DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

June 20, 1997

MEMORANDUM FOR SECRETARY ROBERT E. RUBIN
DEPUTY SECRETARY SUMMERS

FROM: **KARL SCHOLZ**
DEPUTY ASSISTANT SECRETARY (TAX ANALYSIS)

SUBJECT: Distribution Tables

Following this memo are new distribution tables for Senate tax packages.

- o The first two tables show the major provisions of the bill that was passed by the Senate Finance Committee. In contrast to the previous distribution tables you have seen, these tables include the revenue raisers.

  - Including raisers make the distributions less progressive than they would otherwise be. Most of the raisers are excise taxes, which are treated as being borne by consumers. Consumption is more equally distributed than income, making excise taxes (mildly) regressive.

- o As a basis for comparison, we include two older tables showing the distribution of the President's FY98 budget proposals, again including all raisers. Not surprisingly, the Budget package is much less generous to high income families than the Senate Finance package.

- o Tables 5-8 in the package show the major tax cut provisions (raisers have not yet been specified) in evolving Senate Democratic Leadership package. The package currently contains

  - A Kidsave-type child credit of $350 through 1999 and $500 thereafter, where taxpayers receive $100 less if a contribution is not made to a Kidsave account. The credit has the President's income phaseouts ($60k-$80k) and the credit covers children under 13 through 2002 and children under 18 thereafter. The new credit is partially refundable, but only to the point where the EITC and refundable credit do not exceed income taxes plus the employer and employee share of payroll taxes.

  - The education package gives a credit of $1000 and 50 percent of additional expenses up to $200 through 1999, $400 in 2000 and $1,000 thereafter. When a student is no longer eligible for the HOPE scholarship, there is a 20 percent tuition credit on expenses up to $4,000 through 1999, $7,500 in 2000 and $10,000 thereafter. The package includes a permanent extension of Section 127, student loan deductibility, prepaid tuition, a repeal of the $150 million tax-exempt bond cap, school construction, and a subsidy for Internet access for K-12 schools.

- They are now considering a broad-based 30 percent or 40 percent capital gains exclusion. The tables include both variations. The package also includes the President's home sales provision and an expansion of Section 1202 for small businesses.

- The Daschle estate tax package is included as well as the President's other budget initiatives, such as brownfield, the distressed areas initiatives and extensions of expiring provisions.

  -- The tables show that the Democrats package is sharply more progressive than the bill passed by the Finance Committee.

o The final tables show the distribution of current tax payments by families by income class. It shows, for example, that the top quintile of the income distribution pays 62.6 percent of federal taxes. The new tables for the Senate Finance bill show that 68.2 percent of the tax cuts go to the top quintile.

- If you are asked about this, I suggest making the point that the economy has done extremely well over the last four years, but all groups have not shared proportionately in the prosperity. We believe the bulk of the tax cuts in this package should be directed to working middle class families who have not shared as fully in the growth of the economy. Doing so, would modestly increase the overall progressivity of the tax system, but would help millions of families at crucial points in their lives (when they have children, send them to college...).

Very Preliminary.

Major Tax Provisions in the Bill Passed by the Senate Finance Committee (1)

(1998 Income Levels)

Family Economic Income Quintile (2)	Number of Families (millions)	Average Tax Change ($)	Total Tax Change: Amount (3) ($M)	Total Tax Change: Percent Distribution (%)	Tax Change as a Percent of: Current Federal Taxes (4) (%)	Tax Change as a Percent of: Family Economic Income (%)
Lowest (5)	21.6	22	478	-0.9	3.80	0.23
Second	22.2	-37	-813	1.5	-1.32	-0.15
Third	22.3	-234	-5216	9.6	-3.31	-0.55
Fourth	22.3	-520	-11573	21.3	-3.75	-0.72
Highest	22.3	-1667	-37127	68.2	-4.08	-0.90
Total (5)	111.3	-489	-54451	100.0	-3.75	-0.74
Top 10%	11.1	-2168	-24150	44.4	-3.65	-0.83
Top 5%	5.6	-2907	-16209	29.8	-3.32	-0.77
Top 1%	1.1	-6634	-7443	13.7	-2.86	-0.71

Department of the Treasury
Office of Tax Analysis

June 20, 1997

(1) This table distributes the estimated change in tax burdens due to the major tax provision in the bill passed by the Senate Finance Committee which include the following: i) a child credit; ii) a modified HOPE scholarship tax credit; iii) a deduction for student loan interest; iii) a deduction for education expenses paid through State-sponsored prepaid tuition programs; iv) permanent extension of Section 127; v) education investment accounts and private prepaid tuition programs; vi) expanded front-loaded and new back-loaded IRAs; vii) Capital gains provisions (lower individual rates, extension of S. 1202, and $500,000 exclusion for gains on a principal residence); vii) changes in the individual AMT; ix) a modification of the treatment of company-owned life insurance; and x) excise tax provisions (airport and airways excises, tobacco excises, and the extension of LUST through 2007).

(2) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income; IRA and Keogh deductions; nontaxable transfer payments such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent that reliable data allow. Inflationary losses of lenders are subtracted and gains of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family rather than a tax-return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.

(3) The change in Federal taxes is estimated at 1998 income levels but assuming fully phased in (2007) law and behavior. For the IRA provisions and education accounts, the change is measured as the present value of the tax savings from one year's contributions. The effect of the capital gains provision is based on the level of capital gains realizations under current law.

(4) The taxes included are individual and corporate income, payroll (Social Security and unemployment), and excises. Estate and gift taxes and customs duties are excluded. The individual income tax is assumed to be borne by payors, the corporate income tax by capital income generally, payroll taxes (employer and employee shares) by labor (wages and self-employment income), excises on purchases by individuals by the purchaser, and excises on purchases by business in proportion to total consumption expenditures. Federal taxes are estimated at 1998 income levels but assuming 2007 law and, therefore, exclude provisions that expire prior to the end of the Budget period and are adjusted for the effects of unindexed parameters.

(5) Families with negative incomes are excluded from the lowest quintile but included in the total line.

NOTE: Quintiles begin at FEI of: Second $16,950; Third $32,563; Fourth $54,758; Highest $93,222; Top 10% $127,373; Top 5% $170,103; Top 1% $408,551.

Very Preliminary

Major Tax Provisions in the Bill Passed by the Senate Finance Committee (1)

(1998 Income Levels)

Family Economic Income Class (2) (000)	Number of Families (millions)	Average Tax Change ($)	Total Tax Change: Amount (3) ($M)	Total Tax Change: Percent Distribution (%)	Tax Change as a Percent of: Current Federal Taxes (4) (%)	Tax Change as a Percent of: Family Economic Income (%)
0 - 15	18.5	24	442	-0.8	4.74	0.28
15 - 30	21.8	-23	-501	0.9	-1.00	-0.10
30 - 40	12.1	-120	-1447	2.7	-2.33	-0.35
40 - 50	9.7	-270	-2623	4.8	-3.59	-0.60
50 - 60	7.9	-372	-2929	5.4	-3.73	-0.68
60 - 75	9.4	-438	-4124	7.6	-3.44	-0.65
75 - 100	11.7	-736	-8609	15.8	-4.29	-0.85
100 - 200	15.6	-1345	-20980	36.5	-4.84	-1.02
200 & over	3.9	-3444	-13479	24.8	-3.18	-0.75
Total (5)	111.3	-489	-54451	100.0	-3.75	-0.74

Department of the Treasury
Office of Tax Analysis

June 20, 1997

(1) This table distributes the estimated change in tax burdens due to the major tax provision in the bill passed by the Senate Finance Committee which include the following: i) a child credit; ii) a modified HOPE scholarship tax credit; iii) a deduction for student loan interest; iii) a deduction for education expenses paid through State-sponsored prepaid tuition programs; iv) permanent extension of Section 127; v) education investment accounts and private prepaid tuition programs; vi) expanded front-loaded and new back-loaded IRAs; vii) Capital gains provisions (lower individual rates, extension of S. 1202, and $500,000 exclusion for gains on a principal residence); viii) changes in the individual AMT; ix) a modification of the treatment of company-owned life insurance; and x) excise tax provisions (airport and airways excises, tobacco excises, and the extension of LUST thru 2007).

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(3) The change in Federal taxes is estimated at 1998 income levels but assuming fully phased in (2007) law and behavior. For the IRA provisions and education accounts, the change is measured as the present value of the tax savings from one year's contributions. The effect of the capital gains provision is based on the level of capital gains realizations under current law.

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(5) Families with negative incomes are included in the total line but not shown separately.

Tax Proposals in the President's FY1998 Budget (1)

(1998 Income Levels)

Family Economic Income Quintile (2)	Number of Families (millions)	Average Tax Change ($)	Total Tax Change: Amount (3) ($M)	Total Tax Change: Percent Distribution (%)	Tax Change as a Percent of: Current Federal Taxes (4) (%)	Tax Change as a Percent of: Family Economic Income (%)
Lowest (5)	21.6	12	251	-1.3	2.00	0.12
Second	22.2	-90	-1999	10.2	-3.25	-0.37
Third	22.3	-240	-5331	27.3	-3.38	-0.56
Fourth	22.3	-377	-8384	43.0	-2.72	-0.52
Highest	22.3	-182	-4064	20.8	-0.45	-0.10
Total (5)	111.3	-175	-19518	100.0	-1.34	-0.26
Top 10%	11.1	34	376	-1.9	0.06	0.01
Top 5%	5.6	235	1,313	-6.7	0.27	0.06
Top 1%	1.1	935	1,049	-5.4	0.40	0.10

Department of the Treasury
Office of Tax Analysis

February 13, 1997

(1) This table distributes the estimated change in tax burdens due to the tax proposals in the President's FY1998 Budget.

(2) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and under-reported income; IRA and Keogh deductions; nontaxable transfer payments such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent that reliable data allow. Inflationary losses of lenders are subtracted and gains of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family rather than a tax-return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.

(3) The change in Federal taxes is estimated at 1998 income levels but assuming fully phased in (2007) law and behavior. For the IRA proposal, the change is measured as the present value of the tax savings from one year's contributions.

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(5) Families with negative incomes are excluded from the lowest quintile but included in the total line.

NOTE: Quintiles begin at FEI of: Second $16,950, Third $32,563, Fourth $54,758; Highest $93,222, Top 10% $127,373; Top 5% $170,103, Top 1% $408,551

Tax Proposals in the President's FY1998 Budget (1)

(1998 Income Levels)

Family Economic Income Class (2) (000)	Number of Families (millions)	Average Tax Change ($)	Total Tax Change: Amount (3) ($M)	Total Tax Change: Percent Distribution (%)	Tax Change as a Percent of: Current Federal Taxes (4) (%)	Tax Change as a Percent of: Family Economic Income (%)
0 - 15	18.5	15	274	-1.4	2.84	0.17
15 - 30	21.8	-70	-1526	7.8	-3.04	-0.31
30 - 40	12.1	-162	-1952	10.0	-3.14	-0.47
40 - 50	9.7	-268	-2602	13.3	-3.56	-0.60
50 - 60	7.9	-337	-2651	13.6	-3.37	-0.61
60 - 75	9.4	-366	-3441	17.6	-3.83	-0.75
75 - 100	11.7	-403	-4720	24.2	-2.12	-0.42
100 - 200	15.6	-272	-4246	21.8	0.31	0.06
200 & over	3.9	342	1337	-6.9	0.00	0.00
Total (5)	111.3	-175	-19518	100.0	-1.34	-0.26

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(3) The change in Federal taxes is estimated at 1998 income levels but assuming fully phased in (2007) law and behavior. For the IRA proposal, the change is measured as the present value of the tax savings from one year's contributions.

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(5) Families with negative incomes are included in the total line but not shown separately.

Very Preliminary

Major Tax Cut Provisions in the Senate Democrats' Alternative (1) (with 40% general capital gains exclusion)

(1998 Income Levels)

Family Economic Income Quintile (2)	Number of Families (millions)	Average Tax Change ($)	Total Tax Change: Amount (3) ($M)	Total Tax Change: Percent Distribution (%)	Tax Change as a Percent of: Current Federal Taxes (4) (%)	Tax Change as a Percent of: Family Economic Income (%)
Lowest (5)	21.6	-94	-2037	4.7	-16.21	-0.99
Second	22.2	-289	-6434	14.7	-10.45	-1.16
Third	22.3	-445	-9893	22.6	-6.27	-1.04
Fourth	22.3	-579	-12888	29.4	-4.17	-0.80
Highest	22.3	-551	-12267	28.0	-1.35	-0.30
Total (5)	111.3	-393	-43774	100.0	-3.01	-0.59
Top 10%	11.1	-664	-7393	16.9	-1.12	-0.25
Top 5%	5.6	-1005	-5601	12.8	-1.15	-0.27
Top 1%	1.1	-3106	-3485	8.0	-1.34	-0.33

Department of the Treasury
Office of Tax Analysis

June 20, 1997

(1) This table distributes the estimated change in tax burdens due to the major tax cut provisions in the Senate Democrats' Alternative proposal which include the following: i) a child credit (refundable to the extent of payroll taxes); ii) a modified HOPE scholarship tax credit and modified tuition tax deduction; iii) a deduction for student loan interest; iv) a "kidsave" IRA provision; v) permanent extension of Section 127; vi) SFC chair's mark state-sponsored prepaid tuition provision; and vii) capital gains provisions (a $500,000 exclusion for gains on a principal residence, 40% capital gains exclusion and 24% AMT rate, a small business capital gains preference, and a $100 ($200 joint) dividend exclusion).

(2) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income; IRA and Keogh deductions; nontaxable transfer payments such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent that reliable data allow. Inflationary losses of lenders are subtracted and gains of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family rather than a tax-return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.

(3) The change in Federal taxes is estimated at 1998 income levels but assuming fully phased in (2007) law and behavior. For the kidsave provision, the change is measured as the present value of the tax savings from one year's contributions. The effect of the capital gains provision is based on the level of capital gains realizations under current law.

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(5) Families with negative incomes are excluded from the lowest quintile but included in the total line.

NOTE: Quintiles begin at FEI of: Second $16,950; Third $32,563; Fourth $54,758; Highest $93,222; Top 10% $127,373; Top 5% $170,103; Top 1% $406,551.

Very Preliminary

Major Tax Cut Provisions in the Senate Democrats' Alternative (1)
(with 40% general capital gains exclusion)

(1998 Income Levels)

Family Economic Income Class (2) (000)	Number of Families (millions)	Average Tax Change ($)	Total Tax Change: Amount (3) ($M)	Total Tax Change: Percent Distribution (%)	Tax Change as a Percent of: Current Federal Taxes (4) (%)	Tax Change as a Percent of: Family Economic Income (%)
0 - 15	18.5	-83	-1536	3.5	-16.46	-0.98
15 - 30	21.8	-260	-5680	13.0	-11.32	-1.17
30 - 40	12.1	-390	-4704	10.7	-7.57	-1.12
40 - 50	9.7	-452	-4389	10.0	-6.01	-1.01
50 - 60	7.9	-537	-4225	9.7	-5.38	-0.98
60 - 75	9.4	-592	-5577	12.7	-4.65	-0.88
75 - 100	11.7	-563	-6583	15.0	-3.28	-0.65
100 - 200	15.6	-374	-5827	13.3	-1.34	-0.28
200 & over	3.9	-1277	-4998	11.4	-1.18	-0.28
Total (5)	111.3	-393	-43774	100.0	-3.01	-0.59

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June 20, 1997

(1) This table distributes the estimated change in tax burdens due to the major tax cut provisions in the Senate Democrats' Alternative proposal which include the following: i) a child credit (refundable to the extent of payroll taxes); ii) a modified HOPE scholarship tax credit and modified tuition tax deduction; iii) a deduction for student loan interest; iv) a "kidsave" IRA provision; v) permanent extension of Section 127; vi) SFC chair's mark state-sponsored prepaid tuition provision; and vii) capital gains provisions (a $500,000 exclusion for gains on a principal residence, 40% capital gains exclusion and 24% AMT rate, a small business capital gains preference, and a $100 ($200 joint) dividend exclusion).

(2) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and under-reported income; IRA and Keogh deductions; nontaxable transfer payments such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent that reliable data allow. Inflationary losses of lenders are subtracted and gains of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family rather than a tax-return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.

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(5) Families with negative incomes are included in the total line but not shown separately.

Very Preliminary

Major Tax Cut Provisions in the Senate Democrats' Alternative (1)
(with 30% general capital gains exclusion)

(1998 Income Levels)

Family Economic Income Quintile (2)	Number of Families (millions)	Average Tax Change ($)	Total Tax Change: Amount (3) ($M)	Total Tax Change: Percent Distribution (%)	Tax Change as a Percent of: Current Federal Taxes (4) (%)	Tax Change as a Percent of: Family Economic Income (%)
Lowest (5)	21.6	-92	-1994	5.1	-15.87	-0.97
Second	22.2	-285	-6343	16.3	-10.30	-1.16
Third	22.3	-437	-9729	25.0	-6.17	-1.02
Fourth	22.3	-566	-12588	32.3	-4.06	-0.78
Highest	22.3	-363	-8088	20.8	-0.89	-0.20
Total (5)	111.3	-350	-38937	100.0	-2.68	-0.53
Top 10%	11.1	-309	-3440	8.8	-0.52	-0.12
Top 5%	5.6	-338	-1884	4.8	-0.39	-0.09
Top 1%	1.1	-499	-560	1.4	-0.22	-0.05

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June 20, 1997

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Very Preliminary

Major Tax Cut Provisions in the Senate Democrats' Alternative (1)
(with 30% general capital gains exclusion)

(1998 Income Levels)

Family Economic Income Class (2) (000)	Number of Families (millions)	Average Tax Change ($)	Total Tax Change: Amount (3) ($M)	Total Tax Change: Percent Distribution (%)	Tax Change as a Percent of: Current Federal Taxes (4) (%)	Tax Change as a Percent of: Family Economic Income (%)
0 - 15	18.5	-81	-1502	3.9	-16.10	-0.96
15 - 30	21.8	-256	-5592	14.4	-11.14	-1.15
30 - 40	12.1	-385	-4638	11.9	-7.46	-1.11
40 - 50	9.7	-445	-4316	11.1	-5.91	-0.99
50 - 60	7.9	-527	-4147	10.7	-5.28	-0.96
60 - 75	9.4	-580	-5461	14.0	-4.55	-0.86
75 - 100	11.7	-546	-6391	16.4	-3.19	-0.63
100 - 200	15.6	-338	-5271	13.5	-1.22	-0.26
200 & over	3.9	-364	-1424	3.7	-0.34	-0.08
Total (5)	111.3	-350	-38937	100.0	-2.68	-0.53

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Office of Tax Analysis

June 20, 1997

(1) This table distributes the estimated change in tax burdens due to the major tax cut provisions in the Senate Democrats' Alternative proposal which include the following: i) a child credit (refundable to the extent of payroll taxes); ii) a modified HOPE scholarship tax credit and modified tuition tax deduction; iii) a deduction for student loan interest; iv) a "kidsave" IRA provision; v) permanent extension of Section 127; vi) SFC chair's mark state-sponsored prepaid tuition provision; and vii) capital gains provisions (a $500,000 exclusion for gains on a principal residence, 30% capital gains exclusion, a small business capital gains preference, and a $100 ($200 joint) divend exclusion).

(2) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and under-reported income; IRA and Keogh deductions; nontaxable transfer payments such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent that reliable data allow. Inflationary losses of lenders are subtracted and gains of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family rather than a tax-return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.

(3) The change in Federal taxes is estimated at 1998 income levels but assuming fully phased in (2007) law and behavior. For the kidsave provision, the change is measured as the present value of the tax savings from one year's contributions. The effect of the capital gains provision is based on the level of capital gains realizations under current law.

(4) The taxes included are individual and corporate income, payroll (Social Security and unemployment), and excises. Estate and gift taxes and customs duties are excluded. The individual income tax is assumed to be borne by payors, the corporate income tax by capital income generally, payroll taxes (employer and employee shares) by labor (wages and self-employment income), excises on purchases by individuals by the purchaser, and excises on purchases by business in proportion to total consumption expenditures. Federal taxes are estimated at 1998 income levels but assuming 2007 law and, therefore, exclude provisions that expire prior to the end of the Budget period and are adjusted for the effects of unindexed parameters.

(5) Families with negative incomes are included in the total line but not shown separately.

Distribution of Federal Taxes Under Current Law

(1998 Inc..ne Levels)

Family Economic Income Quintile	Number of Families (millions)	Family Economic Income (1) ($B)	Federal Taxes Under Current Law (2) ($B)	Taxes as a Percent of Income (%)	Percent Distribution of: Family Economic Income (%)	Percent Distribution of: Federal Taxes Under Current Law (%)
Lowest (3)	21.6	205.5	12.6	6.1	2.8	0.9
Second	22.2	545.5	61.6	11.3	7.4	4.2
Third	22.3	954.3	157.7	16.5	12.9	10.9
Fourth	22.3	1,604.4	308.8	19.2	21.7	21.2
Highest	22.3	4,123.8	909.8	22.1	55.8	62.6
Total (3)	111.3	7,396.1	1,453.2	19.6	100.0	100.0
Top 10%	11.1	2,915.2	661.8	22.7	39.4	45.5
Top 5%	5.6	2,105.3	488.7	23.2	28.5	33.6
Top 1%	1.1	1,054.9	259.9	24.6	14.3	17.9

Department of the Treasury
Office of Tax Analysis

February 5, 1997

(1) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income; IRA and Keogh deductions; nontaxable transfer payments such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and gains of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family rather than a tax-return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.

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(3) Families with negative incomes are excluded from the lowest quintile but included in the total line.

NOTE: Quintiles begin at FEI of: Second $16,950, Third $32,563; Fourth $54,758; Highest $93,222; Top 10% $127,973; Top 5% $170,103; Top 1% $406,551.

Distribution of Federal Taxes Under Current Law

(1998 Income Levels)

Family Economic Income Class (000)	Number of Families (millions)	Family Economic Income (1) ($B)	Federal Taxes Under Current Law (2) ($B)	Taxes as a Percent of Income (%)	Percent Distribution of: Family Economic Income (%)	Percent Distribution of: Federal Taxes Under Current Law (%)
0 - 15	18.5	156.7	9.3	6.0	2.1	0.6
15 - 30	21.8	485.3	50.2	10.3	6.6	3.5
30 - 40	12.1	419.1	62.2	14.8	5.7	4.3
40 - 50	9.7	436.0	73.1	16.8	5.9	5.0
50 - 60	7.9	431.5	78.6	18.2	5.8	5.4
60 - 75	9.4	632.1	120.0	19.0	8.5	8.3
75 - 100	11.7	1,014.8	200.6	19.8	13.7	13.8
100 - 200	15.6	2,057.6	433.3	21.1	27.8	29.8
200 & over	3.9	1,800.3	423.2	23.5	24.3	29.1
Total (3)	111.3	7,396.1	1,453.2	19.6	100.0	100.0

Department of the Treasury
Office of Tax Analysis

February 5, 1997

(1) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income; IRA and Keogh deductions; nontaxable transfer payments such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and gains of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family rather than a tax-return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.

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Preliminary Assessment of Major Provisions of Competing Tax Packages, June 20, 1997 (Scoring through 2002)			
Item	Administration Package	Ways and Means Package	Senate Finance Committee Package
Education	$1,500 (phased in, initially at $1,200) HOPE scholarship and $10,000 (phased in) tuition deduction ($34.4b)	Modified HOPE scholarship -- 50% of expenses up to $3,000 (phaseout $40,000-50,000 singles/$80,000-100,000 joint) ($22.3b); deduction for undergraduate expenses paid through state-sponsored prepaid tuition program of up to $10,000/yr., $40,000 max. per student ($0.9b)	Modified HOPE scholarship -- 50% of expenses up to $3,000; 75% of up to $2000 for community colleges and technical school students (phaseout $40,000-50,000 singles/$80,000-100,000 joint) ($2x?)
School construction	Allocable tax credits for K-12 construction ($3.0)	None	Raise small issuer arbitrage exemption for education facilities ($.03)
Section 127	Permanent extension of Section 127, for both graduates and undergraduates ($3.5)	Six month extension of Section 127 for undergraduates ($0.2)	Permanent extension of Section 127, for both graduates and undergraduates($3.5)
Computer technology K-12	None.	Enhanced deduction for corporate contributions to schools ($0.2)	Exclude certain teacher training (including technology training) expenses from application of 2% floor on miscellaneous itemized deductions
Student loans	$2500 above-the-line student loan interest deduction. ($1.1)	None	$2500 above-the-line student loan interest deduction. ($1.1)

$150 million bond cap for private colleges and universities	None.	Raise by $10 million per year until it reaches $200 million ($0.13)	Repeal bond cap. ($.32)
IRA withdrawals	No change in IRA rules	Penalty-free IRA withdrawals for undergraduate, post-secondary vocational, and graduate education expenses ($0.8)	Penalty-free IRA withdrawals for undergraduate, post-secondary vocational, and graduate education expenses ($0.8)
Education saving incentives	Included as part of the Kidsave proposal (Create backloaded IRA for educational saving -- limit contributions to $_________)	Education investment accounts for children under 18 (maximum $5,000 annual contribution, $50,000 aggregate contributions), private prepaid tuition plans; deduction for undergraduate and post-secondary vocational expenses of up to $10,000/yr., $40,000 max. per student ($7.0)	Contributions of up to $2000 (plus $500 child credit) per year to Education IRA-- tax-free inside buildup and tax-free withdrawals if used for higher education; allow private prepaid tuition plans $2000 (plus $500 child credit) per year; tax-free withdrawals for prepaid State-sponsored programs.
Middle-Class Tax Relief	Refundable Kidsave Credit under 13 ($77.8), stacked before the EITC	$500 ($400 in 1998) child credit, non-refundable, under 17 ($71.3), stacked after the EITC, 50% offset with dependent care credit[1]	$500 ($250 in 1997only for children under 13) child credit, for children under 17 (18 after 2002); mandatory Kidsave for children age 13 and above; stacked after half of the EITC ($)

[1] Chairman Archer announced this week that he would drop the dependent care offset before consideration of the bill on the House floor.

	None	Index dependent care tax credit expense limit, $75,000-$100,000 AGI phaseout ($0.1)	None
Alternative Minimum Tax	Minor reform of individual AMT, phased in starting 2003	Increase individual AMT exemption amount by $1,000 every other year from 1999 through 2007, index thereafter ($1.2)	Increase individual AMT exemption amount by $600 (joint) for 2001-2002; $950 (joint) every year thereafter ($.35)
Corporate AMT	(Exemption from AMT for small corporations -- included as part of Administration Simplification Proposal)	Exemption from AMT for small corporations ($0.6)	None
	None	Prospective repeal of AMT depreciation ($11.8)	None
Capital Gains Provisions	No broad-based proposal	Separate 20/10 rate schedule, 26% maximum rate on depreciation recapture, indexing starting in 2001 (raises $2.7); phase down of top corporate capital gains rate to 30% for assets held at least 8 years.	Separate 20/10 rate schedule, 24% maximum rate on depreciation recapture, no indexing or corporate capital gains. ($.98)
Home Provision	President's Home Sales Provision ($1.4)	President's Home Sales Provision (included above)	President's Home Sales Provision ($1.4)
Small Business Provisions	Variant of Bumpers-Matsui targeted small business relief ($0.4)	None	Slightly expanded version of Administration's proposal ($0.7)

IRAs	none	Create backloaded American Dream IRA's, penalty free rollovers from IRA (which raises money), special purpose withdrawals for first time home purchase ($.03)	Expand income phaseouts for deductible IRAs; expand availability of spousal IRAs; create backloaded IRA Plus accounts; special purpose withdrawals for first time home purchases ($3.3)
Home Office	Increase availability of home office deduction ($0.6)	Home office provision ($1.1)	None
Estate Tax	Daschle qualified family owned business estate tax relief ($2.3)	Increase unified credit to $1.0 million by 2007 ($7.5)	Increase unified credit to $1.0 million by 2006 ($??). Modified Daschle proposal with $1 million exemption for qualified businesses ($3.1). Up to $1 million exclusion for conservation easements ($0.2)
Urban Initiatives	Distressed areas and welfare-to-work ($2.9)	Modified welfare-to-work provision ($0.1); no brownfields or EZ/ECs.	Restricted brownfields ($.25); no welfare-to-work or EZ/ECs.
Other Presidential Initiatives	Equitable tolling, Puerto Rico, FSC software, and DC ($1.3)	Modified D.C. package ($0.3); no equitable tolling, FSC software, or Puerto Rico	Modified D.C. package ($??); FSC software ($??); no equitable tolling or Puerto Rico
Extenders	R&E, contributions of appreciated stock to private foundations, WOTC and orphan drug credit ($2.2)	1-1/2 year extension of R&E, and contributions of appreciated stock to private foundations; one year extension of modified, two-tier WOTC; and permanent extension of orphan drug credit ($4.1).	Two-and-a-half year extension of R&E and contributions of appreciated stock to private foundations; modified two-tier WOTC and permanent extension of orphan drug credit ($??)

Independent contractors	None	Liberalized independent contractor rules ($1.0)	Provision re: classification of securities brokers.

cc: Elena, Tom F.

"Helping Working Families Win"

1. Protecting Paychecks.

- *Taxes:*

Ensure tax cuts benefit working families:

- Distribution test on Tax Bill (i.e. bulk of tax cuts on fully phased-in basis should go to taxpayers making less than $80,000).
- Insist $100 billion of the Tax Bill over 5 years will be allocated to the education and child credits.
- Release Treasury distributional analysis of tax proposals.
- Request CBO distributional analysis of Roth and Archer Tax proposals.
- Highlight CRS report that disputes JTC methodology for assessing winners and losers from Capital Gains cuts.

- Make Child Credit refundable.
- Highlight any Republican deviation from informal Budget Deal agreements on EITC, education credits total, etc.

- Add safeguard to Tax Bill that will automatically reduce tax cuts in case of out years explosion. Insist the gimmicks that balloon in out years be dropped (i.e. capital gains indexing, phased-in estate tax cuts, backloaded IRAs).
- Highlight CBPP report exposing delayed revenue losses in GOP tax proposals.

Close corporate tax loopholes and use as offsets for agenda priorities above. Citizens for Tax Justice has identified $69 billion in corporate tax breaks, $23 billion go to specific industries like oil & gas, insurance, timber and minerals, or benefit companies that operate abroad, or allow for entertainment and meal deductions. [need more specifics]

Force deadbeat oil companies to pay the $440 million in royalties they owe the federal government. (Boxer)

Democratic tax simplification alternative to GOP proposal.

IRA payroll deduction for workers whose employers do not provide pension benefits. (Daschle/Kennedy/Bingaman)

Make health benefits for self-employed tax deductible.

Expand tax deductions for home offices.

- ***Job/Wage Security:***

Profitable companies that use mass downsizing schemes must pay 6 months severance or training before they may pay dividends or executive raises or bonuses. (Reich)

Penalties for companies where executive compensation exceeds 50 times the average employee salary. (Bingaman)

Companies that receive federal subsidies or contracts must keep a majority of employees in the U.S. not overseas. (Reich) or Eliminate tax break that encourages companies to move jobs overseas. (Dorgan)

Stronger and better enforcement of the Equal Pay Act. (Daschle)

Impose liability on companies and retailers that sub-contract to, or knowingly buy from sweat-shops. (Kennedy); Ban imports made with child labor; (?) Develop labeling to reward products made without child or exploited labor. (Harkin)

- ***Workplaces that work for workers:***

Make child care more accessible by providing tax incentives to employers to create on-site day care centers, or help subsidize employees' off-site arrangements. (Dodd) (Kohl/Hatch)

Allow unpaid leave for school or medical appointments. (Murray)

Extend Family and Medical Leave Act to cover small firms with less than 25 employees. (Dodd)

Flex time to give employees more control of their work schedules. Preserve the 40 hour work week. (Baucus/Kerrey)

- ***Consumer Protection***

Lower the cost of basic financial services by protecting consumers from excessive automated teller, on-line or telephone banking charges. No bank fees for those who carry no balance on credit cards.

Authorize FCC reregulation of cable rates in markets where no competition has taken hold. Moratorium on cable TV rate increases. (Wyden)

Protect consumers from computer junk-e-mail. (CT Atty General); Prevent or limit trading of credit information over the Internet; Protect Internet privacy for children (FTC); Child-safe labelling of Internet sites (Murray); Develop V-chip type technology to block all non-child-safe Internet sites.

Insurance reform to eliminate Lifetime Limits. (Rockefeller)

Improve service and standards of managed care insurance by with incentives and rule changes to help health care professionals become managers of managed care plans; Set minimum standards of quality care to be observed by all managed care plans (Kennedy); Establish standards and procedures to give policy-holders consumer information about managed care plans.

Aviation safety issues (?)

2. Empowering Parents -- Protecting Children.

Repair crumbling schools by reducing the costs of financing school construction for local authorities. Like the popular COPs program, local authorities would retain control. (Mosley-Braun)

Extend health care coverage to all uninsured children [paid for with tax on cigarettes]. (Kennedy)

Fund HeadStart for all eligible 3 and 4 year-olds by adding a fee, or reducing the tax break, for advertising on children's television programs.

Expand school lunch and breakfast program/child nutrition.

Provide grants to local communities to improve the quality of child care programs [set quality or licensing standards]. (Dodd)

Improve technology training for teachers (Murray); Increase school access to communications networks, hardware and software (Rockefeller/Bingaman/Murray)

Protect Internet privacy for children (FTC); Child-safe labelling of Internet sites (Murray); Develop V-chip type technology to block all non-child-safe Internet sites.

Guarantee community Right-to-know about toxic exposures. (Baucus/Boxer)

Child safety locks on guns. (Kohl)

- *Safer Streets.*

Gun standards to combat "junk guns" would extend the same safety and quality standards currently used for import. (Boxer)

Child safety locks on guns. (Kohl)

Provide incentives to local communities to create After school Safe Havens.

Provide assistance for local communities to keep schools open until 5pm with optional programs for kids with parents who work -- also eases child care problems. Gives kids an alternative to the street and gives working parents peace-of-mind to know their children are in a safe, supervised environment. (Boxer)

Juvenile anti-gang initiative; Juvenile sentencing option for non-violent offenders; Expanded drug courts and drug treatment. (Daschle)

- *Cleaner Communities.*

Make polluters pay for clean-up. [need specifics]

Protect kids from toxic poisons by cleaning up all SuperFund sites within 4 miles of any child's home are cleaned up by 2005. Today 10 million children live within 4 miles of a major toxic waste site.

Guarantee community Right-to-know about toxic exposures. (Baucus/Boxer)

3. Making Retirement More Secure.

Extend Social Security solvency by increasing rate of return on investments and instituting other reforms. [need better description]

Protect pensions from being used to prop up company stock -- Color Tile. (Boxer)

Provide women who stay at home or work part-time with access to pension benefits. (Mosley-Braun)

IRA payroll deduction for workers whose employers do not provide pension benefits. (Daschle/Kennedy/Bingaman)

Make pensions portable. (Bingaman)

Protections against spousal impoverishment for long-term care.

Crackdown on Pharmaceuctical price gouging on drugs. (Pryor) Prescription drug coverage for Medicare beneficiaries. (Rep Engel)

Health insurance coverage for early retirees abruptly dropped by insurers. (Daschle)

Others

Incentives for states that lower legal blood alcohol levels.

Increase allies burden sharing of defense costs.

Taxes - Flat Tax

Kemp Commission Report

- The Kemp Commission has clearly read the polls. Instead of coming up with a clear statement of principle, they have produced instead a trojan horse in which to hide a flat tax proposal that will sock the middle class.

- The Commission is vague on specifics, but its main policy prescription is adoption of a flat tax. Since they don't have any specifics in the report, we can only draw on the one proposal for a flat tax with enough detail to analyze -- the Armey flat tax proposal.

- The Republican flat tax is the wrong way to go. It is not fair. It would raise income taxes on low and middle income Americans in order to pay for lowering taxes on the wealthy.

- In many ways, it is merely an extension of Republican budget proposals to raise taxes on working families in order to pay for a tax cut for the wealthy. In the Republican budget, they propose creating new special interest loopholes, let billionaire expatriates escape U.S. taxation, and skew their tax cuts so that nearly half the benefit goes to the top 12 percent, those earning more than $100,000 a year. By contrast, the President's plan closed corporate loopholes by over $46 billion and provided a tax cut focused on the middle class.

- Now they are at it again, raising taxes on working families to pay for tax cuts for the rich.

- The Republican flat tax would raise income taxes on the wages of those who must work to earn their living, but would exempt interest, dividends, and capital gains income.

- The Republican flat tax would end deductions and exemptions for middle income Americans while creating new loopholes for the wealthy and for corporations.

  -- For example, under the Republican flat tax, employer provided health insurance would be taxed, but capital gains, interest and dividends would not be taxed.

  -- Under the Republican flat tax, home owners would lose their mortgage interest payment deductions, but corporations would be able to deduct costs of buildings immediately, even if the buildings have a life of 40 years. Home owners would be doubly hit, because according to some studies, real estate values would decline under their flat tax.

- Republicans always talk about the importance of state and local governance, and about the need for charity to replace welfare, but the Republican flat tax would also end deductions for state and local income and property taxes and for charitable contributions.

- Like their earlier budget proposals, the Republican flat tax would exacerbate the already growing income inequality in the United States.

  -- Families in the bottom 60 percent of the income distribution have experienced a decline in real income between 1979 and 1993. The lowest fifth saw their real income fall by almost 15 percent while the highest fifth enjoyed an 18.4 percent gain. The top 1 percent saw real incomes nearly double over this period.

  -- Now, the Republican flat tax could mean up to an estimated 71 percent tax hike for families earning under $20,000 a year; a 32 percent tax hike for those earning between $20,000 and

$30,000 a year; and a 9-13 percent take hike for those earning between $30,000 and $100,000 a year; while providing an estimated tax break of about 28 percent for those earning more than $200,000 a year.

o Some examples:

-- A married couple with two children earning twice the minimum wage would face a tax hike of $2,442.

-- A married couple with two children earning $50,000 in wages and with employer-provided health insurance would face a tax hike of $1,604.

-- A married couple with two children and two earners, each earning $50,000 in wages, and with employer-provided health insurance and investment income would face a tax increase of $2,683.

-- By contrast, a married couple with two children and one earner with $212,100 of AGI, employer-provided health insurance, and investment income would get a tax cut of $10,943.

o Claims that the Republican flat tax would promote growth and increase savings are also misguided. First, there is no simple correlation between growth and taxation. The most rapid period of growth in the United States occurred prior to 1973, when top marginal tax rates were highest. Second, in the 1980s, taxes on savings were cut, but savings fell too. Third, today, equipment investment as a share of GDP is the highest it has been since records began to be kept almost 70 years ago.

o By contrast, the Administration has already made a major contribution to tax fairness and deficit reduction with the passage of the 1993 Act. Republicans leaders predicted that the Act would send the United States into a recession. In fact, the legislation cut the deficit nearly in half over the last three years, and led to the strongest low-inflation, investment-led recovery since John F. Kennedy, while cutting income taxes for low and moderate income working Americans through expansion of the earned income tax credit. Now the Republicans want to repeal not only the Clinton expansion of the EITC, but also roll back the tax credit expansions of Ronald Reagan, George Bush and their predecessors.

o We share the view that the current tax system is overly complex. We support reform that will make the tax system fairer, will help promote economic growth, and will simplify the tax system. A main tenet of tax fairness is that income taxes should not be increased on low and middle income Americans while they are being decreased for the wealthy.

If issue of double corporate taxation is raised:

o At a time when corporate tax rates have fallen from by about one-third from the 1970s as a ratio to real profits, from about 50 percent to 35 percent today -- reducing the burden on corporate profits is not the highest priority, and the question of who pays for these lower corporate taxes is inevitably answered: middle income Americans.

If IRS is criticized:

o We have been working hard to modernize the IRS, make it more efficient and user-friendly, and there is a national commission currently studying this problem. What will really make taxpayers upset, however, is if the Republican flat tax passes and their income taxes go up while those of the wealthiest taxpayers decline.

If issue of supermajority for taxation is raised:

- o We do not need to tinker with 200 years of constitutional process in order to ensure tax fairness. We just need to stop the congressional majority from continuing to try to raise income taxes on working Americans in order to pay for tax cuts for the wealthy.

Taxes -
Flat Tax

SUMMARY

On July 19, 1995, Representative Armey and Senator Shelby introduced a new flat tax proposal as H.R. 2060 and S. 1050, "The Freedom and Fairness Restoration Act." The Armey-Shelby proposal would replace the current individual and corporate income taxes and the estate and gift taxes with a flat-rate consumption tax that includes three major elements: (1) a flat 17 percent rate on wage and pension distributions, (2) a flat 17 percent rate cash flow tax on businesses (with a deduction for wages, but without a deduction for non-pension fringe benefits), and (3) a standard deduction for all filers ($10,700 for single filers, $21,400 for joint filers, and $14,000 for head-of-household filers), and an additional standard deduction for each dependent ($5,000).

The Treasury Department's Office of Tax Analysis estimated the revenue and distributional effects of the Armey and Shelby proposal. The principal conclusions and findings of that analysis are the following:

- At the proposed 17 percent tax rate and standard deduction amounts, the Armey-Shelby proposal would reduce tax liabilities by approximately $138.3 billion per year at 1996 income levels.

- The revenue loss could be larger if Congress added transition rules to relieve the proposal's large lump-sum tax on existing assets. The proposal would deny about $600 billion of depreciation deductions on existing assets in the first year alone.

- To make the proposal revenue-neutral, the reduction in tax liabilities ($138.3 billion) could be offset either by increasing the flat rate to 20.8 percent, lowering the standard deduction by over half (to $5,100 for single filers, $10,200 for joint filers, $6,700 for head-of-household filers, and $2,400 for each dependent), or some combination of both.

- A revenue-neutral Armey-Shelby proposal would reduce taxes for the group of families with income of $200,000 or more and increase taxes for the group of families with income below $200,000. A 20.8 percent flat tax with Armey-Shelby's proposed standard deductions would reduce Federal taxes for the group of families with income of $200,000 or more by 28.1 percent and increase taxes for the groups of families with income under $200,000 by between 5.0 percent and 70.7 percent.

- The analysis also illustrates the impact of the Armey-Shelby proposal on typical families by six examples which show the effect of the taxes collected at the business level and the tax paid directly by families. While a single person earning the minimum wage would have a small tax cut under the Armey-Shelby proposal, couples with two children and earnings of twice the minimum wage for one earner, couples with earnings of $50,000 for one earner, and couples with earnings of $100,000 divided equally between two earners would have significant tax increases. High income families, in contrast, would have significant tax cuts. The examples show that under the Armey-Shelby proposal:

- The total tax burden for a single worker earning $8,840 per year would decrease $152 because the proposal provides higher standard deductions than current law.

- The total tax burden for a married couple earning $17,680 with two children would increase by $2,442, primarily because the proposal would repeal the earned income tax credit.

- The total tax burden for a married couple with $50,000 of wages, two children, and employer-provided health insurance would increase by $1,604, because the taxation of employer-provided health insurance and the employer's contributions to FICA at the business level would more than offset lower taxes on money wages. Employees would bear the burden in the form of either lower wages, reduced health insurance benefits, or substitution of taxable wages for formerly tax-exempt health benefits.

- The total tax burden for a two-earner married couple with two children, $100,000 of total wages ($50,000 for each earner), employer-provided health insurance, and $4,000 of investment income would increase by $2,683, primarily because of the effects of taxes on the employer's contributions to FICA and health insurance.

- The total tax burden for families with two children and with income of $212,100 (including investment income) would decrease because the Armey-Shelby proposal would exempt investment income of individuals from tax and flatten the rate structure. The total tax burden for a two-earner married couple with each spouse earning $100,000 and a total of $12,100 of investment income would decrease $3,469, even after taking into account the proposal's tax on the employers' contributions to health insurance and FICA. A one-earner couple with the same total income, but a larger share of investment income ($159,100 in wages and $53,000 of investment income) would have a tax reduction of $10,943 for the same reasons.

Office of Tax Analysis
January 4, 1996

AN ANALYSIS OF THE NEW ARMEY-SHELBY FLAT TAX PROPOSAL

In October of 1994, the Department of Treasury's Office of Tax Analysis prepared an analysis of Representative Armey's original proposal to replace the individual and corporate income taxes with a two-part flat-rate consumption tax (H.R. 4585, which he introduced on June 16, 1994). Initially, that analysis was necessarily quite tentative, because Representative Armey had specified few details of his proposal in the original legislation. Treasury's analysis was revised after Representative Armey's staff clarified some features of the proposal. The revised analysis was released in March, 1995, in a letter responding to a request by Senator James Exon for the analysis.

On July 19, 1995, Representative Armey and Senator Shelby introduced a new, somewhat more fully specified, flat tax proposal as H.R. 2060 and S. 1050, "The Freedom and Fairness Restoration Act." The Armey-Shelby proposal would replace the current individual and corporate income taxes and the estate and gift taxes with a flat-rate consumption tax that includes three major elements:

1. a flat 17 percent rate on wages and pension distributions,

2. a flat 17 percent rate cash flow tax on businesses (without a deduction for non-pension fringe benefits), and

3. a standard deduction for all filers ($10,700 for single filers, $21,400 for joint filers and $14,000 for head-of-household filers), and an additional standard deduction for each dependent ($5,000).

This paper presents Treasury's analysis of this new flat tax proposal. As was true of the original Armey proposal, the new proposal would lose substantial revenue and would increase average tax burdens for families with incomes under $200,000 while cutting average tax burdens substantially for families with incomes of $200,000 or more.

Revenue Estimates

No attempt is made in this analysis to estimate the tax-induced behavioral responses of either individuals or corporations. Following the standard revenue estimating conventions used by both the Office of Tax Analysis and the Joint Committee on Taxation, the macroeconomic aggregates, such as the level of compensation, prices, employment, and gross domestic product, have been assumed to be unchanged by the proposal. In addition, we assume no shifts in other forms of behavior, such as portfolio allocations, the allocation of investment, or realizations of capital gains. Because the proposal taxes all forms of income of non-financial businesses at the same rate and exempts realized capital gains, interest, and dividends, such behavioral shifts would, for the most part, not affect revenue.[1]

Estimates are for a single year, using the fully-phased in rate (17 percent). However, the effects and details of the transition from current law to the flat tax have not been considered. For example, unused foreign tax credits, general business credits, AMT credits, depreciation on pre-1996 investment, and stocks of net operating losses from current law would likely be subject to transitional rules that could affect revenue by tens of billions of dollars of tax liability during the transitional phase.

The revenue estimates are presented in Table 1. The 17 percent flat tax, under the assumptions described above, would increase tax liabilities by $615.5 billion at 1996 levels of income -- $335.8 billion from the wage tax on individuals, $16.3 billion from the fringe benefits tax on tax-exempt entities, $91.2 billion from the tax on noncorporate businesses, and $172.2 billion from the tax on corporations. Repealing the current corporate and individual income taxes (including the earned income tax credit (EITC)) and the estate and gift taxes would reduce tax liabilities by $753.8 billion at 1996 income levels --$586.7 billion from the individual income tax, $149.7 billion from the corporate income tax, and $17.4 billion from the estate and gift tax. The proposal would therefore lose about $138.3 billion per year at 1996 income levels.

Revenue Neutral Proposals

Major proponents of replacing the income tax with a consumption tax, such as, for example, Senator Domenici, have stressed the importance of maintaining the same level of Federal revenues. The Armey-Shelby proposal does not meet the goal of revenue-neutrality at the proposed tax rate and standard deduction amounts. To make the proposal revenue-neutral, the $138.3 billion reduction in tax liabilities could be offset by either increasing the flat rate or by lowering the standard deduction (or some combination of both). A 20.8 percent rate would be needed for the proposal to be self-financing, given the standard deductions specified in the proposal. Alternatively, the proposal could be made revenue neutral at the 17 percent flat rate by reducing the specified standard deductions by over half, to $5,100 for single filers, $10,200 for joint filers, $6,700 for head-of-household filers, and an additional standard deduction of $2,400 for each dependent.

Distributional estimates

The three major elements of the proposed flat tax are distributed separately to families by income class. First, the flat tax on wages and pension benefits is assumed to be borne by wage earners and pension beneficiaries, and is distributed proportionately to recipients of

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[1]There may be behavioral adjustments, however, that reduce revenue. For example, businesses would have an incentive to provide cash wages instead of fringe benefits to low-wage workers because the former, but not the latter, would be offset by the standard deduction.

wages and pensions in excess of their specified standard deduction. Second, the tax on employer-provided fringe benefits (except pension contributions) is assumed to be borne by employees and is distributed in proportion to their receipt of these benefits. Third, the tax attributable to the elimination of deductibility of the employer portion of the payroll taxes is assumed to be borne by workers in proportion to the applicable wage base. Fourth, the remaining part of the flat tax on businesses is assumed to be borne in proportion to capital income generally.

The $138.3 billion increase in the deficit under the proposal would have to be financed in some way. Different assumptions about the method of financing the increase in the deficit could result in quite different distributional estimates. For purposes of the distributional estimates presented here, it is assumed that the proposal is made revenue neutral either by increasing the flat tax rate to 20.8 percent, or by reducing the standard deduction amounts by over half (to about 48 percent of the amounts specified in the proposal). An alternative assumption would be that the increase in the deficit is financed by across-the-board reductions in expenditures for entitlement programs. Since entitlement benefits are generally distributed quite progressively (i.e., make up a much larger share of the incomes of lower-income families), this financing assumption would make the proposal more regressive.

The distributional effect of a 20.8 percent flat tax with Armey-Shelby's proposed standard deductions appears in Tables 2 and 3. The total change in after-tax income of adopting this proposal would be zero. The distribution tables show a small decrease in total after-tax income because the proposed repeal of estate and gift taxes and the income tax on fiduciaries is omitted. Table 2 shows that the aggregate after-tax income for the group of families with incomes below $200,000 would be lower under the proposal (i.e., a net tax increase), while the aggregate after-tax income for the group of families with incomes of $200,000 or more would be higher under the proposal (a net tax cut). Expressed as a percentage of after-tax income under current law, the proposal would cause a reduction in aggregate after-tax income of between 1.4 percent and 6.8 percent for the groups of families with incomes below $200,000 and a 8.7 percent increase for the group of families with incomes of $200,000 or more. This amounts to a 28.1 percent reduction in Federal taxes for the group of families with incomes of $200,000 or more and aggregate tax increases ranging from 5.0 percent to 70.7 percent for the groups of families with income under $200,000.

The distributional effect of a 17 percent flat tax with standard deductions reduced to 48 percent of their proposed values appears in Tables 4 and 5. Under this proposal, families with incomes of $200,000 or more would receive a tax reduction of almost $117.3 billion, or about 37.1 percent of their current Federal income taxes (see Table 4). Income groups including families with incomes below $200,000 would have corresponding tax increases averaging between 1.6 percent to 86.3 percent.

Examples

The impact of the Armey-Shelby proposal on typical families is illustrated by six examples. These examples are consistent with the distribution tables, showing the effect of the taxes collected at the business level as well as the tax paid directly by families. While a single person earning the minimum wage would have a small tax cut under the Armey-Shelby proposal (example 1), couples with two children and earnings of twice the minimum wage for one earner (example 2), earnings of $50,000 for one earner (example 3), or earnings of $100,000 divided equally between two earners (example 4) would all have significant tax increases. High income families (such as those depicted in examples 5 and 6), in contrast, would have significant tax cuts.

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Changes in the Armey Flat Tax Proposal

On July 19, 1995, Representative Armey and Senator Shelby introduced H.R. 2060/S. 1050, "The Freedom and Fairness Restoration Act." Like Representative Armey's original flat tax legislation (H.R. 4585, introduced June 16, 1994), the new bill proposes to replace the individual and corporate income taxes with a two-part flat-rate consumption tax, but it differs from the original bill in several respects.

Individual-Level Tax

- The basic standard deductions under H.R. 2060/S. 1050 are approximately 15 percent lower than those in H.R. 4585. The new basic standard deductions are $21,400 for a married couple filing jointly, $14,000 for a head of household, and $10,700 for a single filer or for married individuals filing separately. The standard deduction for a dependent remains $5,000. These amounts would be indexed for inflation.

- The new bill repeals the Earned Income Tax Credit (EITC), whereas H.R. 4585 was unclear on whether the EITC was retained.

- Under the new bill, taxable income for a parent includes the taxable income of dependent children under the age of 14.

- H.R. 4585 defined "taxable earned income" for individuals with reference to current-law Internal Revenue Code section 911(d)(2), which specifies that earned income cannot include more than 30 percent of a business owner's share of the net profit from a trade or business. The new bill contains no reference to section 911(d)(2).

- The new bill repeals the individual alternative minimum tax (AMT), whereas H.R. 4585 was unclear on whether the AMT was retained.

- Whereas H.R. 4585 repealed income tax withholding, H.R. 2060/S. 1050 does not.

- The income tax on fiduciaries (trusts and estates) appears to be repealed under the new bill, but was not explicitly repealed under H.R. 4585.

Business-Level Tax

- As under H.R. 4585, the cost of noncash compensation (other than qualified pension contributions) is not deductible to businesses, and is thus taxed at the employer level. In addition, under the new bill exempt organizations and governments will be liable for an excise tax equal to 17 percent (20 percent through 1997) of the value of noncash compensation provided to their employees.

- H.R. 2060/S. 1050 specifies that the value of financial intermediation services will be included in a business' taxable income, but detailed rules are not provided.

- The new bill repeals the corporate AMT, whereas H.R. 4585 was unclear on whether the AMT was retained.

Estate and Gift Taxes

- The new bill repeals the estate and gift taxes, whereas H.R. 4585 did not.

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Table 1
Revenue Estimates of Armey-Shelby Flat Tax Proposal
1996 level; Static; Fully Phased-in
($Billions)

	Current law	Proposal	Change
Individual Income Tax 1/			
Taxes collected from individuals			
Liability before Earned Income Tax Credit	608.9	335.8	-273.1
Less: Earned Income Tax Credit	29.2	0.0	-29.2
Liability after Earned Income Tax Credit	579.7	335.8	-243.9
Taxes collected from fiduciaries	7.0	0.0	-7.0
Taxes collected from tax-exempt entities	0.0	16.3	16.3
Taxes collected from non-corporate businesses	0.0	91.2	91.2
Total, Individual Income Tax	586.7	443.3	-143.4
Corporate Income Tax 2/	149.7	172.2	22.5
Estate and Gift Tax	17.4	0.0	-17.4
Grand Total	753.8	615.5	-138.3
Revenue Neutral Flat Tax Rate		20.8%	

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1/ For current law, it includes the tax liability from all business income received by individuals while for proposal it includes only the tax liability from non-corporate business income.

2/ For current law, it includes only the tax liability of C corporations, and for proposal, it includes the tax liability of all corporations (including S corporations).

Table 2

Armey-Shelby Proposal with a Revenue-Neutral Tax Rate

Replace Current Individual and Corporate Income Taxes (Including the EITC) and Estate and Gift Taxes with a Revenue-Neutral 20.8% Flat Rate Tax (1)

(1996 Income Levels)

Family Economic Income Class (2) (000)	After-Tax (3) Income Under Current Law ($B)	Change in After-Tax Income Under Proposal (4): Repeal Income Tax ($B)	20.8% Tax on Wages Over Stand. Ded. (5) ($B)	20.8% Tax on Fringes and Payroll Tax (6) ($B)	20.8% Tax on Business Cash Flow ($B)	Total Change (7) ($B)	Percentage Change (%)	Percentage Change In Total Federal Taxes (%)
0 - 10	65.2	-1.5	-0.9	-1.3	-0.3	-4.0	-6.2	70.7
10 - 20	221.9	-3.5	-4.6	-4.2	-2.8	-15.1	-6.8	70.4
20 - 30	325.6	11.1	-13.1	-8.1	-5.7	-15.9	-4.9	31.7
30 - 50	738.5	64.1	-47.8	-20.9	-16.5	-21.0	-2.8	13.4
50 - 75	902.8	104.0	-79.7	-25.0	-21.1	-21.7	-2.4	9.7
75 - 100	735.0	97.6	-80.7	-19.8	-17.4	-20.3	-2.8	10.4
100 - 200	1,077.0	180.9	-139.8	-22.4	-33.8	-15.1	-1.4	5.0
200 & over	1,019.0	275.7	-112.6	-5.9	-68.1	89.1	8.7	-28.1
Total (8)	5,054.7	729.4	-480.3	-107.7	-165.8	-24.4	-0.5	1.9

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(1) This table distributes the estimated change in after-tax income due to the proposal with a revenue-neutral rate of 20.8 percent (approximately).

(2) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income; IRA and Keogh deductions; nontaxable transfer payments, such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family, rather than on a tax return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.

(3) The taxes included are individual and corporate income, payroll (Social Security and unemployment) and excises. Estate and gift taxes and customs duties are excluded. The individual income tax is assumed to be borne by payors, the corporate income tax by capital income generally, payroll taxes (employer and employee shares) by labor (wages and self-employment income), excises on purchases by individuals by the purchaser, and excises on purchases by business in proportion to total consumption expenditures. Taxes due to provisions that expire in the Budget period are excluded.

(4) The change in Federal taxes is estimated at 1996 income levels but assuming fully phased in law and static behavior. The incidence assumptions for the repealed income taxes is the same as for the current law taxes (see footnote 3). The flat tax on wages (plus pension benefits received) is assumed to be borne by wages plus pension benefits received in excess of the standard deduction. The flat tax on the labor component of self-employment income is assumed to be borne by that income. The flat and excise taxes on employer-provided fringe benefits (except pension contributions) and the flat tax on payroll taxes are assumed to be borne by employees in proportion to benefits or taxes. The flat tax on business cash flow (which excludes the labor component of self-employment income) is assumed to be borne by capital income generally.

(5) The standard deduction is $21,400 (joint) or $10,700 (single) plus $5,000 for each dependent. The flat tax on the labor component of self-employment income is included in this column.

(6) The proposal would disallow a deduction for employer-provided fringe benefits (except pension contributions) making these benefits (primarily employer-provided health insurance) subject to the 20.8 percent flat tax, and would impose an equivalent excise tax on such benefits provided by governments and nonprofit organizations. The employer portion of payroll taxes would likewise be nondeductible.

(7) The proposal, in total, is shown here to reduce after-tax income (increase taxes) because the distributions exclude the effect of the Armey proposal to repeal the estate and gift taxes and the income tax on fiduciaries (see footnote (3)).

(8) Families with negative incomes are included in the total line but not shown separately.

Table 3

Armey-Shelby Proposal with a Revenue-Neutral Tax Rate

Replace Current Individual and Corporate Income Taxes (Including the EITC) and Estate and Gift Taxes with a Revenue-Neutral 20.8% Flat Rate Tax (1)

(1996 Income Levels)

Family Economic Income Quintile (2)	After-Tax (3) Income Under Current Law ($B)	Change in After-Tax Income Under Proposal (4): Repeal Income Tax ($B)	20.8% Tax on Wages Over Stand. Ded. (5) ($B)	20.8% Tax on Fringes and Payroll Tax (6) ($B)	20.8% Tax on Business Cash Flow ($B)	Total Change (7) ($B)	Percentage Change (%)	Percentage Change in Total Federal Taxes (%)
Lowest (8)	171.1	-4.5	-2.5	-3.1	-1.5	-11.5	-6.7	80.9
Second	431.0	9.9	-15.6	-10.3	-7.1	-23.1	-5.4	37.7
Third	697.9	59.6	-44.5	-19.7	-15.6	-20.1	-2.9	13.7
Fourth	1,091.9	126.6	-97.6	-30.2	-25.5	-26.7	-2.4	9.8
Highest	2,693.1	536.7	-319.0	-44.3	-116.1	57.3	2.1	-7.4
Total (8)	5,054.7	729.4	-480.3	-107.7	-165.8	-24.4	-0.5	1.9
Top 10%	1,899.8	427.7	-228.5	-23.4	-97.1	78.9	4.2	-14.0
Top 5%	1,371.5	341.2	-159.2	-11.7	-81.9	88.4	6.4	-21.3
Top 1%	683.5	202.7	-68.7	-2.4	-51.5	80.1	11.7	-36.1

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(1) This table distributes the estimated change in after-tax income due to the proposal with a revenue-neutral rate of 20.8 percent (approximately).

(2) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income; IRA and Keogh deductions; nontaxable transfer payments, such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family, rather than on a tax return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.

(3) The taxes included are individual and corporate income, payroll (Social Security and unemployment), and excises. Estate and gift taxes and customs duties are excluded. The individual income tax is assumed to be borne by payors, the corporate income tax by capital income generally, payroll taxes (employer and employee shares) by labor (wages and self-employment income), excises on purchases by individuals by the purchaser, and excises on purchases by business in proportion to total consumption expenditures. Taxes due to provisions that expire in the Budget period are excluded.

(4) The change in Federal taxes is estimated at 1996 income levels but assuming fully phased in law and static behavior. The incidence assumptions for the repealed income taxes is the same as for the current law taxes (see footnote 3). The flat tax on wages (plus pension benefits received) is assumed to be borne by wages plus pension benefits received in excess of the standard deduction. The flat tax on the labor component of self-employment income is assumed to be borne by that income. The flat and excise taxes on employer-provided fringe benefits (except pension contributions) and the flat tax on payroll taxes are assumed to be borne by employees in proportion to benefits or taxes. The flat tax on business cash flow (which excludes the labor component of self-employment income) is assumed to be borne by capital income generally.

(5) The standard deduction is $21,400 (joint) or $10,700 (single) plus $5,000 for each dependent. The flat tax on the labor component of self-employment income is included in this column.

(6) The proposal would disallow a deduction for employer-provided fringe benefits (except pension contributions) making these benefits (primarily employer-provided health insurance) subject to the 20.8 percent flat tax, and would impose an equivalent excise tax on such benefits provided by governments and nonprofit organizations. The employer portion of payroll taxes would likewise be nondeductible.

(7) The proposal, in total, is shown here to reduce after-tax income (increase taxes) because the distributions exclude the effect of the Armey proposal to repeal the estate and gift taxes and the income tax on fiduciaries (see footnote (3)).

(8) Families with negative incomes are excluded from the lowest quintile but included in the total line.

NOTE: Quintiles begin at FEI of: Second $15,604; Third $29,717; Fourth $45,560; Highest $[illegible]; Top 10% $[illegible]; Top 5% $145,412; Top 1% $349,438.

Table 4

Armey-Shelby Proposal with a Revenue-Neutral Standard Deduction
Replace Current Individual and Corporate Income Taxes (Including the EITC) and Estate and Gift Taxes with a Revenue-Neutral 17% Flat Rate Tax (1)

(1996 Income Levels)

Family Economic Income Class (2) (000)	After-Tax (3) Income Under Current Law ($B)	Change in After-Tax Income Under Proposal (4): Repeal Income Tax ($B)	17% Tax on Wages Over Stand. Ded. (5) ($B)	17% Tax on Fringes and Payroll Tax (6) ($B)	17% Tax on Business Cash Flow ($B)	Total Change (7) ($B)	Percentage Change (%)	Percentage Change In Total Federal Taxes (%)
0 - 10	65.2	-1.5	-1.3	-1.0	-0.2	-4.1	-6.4	73.0
10 - 20	221.9	-3.5	-9.3	-3.5	-2.3	-18.5	-8.4	86.3
20 - 30	325.6	11.1	-21.8	-6.6	-4.7	-22.0	-6.8	43.9
30 - 50	738.5	64.1	-67.9	-17.0	-13.5	-34.3	-4.7	22.0
50 - 75	902.8	104.0	-100.4	-20.4	-17.2	-34.0	-3.8	15.2
75 - 100	735.0	97.6	-90.9	-16.1	-14.2	-23.6	-3.2	12.1
100 - 200	1,077.0	180.9	-139.8	-18.3	-27.6	-4.8	-0.4	1.6
200 & over	1,019.0	275.7	-97.9	-4.8	-55.6	117.3	11.5	-37.1
Total (8)	5,054.7	729.4	-530.4	-88.0	-135.4	-24.4	-0.5	1.9

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(1) This table distributes the estimated change in after-tax income due to the proposal with a revenue-neutral standard deduction.

(2) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income; IRA and Keogh deductions; nontaxable transfer payments, such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family, rather than on a tax return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.

(3) The taxes included are individual and corporate income, payroll (Social Security and unemployment), and excises. Estate and gift taxes and customs duties are excluded. The individual income tax is assumed to be borne by payors, the corporate income tax by capital income generally, payroll taxes (employer and employee shares) by labor (wages and self-employment income), excises on purchases by individuals by the purchaser, and excises on purchases by business in proportion to total consumption expenditures. Taxes due to provisions that expire in the Budget period are excluded.

(4) The change in Federal taxes is estimated at 1996 income levels but assuming fully phased in law and static behavior. The incidence assumptions for the repealed income taxes is the same as for the current law taxes (see footnote 3). The flat tax on wages (plus pension benefits received) is assumed to be borne by wages plus pension benefits received in excess of the standard deduction. The flat tax on the labor component of self-employment income is assumed to be borne by that income. The flat and excise taxes on employer-provided fringe benefits (except pension contributions) and the flat tax on payroll taxes are assumed to be borne by employees in proportion to benefits or taxes. The flat tax on business cash flow (which excludes the labor component of self-employment income) is assumed to be borne by capital income generally.

(5) The revenue-neutral standard deduction is $10,200 (joint) or $5,100 (single) plus $2,400 for each dependent. The flat tax on the labor component of self-employment income is included in this column.

(6) The proposal would disallow a deduction for employer-provided fringe benefits (except pension contributions) making these benefits (primarily employer-provided health insurance) subject to the 17 percent flat tax, and would impose an equivalent excise tax on such benefits provided by governments and nonprofit organizations. The employer portion of payroll taxes would likewise be nondeductible.

(7) The proposal, in total, is shown here to reduce after-tax income (increase taxes) because the distributions exclude the effect of the Armey proposal to repeal the estate and gift taxes and the income tax on fiduciaries (see footnote (3)).

(8) Families with negative incomes are included in the total line but not shown separately.

Table 5

Armey-Shelby Proposal with a Revenue-Neutral Standard Deduction
Replace Current Individual and Corporate Income Taxes (Including the EITC) and Estate and Gift Taxes with a Revenue-Neutral 17% Flat Rate Tax (1)

(1996 Income Levels)

Family Economic Income Quintile (2)	After-Tax (3) Income Under Current Law ($B)	Change in After-Tax Income Under Proposal (4): Repeal Income Tax ($B)	17% Tax on Wages Over Stand. Ded. (5) ($B)	17% Tax on Fringes and Payroll Tax (6) ($B)	17% Tax on Business Cash Flow ($B)	Total Change (7) ($B)	Percentage Change (%)	Percentage Change In Total Federal Taxes (%)
Lowest (8)	171.1	-4 5	-4.9	-2.5	-1.2	-13 0	-7.6	92 0
Second	431.0	9 9	-26.7	-8 4	-5 8	-31.0	-7.2	50 7
Third	697.9	59 6	-63 5	-16 1	-12.7	-32.7	-4.7	22.3
Fourth	1,091.9	126 6	-122.2	-24.7	-20 8	-41.1	-3 8	15.1
Highest	2,693.1	536 7	-312.0	-36 2	-94.8	93.7	3 5	-12 0
Total (8)	5,054.7	729 4	-530 4	-88 0	-135 4	-24 4	-0.5	1.9
Top 10%	1,899 8	427 7	-212 3	-19 1	-79 3	117.1	6.2	-20 7
Top 5%	1,371 5	341 2	-142 4	-9 6	-66 9	122.4	8.9	-29.5
Top 1%	683.5	202.7	-58 4	-2 0	-42 0	100 3	14.7	-45.2

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(1) This table distributes the estimated change in after-tax income due to the proposal with a revenue-neutral standard deduction.

(2) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income; IRA and Keogh deductions; nontaxable transfer payments, such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family, rather than on a tax return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.

(3) The taxes included are individual and corporate income, payroll (Social Security and unemployment), and excises. Estate and gift taxes and customs duties are excluded. The individual income tax is assumed to be borne by payors, the corporate income tax by capital income generally, payroll taxes (employer and employee shares) by labor (wages and self-employment income), excises on purchases by individuals by the purchaser, and excises on purchases by business in proportion to total consumption expenditures. Taxes due to provisions that expire in the Budget period are excluded.

(4) The change in Federal taxes is estimated at 1996 income levels but assuming fully phased in law and static behavior. The incidence assumptions for the repealed income taxes is the same as for the current law taxes (see footnote 3). The flat tax on wages (plus pension benefits received) is assumed to be borne by wages plus pension benefits received in excess of the standard deduction. The flat tax on the labor component of self-employment income is assumed to be borne by that income. The flat and excise taxes on employer-provided fringe benefits (except pension contributions) and the flat tax on payroll taxes are assumed to be borne by employees in proportion to benefits or taxes. The flat tax on business cash flow (which excludes the labor component of self-employment income) is assumed to be borne by capital income generally.

(5) The revenue-neutral standard deduction is $10,200 (joint) or $5 100 (single) plus $2 400 for each dependent. The flat tax on the labor component of self-employment income is included in this column.

(6) The proposal would disallow a deduction for employer-provided fringe benefits (except pension contributions) making these benefits (primarily employer-provided health insurance) subject to the 17 percent flat tax, and would impose an equivalent excise tax on such benefits provided by governments and nonprofit organizations. The employer portion of payroll taxes would likewise be nondeductible.

(7) The proposal, in total, is shown here to reduce after-tax income (increase taxes) because the distributions exclude the effect of the Armey proposal to repeal the estate and gift taxes and the income tax on fiduciaries (see footnote (3)).

(8) Families with negative incomes are excluded from the lowest quintile but included in the total line.

NOTE Quintiles begin at FEI of: Second $15,504 Third [illegible] Fourth [illegible] Highest [illegible] Top 10% $108 [illegible] Top 5% $145 412 Top 1% $349 438

Current Law Income Tax Compared to Armey-Shelby Flat Tax with a Revenue Neutral Rate

Example 1
Single Worker Earning Minimum Wage
(1996 Income Levels)

	Current Law Income Tax	Revenue Neutral Flat Tax (1)
A. Tax Paid Directly by Individual		
Income Taxed at Individual Level:		
Wages	8,840	8,840
Total Income	8,840	8,840
Deductions:		
Personal Exemption	2,550	0
Standard Deduction	4,000	10,700
Total Deductions	6,550	10,700
Taxable Income	2,290	0
Tax at Individual Level		
Tax Before Credits	344	0
EITC	(51)	0
Net Tax at Individual Level	293	0
B. Tax Borne by Individual but Paid by Business		
Employer Contributions:		
Employer FICA Contributions (2)	676	676
Tax on Employer Contributions:		
Employer FICA Contributions (3)	0	141
C. Individual's Total Income or Flat Tax Burden		
Net Tax at Individual Level	293	0
Tax Borne by Individual but Paid by Business	0	141
Total Tax Burden	293	141
Change from Current Law		(152)

Department of the Treasury
Office of Tax Analysis

December 20, 1995

(1) The revenue neutral rate for the flat tax is 20.82%

(2) Employer FICA contributions in 1996 are 7.65% of wages up to $62,700 and 1.45% of wages over $62,700

(3) The flat tax on employer FICA contributions is 20.82% of the contributions

Current Law Income Tax Compared to Armey-Shelby Flat Tax with a Revenue Neutral Rate

Example 2
Married Couple with Two Children Earning Twice Minimum Wage
(1996 Income Levels)

	Current Law Income Tax	Revenue Neutral Flat Tax (1)
A. Tax Paid Directly by Family		
Income Taxed at Family Level:		
Wages	17,680	17,680
Total Income	17,680	17,680
Deductions:		
Personal and Dependent Exemptions	10,200	10,000
Standard Deduction	6,700	21,400
Total Deductions	16,900	31,400
Taxable Income	780	0
Tax at Family Level		
Tax Before Credits	117	0
EITC	(2,278)	0
Net Tax at Family Level	(2,161)	0
B. Tax Borne by Family but Paid by Business		
Employer Contributions:		
Employer FICA Contributions (2)	1,353	1,353
Tax on Employer Contributions:		
Employer FICA Contributions (3)	0	282
C. Family's Total Income or Flat Tax Burden		
Net Tax at Family Level	(2,161)	0
Tax Borne by Family but Paid by Business	0	282
Total Tax Burden	(2,161)	282
Change from Current Law		2,442

Department of the Treasury
Office of Tax Analysis

December 20, 1995

(1) The revenue neutral rate for the flat tax is 20.82%

(2) Employer FICA contributions in 1996 are 7.65% of wages up to $62,700 and 1.45% of wages over $62,700

(3) The flat tax on employer FICA contributions is 20.82% of the contributions

Current Law Income Tax Compared to Armey-Shelby Flat Tax with a Revenue Neutral Rate

Example 3
Married Couple with Two Children with $50,000 of Wages and Employer-Provided Health Insurance
(1996 Income Levels)

	Current Law Income Tax	Revenue Neutral Flat Tax (1)
A. Tax Paid Directly by Family		
Income Taxed at Family Level:		
Wages	50,000	50,000
Total Income	50,000	50,000
Deductions:		
Personal and Dependent Exemptions	10,200	10,000
Itemized or Standard Deduction (2)	12,500	21,400
Total Deductions	22,700	31,400
Taxable Income	27,300	18,600
Tax at Family Level	4,095	3,873
B. Tax Borne by Family but Paid by Business		
Employer Contributions:		
Employer FICA Contributions (3)	3,825	3,825
Employer Contributions for Health Insurance (4)	4,950	4,950
Tax on Employer Contributions:		
Employer FICA Contributions (5)	0	796
Employer Contributions for Health Insurance (6)	0	1,031
Total Tax at Business Level	0	1,827
C. Family's Total Income or Flat Tax Burden		
Tax at Family Level	4,095	3,873
Tax Borne by Family but Paid by Business	0	1,827
Total Tax Burden	4,095	5,699
Change from Current Law		1,604

Department of the Treasury
Office of Tax Analysis

December 20, 1995

(1) The revenue neutral rate for the flat tax is 20.82%
(2) The average itemized deductions for a four-person family with $50,000 of wage income is about 25% of income
(3) Employer FICA contributions in 1996 are 7.65% of wages up to $62,700 and 1.45% of wages over $62,700
(4) This is the estimated level in 1996 of the employer contribution for a typical family's health insurance
(5) The flat tax on employer FICA contributions is 20.82% of the contributions
(6) The flat tax on employer health insurance contributions is 20.82% of the contributions

Current Law Income Tax Compared to Armey-Shelby Flat Tax with a Revenue Neutral Rate

Example 4
Married Couple with Two Children and Two Earners
Each Earner with $50,000 of Wages, and with
Employer-Provided Health Insurance and Investment Income

(1996 Income Levels)

	Current Law Income Tax	Revenue Neutral Flat Tax (1)
A. Tax Paid Directly by Family		
Income Taxed at Family Level:		
Wages	100,000	100,000
Investment Income (dividends, interest, etc.)	4,000	0
Total Income	104,000	100,000
Deductions:		
Personal and Dependent Exemptions	10,200	10,000
Itemized or Standard Deduction (2)	22,500	21,400
Total Deductions	32,700	31,400
Taxable Income	71,300	68,600
Tax at Family Level	14,751	14,283
B. Tax Borne by Individual but Paid by Business		
Employer Contributions and Business Income:		
Employer FICA Contributions (3)	7,650	7,650
Employer Contributions for Health Insurance (4)	4,950	4,950
Investment and Other Business Income (5)	14,500	14,500
Tax on Employer Contributions and Business Income:		
Employer FICA Contributions (6)	0	1,593
Employer Contributions for Health Insurance (7)	0	1,031
Investment and Other Business Income (8)	1,327	1,855
Total Tax at Business Level	1,327	4,478
C. Individual's Total Income or Flat Tax Burden		
Tax at Individual Level	14,751	14,283
Tax Borne by Family but Paid by Business	1,327	4,478
Total Tax Burden	16,078	18,760
Change from Current Law		2,683

Department of the Treasury
Office of Tax Analysis

December 20, 1995

(1) The revenue neutral rate for the flat tax is 20.82%.
(2) The average itemized deductions for a four-person family with $100,000 of wage income is about 22% of income.
(3) Employer FICA contributions in 1996 are 7.65% of wages up to $62,700 and 1.45% of wages over $62,700.
(4) This is the estimated level in 1996 of the employer contribution for a typical family's health insurance.
(5) This includes investment income taxable at the family level under current law, and other earnings on investments such as IRA, Keogh, and pension plans, life insurance, and undistributed corporate income.
(6) The flat tax on employer FICA contributions is 20.82% of the contributions.
(7) The flat tax on employer health insurance contributions is 20.82% of the contributions.
(8) For current law, this is the pro-rata share of the corporate income tax allocated to all investment and other business income. For the flat tax, this is the pro-rata share of the flat tax on business cash flow (excluding employer contributions and labor earnings included in the cash flow of unincorporated businesses) allocated to all investment and other business income.

Current Law Income Tax Compared to Armey-Shelby Flat Tax with a Revenue Neutral Rate

Example 5
Married Couple with Two Children and Two Earners
Each Earner with $100,000 of Wages, and with
Employer-Provided Health Insurance and Investment Income
(1996 Income Levels)

	Current Law Income Tax	Revenue Neutral Flat Tax (1)
A. Tax Paid Directly by Family		
Income Taxed at Family Level:		
Wages	200,000	200,000
Long-Term Capital Gains	2,000	0
Other Investment Income (dividends, interest, etc.)	10,100	0
Total Income	212,100	200,000
Deductions:		
Personal and Dependent Exemptions (after limitation) (2)	7,344	10,000
Itemized or Standard Deduction (after limitation) (3)	42,200	21,400
Total Deductions	49,544	31,400
Taxable Income	162,556	168,600
Tax at Family Level	42,855	35,103
B. Tax Borne by Individual but Paid by Business		
Employer Contributions and Business Income:		
Employer FICA Contributions (4)	10,675	10,675
Employer Contributions for Health Insurance (5)	4,950	4,950
Investment and Other Business Income (6)	28,300	28,300
Tax on Employer Contributions and Business Income:		
Employer FICA Contributions (7)	0	2,222
Employer Contributions for Health Insurance (8)	0	1,031
Investment and Other Business Income (9)	2,589	3,620
Total Tax at Business Level	2,589	6,873
C. Individual's Total Income or Flat Tax Burden		
Tax at Individual Level	42,855	35,103
Tax Borne by Family but Paid by Business	2,589	6,873
Total Tax Burden	45,445	41,975
Change from Current Law		(3,469)

Department of the Treasury
Office of Tax Analysis

December 20, 1995

(1) The revenue neutral rate for the flat tax is 20.83%
(2) Under current law, exemptions are reduced by 2 percentage points for each $2,500 or fraction thereof by which AGI exceeds $177,200.
(3) Under current law, itemized deductions are reduced by 3% of the amount by which AGI exceeds $118,100. The average itemized deductions (after reduction) for a four-person family with $200,000 of wage income is about 20% of income
(4) Employer FICA contributions in 1996 are 7.65% of wages up to $62,700 and 1.45% of wages over $62,700
(5) This is the estimated level in 1996 of the employer contribution for a typical family's health insurance
(6) This includes investment income taxable at the family level under current law, and other earnings on investments such as IRA, Keogh, and pension plans, life insurance, and undistributed corporate income
(7) The flat tax on employer FICA contributions is 20.83% of the contributions
(8) The flat tax on employer health insurance contributions is 20.83% of the contributions
(9) For current law, this is the pro-rata share of the corporate income tax allocated to all investment and other business income. For the flat tax, this is the pro-rata share of the flat tax on business cash flow (excluding employer contributions and labor earnings included in the cash flow of unincorporated businesses) allocated to all investment and other business income

Current Law Income Tax Compared to Armey-Shelby Flat Tax, with a Revenue Neutral Rate

Example 6

Married Couple with Two Children and One Earner with $212,100 of AGI, Employer-Provided Health Insurance, and Investment Income

(1996 Income Levels)

	Current Law Income Tax	Revenue Neutral Flat Tax (1)
A. Tax Paid Directly by Family		
Income Taxed at Family Level:		
Wages	159,100	159,100
Long-Term Capital Gains	6,400	0
Other Investment Income (dividends, interest, etc.)	46,600	0
Total Income	212,100	159,100
Deductions:		
Personal and Dependent Exemptions (after limitation) (2)	7,344	10,000
Itemized or Standard Deduction (after limitation) (3)	42,500	21,400
Total Deductions	49,844	31,400
Taxable Income	162,256	127,700
Tax at Family Level	42,395	26,587
B. Tax Borne by Individual but Paid by Business		
Employer Contributions and Business Income:		
Employer FICA Contributions (4)	6,194	6,194
Employer Contributions for Health Insurance (5)	4,950	4,950
Investment and Other Business Income (6)	69,900	69,900
Tax on Employer Contributions and Business Income:		
Employer FICA Contributions (7)	0	1,290
Employer Contributions for Health Insurance (8)	0	1,031
Investment and Other Business Income (9)	6,396	8,940
Total Tax at Business Level	6,396	11,260
C. Individual's Total Income or Flat Tax Burden		
Tax at Individual Level	42,395	26,587
Tax Borne by Family but Paid by Business	6,396	11,260
Total Tax Burden	48,791	37,848
Change from Current Law		(10,943)

Department of the Treasury
Office of Tax Analysis

December 20, 1995

(1) The revenue neutral rate for the flat tax is 20.82%.

(2) Under current law, exemptions are reduced by 2 percentage points for each $2,500 or fraction thereof by which AGI exceeds $177,200

(3) Under current law, itemized deductions are reduced by 3% of the amount by which AGI exceeds $118,100. The average itemized deductions (after reduction) for a four-person family with $212,100 of AGI is about 20% of income

(4) Employer FICA contributions in 1996 are 7.65% of wages up to $62,700 and 1.45% of wages over $62,700.

(5) This is the estimated level in 1996 of the employer contribution for a typical family's health insurance

(6) This includes investment income taxable at the family level under current law, and other earnings on investments such as IRA, Keogh, and pension plans, life insurance, and undistributed corporate income

(7) The flat tax on employer FICA contributions is 20.82% of the contributions

(8) The flat tax on employer health insurance contributions is 20.82% of the contributions

(9) For current law, this is the pro-rata share of the corporate income tax allocated to all investment and other business income. For the flat tax, this is the pro-rata share of the flat tax on business cash flow (excluding employer contributions and labor earnings included in the cash flow of unincorporated businesses) allocated to all investment and other business income.