7	12.6
New Hampshire	57	25	32	32.8	22.7	21.0	10.1	11.8
New Jersey	304	134	169	173.5	120.3	111.1	53.2	62.4
New Mexico	87	39	48	49.9	35.0	32.3	15.0	17.6
New York	897	402	495	513.5	360.0	332.7	153.5	180.7
North Carolina	333	148	186	190.4	132.1	122.0	58.3	68.3
North Dakota	34	15	19	19.3	13.5	12.5	5.7	6.7
Ohio	482	214	267	275.2	191.9	177.3	83.3	97.9
Oklahoma	156	70	86	89.1	62.6	57.8	26.5	31.3
Oregon	147	65	82	84.2	58.5	54.0	25.7	30.2
Pennsylvania	545	242	303	311.3	216.5	200.0	94.8	111.4
Rhode Island	67	30	37	38.4	26.6	24.6	11.7	13.8
South Carolina	150	67	83	85.9	60.0	55.4	25.9	30.5
South Dakota	31	14	17	17.6	12.4	11.5	5.2	6.1
Tennessee	212	94	117	121.1	84.5	78.1	36.6	43.0
Texas	841	374	467	480.5	334.8	309.3	145.7	171.2
Utah	126	56	70	72.3	50.5	46.7	21.8	25.6
Vermont	31	14	17	18.0	12.5	11.6	5.5	6.4
Virginia	321	142	179	183.3	127.1	117.4	56.2	65.9
Washington	255	113	142	145.8	101.3	93.6	44.5	52.3
West Virginia	75	34	41	42.8	30.0	27.7	12.8	15.1
Wisconsin	277	122	155	158.2	109.6	101.2	48.6	57.0
Wyoming	27	12	15	15.4	10.7	9.9	4.7	5.5
US Totals	12,600	5,600	**7,000**	$7,200.0	$5,012.0	$4,630.0	**$2,188.0**	**$2,570.0**

1/ Includes HOPE Scholarship plans and the President's 20% tax credit for lifelong learning.
Calculations do not include interest deductions and tax benefits that could be received in outyears from savings incentives in all three plans.

2/ The number of beneficiaries is the same under the House and Senate plans, though the amounts of benefits differ.

Source: Education Department estimates based on State-level enrollment and Pell Grant recipient data.

Methodology of State-by-State Analysis

Using a nationally-representative sample of postsecondary students and data on Pell Grant recipients, an estimate was derived for the proportion of the total national number of recipients of the tax benefit in 1998. Using that ratio, the number of recipients for each State was determined. Based on the Joint Tax Committee and Treasury revenue estimates of the three plans for 1999, a dollar amount for each State was derived using the same ratio as the State/national number of beneficiaries.

President Clinton's Higher Education Tax Cuts: Greater Benefits for More Families

While providing the greatest help in the first two years, the Administration's plan has always gone *much* farther, granting a substantial tax cut for virtually *any* investment in postsecondary education or training. Unlike the Congressional plans, the President's tax credits cover *more types and ages of postsecondary students*, including:

- part-time students (less than half-time) seeking to improve or acquire job skills;
- students beyond their first two years of undergraduate study;
- graduate students.

Although the Administration, House and Senate plans all provide modest assistance for students who borrow or families who have special education savings accounts, for many situations that families find themselves in, the House and Senate plans provide little or no help. Consider the following:

Tuition Tax Credits Under Various Situations	**President**	**House Plan**	**Senate Plan**
Two kids in college: Married couple, $60,000 income, with two kids in college: one at a community college with $2,000 tuition and $200 books, the other a junior at a private college with $10,000 tuition.	$2,500 ($3,500 after year 2000)	$1,100	$1,500
Divorced parent, same income: Single parent with $50,000 income, one child going to an average community college full-time ($1,200 tuition and fees)	$1,100	$0	$0
Returning to school less than half-time: Family with $30,000 income, one parent going to a public four-year college part-time to change careers ($2,000 tuition and fees)	$400	$0	$0
Child is beyond first two years: Family with $40,000 income, one child is junior at average private college ($12,000 tuition and fees)	$1,000 ($2,000 after year 2000)	$0	$0
Returning to school full-time to become a teacher: Homemaker, family income of $70,000, attending graduate teacher training program at public university after being out of college for 20 years ($3,500 tuition).	$700	$0	$0
Graduate student: Single graduate student with $15,000 income and tuition of $15,000.	$1,000	$0	$0

Alternative Tax Cut Proposals A Comparison of Distributional Impact			
Income by Quintile	***President Clinton***	***House***	***Senate***
Lowest	1.2%	0.6%	0.4%
Second	10.1	2.5	2.7
Third	22.2	9.6	10.2
Fourth	34.6	20.0	21.3
Highest	31.5	66.8	65.0
Top 10%	11.7	47.3	42.3
Top 5%	6.5	34.9	28.2
Top 1%	2.6	18.8	12.5
Middle 60% (Second, third, fourth quintiles)	**66.9%**	**32.1%**	**34.2%**

Source: U.S. Department of Treasury

Tables assumes fully phased-in (2007) law and behavior, in 1998 dollars. It includes major tax cut provisions in each of the plans: HOPE Scholarship, tuition credit, Section 127, Student loan interest deduction, child tax credit, Kidsave accounts, capital gains provisions, home office deduction, distressed areas initiatives, Puerto Rico tax incentives, individual and corporate AMT changes, prepaid tuition programs, IRAs, DC tax incentives, safe harbor for independent contractors, modifications of treatment of company owned life insurance.

Comparison of Tax Incentives in Major Proposals for FY1998
Updated: February 24, 1997 5:00PM

F, 6: Tax proposals

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Administration Proposals	Senate Democratic Leadership Package (Daschle)**	Senate Republican Leadership Package (Lott)	
		Affordable College Act (S.1)	American Family Tax Relief Act (S.2)
1. **Tax credit for dependent children***: Nonrefundable credit for each dependent child under age 13. Fully phased-in amount (by 2000) is $500, phased-out for filers with AGI between $60,000-$75,000. Credit is stacked ahead of the EITC. 5yr.: ($46.7b) 10yr.: ($98.0b)*	No Provision	No Provision	Nonrefundable credit of $500 for each child under age 18. Phaseout, beginning at AGI of $75,000 ($110,000 for joint returns), of $25 of credit for each $1,000 of additional AGI. Credit is not indexed for inflation. Credit is stacked after the EITC. 5 yr: ($109.0b) 10 yr: (199.0b)***
2. **HOPE Scholarship Plan and tuition tax deduction*** HOPE Plan: Nonrefundable credits of up to $1,500 per year per student for the first two years of post-secondary education. Students must be at least half-time status. Taxpayer claims the lesser of maximum credit or tuition and required fees actually paid, i.e., not covered by any scholarship or non-federal grant. Pell or other federal grants reduce the allowable credit. A "B-" average is required to be eligible for the second year credit; drug felons are ineligible. The credit phases out for taxpayers with modified AGI of $80,000 to $100,000 ($50,000 - $70,000 if single); phase-out thresholds and the maximum credits are indexed. Effective for payments made on or after 1/1/97, for education commencing on or after 7/1/97. Tuition tax deduction of up to $5,000 per year ($10,000 after 1998) per taxpayer. For any one student either credit or deduction can be used for tuition and required fees not covered by student aid with the HOPE Plan's AGI phase-out ranges. Also, expand income exclusion for forgiveness of certain student loans. 5 yr.: ($36.2b) 10 yr.: ($87.8b)	Similar except credit is refundable. B average rule based on high school record. $1,500 credit for full-time, $750 credit for part-time half-time students. Effective for taxable years beginning after 1997.	No Provision (Please refer to 19.-22. for continued education incentives)	No Provision

Administration Proposals	Senate Democratic Leadership Package (Daschle)**	Senate Republican Leadership Package (Lott): Affordable College Act (S.1)	Senate Republican Leadership Package (Lott): American Family Tax Relief Act (S.2)
3. **IRA Provisions**+: Double (by 2000) current law income thresholds and phase-out ranges for deductible IRA contributions. Index thresholds and contributions for inflation. Create new back-loaded IRAs subject to income limits, and permit conversion of deductible IRA amounts into back-loaded IRAs with income inclusion (spread over 4 years for pre-1999 conversions). Add exceptions to 10% early withdrawal tax for qualified post-secondary education expenses, first home purchase and long-term unemployment. Expansion of penalty-free withdrawals for medical costs. Expressly permit IRAs to invest in qualified State tuition program instruments. Income tax-free and penalty-free withdrawals from back-loaded IRAs after 5 years. Penalty-free withdrawals for special purposes permitted within 5 year period. (No special provisions made to eliminate income limits for a spouse of an active participant in an employer-sponsored retirement plan.) 5 yr.: ($5.5b) 10 yr.: ($20.9b)	**IRA Provisions**: Raise annual contribution limits for single and joint filers. Permit spouse of active participant in an employer-sponsored retirement plan to make a deductible IRA contribution without regard to the income limits. Index thresholds and contributions for inflation. Penalty-free withdrawals for education and home purchase. Expansion of penalty-free withdrawals for medical costs. (Does not create back-loaded IRAs). *Require employers to allow payroll deduction contributions to IRA of up to $2,000.* The contributions would go to an IRA maintained by government-selected contractor that would offer a limited choice of investments. *Nonrefundable tax credit for IRA contributions by or on behalf of low- and moderate-income individuals (with AGI of $30,000 or less).* Allow deferral of up to $400,000 of capital gains when proceeds from farm sales go to IRA. **Pension Provisions**: Modifies rules for 1996's pension simplification to include provisions in Administration's proposal requiring 1 percent automatic employer contribution for employees participating in small business plan and in plans using the 401(k) safe harbor, and adding multiemployer provisions.	**See Education Investment Accounts** (21.).	**IRA Provisions**: Increase income thresholds and phase-out ranges for joint and single filers. *After 2000, repeal income limits for deductible IRA contributions.* (Prior to repeal, permit spouse of active participants in employer-sponsored retirement plans to make a deductible IRA contribution without regard to the income thresholds). Allow withdrawals for special purposes (qualified business start-up expenses, long-term unemployment and education expenses) to be *income tax free* and exempt from the 10% early withdrawal tax. Create new back-loaded IRAs without income limits, and permit conversion of deductible IRA amounts into back-loaded IRAs with income inclusion (spread over 4 years for pre-1999 conversions). Allow withdrawal of contributions from back-loaded IRA at any time without income tax or 10% early withdrawal tax, allow withdrawal of earnings to be income tax free and exempt from 10% early withdrawal tax if after age 59 1/2 (and after 5 years following initial contribution), death, disability or if for a special purpose. 5yr: ($32.7b) 10 yr.: ($112.7b)

Administration Proposals	Senate Democratic Leadership Package (Daschle)**	Senate Republican Leadership Package (Lott)	
		Affordable College Act (S.1)	American Family Tax Relief Act (S.2)
	Pension Provisions (cont.): A number of proposals were included at the request of other members (e.g., permanent exemption of state/local government pension plans from non-discrimination rules, faster vesting of 401(k) matching contributions, limits on plan investment in employer stock, new rules on spousal benefits and benefits in divorce, new transfer rules, and prohibition on pension-secured credit cards).		
4. **Welfare-to-Work Tax Initiative:** Employers would be permitted a 50 percent tax credit on the first $10,000 of wages paid to certain long-term welfare recipients and could claim this credit for up to two years. Wages would include amounts paid by the employer for employer-provided educational assistance, health care, and dependent care assistance. This credit would be available through September 30, 2000. The present WOTC would be expanded to include as an eligible group adults 18-50 years old who are subject to the time limits for Food Stamps under the Administration's legislative proposal to amend the Welfare Act of 1996. 5yr.: ($0.6b) 10 yr.: ($0.6b)	No Provision	No Provision	No Provision

Administration Proposals	Senate Democratic Leadership Package (Daschle)**	Senate Republican Leadership Package (Lott)	
		Affordable College Act (S.1)	American Family Tax Relief Act (S.2)
5. **Capital Gains Provisions** Exclusion on sale of principal residence: The current rollover provision and one-time exclusion of up to $125,000 of gains on residences would be replaced by an exclusion of up to $500,000 ($250,000 for non-joint filers). The home would have to have been owned and occupied as a principal residence for at least two years during the five years prior to the sale. The exclusion would be available only once every two years. Taxpayers forced to move without meeting these requirements (for example, because of medical reasons or a change in place of employment) would be eligible for a pro-rated exclusion. The effective date would be January 1, 1997, with transition relief. 5 yr.: ($1.5b) 10 yr.: ($2.4b)	Provision similar to Administration proposal but includes extending the exclusion to tenant-stock holding in cooperative housing corporations. Rollover provision allowing deferral of sale of a qualified small business or partnership investment if proceeds reinvested in another such investment within six months. Increase asset size limit for small business exclusion to $100 million and liberalize other provisions. Increase limit on deduction of losses on the sale of small business stock to $300,000. **Note: Senator Ford's sliding scale capital gains proposal:** For assets held more than one year, additional 2 percent decrease in current 28 percent rate for each year the asset is held; for assets held more than eight years, the rate is 14 percent.	No Provision	50 percent exclusion of net long-term gains for individuals, effective 1/1/97. Collectibles ineligible for exclusion but retain maximum rate of 28%. Otherwise, maximum rate repealed. Index basis of stock and tangible property for assets purchased after 12/31/96 and held three years. Increase asset size limit for small business exclusion to $100 million and liberalize other provisions. Provides alternative rate of 28% for corporations. Capital losses on residences deductible. 5 yr: ($33.1b) 10 yr.: ($129.3b)

Administration Proposals	Senate Democratic Leadership Package (Daschle)**	Senate Republican Leadership Package (Lott)	
		Affordable College Act (S.1)	American Family Tax Relief Act (S.2)
6. **Establish D.C. Tax Incentive Program:** *D.C. jobs credit*: 40 percent subsidy to businesses in D.C. on first $10,000 of eligible wages (including employer-provided health care, dependent care, educational assistance) to WOTC-eligible employees or any D.C. resident living in a census tract with poverty rate of 15 percent or more. Employee wages must be less than $28,500. *Additional $20,000 of Sec. 179 expensing*: Businesses must be located within census tracts that have a poverty rate of at least 15 percent to be eligible. *Employment/training grants for tax-exempt organizations:* Would be available to organizations that hire economically disadvantaged D.C. residents or provide job placement assistance to welfare recipients. *Allocated tax credits to lenders to finance buildings and equipment and to investors for equity investments* *Tax-exempt bond authority*: Expand enterprise zone facility bonds by making them available to qualified D.C. businesses within census tracts with at least 15 percent poverty rate. Compared to EZ facility bonds, businesses may count any resident of D.C. to comply with 35 percent residency requirements, $3 million per borrower cap would be raised to $15 million, and a broader range of business property can be financed. 5 yr: ($0.3b) 10 yr.: ($0.3b)	No Provision	No Provision	No Provision

Administration Proposals	Senate Democratic Leadership Package (Daschle)**	Senate Republican Leadership Package (Lott)	
		Affordable College Act (S.1)	American Family Tax Relief Act (S.2)
7. **Small business estate tax relief**: Addresses liquidity problem of small business owners by increasing to $2.5m the amount eligible for special interest rate on deferred estate taxes. Expands the types of business interests eligible to defer estate taxes, and makes other simplifying changes. 5 yr.: ($0.7b) 10 yr: ($1.5b)	Estate tax exemption for first $900,000 of value of a "qualified family-owned business interests" that exceed 50 percent of the value of decedent's estate. This exemption is in addition to the unified credit, which exempts $600,000 of property from the estate or gift tax. Also, liberalize current law regarding special use valuations for estate tax purposes	No Provision	Increase unified estate and gift tax credit to $1m. by 2004. Family-owned business exclusion up to $1.5m where value exceeds 50 percent of decedent's estate. Exclusion is in addition to unified credit. Additional exclusion for 50 percent of value in excess of $1.5m. for qualifying estates. 20 year installment payment plan for certain businesses. No interest on portion of estate tax (on the first $1m. in value) extended under Sec. 6166. 5 yr: ($18.6b) 10 yr: ($66.9b)
8. **Expansion of Empowerment Zone/Enterprise Community (EZ/EC) program and Brownfields clean-up tax incentives**: *EZ/EC expansion*: (i) Second-round designation of 20 new EZs and 80 new ECs; (ii) designate 2 additional first-round EZs; (iii) liberalize current EZ/EC tax-exempt bond provisions and qualifying business definition. Second-round tax incentives -- Qualifying businesses in EZs eligible for tax-exempt bond financing outside the current-law State volume cap, increased §179 expensing, and brownfield clean-up incentive for additional acreage. Qualifying businesses in ECs eligible for current-law EZ/EC tax-exempt bonds and brownfield clean-up incentive. *Brownfield Clean-up Incentive*[+]: Current deduction for expenses incurred to clean-up brownfields in targeted geographic areas (first- and second-round EZs/ECs; census tracts with 20% or higher poverty and contiguous industrial/commercial areas; 76 previously announced EPA Brownfield pilot projects). 5 yr.: ($2.3b) 10 yr.: ($3.8b)	No Provision	No Provision	No Provision

Administration Proposals	Senate Democratic Leadership Package (Daschle)**	Senate Republican Leadership Package (Lott)	
		Affordable College Act (S.1)	American Family Tax Relief Act (S.2)
9. **Tax Credit for Equity Investment in Community Development Financial Institution (CDFI)**: A tax credit (up to 25 percent) for equity investments in qualified CDFIs. Capped amount of credits ($100 million) to be allocated by the CDFI Fund (effective date 1/1/98). 5 yr: ($0.03b) 10 yr.: ($0.09b)	No Provision	No Provision	No Provision
10. **Toll Statute of Limitations for Incapacitated Taxpayers**: 5 yr.: ($0.06b) 10 yr: ($0.7b)	No Provision	No Provision	No Provision
11. **Allow Foreign Sales Corporation (FSC) Benefits for Computer Software Licenses**: 5 yr.:($0.6b) 10 yr.: ($1.5b)	No Provision	No Provision	No Provision
12. **Extension of Sec. 127 through December 31, 2000**: The Administration proposed extension through 12/31/2000 of the exclusion from employees' taxable income of up to $5,250 per year of educational expenses paid for by their employer and reinstatement of the exclusion for graduate courses. Also, reinstate retroactively the exclusion for graduate education. The Administration also proposed a new 10 percent training credit for small businesses. 5 yr.: ($2.4b) 10 yr.: ($2.4b)	The exclusion would be made permanent. Directs the Dept. of Labor, in consultation with Treasury to conduct a study of this provision.	The exclusion would be made permanent and the provision limiting the exclusion to undergraduate courses would be repealed retroactively. 5 yr.: ($3.5b) 10 yr.: ($8.0b)***	No Provision
13. **Extend for One Year the R&E Tax Credit** 5 yr.: ($2.1b) 10 yr.: ($2.2b)	No Provision	No Provision	No Provision
14. **Extend for One Year the Orphan Drug Tax Credit** 5 yr.: ($0.05b) 10 yr.: ($0.05b)	No Provision	No Provision	No Provision
15. **Extend WOTC for One Year** 5 yr.: ($0.4b) 10 yr.: ($0.4b)	No Provision	No Provision	No Provision
16. **Extend for One Year Deduction for Contributions of Appreciated Stock to Private Foundations**: 5 yr.: ($0.07b) 10 yr.: ($0.07b)	No Provision	No Provision	No Provision

Administration Proposals	Senate Democratic Leadership Package (Daschle)**	Senate Republican Leadership Package (Lott)	
		Affordable College Act (S.1)	American Family Tax Relief Act (S.2)
17. **Modify Phase-out of Puerto Rico Economic-Activity Tax Credit** 5 yr.: ($0.4b) 10 yr.: ($3.9b)	No Provision	No Provision	No Provision
18. No Provision	**The Children's Health Coverage Act**: Refundable credit covering 90% of child's health insurance premium, phased-out for families with income above $75,000. Credit available for children ineligible for Medicaid or employer provided plans.	No Provision	No Provision
19. No Provision	**Deduction for Student Loan Interest**: Above the line deduction for interest paid after 12/31/97 for tax payer and spouse. Phase-outs: $70k single filers, $100k joint.	**Deduction for Student Loan Interest**: Same except $2,500 annual limit, including interest on loans for dependent's education. Effective after 1996. Phase-outs: $45k-$65k single filers, $65k-$85k joint. 5yr.: ($0.7b) 10 yr.: ($1.9b)	No Provision
20. No Provision	No Provision	**Tax-free Withdrawals from State Tuition Plans**: No tax would be owed on any portion of a withdrawal made from a qualified state tuition plan for qualified higher education expenses, which would include tuition, fees, room, board, books. Effective after 1996. 5 yr.: ($0.6b) 10 yr.: ($1.6b)	No Provision

Administration Proposals	Senate Democratic Leadership Package (Daschle)**	Senate Republican Leadership Package (Lott)	
		Affordable College Act (S.1)	American Family Tax Relief Act (S.2)
21. No Provision	No Provision	**Bob Dole Education Investment Accounts**: Nondeductible contributions of up to $1,000 per year per child under the age of 18. Distributions used for higher education expenses excluded from income. 10 percent penalty for other distributions. Effective after 1996 5 yr.: ($1.8b) 10 yr.: ($5.6b)	No Provision
22. No Provision	No Provision	**Exclusion of Federal Work Study Payments**: Payments excluded from gross income after 1996. 5 yr.: ($0.4b) 10 yr.: (1.0)	No Provision
23. No Provision	**Creation of Performance Stock Options**: Applicable where over 50 percent of options are available to nonhighly compensated employees. Option price must be less than fair market value at time of grant. No income is recognized on exercise if shares are held for one year and there is a 50 percent exclusion of capital gains on sale of stock.	No Provision	No Provision