SECTION 13 - TAX PROVISIONS RELATED TO RETIREMENT, HEALTH, POVERTY, EMPLOYMENT, DISABILITY AND OTHER SOCIAL ISSUES

CONTENTS

INTRODUCTION

The preceding sections of this publication discuss direct payments to individuals for retirement, health, public assistance, employment, and disability benefits provided through entitlement programs within the jurisdiction of the Committee on Ways and Means. The Federal Government also provides benefits to individuals through elements of the income tax set forth in the Internal Revenue Code of 1986 (the Code). The Code is entirely within the jurisdiction of the Committee on Ways and Means.

TAX PROVISIONS

Several different types of income tax provisions are available to provide economic incentives. Examples include: exclusions, exemptions, deductions, preferential rates, deferrals and credits. Measuring the amount of benefit afforded by a tax provision is difficult. However, one way to measure the benefit is to review the total estimated amounts excluded, exempted, or otherwise afforded special treatment under various provisions of the income tax.

USE OF DISTRIBUTIONAL ANALYSIS

Analyzing the effectiveness of tax provisions at achieving their policy goals often involves examining the distribution of benefits from the provisions allocated by the income class of those who take advantage of the provisions. The income concept used to show the distribution of tax expenditures by income class is adjusted gross income (AGI) plus: (1) tax-exempt interest; (2) employer contributions for health plans and life insurance; (3) employer share of FICA taxes; (4) workers' compensation; (5) nontaxable Social Security benefits; (6) insurance value of Medicare benefits; (7) alternative minimum tax preferences; and (8) excluded income of U.S. citizens living abroad.

This definition of income includes items that clearly increase the ability to pay taxes, but that are not included in the definition of AGI. However, it omits certain items that clearly affect ability to consume goods and services either now or in the future, including accrual of pension benefits, other fringe benefits (such as military benefits, veterans benefits, and parsonage allowances), and means-tested transfer payments (such as Aid to Families with Dependent Children (AFDC), Supplemental Security Income, food stamps, housing subsidies, and general assistance). The tax return is the unit of analysis. Table 13-1 shows the distribution of all tax returns for 2003 by income class.

Unless specifically indicated, all distributional tables exclude returns filed by dependents. All projections of income and deduction items and tax parameters are based on economic assumptions consistent with the December 2002 forecast of the Congressional Budget Office.

TABLE 13-1 -- DISTRIBUTION BY INCOME CLASS OF ALL RETURNS, TAXABLE RETURNS, ITEMIZED RETURNS, AND INDIVIDUAL INCOME TAX LIABILITY FOR TAXABLE YEAR 2003

Income class[1]	All returns[2]	Taxable returns	Itemized returns	Individual income tax liability
Below $10,000	21,365	957	280	-6,813
$10,000-$20,000	25,881	8,340	1,027	-10,358
$20,000-$30,000	21,135	10,251	2,108	1,110
$30,000-$40,000	17,274	11,866	3,137	17,003
$40,000-$50,000	12,776	10,007	3,620	24,438
$50,000-$75,000	23,139	20,868	9,904	82,140
$75,000-$100,000	13,574	13,337	8,953	86,609
$100,000-$200,000	13,241	13,185	11,080	190,989
$200,000 and over	3,490	3,485	3,281	369,055
Total	151,876	92,295	43,390	754,173

[1] The income concept used to place tax returns into classes is adjusted gross income plus: (1) tax-exempt interest; (2) employer contributions for health plans and life insurance; (3) employer share of FICA tax; (4) workers' compensation; (5) nontaxable Social Security benefits; (6) insurance value of Medicare benefits; (7) alternative minimum tax preference items; and (8) excluded income of U.S. citizens living abroad.

[2] Includes filing and nonfiling units. Filing units include all taxable and nontaxable returns. Nonfiling units include individuals with income that is exempt from Federal income taxation (e.g., transfer payments, interest from tax-exempt bonds, etc.) Excludes individuals who are dependents of other taxpayers with negative income.

Note- Money amounts in millions of dollars, returns in thousands. Detail may not add to total due to rounding.

Source: Joint Committee on Taxation.

TAX PROVISION ESTIMATES

Table 13-2 provides various estimates for 37 tax provisions related to retirement, health, poverty, employment, disability, and housing. These provisions are examined in detail in this chapter including their legislative history, an explanation of current law, and a brief assessment of their effects.

NET EXCLUSION OF PENSION CONTRIBUTIONS AND EARNINGS

LEGISLATIVE HISTORY

Prior to 1921, no special tax treatment applied to employee retirement trusts. Retirement payments to employees and contributions to pension trusts were deductible by the employer as an ordinary and necessary business expense. Employees were taxed on amounts actually received as well as on employer contributions to a trust if there was a reasonable expectation of benefits accruing from the trust. The 1921 Code provided an exemption for a trust forming part of a qualified profit sharing or stock bonus plan.

The rules relating to qualified plans were substantially revised by the Employee Retirement Income Security Act of 1974 (ERISA), which added overall limitations on contributions and benefits and other requirements on

TABLE 13-2 -- ESTIMATED TAX BASE EXCEPTIONS AND CREDITS UNDER THE PRESENT INCOME TAX FOR VARIOUS ITEMS,[1] CALENDAR YEARS 2003-2007

[In billions of dollars]

Item	2003	2004	2005	2006	2007	2003-07
Tax base exceptions related to:						
Retirement:						
Net exclusion of pension contributions and earnings	279.1	360.0	410.1	435.4	450.3	1,934.9
Keogh plans	11.4	15.6	18.6	20.2	21.3	87.2
Individual retirement plans	42.7	56.7	67.5	74.3	81.3	322.3
Exclusion of Social Security and railroad retirement benefits in excess of employee share of payroll tax[2]	305.5	311.6	313.2	320.9	331.0	1,582.2
Health:						
Exclusions of employer contributions for medical care, health insurance premiums and long-term care insurance premiums[3]	561.9	618.3	677.4	732.9	485.8	3,076.3
Exclusion of Medicare benefits:						
Medicare Part	165.2	175.5	187.5	199.0	209.6	936.8
Medicare Part B	113.5	118.5	126.8	137.0	147.8	643.6
Deductibility of medical expenses[4]	47.1	50.7	52.3	54.5	55.8	260.4
Deductibility of health insurance expenses of the self employed[5]	19.6	21.6	23.6	25.5	27.3	117.7
Exclusion of accelerated death benefits	2.8	3.4	3.8	4.1	4.4	18.5
Health savings accounts	0.0	0.0	2.2	2.4	2.6	7.2
Poverty:						
Exclusion of public assistance and SSI cash benefits	52.6	53.8	55.3	57.1	59.0	277.7
Employment:						
Exclusion of employer-provided dependent care[6]	3.5	3.7	3.9	4.1	4.3	19.5
Employee stock ownership plans (ESOPs)	5.4	5.6	5.8	6.1	6.3	29.2
Exclusion for benefits provided under cafeteria plans[7]	85.8	94.6	103.5	111.7	119.5	515.1
Elderly and Disabled:						
Exclusion of workers' compensation and special benefits for disabled coal miners:						
Workers' compensation	33.2	36.0	37.4	38.5	39.8	184.9
Special benefits for disabled coal miners	0.3	0.3	0.3	0.3	0.3	1.4
Additional standard deduction for elderly and blind	12.8	13.6	14.4	15.1	15.8	71.7

Housing:						
Deductibility of mortgage interest	362.9	376.8	392.1	409.5	426.3	1,967.6
Deductibility of property tax on owner-occupied housing	154.4	165.4	176.1	186.5	196.3	878.7
Exclusion of interest on State and local government bonds for owner-occupied housing	3.3	3.3	3.4	3.4	3.5	17.0
Depreciation of rental housing in excess of alternative depreciation system	12.6	13.6	15.0	16.9	19.5	77.6
Exclusion of interest on State and local government bonds for rental housing	0.7	0.7	0.7	0.7	0.8	3.6
Families:						
Qualified State tuition programs and Coverdell Education Savings Accounts	0.2	0.2	0.2	0.3	0.3	1.2
Student loan interest deduction	0.6	0.7	0.8	0.8	0.8	3.7
Employer-provided adoption expenses	[8]	[8]	[8]	[8]	[8]	0.1
Tax credits related to:						
Poverty:						
Earned income tax credit:[9]						
Nonrefundable portion	2.7	2.8	3.1	3.1	3.2	14.9
Employment:						
Dependent care credit	3.4	3.3	2.5	2.3	2.2	13.7
Work opportunity tax credit	0.4	0.2	0.1	[8]	[8]	0.8
Welfare-to-Work tax credit	0.1	0.1	[8]	[8]	[8]	0.3
Elderly and Disabled:						
Tax credit for elderly and disabled	[8]	[8]	[8]	[8]	[8]	0.1
Housing:						
Low-income housing tax credit	4.1	4.3	4.5	4.7	4.9	22.5
Families:						
Child tax credit[9]	44.1	44.1	32.1	31.5	30.9	182.7
HOPE Credit and Lifetime Learning Credit	4.3	4.3	4.3	4.3	4.3	21.5
Adoption credit	0.1	0.1	0.1	0.2	0.2	0.7

TABLE 13-2 -- ESTIMATED TAX BASE EXCEPTIONS AND CREDITS UNDER THE PRESENT INCOME TAX FOR VARIOUS ITEMS,[1] CALENDAR YEARS 2003-2007-continued

[In billions of dollars]

[1] Estimates of exclusions and deductions represent changes in the tax base; they do not measure changes in tax liability. Tax effects of provisions are not comparable.

[2] In addition to OASDI benefits for retired workers, these figures also include disability insurance benefits, and benefits for dependents and survivors.

[3] Estimate includes employer-provided health insurance purchased through cafeteria plans and health care spending through flexible spending accounts.

[4] Amounts reported on tax returns in excess of the medical deductions floor (7.5 percent of adjusted gross income).

[5] Amounts deductible from gross income (60 percent of health insurance expenses in 2001, 70 percent in 2002, and 100 percent in 2003 through 2005). Remaining amounts are deductible on Schedule A with other itemized medical expenses.

[6] Estimate includes employer-provided child care purchased through dependent care flexible spending accounts.

[7] Estimate includes amounts of employer-provided health insurance purchased through cafeteria plans and employer-provided child care purchased through dependent care flexible spending accounts. These amounts are also included in other line items in this table.

[8] Less than $50 million.

[9] The amount of child tax credit and earned income tax credit used to offset taxes other than income tax or paid out in refunds is: $40.9 billion in 2003, $41.5 billion in 2004, $39.6 billion in 2005, $39.8 billion in 2006, and $40.0 billion in 2007.

Note- Details may not add to totals due to rounding.

Source: Joint Committee on Taxation.

minimum participation, coverage, vesting, benefit accrual, and funding. Many revisions of these rules have been made since 1974. Since ERISA, Congress has also acted to broaden the range of qualified plans. In the Revenue Act of 1978, Congress provided special rules for qualified cash or deferred arrangements under section 401(k). Under these arrangements, known popularly as 401(k) plans, employees can elect to receive cash or have their employers contribute a portion of their earnings to a qualified profit sharing, stock bonus, or pre-ERISA money purchase pension plan.

An employee stock ownership plan is a special type of qualified plan that is designed to invest primarily in securities of the employer maintaining the plan. Certain qualification rules and tax benefits apply to employee stock ownership plans that do not apply to other types of qualified plans.

EXPLANATION OF PROVISION

In General

Under a plan of deferred compensation that meets the qualification standards of the Internal Revenue Code (sec. 401(a)), an employer is allowed a deduction for contributions to a tax-exempt trust to provide employee benefits. Similar rules apply to plans funded with annuity contracts. An employer that makes contributions to a qualified plan in excess of the deduction limits generally is subject to a 10-percent excise tax on such excess (sec. 4972).

The qualification rules limit the amount of benefits that can be provided through a qualified plan and require that benefits be provided on a basis that does not discriminate in favor of highly compensated employees. In addition, qualified plans are required to meet minimum standards relating to participation (the restrictions that may be imposed on participation in the plan), coverage (the number of employees participating in the plan), vesting (the time at which an employee's benefit becomes nonforfeitable), and benefit accrual (the rate at which an employee earns a benefit). Also, minimum funding standards apply to the rate at which employer contributions are required to be made to defined benefit plans to ensure the solvency of such plans.

If a defined benefit pension plan is terminated, any assets remaining after satisfaction of the plan's liabilities may revert to the employer. Such reversions are included in the gross income of the employer and are subject to income tax plus an additional excise tax (sec. 4980). The excise tax is 20 percent if the employer establishes a qualified replacement plan or provides certain benefit increases. Otherwise, the excise tax is 50 percent. Transfers of excess assets can be made from an ongoing defined benefit plan to pay certain retiree health benefits if certain requirements are satisfied (sec. 420). The assets transferred are not includible in the income of the employer or subject to the tax on reversions.

Minimum Participation Rules

A qualified plan generally may not require as a condition of participation that an employee complete more than 1 year of service or be older than age 21 (sec. 410(a)).

Vesting Rules

In general a plan is not a qualified plan unless a participant's employer-provided benefit vests at least as rapidly as under one of two alternative minimum vesting schedules (sec. 411). More rapid vesting applies to employer matching contributions. In addition, elective contributions to a section 401(k) plan and after-tax employee contributions must be fully vested at all times.

Benefit Accrual Rules

The protection afforded employees under the minimum vesting rules depends not only on the minimum vesting schedules, but also on the accrued benefits to which these schedules are applied. In the case of a defined contribution plan, the accrued benefit is the participant's account balance. In the case of a defined benefit plan, a participant's accrued benefit is determined under the plan benefit formula, subject to certain restrictions. In general, the accrued benefit is defined in terms of the benefit payable at normal retirement age and does not include certain ancillary nonretirement benefits.

Each defined benefit plan is required to satisfy one of three accrued benefit tests. The primary purpose of these tests is to prevent undue backloading of benefit accruals (i.e., by providing low rates of benefit accrual in the employee's early years of service when the employee is most likely to leave and by concentrating the accrual of benefits in the employee's later years of service when the employee is most likely to remain with the employer until retirement) (sec. 412).

Coverage Rules

A plan is not qualified unless the plan satisfies at least one of the following coverage requirements: (1) the plan benefits at least 70 percent of all nonhighly compensated employees, (2) the plan benefits a percentage of nonhighly compensated employees that is at least 70 percent of the percentage of highly compensated employees benefiting under the plan, or (3) the plan meets an average benefits test (sec. 410(b)). In addition, a defined benefit plan is not a qualified plan unless it benefits at least the lesser of: (1) 50 employees, or (2) the greater of 40 percent of the employees of the employer or two employees (or if there is only one employee, such employee) (sec. 401(a)(26)).

General Nondiscrimination Rule

In general, a plan is not a qualified plan if the contributions or benefits under the plan discriminate in favor of highly compensated employees (sec. 401(a)(4)).

Limitations on Contributions and Benefits

The maximum annual benefit that may be provided by a defined benefit pension plan (payable at age 65) is the lesser of 100 percent of average compensation, or $160,000 for 2003 (sec. 415(b)). The dollar limit is adjusted annually for inflation. The dollar limit is reduced if payments of benefits begin before age 62 and increased if benefits begin after age 65. The maximum contributions that may be made to a defined contribution plan with respect to a participant is the lesser of 100 percent of the participant's compensation, or $40,000 for 2003 (sec.415(c)). The dollar limit is adjusted annually for inflation.

Funding Rules

Pension plans are required to meet a minimum funding standard for each plan year (sec. 412). In the case of a defined benefit pension plan, an employer must contribute an annual amount sufficient to fund a portion of participants' projected benefits determined in accordance with one of several prescribed funding methods, using reasonable actuarial assumptions. Certain plans with asset values of less than 100 percent of current liabilities are subject to additional, faster funding rules.

Taxation of Distributions

An employee who participates in a qualified plan is taxed when the employee receives a distribution from the plan to the extent the distribution is not attributable to after-tax employee contributions (sec. 402). With certain exceptions, a 10-percent additional income tax is imposed on early distributions from a qualified plan (sec. 72(t)).

Failure to Satisfy Qualification Requirements

If a plan fails to satisfy the qualification requirements, the trust that holds the plan's assets is not tax exempt. An employer's deduction for plan contributions is only allowed when the employee includes the contributions or benefits in income, and benefits generally are includable in an employee's income when they are no longer subject to a substantial risk of forfeiture.

SIMPLE Retirement Plans

The Small Business Job Protection Act of 1996 created a simplified retirement plan for small business called the Savings Incentive Match Plan for Employees (SIMPLE) (secs. 408(p) and 401(k)(11)). SIMPLE plans may be adopted by employers with 100 or fewer employees and who do not maintain another employer-sponsored retirement plan. A SIMPLE plan can be either an individual retirement arrangement (IRA) for each employee or part of a qualified cash or deferred arrangement (401(k) plan). If established in IRA form, a SIMPLE plan is not subject to the nondiscrimination rules generally applicable to qualified plans and simplified reporting requirements apply. If adopted as part of a 401(k) plan, the plan does not have to satisfy the special nondiscrimination tests applicable to 401(k) plans and is not subject to the top-heavy rules. The other qualified plan rules continue to apply. SIMPLE plans are subject to special rules regarding eligibility of employees to participate and special contribution limits.

Other Employer-Sponsored Retirement Arrangements

Certain other types of employer-sponsored retirement plans provide tax benefits similar to those provided under qualified retirement plans, including tax-sheltered annuities (sec. 403(b) annuities), eligible deferred compensation plans of State and local governmental employers (governmental sec. 457 plans), and simplified employee pensions, referred to as "SEPs" (sec. 408(k)). Each of these arrangements is subject to different requirements, including contribution limits. These arrangements are not subject to many of the requirements applicable to qualified plans.

Saver's Credit

The Economic Growth and Tax Relief Reconciliation Act, "EGTRRA," provides a temporary nonrefundable tax credit for eligible taxpayers for qualified retirement saving contributions, effective for taxable years beginning after December 31, 2001, and before January 1, 2007. The credit is available with respect to (1) elective deferrals to 401(k) loans, tax-sheltered annuities, governmental 457 plans, SIMPLE retirement plans, or SEPs; (2) contributions to a traditional or Roth IRA; and (3) voluntary after-tax employee contributions to a tax sheltered annuity or qualified retirement plan. The amount of any contribution eligible for the credit is reduced by certain distributions received from these arrangements.

The maximum annual contribution eligible for the credit is $2,000. The credit rate varies from 10 percent to 50 percent, depending on the adjusted gross income (AGI) of the taxpayer. Taxpayers filing joint returns with AGI of $50,000 or less, head of household returns of $37,500 or less, and single returns of $25,000 or less are eligible for the credit. The AGI limits applicable to single taxpayers apply to married taxpayers filing separate tax returns. The credit is in addition to any deduction or exclusion that would otherwise apply with respect to the contribution. The credit offsets minimum tax liability as well as regular tax liability. The credit is available to individuals who are 18 or over, other than individuals who are full-time students or claimed as a dependent on another taxpayer's return.

EFFECT OF PROVISION

The tax treatment of pension contributions and earnings has encouraged employers to establish qualified retirement plans and to compensate employees in the form of pension contributions to such plans. There are two potential tax advantages of being compensated through pension contributions. One advantage is the ability to earn tax-free returns to savings. When saving is done through a pension plan, the employee earns a higher rate of return than on fully taxed savings.[1] The second advantage is that an employee's tax rate may be lower during retirement than during the working years.

These tax provisions directly benefit only persons who work for employers with qualified plans and who work for a sufficient period of time before their benefits vest in such plans. The current extent of this coverage and recent trends in coverage are described below.

COVERAGE

The term "covered," as used here, means that an employee is accruing benefits in an employer pension or other retirement plan. The most recent data regarding pension coverage is the March 2003 Current Population Survey. The data referred to below come from that survey unless otherwise noted.

As of March 2003, 57 percent of the nonelderly full-time wage and salary workers employed in the private sector reported that they worked in firms with an employer-sponsored pension plan in 2002 (Table 13-3). Slightly less than half (46 percent) of the full-time wage and salary workers employed in the private sector were covered by an employer-sponsored pension plan.

Pension coverage varies substantially among full-time, privately employed workers. Differences depend on the age of the worker, job earnings, the industry of employment, and the size of the firm.

Younger workers are much less likely to be covered by a pension than middle aged and older workers. Coverage rates rise steadily from 19 percent for those under age 25 to about 60 percent for those between ages 40 and 60 before falling off substantially for those over age 65. This pattern holds for both men and women. However, the jump in coverage for middle aged men is slightly larger than the increase for middle aged women (Table 13-4).

Higher paying jobs are more likely to offer pensions. Just 10 percent of full-time private wage and salary workers earning less than $10,000 per year in 2002 were covered compared to 68 percent or more of those earning $50,000 or more (Table 13-5). Coverage may be higher for higher paying jobs because of the greater value of the pension tax benefits to workers in higher tax brackets and because of the declining replacement rate of Social Security at higher earnings levels.

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[1] This applies to pension contributions made by employers. Employees may also be able to contribute to qualified plans. Employee contributions may be made with aftertax dollars. If so, the tax advantage given to these contributions is smaller than the tax-advantage given to employer contributions, and consists of the deferral of tax on accumulated earnings.

TABLE 13-3 -- EMPLOYER SPONSORSHIP AND EMPLOYEE PARTICIPATION IN RETIREMENT PLANS, 2002

[Private sector wage and salary workers]

	Percent covered		
	Total	Full-time	Part-time
Employer sponsorship			
Employer sponsors plans	52	57	33
Employer does not sponsor plan	48	43	67
Employee participation			
Employee participates	39	46	13
Employee does not participate	61	54	87
Number of workers, in thousands	118,146	94,611	23,535

Source: Congressional Research Service analysis of the Census Bureau's March 2003 Current Population Survey.

TABLE 13-4 -- PARTICIPATION IN EMPLOYER-SPONSORED RETIREMENT PLANS AMONG PRIVATE-SECTOR WAGE AND SALARY WORKERS EMPLOYED FULL-TIME IN 2002, BY WORKERS' AGE

Worker's Age	Percent participating		
	Total	Men	Women
Under 25	19	19	20
25-29	37	36	38
30-34	44	44	44
35-39	49	49	49
40-44	53	53	52
45-49	55	57	53
50-54	58	60	55
55-59	57	59	54
60-64	54	54	53
65 or older	36	35	38
All workers	46	47	45

Source: Congressional Research Service analysis of the Census Bureau's March 2003 Current Population Survey.

TABLE 13-5 -- PARTICIPATION IN EMPLOYER-SPONSORED RETIREMENT PLANS AMONG PRIVATE-SECTOR WAGE AND SALARY WORKERS EMPLOYED FULL TIME IN 2002, BY WORKER'S EARNINGS

Worker's Earnings	Percent participating		
	Total	Men	Women
Under $10,000	10	10	10
$10,000-14,999	16	13	19
$15,000-19,999	27	22	31
$20,000-24,999	35	29	42
$25,000-29,999	45	39	52
$30,000-34,999	51	47	56
$35,000-39,999	56	54	58
$40,000-49,999	62	61	65
$50,000-74,999	68	67	70
$75,000 or more	70	69	73
All workers	46	47	45

Source: Congressional Research Service analysis of the Census Bureau's March 2003 Current Population Survey.

Coverage is much lower for smaller firms. Smaller firms are less likely to offer comprehensive fringe benefit packages as part of total compensation. Only 19 percent of full-time private wage and salary workers in firms with fewer than 10 employees are covered. The rate rises with employer size but does not reach 46 percent (the average across all firm sizes) until firms have 100 or more employees (Table 13-6).

Significant differences in coverage also are apparent between full-time private wage and salary workers and other wage and salary workers. Coverage is much lower among part-time workers and much higher among public employees. Among part-time, private wage and salary workers, 13 percent are covered. Seventy-two percent of public sector wage and salary workers are covered including 80 percent of those who are full-time workers (Table 13-7).

TABLE 13-6 -- PARTICIPATION IN EMPLOYER-SPONSORED RETIREMENT PLANS AMONG PRIVATE-SECTOR WAGE AND SALARY WORKERS EMPLOYED FULL TIME IN 2002, BY SIZE OF FIRM

Size of firm (Number of workers)	Percent participating		
	Total	Men	Women
Fewer than 10	19	18	19
10-24	28	30	27
25-99	41	42	39
100-499	50	51	49
500-999	57	60	55
1,000 or more	62	65	59
All workers	46	47	45

Source: Congressional Research Service analysis of the Census Bureau's March 2003 Current Population Survey.

TRENDS IN COVERAGE

At the outset of World War II, private employer pensions were offered by about 12,000 firms. Pensions spread rapidly during and after the war, encouraged by high marginal tax rates and wartime wage controls that exempted pension benefits. By 1972, when the first comprehensive survey was undertaken, 48 percent of full-time private employees were covered. Subsequent surveys in 1979, 1983, 1988, and 1993 showed that coverage remained fairly constant, never falling below 46 percent or rising above 50 percent. However, the survey in 1998 showed a drop in coverage to 43 percent. The most recent survey in 2003 showed coverage at 46 percent (Table 13-3).

For workers with pension coverage, there has been a shift away from defined benefit plans. Of the private wage and salary workers covered by a pension plan in 1975, 87 percent were covered by a defined benefit plan (Turner & Beller, 1989, pp. 65 & 357). This proportion dropped to 83 percent by 1980 and to 71 percent by 1985. This proportion dropped even lower to 65 percent in 1993 (Department of Labor, 1994, tables A2, B1, B2). This shifting composition has largely been the result of rapid growth in primary defined contribution plans.

Employee stock ownership plans and 401(k) plans have been among the most rapidly growing defined contribution plans.

TABLE 13-7 -- PARTICIPATION IN EMPLOYER-SPONSORED RETIREMENT PLANS AMONG ALL WAGE AND SALARY WORKERS IN 2002, BY SECTOR OF EMPLOYMENT

Sector of employment	Percent participating		
	Total	Full-time	Part-time
All wage and salary workers	45	52	15
Men	46	51	10
Women	43	52	18
Private sector	39	46	13
Men	42	47	9
Women	37	45	15
Public sector	72	80	30
Men	74	80	21
Women	69	79	33

Source: Congressional Research Service analysis of the Census Bureau's March 2003 Current Population Survey.

INDIVIDUAL RETIREMENT ARRANGEMENTS "IRAS"

LEGISLATIVE HISTORY

ERISA added section 219 to the Internal Revenue Code, providing a tax deduction for certain contributions to IRAs and permitting the deferral of tax on amounts held in such arrangements until withdrawal. Active participants in employer plans were not permitted to make deductible IRA contributions.

The Economic Recovery Tax Act of 1981 expanded eligibility to individuals who were active participants and increased the amount of the permitted deduction. The Tax Reform Act of 1986 limited the full IRA deduction to individuals with income below certain levels and to individuals who are not active participants in employer plans. Individuals who are not entitled to the full IRA deduction may make nondeductible contributions to an IRA. The Small Business Job Protection Act of 1996 increased contributions that can be made to the IRA of a nonworking spouse. The Health Insurance Portability and Accountability Act provided that the early withdrawal tax does not apply to withdrawals from IRAs: (1) for medical expenses that would be deductible (i.e., to the extent that total medical expenses exceed 7.5 percent of AGI); and (2) for health insurance expenses of unemployed individuals.

The Taxpayer Relief Act of 1997, effective for years beginning after December 31, 1997, made the following changes to the IRA provisions: (1) the income limits on deductible IRA contributions that apply to active participants in an employer-sponsored retirement plan were increased; (2) the nonworking spouse of an active participant in an employer-sponsored retirement plan may make a deductible contribution of up to $2,000 to an IRA; (3) a new tax-free nondeductible IRA, the Roth IRA, was added; and (4) the 10-percent early withdrawal tax was waived for distributions from IRAs for education and first-time home buyer expenses.

The annual limit on aggregate IRA contributions was increased again by The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA").[2] EGTRRA also allows individuals who have attained age 50 to make additional catch-up contributions to an IRA.

EXPLANATION OF PROVISION

Traditional IRAs

An individual who is an active participant in an employer-sponsored retirement plan may deduct annual IRA contributions up to the lesser of $3,000 (for 2003) or 100 percent of compensation if the individual's adjusted gross income (AGI) does not exceed certain limits.

The maximum deduction for IRA contributions for an individual who has attained age 50 before the end of the year is increased by a certain dollar amount ($500 for 2003). (The maximum dollar limit on IRA contributions applies to aggregate IRA contributions of an individual, including contributions to a Roth IRA.)

If an individual (or the individual's spouse) is an active participant in an employer-sponsored retirement plan, the deduction is phased out for taxpayers with adjusted gross income over certain levels for the taxable year. The adjusted gross income phase-out limits for taxpayers who are active participants in employer-sponsored plans are as follows:

Single Taxpayers

Taxable years beginning in:	*Phase-out range*
2003	40,000-50,000
2004	45,000-55,000
2005 and thereafter	50,000-60,000

Joint Returns

Taxable years beginning in:	*Phase-out range*
2003	60,000-70,000
2004	65,000-75,000
2005	70,000-80,000
2006	75,000-85,000
2007 and thereafter	80,000-100,000

The adjusted gross income phase-out range for married taxpayers filing a separate return is $0 to $10,000.

An individual who is not an active participant, but whose spouse is, may make a full deductible IRA contribution if the AGI for the couple does not exceed $150,000. The deduction limit in such cases is phased out for AGI between $150,000 and $160,000. An individual who is not an active participant

[2] The provisions of EGTTRA generally do not apply for years beginning after December 31, 2010.

in an employer-sponsored retirement plan may deduct IRA contributions up to the limits described above without limitation based on income.

The investment income of IRA accounts is not taxed until withdrawn. Withdrawn amounts attributable to deductible contributions and all earnings are includible in income. A 10-percent additional income tax applies unless the withdrawal: (1) is made after the IRA owner attains age 59½ or dies; (2) is made on account of the disability of the IRA owner; (3) is one of a series of substantially equal periodic payments made not less frequently than annually over the life or life expectancy of the IRA owner (or the IRA owner and his or her beneficiary); (4) is made to pay medical expenses in excess of 7.5 percent of AGI or for health insurance premiums for unemployed individuals; or (5) is made for first-time home buyer expenses (subject to a $10,000 lifetime cap) or for qualified higher education expenses.

Nondeductible IRAs

An individual may make nondeductible contributions to a traditional IRA to the extent the individual does not or cannot make deductible contributions to an IRA or contributions to a Roth IRA. Earnings on contributions to a nondeductible IRA accumulate tax free, and are includible in income when withdrawn. The 10-percent early withdrawal tax applies to such earnings, subject to the exceptions for IRAs as described above.

Roth IRAs

Individuals with adjusted gross income below certain levels may make nondeductible contributions to a Roth IRA. The maximum annual contribution that may be made to a Roth IRA is the lesser of a certain dollar amount ($3,000 for 2003) or the individual's compensation for the year. An individual who has attained age 50 before the end of the taxable year also may make catch-up contributions to a Roth IRA up to a certain dollar amount ($500 for 2003). The contribution limit is reduced to the extent an individual makes contributions to any other IRA for the same taxable year. The maximum annual contribution that can be made to a Roth IRA is phased out for single individuals with adjusted gross income between $95,000 and $110,000 and for joint filers with adjusted gross income between $150,000 and $160,000. The adjusted gross income phase-out range for married taxpayers filing a separate return is $0 to $10,000.

Qualified distributions from a Roth IRA are not includable in income. Qualified distributions are distributions: (1) made after the 5-year taxable period beginning with the first taxable year for which a contribution is made, and (2) which are made on or after the date the individual attains age 59½, are made to a beneficiary on or after the death of the individual, are attributable to the individual's being disabled, or are for a qualified special purpose distribution. A qualified special purpose distribution is a distribution for first-time home buyer expenses, as described above. Distributions that are not qualified distributions are includible in income, to the extent earnings are included in the distribution, and are subject to the 10-percent tax on early withdrawal, unless an exception applies, as described above for traditional IRAs.

Taxpayers with AGI of less than $100,000 may convert an IRA to a Roth IRA at any time. If the conversion was made before January 1, 1999, the amounts that would have been includible in income had the amounts converted been withdrawn are includible in income ratably over four years. The 10-percent tax on early withdrawals does not apply to conversions of IRAs to Roth IRAs.

EFFECT OF PROVISION

Use of IRAs expanded significantly when eligibility was expanded in 1982 to all persons with earnings and contracted correspondingly in 1987 when deductibility was restricted for higher income taxpayers who were covered by an employer-provided pension. The number of taxpayers claiming a deductible IRA contribution jumped from 3.4 million in 1981 to 12.0 million in 1982 and peaked at 16.2 million in 1985. In 1987, only 7.3 million taxpayers reported deductible contributions. Since then, the number generally has continued to fall (Table 13-8).

Upper-income taxpayers facing higher marginal tax rates receive more benefit per dollar of IRA deduction than do low-income taxpayers facing lower marginal tax rates. When IRAs were available to all workers, the percentage of taxpayers contributing to an IRA was substantially higher among taxpayers with higher income. For example, in 1985, 13.6 percent of taxpayers with AGI between $10,000 and $30,000 contributed to an IRA compared with 74.1 percent of taxpayers with AGI between $75,000 and $100,000.

The decline in IRA use between 1985 and 1990 among those with AGI between $10,000 and $30,000 appears to be larger than the reduction required by the change in law since the restrictions on deductible contributions apply only to a small fraction of taxpayers with AGI below $30,000.

Before EGTRRA, eligibility percentages and the real value of the IRA contribution limits declined over time because prior law did not index the contribution limits or the income eligibility limits for inflation. For example, the real value of a $2,000 contribution declined more than 38 percent between 1986 and 2001 because of inflation. Under EGTRRA, the IRA contribution limit increases to $5,000 in 2008 and is indexed for inflation (subject to the general EGTRRA sunset for years beginning after December 31, 2010).

Congress established IRAs to allow workers not covered by employer pension plans to have tax-advantaged retirement saving. Nonetheless, since 1981 IRA participation rates have been higher among those covered by an employer-provided pension plan than those without one, and many of those who are not covered by a pension plan do not contribute to an IRA. In 1987, 10 percent of full-time private-sector earners without pension coverage contributed to an IRA, while 15 percent of those with coverage contributed (Woods, 1989, p. 9).

TABLE 13-8 -- USE OF DEDUCTIBLE IRAs, 1980-2000

Year	Number of tax returns deducting IRA contributions (millions)	Total IRA deductions (billions)
1980	2.6	$3.4
1981	3.4	4.8
1982	12.0	28.3
1983	13.6	32.1
1984	15.2	35.4
1985	16.2	38.2
1986	15.5	37.8
1987	7.3	14.1
1988	6.4	11.9
1989	5.8	10.8
1990	5.2	9.9
1991	4.7	9.0
1992	4.5	8.7
1993	4.4	8.5
1994	4.3	8.4
1995	4.3	8.3
1996	4.4	8.6
1997	4.1	8.7
1998	3.9	8.2
1999	3.7	7.9
2000	3.5	7.5

Source: Internal Revenue Service, Statistics of Income, various years.

EXCLUSION OF SOCIAL SECURITY AND RAILROAD RETIREMENT BENEFITS

LEGISLATIVE HISTORY

The exclusion from gross income for Social Security benefits was not initially established by statute. Prior to the Social Security Amendments of 1983, the exclusion was based on a series of administrative rulings issued by the Internal Revenue Service in 1938 and 1941.[32]

Under the Social Security Amendments of 1983, a portion of the Social Security benefits paid to higher income taxpayers is included in gross income. In 1993, the Omnibus Budget Reconciliation Act increased the amount of benefits subject to tax and increased the rate of tax for some benefit recipients.

The exclusion from gross income of benefits paid under the Railroad Retirement System was enacted in the Railroad Retirement Act of 1935. A portion of the benefits payable under the Railroad Retirement System (generally, tier 1 benefits) is equivalent to Social Security benefits. The tax treatment of tier 1 railroad retirement benefits was modified in the Social Security Amendments of 1983 to conform to the tax treatment of Social Security benefits. Other railroad retirement benefits are taxable in the same manner as employer-provided retirement benefits. The Consolidated Omnibus Budget Reconciliation

[3] See Internal Revenue Service, Internal Revenue Bulletin, 1938-1, Income Tax Unit 3154, p. 114; 1938-2, Income Tax Unit 3229, p. 136; and 1941-1, Income Tax Unit 3447, p. 191.

Act of 1985 provided that tier 1 benefits are taxable in the same manner as Social Security benefits only to the extent that Social Security benefits otherwise would be payable. Other tier 1 benefits are taxable in the same manner as all other railroad retirement benefits (for further details, see section 5).

EXPLANATION OF PROVISION

For taxpayers whose modified AGI exceeds certain limits, a portion of Social Security and tier 1 railroad retirement benefits is included in taxable income. Modified AGI is AGI plus interest on tax-exempt bonds plus 50 percent of Social Security and tier 1 railroad retirement benefits. A two-tier structure applies. The base tier is $25,000 for unmarried individuals and $32,000 for married couples filing joint returns, and zero for married persons filing separate returns who do not live apart at all times during the taxable year. The amount of benefits includable in income is the lesser of 50 percent of the Social Security and tier 1 railroad retirement benefits or 50 percent of the excess of the taxpayer's combined income over the base amount.

The second tier applies to taxpayers with modified AGI of at least $34,000 (unmarried taxpayers) or $44,000 (married taxpayers filing joint returns). For these taxpayers, the amount of benefits includable in gross income is the lesser of 85 percent of Social Security benefits or the sum of 85 percent of the amount by which modified AGI exceeds the second-tier thresholds, and the smaller of the amount included under prior law or $4,500 (unmarried taxpayers) or $6,000 (married taxpayers filing jointly). The portion of tier 1 railroad retirement benefits potentially includable in taxable income under the above formula is the amount of benefits the taxpayer would have received if covered under Social Security. Pursuant to section 72(r) of the Internal Revenue Code, all other benefits payable under the Railroad Retirement System are includable in income when received to the extent they exceed employee contributions.

EFFECT OF PROVISION

Approximately one-third of all Social Security recipients pay taxes on their benefits. This percentage is likely to increase over time because the thresholds are not adjusted annually for past inflation or other factors.

EXCLUSION OF EMPLOYER CONTRIBUTIONS FOR MEDICAL INSURANCE PREMIUMS AND MEDICAL CARE

LEGISLATIVE HISTORY

In 1943, the Internal Revenue Service (IRS) ruled that employer contributions to group health insurance policies were not taxable to the employee. Employer contributions to individual health insurance policies, however, were declared to be taxable income in an IRS revenue ruling in 1953.

Section 106 of the Internal Revenue Code, enacted in 1954, reversed the 1953 IRS ruling. As a result, employer contributions to all accident or health plans generally are excluded from gross income and therefore are not subject to tax. Under section 105 of the Internal Revenue Code, benefits received under an employer's accident or health plan generally are not included in the employee's income.

In the Revenue Act of 1978, Congress added section 105(h) to tax the benefits payable to highly compensated employees under a self-insured medical reimbursement plan if the plan discriminated in favor of highly compensated employees.

EXPLANATION OF PROVISION

Gross income of an employee generally excludes employer-provided coverage under an accident or health plan. The exclusion applies to coverage provided to former employees, their spouses, or dependents. Amounts excluded include those received by an employee for personal injuries or sickness if the amounts are paid directly or indirectly to reimburse the employee for expenses incurred for medical care. However, this exclusion does not apply in the case of amounts paid to a highly compensated individual under a self-insured medical reimbursement plan if the plan violates the nondiscrimination rules of section 105(h).

Present law permits employers to prefund medical benefits for retirees. Postretirement medical benefits may be prefunded by the employer in two basic ways: (1) through a separate account in a tax-qualified pension plan (sec. 401(h)); or (2) through a welfare benefit fund (secs. 419 and 419A). Generally, the amounts contributed are excluded from the income of the plan or participants. Although amounts held in a section 401(h) account are accorded tax-favored treatment similar to assets held in a pension trust, the benefits provided under a section 401(h) account are required to be incidental to the retirement benefits provided by the plan. Amounts contributed to welfare benefit funds are subject to certain deduction limitations (secs. 419 and 419A). In addition, the fund is subject to income tax relating to any set-aside to provide postretirement medical benefits.

EFFECT OF PROVISION

The exclusion for employer-provided health coverage provides an incentive for compensation to be furnished to the employee in the form of health coverage, rather than in cash subject to current taxation. For example, an employer designing a compensation package for an employee would be indifferent between paying the employee one dollar in cash and purchasing one dollar's worth of health insurance for the employee.[43] On the other hand, because the employee is likely to pay Federal and State income taxes and payroll taxes on cash compensation and no tax on health insurance contributions made on his behalf, the employee would likely prefer that some compensation be in the form of health insurance. Employees subject to tax at the highest marginal tax rates have the greatest incentive to receive compensation in nontaxable forms.

The tax preference that the exclusion provides is substantial and has resulted in widespread access to health coverage. A majority of the population now receives health insurance as a consequence of their own employment or of a family member's employment. According to a special analysis of data from the Current Population Survey conducted by the Congressional Budget Office, nearly 75 percent of all workers under age 65 were covered by employment-based health insurance. Slightly over 4 percent of the workers under age 65 purchased insurance privately and nearly 3 percent received public insurance either through Medicare, Medicaid, or the Department of Veterans Affairs. The analysis reveals that slightly more than 18 percent of the workers under age 65 had no health insurance, up from 15 percent in 1996 (Committee, 1998, pp. 853-54).

Health coverage through employer-based plans tends to be more prevalent in the finance, government, manufacturing, mining, professional service, transportation, and wholesale trade sectors of the economy; among medium and large firms; for more highly paid workers; and among those over age 30 (Table 13-9).

TAX CREDIT FOR HEALTH INSURANCE OF ELIGIBLE INDIVIDUALS

The Trade Act of 2002 created a refundable tax credit equal to 65 percent of an eligible taxpayer’s expenses for qualified health insurance of the taxpayer and qualifying family members for certain periods. Eligible individuals include eligible TAA recipients, eligible alternative TAA recipients, and eligible PBGC pension recipients. The credit is payable on an advanced basis.

MEDICAL SAVINGS ACCOUNTS

The Health Insurance Portability and Accountability Act of 1996 included provisions for medical savings accounts (MSAs), effective for years beginning after December 31, 1996. MSAs were renamed Archer MSAs by the Community Renewal Tax Relief Act of 2000 (P.L. 106-554). Within limits, contributions to an Archer MSA are deductible if made by an eligible individual and are excludable from income and employment taxes if made by the employer (other than contributions made through a cafeteria plan). Earnings on amounts in

[4] To the extent the employer bears a portion of the payroll tax, the employer may actually prefer to provide compensation through health insurance (which is not subject to payroll tax).

an Archer MSA are not currently taxable. Distributions from an Archer MSA for medical expenses are not includible in gross income. Distributions from an Archer MSA that are not for medical expenses are includible in gross income and are subject to an additional tax of 15 percent, unless the distribution is made after death, disability, or age 65.

TABLE 13-9--PRIMARY SOURCE OF HEALTH INSURANCE FOR WORKERS UNDER AGE 65, BY DEMOGRAPHIC CATEGORY, MARCH 2003

Category	Number of Workers (millions)	Percentage distribution by source of insurance			
		Own or Other Employer	Individual Policy	Public Insurance[1]	No Insurance
Industry:					
Agriculture	1.8	49.9	12.9	6.1	31.0
Mining	0.6	83.8	2.6	1.2	12.5
Construction	10.2	59.8	5.6	2.1	32.6
Manufacturing	16.7	83.1	2.0	1.6	13.3
Wholesale & Retail Trade	18.4	73.4	4.2	3.1	19.3
Transportation & Utilities	6.9	78.3	2.7	1.7	17.3
Information	3.5	84.5	3.0	1.5.0	11.0
Financial Activities	9.4	82.7	5.8	1.1	10.4
Professional & Business Services	14.0	73.2	5.3	2.5	19.0
Education & Health Services	27.2	83.4	3.2	2.7	10.7
Leisure & Hospitality	9.9	53.7	5.0	5.5	35.8
Other Services	6.1	59.7	8.2	3.8	28.2
Public Administration	5.8	92.6	1.3.0	1.0	5.1
Family Income (as a percentage of poverty):					
Under 100	8.5	28	5.6	18.9	47.5
100--199	18.7	49.7	4.5	7.2	38.6
200--299	22.8	69.9	4.3	2.6	23.2
300 or more	87.8	85.7	4.0	0.6	9.7
Firm Size (number of employees):					
Fewer than 10	27.5	51.1	12.2	4.4	32.3
10 - 24	12.9	65	4.9	3.9	26.2
25 - 99	17.9	73.9	2.8	3.2	20.1
100 - 499	19.0	82.2	1.9	2.5	13.5
500 - 999	7.5	85.7	1.7	2.0	10.6
1,000 or more	52.9	85.3	1.6	2.2	10.9
Age:					
Under 30	31.0	61.1	3.4	5.7	29.8
30-39	35.4	75.3	3.4	3.0	18.2
40-49	37.7	79.3	4.4	2.0	14.3
50-64	33.7	81.3	5.6	1.5	11.7
Region:					
Northeast	26.0	77.2	3.4	3.5	15.9
Midwest	32.0	78.6	4.1	3	14.3
South	48.3	72.7	4.2	2.4	20.8
West	31.5	71.7	5.0	3.3	20.0
All nonelderly workers	137.8	74.7	4.2	3.0	18.2

[1] Public insurance includes Medicaid, SCHIP, Medicare, and other government health care.

Source: Congressional Budget Office estimates based on the March 2003 Current Population Survey.

Archer MSAs are available to employees covered under an employer-sponsored high deductible health plan of a small employer and to self-employed individuals covered under a high deductible health plan (regardless of the size of the entity for which the self-employed individual performs services). A small employer is defined as an employer with 50 or fewer employees.

In order to be eligible for an Archer MSA contribution, an otherwise eligible individual must be covered under a high deductible health plan and no other health plan. A high deductible health plan is a plan with an annual deductible of at least $1,500 and no more than $2,250 in the case of individual coverage (and at least $3,000 and no more than $4,500 in the case of family coverage). The adjusted annual deductible amounts for tax years beginning in 2003 are between $1,700 and $2,500 for individual coverage and between $3,350 and $5,050 for family coverage. The dollar limits are indexed for inflation. High deductible plans must also meet certain limits on out-of-pocket expenses.

The number of taxpayers benefiting annually from an Archer MSA contribution is limited to a threshold level (generally, 750,000 taxpayers). If it is determined in a year that the threshold level has been exceeded (called a cutoff year), then, in general, for succeeding years during the pilot period 1997-2003, only those individuals who (1) made an MSA contribution or had an employer Archer MSA contribution for the year or a preceding year (i.e., are active Archer MSA participants) or (2) are employed by a participating employer, would be eligible for an MSA contribution. In determining whether the threshold for any year has been exceeded, Archer MSAs of previously uninsured individuals are not taken into account.

After December 31, 2003, no new contributions may be made to Archer MSAs except by or on behalf of an individual who previously had Archer MSA contributions and employees who are employed by a participating employer. Self-employed individuals who made contributions to an Archer MSA during the period 1997-2003 also may continue to make contributions after 2003.

HEALTH SAVINGS ACCOUNTS

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (P.L. 108-173) added provisions for health savings accounts (HSAs), effective for taxable years beginning after December 31, 2003. Within limits, contributions to an HSA made by or on behalf of an eligible individual are deductible by the individual. Contributions to an HSA are excludable from income and employment taxes if made by the employer. Earnings on amounts in HSAs are not taxable. Distributions from an HSA for qualified medical expenses are not includible in gross income. Distributions from an HSA that are not used for qualified medical expenses are includible in gross income and are subject to an additional tax of 10 percent, unless the distribution is made after death, disability, or the individual attains the age of Medicare eligibility (i.e., age 65).

Eligible individuals for HSAs are individuals who are covered by a high deductible health plan and no other health plan that is not a high deductible health plan. A high deductible health plan is a health plan that has a deductible that is at least $1,000 for self-only coverage or $2,000 for family coverage (indexed for inflation) and that has an out-of-pocket expense limit that is no more than $5,000 in the case of self-only coverage and $10,000 in the case of family coverage.

The maximum aggregate annual contribution that can be made to an HSA is the lesser of (1) 100 percent of the annual deductible under the high deductible health plan, or (2) the maximum deductible permitted under an Archer MSA high deductible health plan under present law, as adjusted for inflation. For 2004, the amount of the maximum deductible under an Archer MSA high deductible health plan is $2,600 in the case of self-only coverage and $5,150 in the case of family coverage. The annual contribution limits are increased for individuals who have attained age 55 by the end of the taxable year. In the case of policyholders and covered spouses who are age 55 or older, the HSA annual contribution limit is greater than the otherwise applicable limit by $500 in 2004, $600 in 2005, $700 in 2006, $800 in 2007, $900 in 2008, and $1,000 in 2009 and thereafter.

CAFETERIA PLANS

LEGISLATIVE HISTORY

Under present law, compensation generally is includible in gross income when received. An exception applies if an employee may choose between cash and certain employer-provided nontaxable benefits under a cafeteria plan.

Prior to 1978, ERISA provided that an employer contribution made before January 1, 1977, to a cafeteria plan in existence on June 27, 1974, had to be included in an employee's gross income only to the extent that the employee actually elected taxable benefits. If a plan did not exist on June 27, 1974, the employer contribution was to be included in income to the extent the employee could have elected taxable benefits. The Revenue Act of 1978 set up permanent rules for plans that offer an election between taxable and nontaxable benefits.

The Deficit Reduction Act of 1984 (P.L. 98-369) clarified the types of employer-provided benefits that could be provided through a cafeteria plan, added a 25-percent concentration test, and required annual reporting to the IRS by employers.

The Tax Reform Act of 1986 also modified the rules relating to cafeteria plans in several respects.

EXPLANATION OF PROVISION

A participant in a cafeteria plan (sec. 125) is not treated as having received taxable income solely because the participant had the opportunity to elect to receive cash or certain nontaxable benefits. In order to meet the requirements of section 125, the plan must be in writing, must include only employees (including former employees) as participants, and must satisfy certain nondiscrimination requirements.

In general, a nontaxable benefit may be provided through a cafeteria plan if the benefit is excludable from the participant's gross income by reason of a specific provision of the Code. These include employer-provided health coverage, group-term life insurance coverage, and benefits under dependent care assistance programs. A cafeteria plan may not provide qualified scholarships or tuition reduction, educational assistance, miscellaneous employer-provided fringe benefits, or deferred compensation except through a qualified cash or deferred arrangement.

If the plan discriminates in favor of highly compensated individuals regarding eligibility to participate, to make contributions, or to receive benefits under the plan, then the exclusion does not apply to such individuals. For purposes of these nondiscrimination requirements, a highly compensated individual is an officer, a shareholder owning more than 5 percent of the employing firm, a highly compensated individual determined under the facts and circumstances of the case, or a spouse or dependent of the above individuals.

EFFECT OF PROVISION

The optimal compensation of employees (in a tax planning sense) would require that employers and employees arrive at the compensation package that provides the largest after-tax benefit to the employee at minimum after-tax cost to the employer (see Scholes & Wolfson, 1992, chapter 10). Both the potential taxation of compensation provided to employees and the deductibility of compensation provided by the employer would be considered. If only income taxes were considered, employers would be indifferent between the payment of $1 in salary or wages and the payment of $1 in fringe benefits to an employee, because both types of compensation are fully deductible. When the employer payments for FICA and Federal Unemployment Tax Act (FUTA) taxes are considered, however, the employer might actually find it less costly to compensate an employee with a dollar's worth of fringe benefit not subject to FICA and FUTA taxes rather than a dollar of wage or salary payments that are subject to these taxes.

The employee, however, would prefer to be compensated in the form that provides the highest after-tax value. An additional dollar of salary or wage paid to the employee will be subject to tax. If a fringe benefit is excludable from the employee's income, the employee pays no tax on receipt of the benefit. Consequently, the employee receives greater compensation via the fringe benefit. This differential treatment of salary or wage payments and excludable fringe benefits implies that compensation packages designed to minimize the joint tax liability of employers and employees could include substantial amounts of excludable fringe benefits.

Employees may have different preferences about the allocation of their compensation. For example, an employee with no dependents may place little value on employer provided life insurance. Cafeteria plans permit employees some discretion as to the provided benefits, and will tend to be preferred to benefit plans in which all employees of the firm receive the identical benefit package.

Cafeteria plans are a growing part of compensation plans, particularly for larger employers. The Bureau of Labor Statistics estimated that in 1997, 52 percent of employees at large- and medium-sized firms were eligible for some type of cafeteria plan. This figure has grown from an estimated 5 percent in 1986 (U.S. Bureau of Labor Statistics, 1993). Smaller firms generally do not offer cafeteria plans to their workers. For example, in 1996, only 23 percent of the workers in small, private establishments (nonfarm establishments with fewer than 100 employees) were eligible to participate in a cafeteria plan (U.S. Bureau of Labor Statistics, 1996). The lower figure for smaller firms reflects in part the less generous fringe benefit packages provided by smaller firms.

Like any income exclusion, the exclusion from gross income for cafeteria plan benefits can lead to disparities in the tax system. Employees with the same total compensation can have taxable incomes that are substantially different because of the form in which compensation is received. The exclusion for cafeteria plan benefits also may be used in some cases to avoid the 7.5 percent of AGI floor on deductible medical expenses. The use of cafeteria plans reduces the aftertax cost of health care to employees using these plans, which could cause these employees to purchase a larger amount of health care services. On the other hand, cafeteria plans could encourage employers to increase the share of premiums, copayments, and deductibles paid by employees, resulting in increased employee awareness of the costs of their health plans. This incentive could result in reduced health care costs.

HEALTH CARE CONTINUATION RULES

LEGISLATIVE HISTORY

The Consolidated Omnibus Budget Reconciliation Act of 1985 added sections 106(b), 162(i)(2), and 162(k) to the Internal Revenue Code under which certain group health plans are required to offer health coverage to certain employees and former employees, as well as to their spouses and dependents. Parallel requirements were added to title I of ERISA and the Public Health Services Act. If an employer failed to satisfy the health care continuation rules, the employer was denied a deduction for contributions to its group health plans and highly compensated employees were required to include in taxable income the employer-provided value of the coverage received under such plans.

The Technical and Miscellaneous Revenue Act of 1988 made several changes to the health care continuation rules. Sections 106(b), 162(i)(2), and 162(k) were repealed and replaced by section 4980B. Section 4980B imposes an excise tax on the employer or other responsible party who fails to satisfy the rules instead of denying deductions and the exclusion. The Health Insurance Portability and Accountability Act of 1996 made some changes to the health care continuation rules in cases of disability.

EXPLANATION OF PROVISION

The health care continuation rules in section 4980B require that an employer provide qualified beneficiaries with the opportunity to participate for a specified period in the employer's health plan after that participation otherwise would have terminated. If the employee elects such continuation coverage, the employee may be required to pay for the coverage. The amount the employee can be required to pay is subject to certain limits.

The qualifying events that may trigger rights to continuation coverage are: (1) the death of the employee; (2) the voluntary or involuntary termination of the employee's employment (other than by reason of gross misconduct); (3) a reduction of the employee's hours; (4) the divorce or legal separation of the employee; (5) the employee becoming entitled to benefits under Medicare; and (6) a dependent child of the employee ceasing to be a dependent under the employer's plan. The maximum period of continuation coverage is 36 months, except in the case of termination of employment or reduction of hours for which the maximum period is 18 months. The 18-month period is extended to 29 months in certain cases involving the disability of the qualified beneficiary. Certain events, such as the failure by the qualified beneficiary to pay the required premium, may trigger an earlier cessation of the continuation coverage.

A beneficiary has a prescribed period of time during which to elect continuation coverage after the employee receives notice from the plan administrator of the right to continuation coverage.

GROUP HEALTH PLAN REQUIREMENTS

The Health Insurance Portability and Accountability Act of 1996 imposes certain requirements regarding health coverage portability through limitations on preexisting condition exclusions, prohibitions on excluding individuals from coverage based on health status, and guaranteed renewability of health insurance coverage. An excise tax is imposed with respect to failures of a group health plan to comply with the requirements. The tax is usually imposed on the employer sponsoring the plan. The amount of the tax is generally equal to $100 per day for each day during which the failure occurs until the failure is corrected. The maximum tax that can be imposed is the lesser of 10 percent of the employer's payments during the taxable year in which the failure occurred under group health plans or $500,000. The Secretary of the Treasury may waive all or part of the tax to the extent that payment of the tax would be excessive relative to the failure involved (see discussion of health care continuation rules).

TAX BENEFITS FOR ACCELERATED DEATH BENEFITS AND LONG-TERM CARE INSURANCE

LEGISLATIVE HISTORY

Accelerated Death Benefits

If a contract meets the definition of a life insurance contract, gross income does not include insurance proceeds that are paid pursuant to the contract by reason of the death of the insured (sec. 101(a)). In addition, the undistributed investment income (inside buildup) earned on premiums credited under the contract is not subject to current taxation to the owner of the contract. The exclusion under section 101 applies regardless of whether the death benefits are paid as a lump sum or otherwise.

If a contract fails to be treated as a life insurance contract under section 7702(a), inside buildup on the contract is generally subject to tax (sec. 7702(g)).

To qualify as a life insurance contract for Federal income tax purposes, a contract must be a life insurance contract under the applicable State or foreign law and must satisfy either of two alternative tests: (1) a cash value accumulation test, or (2) a test consisting of a guideline premium requirement and a cash value corridor requirement (sec. 7702(a)). A contract satisfies the cash value accumulation test if the cash surrender value of the contract may not at any time exceed the net single premium that would have to be paid at such time to fund future benefits under the contract. A contract satisfies the guideline premium and cash value corridor tests if the premiums paid under the contract do not at any time exceed the greater of the guideline single premium or the sum of the guideline level premiums, and if the death benefit under the contract is not less than a varying statutory percentage of the cash surrender value of the contract.

Long-Term Care Insurance

Prior to the Health Insurance Portability and Accountability Act of 1996, tax law generally did not provide explicit rules relating to the tax treatment of long-term care insurance contracts or long-term care services. Thus, the treatment of long-term care contracts and services was unclear. Prior and present law provide rules relating to medical expenses and accident or health insurance. Amounts received by a taxpayer under accident or health insurance for personal injuries or sickness generally are excluded from gross income to the extent that the amounts received are not attributable to medical expenses that were allowed as a deduction for a prior taxable year (sec. 104).

EXPLANATION OF PROVISION

Accelerated Death Benefits

The Health Insurance Portability and Accountability Act of 1996 provides an exclusion from gross income as an amount paid by reason of the death of an insured for amounts received under a life insurance contract and for amounts received for the sale or assignment of a life insurance contract to a qualified viatical settlement provider, provided that the insured under the life insurance contract is either terminally ill or chronically ill.

The exclusion does not apply in the case of an amount paid to any taxpayer other than the insured, if such taxpayer has an insurable interest by reason of the insured being a director, officer, or employee of the taxpayer, or by reason of the insured being financially interested in any trade or business carried on by the taxpayer.

A terminally ill individual is defined as one who has been certified by a physician as having an illness or physical condition that reasonably can be expected to result in death within 24 months of the date of certification.

A chronically ill individual has the same meaning as provided under the long-term care rules (see below). In the case of a chronically ill individual, the exclusion with respect to amounts paid under a life insurance contract and amounts paid in a sale or assignment to a viatical settlement provider applies if the payment received is for costs incurred by the payee (not compensated by insurance or otherwise) for qualified long-term care services for the insured person for the period, and two other requirements (similar to requirements applicable to long-term care insurance contracts) are met.

The first requirement is that under the terms of the contract giving rise to the payment, the payment is not a payment or reimbursement of expenses reimbursable under Medicare (except where Medicare is a secondary payor under the arrangement, or the arrangement provides for per diem or other periodic payments without regard to expenses for qualified long-term care services). No provision of law shall be construed or applied so as to prohibit the offering of such a contract giving rise to such a payment on the basis that the contract coordinates its payments with those provided under Medicare. The second requirement is that the arrangement complies with the consumer protection provisions applicable to long-term care insurance contracts and issuers that are specified in Treasury regulations.

Long-Term Care Insurance

Exclusion of Long-Term Care Insurance Proceeds—The Health Insurance Portability and Accountability Act of 1996 provides that a long-term care insurance contract generally is treated as an accident and health insurance contract. Amounts (other than policyholder dividends or premium refunds) received under a long-term care insurance contract generally are excludable as amounts received for personal injuries and sickness, subject to a dollar cap on aggregate payments under per diem contracts. A reporting requirement applies to payors of excludable amounts.

The amount of the dollar cap on aggregate payments under per diem contracts with respect to any one chronically ill individual (who is not also terminally ill) is $220 per day for calendar year 2003 ($80,520 annually) as indexed,[4] reduced by the amount of reimbursements and payments received by anyone for the cost of qualified long-term care services for the chronically ill individual. If more than one payee receives payments with respect to any one chronically ill individual, then everyone receiving periodic payments with respect to the same insured is treated as one person for purposes of the dollar cap. The amount of the dollar cap is used first by the chronically ill person, and any remaining amount is to be allocated in accordance with Treasury regulations. If payments under such contracts exceed the dollar cap, then the excess is excludable only to the extent of actual costs (in excess of the dollar cap) incurred for long-term care services. Amounts in excess of the dollar cap, with respect to which no actual costs were incurred for long-term care services, are fully includible in income without regard to rules relating to return of basis under section 72. A grandfather rule applies to any per diem-type contract issued to a policyholder on or before July 31, 1996.

Exclusion for Employer-Provided Long-Term Care Coverage—A plan of an employer providing coverage under a long-term care insurance contract generally is treated as an accident and health plan. Thus, employer-provided long-term care coverage is generally excludable from income and wages and deductible by the employer. Employer-provided coverage under a long-term care insurance contract is not, however, excludable by an employee if provided through a cafeteria plan; similarly, expenses for long-term care services cannot be reimbursed under a flexible spending arrangement.

Definition of Long-Term Care Insurance Contract—A long-term care insurance contract is defined as any insurance contract that provides only coverage of qualified long-term care services and that meets other requirements. The other requirements are that: (1) the contract is guaranteed renewable; (2) the contract does not provide for a cash surrender value or other money that can be paid, assigned, pledged or borrowed; (3) refunds (other than refunds on the death of the insured or complete surrender or cancellation of the contract) and dividends under the contract may be used only to reduce future premiums or increase future benefits; and (4) the contract generally does not pay or reimburse expenses reimbursable under Medicare (except where Medicare is a secondary payor, or the contract makes per diem or other periodic payments without regard to expenses).

A contract does not fail to be treated as a long-term care insurance contract solely because it provides for payments on a per diem or other periodic basis without regard to expenses incurred during the period.

Medicare Duplication Rules—No provision of law may be applied to prohibit the offering of a long-term care insurance contract on the basis that the contract coordinates its benefits with those provided under Medicare.

Definition of Qualified Long-Term Care Services—Qualified long-term care services means necessary diagnostic, preventive, therapeutic, curing, treating, mitigating and rehabilitative services, and maintenance or personal care services that are required by a chronically ill individual and that are provided pursuant to a plan of care prescribed by a licensed health care practitioner.

Chronically Ill Individual—A chronically ill individual is one who has been certified within the previous 12 months by a licensed health care practitioner as: (1) being unable to perform (without substantial assistance) at least two activities of daily living for at least 90 days due to a loss of functional capacity; (2) having a similar level of disability as determined by the Secretary of the Treasury in consultation with the Secretary of Health and Human Services; or (3) requiring substantial supervision to protect such individual from threats to health and safety due to severe cognitive impairment. Activities of daily living are eating, toileting, transferring, bathing, dressing and continence. For purposes of determining whether an individual is chronically ill, the number of activities of daily living that are taken into account under the long-term care insurance contract may not be less than five.

Expenses for Long-Term Care Services Treated as Medical Expenses—Unreimbursed expenses for qualified long-term care services provided to the taxpayer or the taxpayer's spouse or dependents are treated as medical expenses for purposes of the itemized deduction for medical expenses (subject to the present-law floor of 7.5 percent of AGI). For this purpose, amounts received under a long-term care insurance contract (regardless of whether the contract reimburses expenses or pays benefits on a per diem or other periodic basis) are treated as reimbursement for expenses actually incurred for medical care.

For purposes of the deduction for medical expenses, qualified long-term care services do not include services provided to an individual by a relative or spouse (directly, or through a partnership, corporation, or other entity), unless the relative is a licensed professional with respect to such services, or by a related corporation (within the meaning of Code section 267(b) or 707(b)).

Long-Term Care Insurance Premiums Treated as Medical Expenses—Long-term care insurance premiums that do not exceed specified dollar limits are treated as medical expenses for purposes of the itemized deduction for medical expenses.

Consumer Protection Provisions—Certain consumer protection provisions apply with respect to the terms of a long-term care insurance contract, for purposes of determining whether the contract is a qualified long-term care insurance contract. In addition, certain consumer protection provisions apply to issuers of long-term care insurance contracts.

DEDUCTION FOR HEALTH INSURANCE EXPENSES OF SELF-EMPLOYED INDIVIDUALS

Self-employed individuals may currently deduct 100 percent of their health insurance expenses for themselves and their spouses and dependents. The deduction also applies to certain long-term care premiums treated as medical expenses.

EXCLUSION OF MEDICARE BENEFITS

LEGISLATIVE HISTORY

The exclusion from income of Medicare benefits has never been expressly established by statute. A 1970 IRS ruling, Rev. Rul. 70-341, 1970-2 C.B. 31, provided that the benefits under part A of Medicare are not includible in gross income because they are disbursements made to further the social welfare objectives of the Federal Government. The Internal Revenue Service relied on a similar ruling, Rev. Rul. 70-217, 1970-1 C.B. 13, with respect to the excludability of Social Security disability insurance benefits in reaching this conclusion. (For background on the exclusion of Social Security benefits, see above section on pension contributions.) Rev. Rul. 70-341 also held that benefits under part B of Medicare are excludable as amounts received through accident and health insurance (though the subsidized portion of part B also may be excluded under the same theory applicable to the exclusion of part A benefits).

EXPLANATION OF PROVISION

Benefits under part A and part B of Medicare are excludable from the gross income of the recipient. In general, part A pays for certain inpatient hospital care, skilled nursing facility care, home health care, and hospice care for eligible individuals (generally the elderly and the disabled). Part B covers certain services of a physician and other medical services for elderly or disabled individuals who elect to pay the required premium.

DEDUCTIBILITY OF MEDICAL EXPENSES

LEGISLATIVE HISTORY

An itemized deduction for unreimbursed medical expenses above a specified floor has been allowed since 1942. From 1954 through 1982, the floor under the medical expense deduction was 3 percent of the taxpayer's adjusted gross income (AGI); a separate floor of 1 percent of AGI applied to expenditures for medicine and drugs.

In the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), the floor was increased to 5 percent of AGI (effective for 1983 and thereafter) and was applied to the total of all eligible medical expenses, including prescription drugs and insulin. TEFRA made nonprescription drugs ineligible for the deduction and eliminated the separate floor for drug costs.

The Tax Reform Act of 1986 increased the floor under the medical expense deduction to 7.5 percent of AGI, beginning in 1987.

EXPLANATION OF PROVISION

Individuals who itemize deductions may deduct amounts they pay during the taxable year, if not reimbursed by insurance or otherwise, for medical care of the taxpayer and of the taxpayer's spouse and dependents, to the extent that the total of such expenses exceeds 7.5 percent of AGI (sec. 213).

Medical care expenses eligible include: (1) health insurance (including after-tax employee contributions to employer health plans); (2) diagnosis, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body; (3) transportation primarily for and essential to medical care; (4) lodging away from home primarily for and essential to medical care, up to $50 per night; and (5) prescription drugs and insulin.

Expenses paid for the general improvement of health, such as fees for exercise programs, are not eligible for the deduction unless prescribed by a physician to treat a specific illness. A deduction is not allowed for cosmetic surgery or similar procedures that do not meaningfully promote the proper function of the body or treat disease. However, such expenses are deductible if the cosmetic procedure is necessary to correct a deformity arising from a congenital abnormality, an injury resulting from an accident, or disfiguring disease.

Medical expenses are not subject to the general limitation on itemized deductions applicable to taxpayers with AGIs above a certain limit ($139,500 for 2003, and adjusted annually for inflation.

EFFECT OF PROVISION

The Tax Code allows taxpayers to claim an itemized deduction if unreimbursed medical expenses absorb a substantial portion of income and thus adversely affect the taxpayer's ability to pay taxes. In order to limit the deduction to extraordinary expenses, medical expenses are deductible only to the extent that they exceed 7.5 percent of the taxpayer's AGI.

Table 13-10 shows the effect on medical expense deductions of the increases in the floor on medical deductions. In the absence of those increases, one would have expected the number of taxpayers claiming the deduction to have increased because of inflation of medical costs. However, increasing the floor should reduce the number of taxpayers claiming the deduction because many taxpayers with relatively modest expenses no longer qualify.

Taxpayers in higher tax rate brackets receive more of a benefit from each dollar of deductible medical expense than do taxpayers in lower tax rate brackets. However, because the floor automatically rises with a taxpayer's income, higher income taxpayers are able to deduct a smaller amount (if any) of medical expenses above their floor than are low-income taxpayers incurring the same aggregate amount of medical expenses (Table 13-11).

TABLE 13-10 -- TAX RETURNS CLAIMING DEDUCTIBLE MEDICAL AND DENTAL EXPENSES, 1980-2000

Year	Number of returns filed (in millions)	Returns claiming medical and dental expenses in excess of the AGI floor		
		Number of returns (in millions)	Expenses in excess of the AGI floor (in billions)	Average amount over floor
1980	93.9	19.5	$15.0	$769
1981	95.4	21.4	17.9	836
1982	95.3	22.0	21.7	986
1983	96.3	9.7	18.1	1,859
1984	99.4	10.7	21.5	2,009
1985	101.7	10.8	22.9	2,127
1986	103.0	10.5	25.1	2,382
1987	107.0	5.4	17.2	3,202
1988	110.1	4.8	18.0	2,741
1989	112.1	5.1	20.9	4,079
1990	113.7	5.1	21.5	4,215
1991	114.7	5.3	23.7	4,444
1992	113.6	5.5	25.7	4,675
1993	114.6	5.5	26.5	4,829
1994	115.9	5.2	26.4	5,044
1995	118.2	5.4	27.0	5,039
1996	120.4	5.4	27.0	5,003
1997	122.4	5.3	29.3	5,571
1998	124.8	5.6	32.0	5,753
1999	127.1	5.9	35.4	6,012
2000	129.4	6.5	39.3	6,027

Source: Internal Revenue Service.

TABLE 13-11 -- DISTRIBUTION OF ITEMIZED DEDUCTIONS FOR MEDICAL EXPENSES, 2003

Income class[1]	Average deduction	Returns (thousands)	Total amount (billions)[2]
Below $10,000	$6,064	256	$1.5
$10,000-$20,000	4,702	378	1.8
$20,000-$30,000	7,785	749	5.8
$30,000-$40,000	6,629	908	6.0
$40,000-$50,000	7,072	852	6.0
$50,000-$75,000	7,532	1554	11.7
$75,000-$100,000	7,770	807	6.3
$100,000-$200,000	13,545	477	6.5
$200,000 and over	26,544	56	1.5
Total	7.805	6,035	47.1

[1] The income concept is defined in the introduction to this chapter.
[2] Amounts in excess of the floor on itemized medical deductions (7.5 percent of adjusted gross income).
Source: Joint Committee on Taxation.

EARNED INCOME CREDIT

LEGISLATIVE HISTORY

The earned income credit (EIC; Code sec. 32), enacted in 1975, generally equals a specified percentage of wages up to a maximum dollar amount. The maximum amount applies over a certain income range and then diminishes to zero over a certain income range. The income ranges and percentages have been revised several times since original enactment, expanding the credit (Table 13-12).

In 1987, the credit was indexed for inflation. In 1990 and again in 1993, Congress enacted substantial expansions of the credit. Auxiliary credits were added for very young children and for health insurance premiums paid on behalf of a qualifying child in 1990. They were repealed in 1993. Also, in 1993, eligibility for the credit was expanded to include childless workers. The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 incorporated new rules relating to taxpayer identification numbers and modified AGI phase-out of the credit in addition to amending the credit's unearned income test (described below).

The Taxpayer Relief Act of 1997 also included provisions to improve compliance. The provisions: (1) deny the EIC for 10 years to taxpayers who fraudulently claimed the EIC, 2 years for EIC claims which are a result of reckless or intentional disregard of rules or regulations); (2) require EIC recertification for a taxpayer who is denied the EIC; (3) imposes due diligence requirements on paid preparers of returns involving the EIC; (4) requires information sharing between the Treasury Department and State and local governments regarding child support orders; and (5) allows expanded use of Social Security Administration records to enforce the tax laws, including the EIC. The Balanced Budget Act of 1997 also increased the IRS authorization to improve enforcement of the EIC.

EGTRRA made several changes to the EIC to provide marriage penalty relief and promote simplification, including: (1) increasing the beginning and ending amounts of the phase out ranges by $1,000 (for 2002-2004), $2,000 (for 2005-2007), and $3,000 (in 2007, indexed thereafter) for married taxpayers who file a joint return; (2) excluding nontaxable employee compensation from the definition of earned income; (3) repealing the reduction of the EIC by the amount of an individual's alternative minimum tax; (4) eliminating the need to calculate modified adjusted gross income for EIC purposes; (5) expanding the relationship test for purposes of qualifying child, and eliminating the requirement that certain individuals have the same principal place of abode as the taxpayer for the entire year; (6) simplifying the tie-breaker rule that applies if multiple taxpayers claim the same qualifiying child; and (7) effective January 1, 2004, with respect to noncustodial parents, expanding the math error authority of the Internal Revenue Service based on the Federal Case Registry of Child Support Orders.

EXPLANATION OF PROVISION

The EIC is available to low-income working taxpayers. Three separate schedules apply.

Taxpayers with one qualifying child may claim a credit in 2003 of 34 percent of their earnings up to $7,490, resulting in a maximum credit of $2,547. The maximum credit is available for those with earnings between $7,490 and $13,730 ($14,730 if married filing jointly). The credit begins to phase down at a rate of 15.98 percent of earnings above $13,730 ($14,730 if married filing jointly). The credit is phased down to $0 at $33,692 of earnings ($34,692 if married filing jointly).

Taxpayers with more than one qualifying child may claim a credit in 2003 of 40 percent of earnings up to $10,510, resulting in a maximum credit of $4,204. The maximum credit is available for those with earnings between $10,510 and $13,730 ($14,720 if married filing jointly). The credit begins to phase down at a rate of 21.06 percent of earnings above $13,730 ($14,730 if married filing jointly). The credit is phased down to $0 at $33,692 of earnings ($34,692 if married filing jointly).

Taxpayers with no qualifying children may claim a credit if they are over age 24 and below age 65. The credit is 7.65 percent of earnings up to $4,990, resulting in a maximum credit of $382. The maximum credit is available for those with incomes between $4,990 and $6,240 ($7,240 if married filing jointly). The credit begins to phase down at a rate of 7.65 percent of earnings above $6,240 ($7,240 if married filing jointly) resulting in a $0 credit at $11,230 of earnings ($12,230 if married filing jointly).

All income thresholds are indexed for inflation annually. In order to be a qualifying child, an individual must satisfy a relationship test, a residency test, and an age test. The relationship test requires that the individual be (1) a child, stepchild, or descendant of a child or of a sibling or stepsibling. The residency test requires that the individual have the same place of abode as the taxpayer for more than half the taxable year. The households must be located in the United States. The age test requires that the individual be under 19 (24 for a full time student) or be permanently and totally disabled.

TABLE 13-12 -- EARNED INCOME CREDIT PARAMETERS, 1975-2003

Calendar year	Credit rate (percent)	Minimum income for maximum credit	Maximum credit	Phaseout rate (percent)	Phaseout range: Non joint filers: Beginning income	Phaseout range: Non joint filers: Ending income	Phaseout range: Joint filers: Beginning income	Phaseout range: Joint filers: Ending income
1975-1978	10.00	$4,000	$400	10.00	$4,000	$8,000	NA	NA
1979-1984	10.00	5,000	500	12.50	6,000	10,000	NA	NA
1985-1986	14.00	5,000	550	12.22	6,500	11,000	NA	NA
1987	14.00	6,080	851	10.00	6,920	15,432	NA	NA
1988	14.00	6,240	874	10.00	9,840	18,576	NA	NA
1989	14.00	6,500	910	10.00	10,240	19,340	NA	NA
1990	14.00	6,810	953	10.00	10,730	20,264	NA	NA
1991:								
One child	16.70	7,140	1,192	11.93	11,250	21,250	NA	NA
Two children	17.30	7,140	1,235	12.36	11,250	21,250	NA	NA
1992:								
One child	17.60	7,520	1,324	12.57	11,840	22,370	NA	NA
Two children	18.40	7,520	1,384	13.14	11,840	22,370	NA	NA
1993:								
One child	18.50	7,750	1,434	13.21	12,200	23,050	NA	NA
Two children	19.50	7,750	1,511	13.93	12,200	23,050	NA	NA
1994:								
No children	7.65	4,000	306	7.65	5,000	9,000	NA	NA
One child	26.30	7,750	2,038	15.98	11,000	23,755	NA	NA
Two children	30.00	8,425	2,528	17.68	11,000	25,296	NA	NA
1995:								
No children	7.65	4,100	314	7.65	5,130	9,230	NA	NA
One child	34.00	6,160	2,094	15.98	11,290	24,396	NA	NA
Two children	36.00	8,640	3,110	20.22	11,290	26,673	NA	NA
1996:								
No children	7.65	4,220	323	7.65	5,280	9,500	NA	NA
One child	34.00	6,330	2,152	15.98	11,610	25,078	NA	NA
Two children	40.00	8,890	3,556	21.06	11,610	28,495	NA	NA

TABLE 13-12 -- EARNED INCOME CREDIT PARAMETERS, 1975-2003- continued

Calendar year	Credit rate (percent)	Minimum income for maximum credit	Maximum credit	Phaseout rate (percent)	Phaseout range			
					Non joint filers		Joint filers	
					Beginning income	Ending income	Beginning income	Ending income
1997:								
No children	7.65	4,340	332	7.65	5,430	9,770	NA	NA
One child	34.00	6,500	2,210	15.98	11,930	25,750	NA	NA
Two children	40.00	9,140	3,656	21.06	11,930	29,290	NA	NA
1998:								
No children	7.65	4,460	341	7.65	5,570	10,030	NA	NA
One child	34.00	6,680	2,271	15.98	12,260	26,473	NA	NA
Two children	40.00	9,390	3,756	21.06	12,260	30,095	NA	NA
1999:								
No children	7.65	4,530	347	7.65	5,670	10,200	NA	NA
One child	34.00	6,800	2,312	15.98	12,460	26,928	NA	NA
Two children	40.00	9,540	3,816	21.06	12,460	30,580	NA	NA
2000								
No children	7.65	4,610	353	7.65	5,770	10,380	NA	NA
One child	34	6,920	2,353	15.98	12,690	27,415	NA	NA
Two children	40	9,720	3,888	21.06	12,690	31,152	NA	NA
2001								
No children	7.65	4,760	364	7.65	5,950	10,710	NA	NA
One child	34	7,140	2,428	15.98	13,090	28,281	NA	NA
Two children	40	10,020	4,008	21.06	13,090	32,121	NA	NA
2002								
No children	7.65	4,910	376	7.65	6,150	11,060	7,150	12,060
One child	34	7,370	2,506	15.98	13,520	29,201	14,520	30,201
Two children	40	10,350	4,140	21.06	13,520	33,178	14,520	34,178
2003								
No children	7.65	4,990	382	7.65	6,240	11,230	7,240	12,230
One child	34	7,490	2,547	15.98	13,730	29,666	14,730	30,666
Two children	40	10,510	4,204	21.06	13,730	33,692	14,730	34,692

Source: Joint Committee on Taxation.

An individual is not eligible for the EIC if the aggregate amount of disqualified income of the taxpayer for the taxable year exceeds $2,600 (for 2003). This threshold is indexed. Disqualified income is the sum of:

1. Interest (taxable and tax exempt),
2. Dividends,
3. Net rent and royalty income (if greater than zero),
4. Capital gains net income, and
5. Net passive income (if greater than zero) that is not self-employment income.

For taxpayers with earned income (or AGI, if greater) in excess of the beginning of the phaseout range, the maximum EIC amount is reduced by the phaseout rate multiplied by the amount of earned income (or AGI, if greater) in excess of the beginning of the phaseout range. For taxpayers with earned income (or AGI, if greater) in excess of the end of the phaseout range, no credit is allowed.

Individuals are ineligible for the credit if they do not include their taxpayer identification number and their qualifying child's number (and, if married, their spouse's taxpayer identification number) on their tax return. Solely for these purposes and for purposes of the present-law identification test for a qualifying child, a taxpayer identification number is defined as a Social Security number issued to an individual by the Social Security Administration other than a number issued under section 205(c)(2)(B)(i)(II) (or that portion of sec. 205(c)(2)(B)(i)(III) relating to it) of the Social Security Act regarding the issuance of a number to an individual applying for or receiving federally funded benefits.

If an individual fails to provide a correct taxpayer identification number, such omission will be treated as a mathematical or clerical error by the Internal Revenue Service. Similarly, if an individual who claims the credit with respect to net earnings from self-employment fails to pay the proper amount of self-employment tax on such net earnings, the failure will be treated as a mathematical or clerical error for purposes of the amount of credit allowed.

The EIC is relatively unique because it is a refundable tax credit; i.e., if the amount of the credit exceeds the taxpayer's Federal income tax liability, the excess is payable to the taxpayer as a direct transfer payment. In this sense, the EIC is like other Federal programs that provide poor and low-income families with public benefits. However, the EIC differs from other Federal programs in that its benefits require earnings.

Under an advance payment system, available since 1979, eligible taxpayers may elect to receive the credit in their paychecks, rather than waiting to claim a refund on their tax return filed by April 15 of the following year. In 1993, Congress required that the IRS begin to notify eligible taxpayers of the advance payment option.

INTERACTION WITH MEANS-TESTED PROGRAMS

The treatment of the EIC for purposes of Aid to Families with Dependent Children (AFDC) and food stamp benefit computations has varied since inception of the credit. When enacted in 1975, the credit was not considered income in determining AFDC and food stamp benefits, and the credit could not be received on an advance basis. From January 1979 through September 1981, the credit was treated as earned income when actually received.

From October 1981 to September 1984, the amount of the credit was treated as earned income and was imputed to the family even though it may not have been received as an advance payment. Pursuant to the Deficit Reduction Act of 1984, the credit was treated as earned income only when received, either as an advance payment or as a refund after the conclusion of the year.

Under the Family Support Act of 1988, States generally were required to disregard any advance payment or refund of the EIC when calculating AFDC eligibility or benefits. However, the credit was counted against the gross income eligibility standard (185 percent of the State need standard) for both applicants and recipients.

OBRA 1990 specified that, effective January 1, 1991, the EIC was not to be taken into account as income (for the month in which the payment is received or any following month) or as a resource (for the month in which the payment is received or the following month) for determining the eligibility or amount of benefit for AFDC, Medicaid, SSI, food stamps, or low-income housing programs.

EFFECT OF PROVISION

More than 19.2 million taxpayers are expected to take advantage of the EIC for 2003 (Table 13-13). Their claims are expected to total $34 billion, approximately 90 percent of which will be refunded as direct payments to these families (Table 13-14). As Table 13-13 also shows, approximately 75 percent of the tax relief or direct spending from the EIC accrues to taxpayers who file as singles or heads of households.

Table 13-14 shows the total amount of EIC received for each of the calendar years since the inception of the program, the number of recipient families, the amount of the credit received as refunded payments, and the average amount of credit received per family.

TABLE 13-13 -- DISTRIBUTION OF EARNED INCOME CREDIT, 2003

Income class	Joint returns		Head of household and single returns		All returns	
	Number	Amount	Number	Amount	Number	Amount
Below $10,000	510	$816	5,062	$6,129	5,572	$6,945
$10,000-$20,000	1,033	2,851	4,505	10,901	5,538	13,752
$20,000-$30,000	1,327	3,007	3,207	6,758	4,534	9,766
$30,000-$40,000	1,229	1,543	1,765	1,976	2,994	3,519
$40,000-$50,000	397	262	210	130	608	392
$50,000-$75,000	36	37	2	2	38	39
$75,000 and over	0	0	0	0	0	0
Total	4,533	8,516	14,752	25,896	19,284	34,412
Percent distribution by type of return	23.5	24.8	76.5	75.3	100.0	100.0

Note- Numbers in thousands; amount in millions of dollars. Detail may not add due to rounding.
Source: Joint Committee on Taxation.

TABLE 13-14 -- EARNED INCOME CREDIT: NUMBER OF RECIPIENTS AND AMOUNT OF CREDIT, 1975-2003

Year	Number of recipient families (thousands)	Total amount of credit (millions)	Refunded portion of credit (millions)	Average credit per family
1975	6,215	$1,250	$900	$201
1976	6,473	1,295	890	200
1977	5,627	1,127	880	200
1978	5,192	1,048	801	202
1979	7,135	2,052	1,395	288
1980	6,954	1,986	1,370	286
1981	6,717	1,912	1,278	285
1982	6,395	1,775	1,222	278
1983	7,368	1,795	1,289	224
1984	6,376	1,638	1,162	257
1985	7,432	2,088	1,499	281
1986	7,156	2,009	1,479	281
1987	8,738	3,391	2,930	450
1988	11,148	5,896	4,257	529
1989	11,696	6,595	4,636	564
1990	12,542	7,542	5,266	601
1991	13,665	11,105	8,183	813
1992	14,097	13,028	9,959	924
1993	15,117	15,537	12,028	1,028
1994	19,017	21,105	16,598	1,110
1995	19,334	25,956	20,829	1,342
1996	19,464	28,825	23,157	1,481
1997	19,391	30,389	24,396	1,567
1998	20,273	32,340	27,175	1,595
1999	19,259	31,901	27,604	1,656
2000	19,277	32,296	27,803	1,675
2001	19,593	33,376	29,043	1,704
2002[1]	19,795	35,784	31,769	1,808
2003[1]	19,284	34,412	30,869	1,784

[1] Preliminary
Source: For 1975-2001, Internal Revenue; for 2002-2003, Joint Committee on Taxation.

EXCLUSION OF PUBLIC ASSISTANCE AND SSI BENEFITS

LEGISLATIVE HISTORY

While there is no specific statutory authorization, a number of revenue rulings under Code section 61 have held that specific types of public assistance payments are excludable from gross income. Revenue rulings generally exclude government transfer payments from income because they are considered to be general welfare payments. In addition, taxing benefits provided in kind, rather than in cash, would require valuation of these benefits, which could create administrative difficulties.

EXPLANATION OF PROVISION

The Federal Government provides tax-free public assistance benefits to individuals either by cash payments or by provision of certain goods and services at reduced cost or free of charge. Cash payments come mainly from the AFDC and Supplemental Security Income (SSI) Programs. Inkind payments include food stamps, Medicaid, and housing assistance. None of these payments is subject to income tax.

DEPENDENT CARE TAX CREDIT

LEGISLATIVE HISTORY

Under section 21 of the Internal Revenue Code, taxpayers are allowed an income tax credit for certain employment-related expenses for dependent care. The Internal Revenue Code of 1954 provided a deduction to gainfully employed women, widowers, and legally separated or divorced men for certain employment-related dependent care expenses. The deduction was limited to $600 per year and phased out for families with incomes between $4,500 and $5,100.

The Revenue Act of 1964 made husbands with incapacitated wives eligible for the dependent care deduction and raised the threshold for the income phaseout from $4,500 to $6,000.

The Revenue Act of 1971: (1) made any individual who maintained a household and was gainfully employed eligible for the deduction; (2) modified the definition of a dependent; (3) raised the deduction limit to $4,800 per year; (4) increased from $6,000 to $18,000 the income level at which the deduction began to phase out; (5) allowed the deduction for household services in addition to direct dependent care; and (6) limited the deduction with respect to services outside the taxpayer's household.

The Tax Reduction Act of 1975 increased from $18,000 to $35,000 the income level at which the deduction began to be phased out.

The Tax Reform Act of 1976 replaced the deduction with a nonrefundable credit. This change broadened eligibility to those who do not itemize deductions and provided relatively greater benefit to low-income taxpayers. In addition, the act eased the rules related to family status and simplified the computation.

In the Economic Recovery Tax Act of 1981, Congress provided a higher ceiling on creditable expenses, a larger credit for low-income individuals, and modified rules relating to care provided outside the home.

The Family Support Act of 1988 reduced to 13 the age of a child for whom the dependent care credit may be claimed, reduced the amount of eligible expenses by the amount of expenses excludable from that taxpayer's income under the dependent care exclusion, lowered from five to two the age at which a taxpayer identification number had to be submitted for children for whom the credit was claimed, and disallowed the credit unless the taxpayer reports on her tax return the correct name, address, and taxpayer identification number (generally, an employer identification number or a Social Security number) of the dependent care provider.

The Small Business Job Protection Act of 1996 required a TIN for all children for whom a dependent care credit may be claimed.

EGTRRA increased the credit rate for lower-income taxpayers, as well as the maximum eligible expense amount for the credit for all taxpayers.

EXPLANATION OF PROVISION

A taxpayer may claim a nonrefundable credit against income tax liability for up to 35 percent of a limited amount of employment-related dependent care expenses. Eligible employment-related expenses are limited to $3,000 if there is one qualifying dependent or $6,000 if there are two or more qualifying dependents. Generally, a qualifying individual is a dependent under the age of 13 or a physically or mentally incapacitated dependent or spouse.

Employment-related dependent care expenses are expenses for the care of a qualifying individual incurred to enable the taxpayer to be gainfully employed, other than expenses incurred for an overnight camp. For example, amounts paid for the services of a housekeeper generally qualify if such services are performed at least partly for the benefit of a qualifying individual; amounts paid for a chauffeur or gardener do not qualify.

Expenses that may be taken into account in computing the credit generally may not exceed an individual's earned income or, in the case of married taxpayers, the earned income of the spouse with the lesser earnings. Thus, if one spouse is not working, no credit generally is allowed. Also, the amount of expenses eligible for the dependent care credit is reduced, dollar for dollar, by the amount of expenses excludable from that taxpayer's income under the dependent care exclusion (discussed below).

The 35-percent credit rate is reduced, but not below 20 percent, by 1 percentage point for each $2,000 (or fraction thereof) of AGI above $15,000.

Because married couples are required to file a joint return to claim the credit, a married couple's combined AGI is used for purposes of this computation.

EFFECT OF PROVISION

From 1976 to 2001, the number of families that claimed the dependent care credit increased from 2.7 to a projected 6.3 million, the aggregate amount of credits claimed increased from $0.5 to $2.7 billion, and the average amount of credit claimed per family increased from $206 to $440 (table 13-15).

Changes made in the Family Support Act of 1988 reduced the use of the credit in 1989. The number of families who claimed the credit dropped by about one-third and the amount of credit claimed declined by $1.373 billion.

Data for 1997 from the Internal Revenue Service show that about 10 percent of the benefit from the credit accrues to families with AGI of less than $20,000; about 42 percent to families with AGI between $20,000 and $50,000; and about 48 percent to families with AGI above $50,000.

TABLE 13-15 -- DEPENDENT CARE TAX CREDIT: NUMBER OF FAMILIES AND AMOUNT OF CREDIT, 1976-2001

Year	Number of returns claiming credit (thousands)	Aggregate amount of credit claimed (millions)	Average credit claimed per return
1976	2,660	$548	$206
1977	2,910	521	179
1978	3,431	654	191
1979	3,833	793	207
1980	4,231	956	226
1981	4,578	1,148	251
1982	5,004	1,501	300
1983	6,367	2,051	322
1984	7,456	2,649	351
1985	8,417	3,127	372
1986	8,950	3,398	380
1987	8,520	3,438	404
1988	9,023	3,813	423
1989	6,028	2,440	405
1990	6,144	2,549	415
1991	5,896	2,521	427
1992	5,980	2,527	433
1993	6,090	2,559	419
1994	6,012	2,526	420
1995	5,964	2,518	445
1996	6,003	2,663	444
1997	5,796	2,464	425
1998	6,128	2,661	434
1999	6,182	2,677	432
2000	6,368	2,794	439
2001[1]	6,335	2,741	440

[1] Preliminary.

Source: Joint Committee on Taxation.

HOPE CREDIT AND LIFETIME LEARNING CREDIT

The Taxpayer Relief Act of 1997 established the HOPE credit and the lifetime learning credit as nonrefundable credits against Federal income tax liability for qualified tuition and fees required for the attendance of an eligible student at an eligible educational institution.

The HOPE credit rate is 100 percent of the first $1,000 of qualified tuition and fees per eligible student per year, and 50 percent of the next $1,000 of qualified tuition and fees per eligible student per year. The HOPE credit is available only for the first two years of postsecondary education. The qualified tuition and fees must be incurred on behalf of the taxpayer, the taxpayer's spouse, or a dependent. Charges and fees associated with meals, lodging, books, student activities, athletics, insurance, transportation, and similar personal, living, or family expenses are not eligible for the credit. An eligible student for purposes of the HOPE credit is a student enrolled in a degree, certificate, or other program on at least a half-time basis. Eligible educational institutions are defined by reference to section 481 of the Higher Education Act of 1965. Such institutions generally are accredited postsecondary educational institutions offering credit toward a bachelor's degree, an associate's degree, or another recognized postsecondary credential. Certain proprietary institutions and postsecondary vocational institutions are also eligible educational institutions. The $1,500 maximum HOPE credit amount is indexed for inflation.

The lifetime learning credit rate is 20 percent of up to $10,000 in qualified tuition and fees for a maximum credit of $2,000. In contrast to the HOPE credit, the lifetime learning credit is available for an unlimited number of years of education. Also in contrast to the HOPE credit, which requires a half-time or greater enrollment status, the lifetime learning credit is available with respect to any course of instruction at an eligible educational institution to acquire or improve job skills, regardless of enrollment status. Qualified tuition and fees are defined in the same manner as under the HOPE credit provisions. As with the HOPE credit, eligible students are the taxpayer, the taxpayer's spouse, or a dependent. In contrast to the HOPE credit, the maximum amount of the lifetime learning credit that may be claimed on a taxpayer's return will not vary with the number of students in the taxpayer's family. The maximum lifetime learning credit amount is not indexed for inflation.

Eligibility for the HOPE credit and the lifetime learning credit is phased out ratably for taxpayers with modified adjusted gross income (AGI) between $41,000 and $51,000 ($83,000 and $103,000 for joint returns). These phase-outs are indexed for inflation. For a taxable year, a taxpayer may elect with respect to an eligible student either the HOPE credit, the lifetime learning credit, or the deduction for qualified tuition and related expenses. For purposes of both the HOPE credit and the lifetime learning credit, if a parent claims a child as a dependent, then only the parent may claim the credit.

QUALIFIED TUITION PROGRAMS AND COVERDELL EDUCATION SAVINGS ACCOUNTS

The Taxpayer Relief Act of 1997 and EGTRRA modified section 529 of the Tax Code, which governs the tax treatment of qualified tuition programs. Section 529 was enacted as part of the Small Business Job Protection Act of 1996, and provided tax-exempt status and deferral of tax on earnings of qualified State tuition programs. The Taxpayer Relief Act of 1997 also provided that taxpayers may establish education IRAs. (Renamed Coverdell Education Savings Accounts by P.L. 107-22). EGTRRA extended the provisions to programs established by eligible education institutions.

Qualified State tuition programs are programs established and maintained by a State or agency or instrumentality thereof or by one or more eligible educational institutions under which persons may: (1) purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to a waiver or payment of qualified higher education expenses of the beneficiary; or (2) in the case of a program established by a State agency or instrumentality thereof make contributions to an account that is established for the purpose of meeting qualified higher education expenses of a designated beneficiary. Qualified higher education expenses are defined as tuition, fees, books, supplies, and equipment required for the enrollment of or attendance at a college or university (or certain vocational schools). The Taxpayer Relief Act of 1997 expanded the definition of qualified expenses to include room and board expenses. Contributions to qualified tuition programs are not deductible. EGTRRA provided that earnings on qualified tuition programs are not includible in income if used for qualified expenses. Distributions from a qualified tuition program also entitle the distributee to claim either the HOPE or the lifetime learning credit with respect to education expenses paid with such distributions, assuming the other requirements for claiming the HOPE credit or the lifetime learning credit are satisfied. There are no income limits for participation in qualified tuition programs, though contributions must be limited by the program to amounts no greater than an amount necessary to provide for the education of the beneficiary. Withdrawals of earnings that are not used for qualified expenses are includible in income and also are subject to an additional 10 percent tax.

A Coverdell Education Savings Account is a trust or custodial account created exclusively for the purpose of paying qualified higher education expenses of a named beneficiary. Contributions to a Coverdell Education Savings Account are not deductible; earnings on contributions are not currently includable in income. Contributions to a Coverdell education savings account are limited to $2,000 per year per beneficiary. The contribution limit is phased out ratably for contributions with modified AGI between $95,000 and $110,000 ($190,000 and $220,000 for joint returns). With respect to post-secondary education, qualified expenses are the same as those for qualified tuition programs. Qualified expenses also include elementary and secondary education expenses. Qualified elementary and secondary education expenses include tuition, fees, academic tutoring, special needs services, books, supplies, room and board, and education-related computer equipment and software. Withdrawals of earnings from education IRAs are excludable from income provided that such withdrawals are used to pay for qualified higher education expenses. If the earnings are not used for qualified expenses, they are includable in income and are also subject to an additional 10-percent penalty tax.

STUDENT LOAN INTEREST DEDUCTION

The Taxpayer Relief Act of 1997 provided for the above-the-line deductibility of interest on qualified education loans. A qualified education loan is generally defined as any indebtedness incurred to pay for the qualified higher education expenses of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred in attending either postsecondary educational institutions and certain vocational schools defined by reference to section 481 of the Higher Education Act of 1965, or institutions conducting internship or residency programs leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility conducting postgraduate training. Qualified higher education expenses are defined as the student's cost of attendance as defined in section 472 of the Higher Education Act of 1965 (generally, tuition, fees, room and board, and related expenses), reduced by: (1) any amount excluded under section 135 (i.e., U.S. saving bonds used to pay higher education tuition and fees); (2) any amount distributed from a Coverdell education savings account or qualified tuition program and excluded from gross income; and (3) the amount of any scholarship or fellowship grants excludable from gross income under section 117, as well as any other tax-free education benefits, such as employer-provided educational assistance that is excludable from the employee's gross income under section 127.

The maximum deduction is $2,500 and is not indexed for inflation. This deduction is phased out ratably for individuals with modified AGI of $50,000-$65,000 ($100,000 and $130,000 for joint returns). These income ranges are indexed for inflation and rounded down to the closest multiple of $5,000.

QUALIFIED TUITION DEDUCTION

The Economic Growth and Tax Relief Reconciliation Act of 2001 added an above-the-line deduction for qualified tuition and related expenses paid by the taxpayer during a taxable year. Qualified expenses are defined in the same manner as for the purposes of the HOPE credit.

In 2002 and 2003, taxpayers with adjusted gross income that does not exceed $65,000 ($130,000 in the case of married couples filing joint returns) are entitled to a maximum deduction of $3,000 per year. Taxpayers with adjusted gross income above these thresholds would not be entitled to a deduction. In 2004 and 2005, taxpayers with adjusted gross income that does not exceed

$65,000 ($130,000 in the case of married taxpayers filing joint returns) are entitled to a maximum deduction of $4,000 and taxpayers with adjusted gross income that does not exceed $80,000 ($160,000 in the case of married taxpayers filing joint returns) are entitled to a maximum deduction of $2,000. The deduction is not available in 2006 and thereafter.

Taxpayers are not eligible to claim the deduction and a HOPE or Lifetime Learning Credit in the same year with respect to the same student. A taxpayer may not claim a deduction for amounts taken into account in determining the amount excludable due to a distribution (i.e., the earnings and contribution portion of a distribution) from a Coverdell education savings account or the amount of interest excludable with respect to education savings bonds. A taxpayer may not claim a deduction for the amount of a distribution from a qualified tuition program that is excludable from income; however, a taxpayer may claim a deduction for the amount of a distribution from a qualified tuition program that is not attributable to earnings.

EXCLUSION FOR EMPLOYER-PROVIDED DEPENDENT CARE

LEGISLATIVE HISTORY

The value of certain employer-provided dependent care is excluded from the employee's gross income. The Economic Recovery Tax Act of 1981 added this exclusion (sec. 129) and amended Code sections 3121(a)(18) and 3306(b)(13) to exclude such employer-provided dependent care from wages for purposes of the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA). The Tax Reform Act of 1986 modified the nondiscrimination rules and limited the exclusion to $5,000 a year ($2,500 in the case of a separate return by a married individual). The Family Support Act of 1988 required the amount of employer-provided dependent care excluded from the taxpayer's income to reduce, dollar for dollar, the amount of expenses eligible for the dependent care tax credit.

EXPLANATION OF PROVISION

Amounts paid or incurred by an employer for dependent care assistance provided to an employee generally are excluded from the employee's gross income if the assistance is furnished under a program meeting certain requirements. These requirements include that the program be described in writing, satisfy certain nondiscrimination rules, and provide for notification to all eligible employees. The type of dependent care eligible for the exclusion is the same as the type eligible for the dependent care credit.

The dependent care exclusion is limited to $5,000 per year except that a married taxpayer filing a separate return may exclude only $2,500. Amounts excluded from gross income generally are excludable from wages for employment tax purposes. Dependent care expenses excluded from income are not eligible for the dependent care tax credit.

EFFECT OF PROVISION

The exclusion provides an incentive to taxpayers with expenses for dependent care to seek compensation in the form of dependent care assistance rather than in cash subject to taxation. This incentive is of greater value to employees in higher tax brackets.

Many employees covered by the exclusion for employer-provided dependent care also are eligible to use the dependent care tax credit. While the limitations on the exclusion and the credit differ, the credit generally is less valuable than the exclusion for taxpayers who are above the 15-percent tax bracket.

According to a survey of private firms with 100 or more workers conducted by the U.S. Bureau of Labor Statistics (1993), nearly one-tenth of full-time workers at these firms were eligible for child care benefits provided by the employer in the form of on-site or near-site child care facilities or through direct reimbursement of employee expenses. A more prevalent form of providing dependent care benefits is through reimbursement accounts, which may cover other nontaxable fringe benefits, such as out-of-pocket health care expenses, in addition to dependent care. Slightly over one-third of full-time employees at large- and medium-sized firms were eligible for such accounts in 1991.

WORK OPPORTUNITY TAX CREDIT

The work opportunity tax credit is available on an elective basis for employers hiring individuals from one or more of eight targeted groups. The targeted groups are: (1) families eligible to receive benefits under the Title IV-A Temporary Assistance for Needy Families Program (TANF; the successor to AFDC); (2) qualified ex-felons; (3) vocational rehabilitation referrals; (4) qualified summer youth employees; (5) qualified veterans; (6) youths who reside in an empowerment zone or enterprise community; (7) families receiving food stamps; and (8) persons receiving certain Supplemental Security Income (SSI) benefits.

The credit generally is equal to 40 percent (25 percent for employment of 400 hours or less) of qualified wages. Qualified wages consist of wages attributable to service rendered by a member of a targeted group during the 1-year period beginning with the day the individual begins work for the employer. For a vocational rehabilitation referral, however, the period will begin on the day the individual begins work for the employer on or after the beginning of the individual's vocational rehabilitation plan as under prior law.

Generally, no more than $6,000 of wages during the first year of employment is permitted to be taken into account with respect to any individual.

Thus, the maximum credit per individual is $2,400. With respect to qualified summer youth employees, the maximum credit is 40 percent of up to $3,000 of qualified first-year wages, for a maximum credit of $1,200.

In general, an individual is not to be treated as a member of a targeted group unless: (1) on or before the day the individual begins work for the employer, the employer received in writing a certification from the designated local agency that the individual is a member of a specific targeted group; or (2) on or before the day the individual is offered work with the employer, a prescreening notice is completed with respect to that individual by the employer and within 21 days after the individual begins work for the employer, the employer submits such notice, signed by the employer and the individual under penalties of perjury, to the designated local agency as part of a written request for certification. The prescreening notice will contain the information provided to the employer by the individual that forms the basis of the employer's belief that the individual is a member of a targeted group.

No credit is allowed for wages paid unless the eligible individual is employed by the employer for at least 120 hours. The credit percentage is 25 percent for employment of 400 hours or less, assuming that the minimum employment period is satisfied with respect to that employee. For employment of more than 400 hours, the credit percentage is 40 percent.

The credit is effective for wages paid or incurred to a qualified individual who begins work for an employer after September 30, 1996, and before January 1, 2004.

WELFARE-TO-WORK TAX CREDIT

The Code provides to employers a tax credit on the first $20,000 of eligible wages paid to qualified long-term family assistance (TANF) recipients during the first 2 years of employment. The credit is 35 percent of the first $10,000 of eligible wages in the first year of employment and 50 percent of the first $10,000 of eligible wages in the second year of employment. The maximum credit is $8,500 per qualified employee.

Qualified long-term family assistance recipients are: (1) members of a family that has received TANF benefits for at least 18 consecutive months ending on the hiring date; (2) members of a family that has received TANF benefits for a total of at least 18 months (whether or not consecutive) after the date of enactment of this credit if they are hired within two years after the date that the 18-month total is reached; and (3) members of a family who are no longer eligible for TANF because of either Federal or State time limits, if they are hired within two years after the Federal or State time limits made the family ineligible for family assistance.

Eligible wages include cash wages paid to an employee plus amounts paid by the employer for the following: (1) educational assistance excludable under a section 127 program (or that would be excludable but for the expiration of sec. 127); (2) health plan coverage for the employee, but not more than the applicable premium defined under section 4980B(f)(4); and (3) dependent care assistance excludable under section 129.

The welfare to work credit is effective for wages paid or incurred to a qualified individual who begins work for an employer on or after January 1, 1998, and before January 1, 2004.

EXCLUSION OF WORKERS' COMPENSATION AND SPECIAL BENEFITS FOR DISABLED COAL MINERS

LEGISLATIVE HISTORY

Workers' compensation benefits generally are not taxable under section 104(a)(1) of the Internal Revenue Code. Workers' compensation benefits are treated as Social Security benefits to the extent that they reduce Social Security benefits received (see above). This exclusion from gross income was first codified in the Revenue Act of 1918. The Ways and Means Committee report for that act suggests that such payments were not subject to tax even prior to the 1918 act.

Payments made to coal miners or their survivors for death or disability resulting from pneumoconiosis (black lung disease) under the Federal Coal Mine Health and Safety Act of 1969 (as amended) are excluded from gross income. Payments made as a result of claims filed before December 31, 1972, originally were excluded from Federal income tax by the Federal Coal Mine Health and Safety Act of 1969. Later payments are excluded from gross income because they are considered to be in the nature of workers' compensation (Rev. Rul. 72-400, 1972-2 C.B. 75).

EXPLANATION OF PROVISION

Gross income does not include amounts received as workers' compensation for personal injuries or sickness. This exclusion also applies to benefits paid under a workers' compensation act to a survivor of a deceased employee.

Benefits for disabled coal miners (black lung benefits) are not includable in gross income.

There are two types of black lung programs. The first involves Federal payments to coal miners and their survivors due to death or disability, payable for claims filed before July 1, 1973 (December 31, 1973, in the case of survivors). This program provided total annual payments of around $672 million to approximately 143,000 beneficiaries in December 1995 (Social Security Administration, 1996).

The second program requires coal mine operators to ensure payment of black lung benefits for claims filed on or after July 1, 1973 (December 31, 1973, in the case of survivors) in a federally mandated workers' compensation program. Benefits include medical treatment as well as cash payments. These benefits are paid from a trust fund financed by an excise tax on coal production if there is no responsible operator (an operator for whom the miner worked for at least 1 year) or if the responsible operator is in default. This program provided total annual payments of around $610 million to approximately 156,550 claimants in 1986 (U.S. Department of Labor, 1989, tables 3 & 6).

ADDITIONAL STANDARD DEDUCTION FOR THE ELDERLY AND BLIND

LEGISLATIVE HISTORY

From 1954 through 1986, an additional personal exemption was allowed for a taxpayer or a spouse who was 65 years or older at the close of the year. An additional personal exemption also was allowed for a taxpayer or a spouse who was blind.

The Tax Reform Act of 1986 repealed the additional personal exemption for the elderly and blind and replaced it with an additional standard deduction amount. These additional standard deduction amounts are adjusted for inflation.

EXPLANATION OF PROVISION

The additional standard deduction amount for the elderly or the blind is $950 in 2003 for an elderly or a blind individual who is married (whether filing jointly or separately) or is a surviving spouse, and $1,900 for such an individual who is both elderly and blind. The additional amount is $1,150 for a head of household who is elderly or blind ($2,300, if both), and for a single individual (i.e., an unmarried individual other than a surviving spouse or head of household) who is elderly or blind.

The definitions of elderly and blind status have not been changed since 1954. An elderly person is an individual who is at least 65 years of age. Blindness is defined in terms of the ability to correct a deficiency in distance vision or the breadth of the area of vision. An individual is blind only if central vision acuity is not better than 20/200 in the better eye with correcting lenses, or if visual acuity is better than 20/200 but is accompanied by a limitation in the fields of vision such that the widest diameter of the visual field subtends an angle no greater than 20 degrees.

EFFECT OF PROVISION

In 2000, approximately 11.3 million taxpayers claimed the extra standard deduction. About 76 percent of the 11.3 million beneficiaries had incomes of less than $40,000.

TAX CREDIT FOR THE ELDERLY AND CERTAIN DISABLED INDIVIDUALS

LEGISLATIVE HISTORY

The present tax credit for individuals who are age 65 or older, or who have retired on permanent and total disability, was enacted in the Social Security amendments of 1983 (Code sec. 22). This credit replaced the previous credit for the elderly, which had been enacted in the Tax Reform Act of 1976. Prior to that provision, the tax law provided a retirement income credit, which initially was enacted in the Internal Revenue Code of 1954.

EXPLANATION OF PROVISION

Individuals who are age 65 or older may claim a nonrefundable income tax credit equal to 15 percent of a base amount. The credit also is available to an individual, regardless of age, who is retired on disability and who was permanently and totally disabled at retirement. For this purpose, an individual is considered permanently and totally disabled if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death, or that has lasted or can be expected to last for a continuous period of not less than 12 months. The individual must furnish proof of disability to the IRS.

The maximum base amount for the credit is $5,000 for unmarried elderly or disabled individuals and for married couples filing a joint return if only one spouse is eligible; $7,500 for married couples filing a joint return with both spouses eligible; or $3,750 for married couples filing separate returns. For a nonelderly, disabled individual the initial base amount is the lesser of the applicable specified amount or the individual's disability income for the year. Consequently, the maximum credit available is $750 (15 percent of $5,000), $1,125 (15 percent of $7,500), or $562.50 (15 percent of $3,750).

The maximum base amount is reduced by the amount of certain nontaxable income of the taxpayer, such as nontaxable pension and annuity income or nontaxable Social Security, railroad retirement, or veterans' nonservice-related disability benefits. In addition, the base amount is reduced by one-half of the taxpayer's AGI in excess of certain limits: $7,500 for a single individual, $10,000 for married taxpayers filing a joint return, or $5,000 for married taxpayers filing separate returns. These computational rules reflect that the credit is designed to provide tax benefits to individuals who receive only taxable retirement or disability income, or who receive a combination of taxable retirement or disability income plus Social Security benefits that generally are comparable to the tax benefits provided to individuals who receive only Social Security benefits (including Social Security disability benefits).

EFFECT OF PROVISION

In 2000, $33 million in elderly and disabled credit was claimed. Though the number of families claiming the credit has fallen significantly, the average credit granted has been relatively stable since the credit was modified by the Social Security Amendments of 1983, as shown in Table 13-16.

TABLE 13-16 -- CREDIT FOR THE ELDERLY AND DISABLED 1976-2000

Year	Number of families that received credit (thousands)	Total amount of credit (millions)	Average credit per return
1976	1,011	$206	$204
1977	569	93	163
1978	689	145	210
1979	607	132	217
1980	562	135	240
1981	474	124	262
1982	483	131	271
1983	423	116	275
1984	475	107	225
1985	460	106	230
1986	430	86	200
1987	354	67	189
1988	357	69	193
1989	320	65	202
1990	342	63	183
1991	285	57	200
1992	240	51	213
1993	223	49	220
1994	222	47	210
1995	252	48	191
1996	168	32	189
1997	190	41	217
1998	180	36	198
1999	182	34	185
2000	156	33	209

Source: Joint Committee on Taxation.

TAX PROVISIONS RELATED TO HOUSING

OWNER-OCCUPIED HOUSING

Legislative History

Deductibility of Mortgage Interest—Prior to the Tax Reform Act of 1986, all interest payments on indebtedness incurred for personal use (e.g., to purchase consumption goods) were deductible in computing taxable income. The 1986 act amended section 163(h) of the Internal Revenue Code to disallow deductions for all personal interest except for interest on indebtedness secured by a first or second home.

In the Omnibus Budget Reconciliation Act of 1987, Congress further restricted the deductibility of mortgage interest. Only two classes of interest were distinguished as deductible: interest on acquisition indebtedness and interest on home equity indebtedness. Acquisition indebtedness, defined as indebtedness secured by a residence and used to acquire or improve the residence by which it is secured, was limited to $1,000,000 ($500,000 in the case of a married individual filing a separate return). Home equity indebtedness, defined as any nonacquisition indebtedness secured by a residence (for example, a home equity loan), was limited to the lesser of $100,000 ($50,000 for married taxpayers filing separately) or the excess of the fair market value of the residence over the acquisition indebtedness.

Exclusion of Capital Gains for Certain Taxpayers.—In the Revenue Act of 1964, Congress introduced section 121 of the Internal Revenue Code of 1954, which permitted a one-time exclusion of all or part of the gain on the sale of a principal residence by older individuals. This exclusion was limited to homeowners who had lived in the property as a principal residence for five out of the last eight years before the property's sale or exchange. Furthermore, full exclusion was permitted only for houses that sold for $20,000 or less.

The parameters of this exclusion have been modified and expanded a number of times. Most recently, the Taxpayer Relief Act of 1997 significantly expanded the exclusion by repealing the age 55 requirements and one-time applicability, and increasing the maximum excludible amount.

Explanation of Provision

Homeowners may deduct a number of expenses related to housing as itemized deductions in computing taxable income. These include payments of interest on qualified residence debt, certain interest on home equity loans, certain payments of points (i.e., up front interest payments) on the purchase of a house, and payments of real property taxes. Interest on acquisition debt of $1,000,000 or less is fully deductible, as is any interest on debt secured by a residence that was incurred on or before October 13, 1987. Interest on home equity indebtedness of $100,000 is fully deductible for regular tax purposes, as long as the total amount of debt (acquisition plus home equity indebtedness) does not exceed the fair market value of the house. Interest on home equity indebtedness exceeding $100,000 (and incurred after October 13, 1987) or exceeding the difference between the fair market value of the home and the acquisition indebtedness is not deductible. Interest paid on home equity loans is generally not deductible in computing the alternative minimum tax.

Under present law, a taxpayer generally is able to exclude up to $250,000 ($500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. The exclusion is allowed each time a taxpayer selling or exchanging a principal residence meets the eligibility requirements, but generally no more frequently than once every two years.

To be eligible for the exclusion, a taxpayer must have owned the residence and occupied it as a principal residence for at least two of the five years prior to the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or other unforeseen circumstances is able to exclude the fraction of the $250,000 ($500,000 if married filing a joint return) equal to the fraction of two years that these requirements are met.

Effects of Provision

Preliminary tax return information for 2000 indicates that 35 million taxpayers claimed the deduction for mortgage interest. Reliable data are not yet available on how many claimed the one-time exclusion.

The favorable treatment of owner-occupied housing may affect both the home ownership rate and the share of total investment in housing in the United States.

The home ownership tax provisions may benefit neighborhoods because they encourage home ownership and home improvement. The United States has maintained a high rate of home ownership—66 percent of all American households own the homes they live in (U.S. Census Bureau, 1999, p. 729, table 1212).

The tax advantages for owner-occupied housing encourage people to invest in homes instead of taxable business investments. This shift may reduce investment in business assets in the United States. One study suggested that housing capital is 25 percent higher and other capital is 12 percent lower than it would be if tax policy provided equal treatment for all forms of capital (Mills, 1987). Currently, about one-third of net private investment goes into owner-occupied housing, so even a modest shift of investment to other assets could have sizable effects.

LOW-INCOME HOUSING CREDIT

Legislative History

The low-income rental housing tax credit was first enacted in the Tax Reform Act of 1986. The Omnibus Budget Reconciliation Act of 1989 substantially modified the credit. The Omnibus Budget Reconciliation Act of 1993 modified the credit again and made it permanent. The Community Renewal Tax Relief Act of 2000 increased and indexed the annual amount of allocable credits.

Explanation of Provision

A tax credit may be claimed by owners of residential rental property used for low-income rental housing. The credit is claimed annually, generally for a period of 10 years. New construction and rehabilitation expenditures for low-income housing projects are eligible for a maximum 70-percent present value credit, claimed annually for 10 years. The acquisition cost of existing projects that meet the substantial rehabilitation requirements and the cost of newly constructed projects receiving other Federal subsidies are eligible for a maximum 30-percent present value credit, also claimed annually for 10 years. These credit percentages are adjusted monthly based on an Applicable Federal Rate.

The credit amount is based on the qualified basis of the housing units serving the low-income tenants. A residential rental project will qualify for the credit only if: (1) 20 percent or more of the aggregate residential rental units in the project are occupied by individuals with 50 percent or less of area median income; or (2) 40 percent or more of the aggregate residential rental units in the project are occupied by individuals with 60 percent or less of area median income. These income figures are adjusted for family size. Maximum rents that may be charged families in units on which a credit is claimed depend on the number of bedrooms in the unit. The rent limitation is 30 percent of the qualifying income of a family deemed to have a size of 1.5 persons per bedroom (e.g., a two-bedroom unit has a rent limitation based on the qualifying income for a family of three).

Credit eligibility also depends on the existence of a 30-year extended low-income use agreement for the property. If property on which a low-income housing credit is claimed ceases to qualify as low-income rental housing or is disposed of before the end of a 15-year credit compliance period, a portion of the credit may be recaptured. The 30-year extended use agreement creates a State law right to enforce low-income use for an additional 15 years after the initial 15-year recapture period.

In order for a building to be a qualified low-income building, the building owner generally must receive a credit allocation from the appropriate credit authority. An exception is provided for property that is substantially financed with the proceeds of tax-exempt bonds subject to the State's private-activity bond volume limitation. The low-income housing credit is allocated by State or local government authorities subject to an annual limitation for each State based on State population. The annual credit allocation per State for 2003 is $1.75 per resident or $2.03 million in total, if larger.

Effect of Provision

Comprehensive data from tax returns concerning the low-income housing tax credit are unavailable. Table 13-17 presents data from a survey of State credit allocating agencies. These data indicate that annual allocation of available credit authority generally has been 90 percent or greater since 1994. Year-to-year variations in credit allocation probably reflect changes in Federal law affecting the credit and changing economic conditions affecting the construction and housing markets. For example, 1990 was the first year following substantial modification to the credit and included a temporary period during which State credit allocating agencies were limited to allocating authority of $0.9375 per capita rather than the $1.25 per capita of present and prior law.

An allocation percentage of less than 100 percent does not imply that some credits available for allocation to low-income housing projects go unused. Since 1990, States are permitted to carry forward unused credit subsequently made available for allocation by other States. Thus, the amount allocated in any one year could be less than the States' authority, but such authority may ultimately be allocated.

TABLE 13-17 -- ALLOCATION OF THE LOW-INCOME HOUSING CREDIT, 1987-2000

Years	Authority (millions)	Allocated (millions)	Allocated (percent)
1987	313.1	62.9	20.1
1988	311.5	209.8	67.4
1989	314.2	307.2	97.8
1990	317.7	213.1	67.0
1991[1]	497.3	400.6	80.6
1992[1]	476.4	332.7	70.0
1993[1]	564.4	424.7	77.7
1994[1]	523.7	495.5	94.7
1995[1]	432.6	410.9	95.0
1996[1]	391.6	379.9	97.0
1997	387.3	382.9	98.9
1998	376.8	373.8	99.0
1999	373.6	370.0	99.0
2000	382.3	378.7	99.0

[1] Increased authority includes credits unallocated from prior years carried over to the current year.
Source: Survey of the State allocating agencies conducted by the National Council of State Housing Agencies.

TAX CREDIT AND EXCLUSION FOR ADOPTION EXPENSES

The Small Business Job Protection Act of 1996 (Public Law 104-188) enacted two tax provisions designed to reduce economic barriers to adoption. First, a tax credit of up to $5,000 (or $6,000 in the case of families adopting special-needs children from the United States) was created to help defray one-time adoption expenses (Code section 23). The credit was phased out for families with incomes above $75,000, and was unavailable to families with incomes above $115,000. Second, employees could receive an income tax exclusion of up to $5,000 per child (or $6,000 in the case of special-needs children) for employer-provided adoption assistance (Code section 137). Under the Act, the credit (other than for foreign special-needs adoptions) and the exclusion were not available after December 31, 2001.

EGTRRA and the Job Creation and Worker's Assistance Act of 2002 ("JCWAA") made several changes to these provisions. EGTRRA, as clarified by JCWWA: (1) made permanent the adoption credit and exclusion for employer-provided assistance; (2) increased the maximum credit and exclusion amounts to $10,000; (3) provided that the maximum credit and exclusion amounts for special-needs adoption expenses are available regardless of whether the taxpayer has qualified adoption expenses (effective after 2002); and (4) increased the beginning and end points of the income phase out ranges to $150,000 and $190,000, respectively, for both the credit and the exclusion.

EGTTRA also provided that the dollar limits and the income limitations of the credit and the exclusion are adjusted for inflation in taxable years beginning after December 31, 2002. For 2003, the maximum credit and exclusion amounts are $10,160 and the beginning and end points of the income phase out ranges are $152,390 and $192,390, respectively.

CHILD TAX CREDIT

The Taxpayer Relief Act of 1997 provided for a $500 ($400 for taxable year 1998) tax credit for each qualifying child under the age of 17. A qualifying child is defined as an individual for whom the taxpayer can claim a dependency exemption and who is a son or daughter of the taxpayer (or a descendant of either), a stepson or stepdaughter of the taxpayer, or an eligible foster child of the taxpayer. For taxpayers with modified AGI in excess of certain thresholds, the allowable child credit is phased out.

EGTRRA increased the child credit on a phased in basis, reaching $1,000 in 2011, and provided for limited refundability of the credit. JCWAA accelerated this increase in the credit to $1,000, effective for 2003 and 2004, and expanded the refundability of the credit.

The child credit is refundable to the extent of 10 percent of the taxpayer's earned income in excess of $10,500 (indexed for inflation) in 2003. This percentage is increased to 15 percent for calendar year 2005 and thereafter. Families with three or more children are allowed a refundable credit for the amount by which the taxpayer's Social Security taxes exceed the taxpayer's earned income credit, if that amount is greater than the refundable credit based on the taxpayer's earned income in excess of $10,500.

For taxpayers with modified AGI in excess of certain thresholds, the child credit is phased out. The phase out rate is $50 for each $1,000 of modified AGI (or fraction thereof) in excess of the threshold. For these purposes modified AGI is computed by increasing the taxpayer's AGI by the amount otherwise excluded under Code sections 911, 931, and 933 (relating to the exclusion of income of U.S. citizens or residents living abroad; residents of Guam, American Samoa, and the Northern Mariana Islands; and residents of Puerto Rico, respectively).

For married taxpayers filing joint returns, the threshold is $110,000. For taxpayers filing single or head of household returns, the threshold is $75,000. For married taxpayers filing separate returns, the threshold is $55,000. These thresholds are not indexed for inflation.

EFFECT OF TAX PROVISIONS ON THE INCOME AND TAXES OF THE ELDERLY AND THE POOR

Tables 13-18 and 13-19 present actual and projected values of the personal exemptions, standard deductions, additional standard deductions for the elderly and the blind, and taxable income brackets for 1996-2013. The figures for 2004-13 are based on Congressional Budget Office projections. The value to taxpayers of personal exemptions, standard deductions, and additional standard deductions for the elderly and the blind (with the exception of joint filers after 2010) will grow steadily over the 10-year period.

HYPOTHETICAL TAX CALCULATIONS FOR SELECTED FAMILIES

Table 13-20 presents examples of tax liabilities for hypothetical taxpayers. The table presents 2003 Federal income and payroll tax burdens. The worker is assumed to bear both the employer and employee shares of FICA tax (7.65 percent for each). Taxpayers claim the EIC, if eligible, and they claim the standard deduction, except where noted in the footnotes. Income sources are listed in the table's footnotes for each example.

TAX TREATMENT OF THE ELDERLY

Present law contains several provisions that reduce, or in some cases eliminate, the burden of Federal income tax on senior citizens. These provisions are: the exemption from income taxation of some or all of an individual's Social Security benefits; a tax credit for certain taxpayers who do not receive substantial Social Security income; and an additional standard deduction for taxpayers age 65 and older. These are described in detail in preceding portions of this section.

As a result of these favorable tax provisions, the tax threshold (the level of income, excluding Social Security, at which tax liability is incurred) for elderly taxpayers is very close to or above the poverty level. For example, in 2002, a single elderly individual with $5,000 in Social Security benefits can have up to $8,850 in other income without incurring tax liability (or total income of $13,850). An elderly married couple filing jointly with $5,000 in excluded Social Security benefits has a tax threshold of $15,650 (or total income of $20,650). By comparison, the poverty thresholds in 2002 for a single elderly person and an elderly couple were $8,628 and $10,874, respectively. Table 13-21 displays similar information for other years and for varying amounts of Social Security benefits.

The combination of these tax provisions means that an estimated 50 percent of elderly individuals will have no tax liability, applying 2003 tax law to 2000 population and income data (Table 13-22).

TABLE 13-18 -- ACTUAL PERSONAL EXEMPTIONS, STANDARD DEDUCTIONS, AND TAXABLE INCOME LEVELS, 1996-2003

Exemption, deduction, or income level	1996	1997	1998	1999	2000	2001	2002	2003
Personal exemptions	2,550	2,650	2,700	2,750	2,800	2,900	3,000	3,050
Standard deductions:								
Joint	6,700	6,900	7,100	7,200	7,350	7,600	7,850	9,500
Single	4,000	4,150	4,250	4,300	4,400	4,550	4,700	4,750
Head of household	5,900	6,050	6,250	6,350	6,450	6,650	6,900	7,000
Additional standard deductions for elderly/blind:								
Joint (each individual)	800	800	850	850	850	900	900	950
Single/head of household	1,000	1,000	1,050	1,050	1,100	1,100	1,150	1,150
Taxable brackets:								
First rate	0.0%	0.0%	0.0%	0.0%	0.0%	10.0%	10.0%	10.0%
Second rate	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%
Third rate	28.0%	28.0%	28.0%	28.0%	28.0%	28.0%	28.0%	25.0%
Fourth rate	31.0%	31.0%	31.0%	31.0%	31.0%	31.0%	30.0%	28.0%
Fifth rate	36.0%	36.0%	36.0%	36.0%	36.0%	36.0%	35.0%	33.0%
Sixth rate	39.6%	39.6%	39.6%	39.6%	39.6%	39.1%	38.6%	35.0%
Tax income levels:								
Single								
First rate	0	0	0	0	0	6,000	6,000	7,000
Second rate	24,000	24,650	25,350	25,750	26,250	27,050	27,950	28,350
Third rate	58,150	59,750	61,400	62,450	63,550	65,550	67,700	68,700
Fourth rate	121,300	124,650	128,100	130,250	132,600	136,750	141,250	143,350
Fifth rate	263,750	271,050	278,450	283,150	288,350	297,350	307,050	311,650
Joint								
First rate	0	0	0	0	0	12,000	12,000	14,000
Second rate	40,100	41,200	42,350	43,050	43,850	45,200	46,700	56,700
Third rate	96,900	99,600	102,300	104,050	105,950	109,250	112,850	114,500
Fourth rate	147,700	151,750	155,950	158,550	161,450	166,500	171,950	174,500
Fifth rate	263,750	271,050	278,450	283,150	288,350	297,350	307,050	311,650
Head of household								
First rate	0	0	0	0	0	10,000	10,000	10,000
Second rate	32,150	33,050	33,950	34,550	35,150	36,250	37,450	38,000

TABLE 13-18 -- ACTUAL PERSONAL EXEMPTIONS, STANDARD DEDUCTIONS, AND TAXABLE INCOME LEVELS, 1996-2003-continued

Exemption, deduction, or income level	1996	1997	1998	1999	2000	2001	2002	2003
Third rate	83,050	85,350	87,700	89,150	90,800	93,650	96,700	98,150
Fourth rate	134,500	138,200	142,000	144,400	147,050	151,650	156,600	158,950
Fifth rate	263,750	271,050	278,450	283,150	288,350	297,350	307,050	311,650

Source: Congressional Budget Office.

TABLE 13-19 -- PROJECTED PERSONAL EXEMPTIONS, STANDARD DEDUCTIONS, AND TAXABLE INCOME LEVELS, 2004-2013

Exemption, deduction, or income level	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Personal exemptions	3,100	3,200	3,250	3,350	3,400	3,500	3,600	3,700	3,750	3,850
Standard deductions:										
Joint	9,700	8,600	9,350	9,700	10,150	11,000	11,200	9,600	9,850	10,100
Single	4,850	4,950	5,100	5,200	5,350	5,500	5,600	5,750	5,900	6,050
Head of household	7,150	7,300	7,500	7,650	7,850	8,050	8,250	8,450	8,650	8,900
Additional standard deductions for elderly/blind:										
Joint (each individual)	950	950	1,000	1,000	1,050	1,100	1,100	1,150	1,150	1,200
Single/head of household	1,200	1,200	1,250	1,300	1,300	1,350	1,400	1,400	1,450	1,500
Taxable brackets										
First rate	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	0.0%	0.0%	0.0%
Second rate	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%
Third rate	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	28.0%	28.0%	28.0%
Fourth rate	28.0%	28.0%	28.0%	28.0%	28.0%	28.0%	28.0%	31.0%	31.0%	31.0%
Fifth rate	33.0%	33.0%	33.0%	33.0%	33.0%	33.0%	33.0%	36.0%	36.0%	36.0%
Sixth rate	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%	39.6%	39.6%	39.6%
Tax income levels:										
Single										
First rate	7,000	6,000	6,000	6,000	7,000	7,175	7350	0	0	0
Second rate	29,050	29,650	30,350	31,100	31,900	32,700	33500	34350	35200	36050
Third rate	70,350	71,850	73,500	75,350	77,200	79,150	81,100	83,150	85,250	87,350

Fourth rate	146,700	149,850	153,350	157,150	161,100	165,100	169,250	173,450	177,800	182,250
Fifth rate	318,950	325,800	333,400	341,650	350,200	358,950	367,900	377,100	386,550	396,200
Joint										
First rate	14,000	12,000	12,000	12,000	14,000	14,350	14,700	0	0	0
Second rate	58,100	53,350	56,750	60,000	63,800	65,400	67,000	57,350	58,800	60,250
Third rate	117,200	119,700	122,500	125,550	128,700	131,900	135,200	138,600	142,050	145,600
Fourth rate	178,600	182,450	186,700	191,300	196,100	201,000	206,050	211,200	216,450	221,850
Fifth rate	318,950	325,800	333,400	341,650	350,200	358,950	367900	377100	386550	396200
Head of household										
First rate	10,000	10,000	10,000	10,000	10,000	10,250	10,500	0	0	0
Second rate	38,900	39,750	40,650	41,650	42,700	43,800	44,850	46,000	47,150	48,350
Third rate	100,450	102,600	105,000	107,600	110,300	113,050	115,850	118,750	121,750	124,750
Fourth rate	162,650	166,150	170,000	174,250	178,600	183,050	187650	192300	197150	202050
Fifth rate	318,950	325,800	333,400	341,650	350,200	358,950	367,900	377,100	386,550	396,200

Note: Tax law for future years are those in effect as of July 2003.
Source: Congressional Budget Office.

TABLE 13-20 -- EXAMPLES OF FEDERAL INCOME AND PAYROLL TAX LIABILITIES OF HYPOTHETICAL TAXPAYERS, 2003

Type of filing unit and income	Income tax liability	FICA tax liability	Total tax liability	Overall average tax rate (percent)[1]	Overall marginal tax rate (percent)[1]
Joint filer- 3 exemptions:[2]					
$10,000	-2,547	1,530	-1,017	-9.4	14.2
$30,000	29	4,590	4,619	14.3	38.3
$50,000[3]	2,928	7,650	10,578	19.7	28.1
$100,000[4]	10,333	13,688	24,021	22.5	27.5
Head of household- 2 exemptions:[2]					
$10,000	-2,547	1,530	-1,017	-9.4	14.2
$30,000	1,035	4,590	5,625	17.4	28.1
$50,000[3]	3,585	7,650	11,235	20.9	28.1
$100,000[4]	14,710	13,688	27,858	26.1	27.5
Elderly couple filing joint return:					
$10,000[5]	0	0	0	0.0	0.0[6]
$30,000[7]	50	0	50	0.2	10.0[8]
$50,000[9]	3,275	1,530	4,805	9.5	40.0
Elderly single filer:					
$10,000[10]	0	0	0	0.0	0.0[6]
$30,000[11]	1,870	0	1,870	6.2	22.5[12]
$50,000[13]	6,791	3,060	9,851	19.1	37.4

[1] The average tax rate is total tax liability divided by income plus the employer share of FICA. The marginal rate computations also count the employer share of FICA tax as income to the employee (for both payroll and income tax purposes). Unless otherwise noted, all calculations assume the taxpayer takes the standard deduction rather than the itemized deductions.

[2] Assumes one child who is eligible for the child credit, one earner, and all income is wage income.

[3] Assumes taxpayer claims itemized deductions of $10,000.

[4] Assumes taxpayer claims itemized deductions of $20,000.

[5] All income is Social Security.

[6] If the marginal dollar of income is assumed to consist of wage income, the marginal tax rate would be 14.2 percent. This represents the FICA tax liability on this income.

[7] Of the total, $12,000 is Social Security, $12,000 is a taxable pension, and $6,000 is taxable interest.

[8] If the marginal dollar of income is assumed to consist of wage income, the marginal tax rate would be 23.5 percent, representing both the income tax liability and the FICA tax liability on this income.

[9] Same as above plus additional $10,000 of taxable interest and $10,000 of wages.

[10] Of the total, $7,500 is Social Security, and $2,500 is taxable pension.

[11] Of the total, $7,500 is Social Security, $7,500 is taxable pension, and $15,000 is taxable interest.

[12] If the marginal dollar of income is assumed to consist of wage income, the marginal tax rate would be 35.1 percent, representing both the income tax liability (22.5 percent marginal rate reflects the inclusion of 50 cents of Social Security benefits as taxable for each additional dollar of the adjusted gross income) and the FICA tax liability on this income.

[13] Same as above plus $20,000 of wages.

Source: Joint Committee on Taxation.

TABLE 13-21 -- INCOME TAX THRESHOLDS FOR ELDERLY INDIVIDUALS, 1996-2003 (ACTUAL) AND 2004-2013 (PROJECTED)

Year and filing status		Amount of Social Security Income			
		None	$2,500	$5,000	$7,500
1996:	Single	10,867	11,700	12,550	15,050
	Joint	17,267	18,100	18,933	20,900
1997:	Single	11,033	11,867	12,800	15,300
	Joint	17,533	18,367	19,200	21,300
1998:	Single	11,167	12,000	13,000	15,500
	Joint	17,800	18,633	19,467	21,700
1999:	Single	11,233	12,067	13,100	15,600
	Joint	17,933	18,767	19,600	21,900
2000:	Single	11,367	12,200	13,300	15,800
	Joint	18,100	18,933	19,767	22,150
2001:	Single	12,386	13,457	13,550	16,050
	Joint	19,400	20,471	20,200	22,700
2002:	Single	12,557	13,629	13,850	16,350
	Joint	19,657	20,729	20,650	23,150
2003:	Single	12,614	13,686	13,950	16,450
	Joint	20,714	21,786	22,500	25,000
2004:	Single	12,729	13,800	14,150	16,650
	Joint	20,886	21,957	22,800	25,300
2005:	Single	12,843	13,914	14,350	16,850
	Joint	20,371	21,443	21,900	24,400
2006:	Single	12,986	14,057	14,600	17,100
	Joint	20,914	21,986	22,850	25,350
2007:	Single	13,129	14,200	14,850	17,350
	Joint	21,229	22,300	23,400	25,900
2008:	Single	13,243	14,314	15,050	17,550
	Joint	21,600	21,550	24,050	26,550
2009:	Single	13,414	14,486	15,350	17,850
	Joint	22,257	22,700	25,200	27,700
2010:	Single	13,557	14,629	15,600	18,100
	Joint	22,486	23,100	25,600	28,100
2011:	Single	13,700	14,771	15,850	18,350
	Joint	21,743	21,800	24,300	26,800
2012:	Single	13,843	14,914	16,100	18,600
	Joint	21,943	22,150	24,650	27,150
2013:	Single	14,014	15,086	16,400	18,900
	Joint	22,257	22,700	25,200	27,700

Note- Tax law for future years are those in effect as of July 2003.
Source: Congressional Budget Office.

TABLE 13-22 -- TAX FILING UNITS CLASSIFIED BY MARGINAL FEDERAL INCOME TAX RATE,[1] 2003 TAX LAW (2000 POPULATION AND INCOME)

[Thousands of units]

Family type and marginal tax rate (percent)	Returns	Percent
With children:		
0	21,388	45.8
10	1,500	3.2
15	14,311	30.6
25	6,389	13.7
28	740	1.6
33	247	0.5
35	312	0.7
AMT	1,830	3.9
Total	46,717	100.0
Elderly:		
0	11,070	49.6
10	3,216	14.4
15	4,922	22.1
25	2,225	10.0
28	361	1.6
33	79	0.4
35	67	0.3
AMT	373	1.7
Total	22,313	100.0
Other:		
0	21,378	28.6
10	12,691	17.0
15	24,704	33.0
25	12,697	17.0
28	1,827	2.4
33	339	0.5
35	238	0.3
AMT	902	1.2
Total	74,776	100.0
All tax units:		
0	53,836	37.4
10	17,406	12.1
15	43,937	30.6
25	21,311	14.8
28	2,928	2.0
33	665	0.5
35	617	0.4
AMT	3,105	2.2
Total	143,805	100.0

[1] The rate used is the ordinary rate bracket for taxable income without capital gains. Some tax payers classified with a marginal rate greater than 0 may owe no income tax because of their ability to claim tax credits.

Source: Congressional Budget Office tax simulation model.

Table 13-23 is a more comprehensive version of Table 13-22. It illustrates for various types of wage earners the additional (marginal) Federal tax these wage earners will pay if they earn one more dollar of wages. For purposes of this table, marginal tax rates include both Federal income and payroll taxes. The majority of single wage earners have income below $30,000 per year and face marginal tax rates of 20.0-24.9 percent. In addition, the phaseout of certain deductions or exclusions under the Code (e.g., the personal exemption phaseout) and the overall limitation on itemized deductions also have the effect of imposing additional dollars of tax liability on a taxpayer as the taxpayer's income increases. Hence, effective marginal tax rates can exceed the sum of the statutory individual income tax rate and payroll tax rate.

FEDERAL TAX TREATMENT OF FAMILIES IN POVERTY

During the 1970s and early 1980s, inflation gradually increased the tax burdens of the poor and lowered the real income level at which a poor family became liable for income taxation. Legislation passed by Congress reversed or slowed this trend, but in the absence of indexing, inflation during this period gradually offset these legislative efforts. One measure of this trend is the degree to which the income at which a poor family begins to pay income taxes (termed the tax threshold, or the tax entry point) exceeds or falls below the poverty threshold. A second measure is the actual amount of tax liability incurred by a family with income at the poverty line.

Table 13-24 shows the income tax threshold, the poverty level, and the tax threshold as a percent of the poverty level for a married couple with two children in selected years. These figures demonstrate that before 1975 a family of four was generally liable for Federal income tax if the family's income was significantly below the poverty line. In 1975, following the enactment of the earned income credit (EIC), a family of four incurred no tax liability until its income exceeded the poverty threshold by 22 percent. Over the next decade this margin eroded; by 1984, a poor family of four incurred income tax liability when its income was 17 percent below the poverty line. By 1993, changes in the tax law resulted in no tax liability for a typical family of four until its income exceeded the poverty threshold by nearly 30 percent.

Table 13-25 shows the income tax burden and payroll tax burden of households with incomes at the poverty line for families of different sizes. As a result of the refundable EIC, the table reflects that many individuals receive a substantial credit that more than offsets total income, and in many cases Social Security, taxes paid.

TABLE 13-23 -- DISTRIBUTION OF EARNERS BY INCOME AND MARGINAL TAX RATES ON WAGES, 2003 TAX LAW (2000 POPULATIONS AND INCOMES)

[In thousands of 2000 dollars]

Family type and marginal tax rate (percent)	Income in thousands of 2000 dollars									
	Less than $10	$10-$20	$20-$30	$30-$40	$40-$50	$50-$75	$75-$100	$100-$200	$200 and over	All incomes
All earners ages 21-64 without Social Security earnings:										
Less than 0	3,150	1,538	103	41	24	19	0	1	0	4,876
0-4.9	1,912	271	220	174	53	15	5	12	9	2,671
5.0-9.9	3,586	1,598	360	274	102	81	12	11	6	6,029
10.0-14.9	543	1,190	137	74	37	37	20	3	1	2,042
15.0-19.9	2,354	6,657	4,460	2,012	351	218	179	12	7	16,250
20.0-24.9	426	5,109	8,957	9,511	9,509	17,877	1,921	65	29	53,403
25.0-29.9	782	366	235	337	64	316	1,739	1,820	278	5,937
30.0-34.9	1	1,292	1,099	2,591	3,091	5,372	9,109	6,140	428	29,122
35.0-39.9	0	253	2,038	148	33	273	263	3,909	1,899	8,816
40.0-44.9	0	7	572	26	0	11	30	558	1,344	2,547
45.0-49.9	0	0	36	0	1	0	17	177	193	423
Total	12,754	18,281	18,216	15,188	13,265	24,219	13,293	12,708	4,193	132,116
Mean marginal tax rate	2.1	17.5	23.9	23.4	24.7	25.0	30.4	33.7	38.1	23.2
Mean marginal income tax rate	-5.6	9.9	16.3	15.8	17.1	17.4	23.7	28.3	34.0	16.0
Mean marginal Social Security tax rate	7.6	7.6	7.6	7.6	7.6	7.6	6.7	5.4	4.0	7.2
Single earners:										
Less than 0	2,313	864	13	1	2	0	0	0	0	3,192
0-4.9	1,539	151	26	8	3	6	4	2	1	1,742
5.0-9.9	2,748	646	77	47	13	2	0	1	0	3,535
10.0-14.9	477	679	35	6	1	2	0	0	0	1,201

15.0-19.9	2,066	4,622	667	87	12	5	2	1	1	7,463
20.0-24.9	418	4,910	8,465	4,424	1,129	254	2	3	2	19,606
25.0-29.9	777	168	120	327	64	84	590	297	45	2,472
30.0-34.9	1	1,110	404	2,578	3,091	3,739	429	366	29	11,747
35.0-39.9	0	244	1,218	23	33	264	184	180	176	2,322
40.0-44.9	0	7	564	26	0	8	12	39	30	686
45.0-49.9	0	0	36	0	1	0	2	11	2	51
Total	10,339	13,401	11,624	7,528	4,349	4,364	1,225	900	287	54,017
Mean marginal tax rate	3.3	19.1	25.4	26.3	29.9	32.3	31.1	32.4	35.7	20.9
Mean marginal income tax rate	-4.3	11.5	17.7	18.6	22.3	24.7	27.3	29.8	33.2	13.5
Mean marginal Social Security tax rate	7.6	7.6	7.6	7.6	7.6	7.5	3.8	2.6	2.5	7.4
Married earners:										
Less than 0	837	674	91	40	22	19	0	1	0	1,684
0-4.9	373	120	194	165	49	9	1	10	8	930
5.0-9.9	838	952	282	226	89	79	12	11	6	2,494
10.0-14.9	67	511	102	68	36	35	19	3	1	841
15.0-19.9	288	2,035	3,793	1,925	339	212	177	11	6	8,787
20.0-24.9	8	199	492	5,087	8,380	17,623	1,919	62	26	33,797
25.0-29.9	5	197	115	10	0	232	1,149	1,522	233	3,465
30.0-34.9	0	182	694	12	0	1,633	8,680	5,775	398	17,374
35.0-39.9	0	9	820	125	0	9	79	3,729	1,723	6,494
40.0-44.9	0	0	8	0	0	3	17	519	1,314	1,861
45.0-49.9	0	0	0	0	0	0	14	166	191	372
Total	2,415	4,880	6,591	7,660	8,916	19,855	12,068	11,808	3,906	78,099
Mean marginal tax rate	-3.2	13.2	21.4	20.6	22.2	23.5	30.4	33.8	38.2	24.8
Mean marginal income tax rate	-10.8	5.6	13.8	12.9	14.5	15.8	23.3	28.2	34.1	17.7
Mean marginal Social Security tax rate	7.6	7.6	7.6	7.6	7.6	7.6	7.0	5.6	4.1	7.1

TABLE 13-23 -- DISTRIBUTION OF EARNERS BY INCOME AND MARGINAL TAX RATES ON WAGES, 2003 TAX LAW (2000 POPULATIONS AND INCOMES)-continued

[In thousands of 2000 dollars]

Family type and marginal tax rate (percent)	Income in thousands of 2000 dollars									
	Less than $10	$10-$20	$20-$30	$30-$40	$40-$50	$50-$75	$75-$100	$100-$200	$200 and over	All incomes
Earners with children:										
Less than 0	2,912	1,467	102	41	24	19	0	1	0	4,566
0-4.9	349	260	212	172	49	9	2	6	7	1,067
5.0-9.9	1,026	616	229	235	82	72	11	6	4	2,282
10.0-14.9	27	895	68	54	15	18	12	2	0	1,091
15.0-19.9	96	2,742	2,440	1,769	299	160	151	6	4	7,668
20.0-24.9	10	364	852	4,367	6,108	12,041	1,638	39	15	25,436
25.0-29.9	6	345	230	36	27	147	825	886	160	2,662
30.0-34.9	0	1,195	1,054	69	213	1,183	5,306	3,319	270	12,609
35.0-39.9	0	223	1,962	139	7	112	97	2,983	1,098	6,620
40.0-44.9	0	1	535	26	0	7	21	414	898	1,902
45.0-49.9	0	0	36	0	0	0	13	114	135	298
Total	4,426	8,108	7,720	6,909	6,825	13,770	8,075	7,776	2,591	66,200
Mean marginal tax rate	-14.1	15.8	27.0	20.7	22.4	23.6	29.9	34.3	38.3	22.7
Mean marginal income tax rate	-21.7	8.1	19.4	13.0	14.8	16.0	23.0	28.9	34.2	15.5
Mean marginal Social Security tax rate	7.6	7.6	7.6	7.6	7.6	7.6	6.9	5.4	4.1	7.2

Source: Congressional Budget Office tax simulation model.

TABLE 13-24 -- RELATIONSHIP BETWEEN INCOME TAX THRESHOLD AND POVERTY LEVEL FOR A FAMILY OF FOUR, SELECTED YEARS 1959-2013

Year	Income tax threshold	Poverty level	Tax threshold as a percent of poverty level
1959	$2,667	$2,978	89.6%
1960	$2,667	$3,022	88.3%
1965	$3,000	$3,223	93.1%
1970	$3,600	$3,968	90.7%
1975	$6,692	$5,500	121.7%
1980	$8,626	$8,414	102.5%
1984	$8,783	$10,610	82.8%
1990	$16,296	$13,359	122.0%
1991	$17,437	$13,924	125.2%
1992	$18,548	$14,335	129.4%
1993	$19,187	$14,763	130.0%
1994	$21,098	$15,141	139.3%
1995	$22,362	$15,570	143.6%
1996	$23,671	$15,911	148.8%
1997	$24,385	$16,276	149.8%
1998	$27,795	$16,530	168.1%
1999	$28,203	$16,895	166.9%
2000	$28,682	$17,463	164.2%
2001	$31,738	$17,960	176.7%
2002	$33,209	$18,250	182.0%
2003	$39,700	$18,667	212.7%
2004	$40,100	$19,074	210.2%
2005	$36,170	$19,527	185.2%
2006	$37,047	$20,014	185.1%
2007	$37,874	$20,515	184.6%
2008	$39,544	$21,027	188.1%
2009	$41,257	$21,553	191.4%
2010	$43,833	$22,092	198.4%
2011	$36,716	$22,644	162.1%
2012	$37,498	$23,210	161.6%
2013	$38,374	$23,791	161.3%

Note- Tax law for future years are those in effect as of July 2003.
Source: Congressional Budget Office.

TABLE 13-25 -- TAX THRESHOLDS, POVERTY LEVELS, AND FEDERAL TAX AMOUNTS FOR DIFFERENT FAMILY SIZES WITH EARNINGS EQUAL TO THE POVERTY LEVEL, 1995-2012

Measure	Family size					
and year	1	2	3	4	5	6
1996	8,163	10,564	12,629	15,911	18,725	20,965
1997	8,350	10,805	12,919	16,276	19,154	21,446
1998	8,480	10,972	13,120	16,530	19,453	21,780
1999	8,667	11,214	13,410	16,895	19,882	22,261
2000	8,959	11,590	13,861	17,463	20,550	23,009
2001	9,214	11,920	14,255	17,960	21,135	23,664
2002	9,363	12,113	14,485	18,250	21,477	24,047
2003	9,577	12,389	14,816	18,667	21,967	24,595
2004	9,786	12,659	15,139	19,074	22,446	25,132
2005	10,018	12,960	15,499	19,527	22,979	25,729
2006	10,268	13,283	15,885	20,014	23,552	26,371
2007	10,525	13,615	16,283	20,515	24,141	27,030
2008	10,788	13,956	16,690	21,027	24,745	27,706
2009	11,057	14,305	17,107	21,553	25,363	28,398
2010	11,334	14,662	17,535	22,092	25,997	29,108
2011	11,617	15,029	17,973	22,644	26,647	29,836
2012	11,908	15,405	18,422	23,210	27,314	30,582
2013	12,205	15,790	18,883	23,791	27,996	31,346
Income tax threshold:						
1996	7,546	11,800	19,883	23,671	24,732	25,793
1997	7,803	12,200	20,477	24,385	25,487	26,590
1998	7,990	12,500	22,628	27,795	30,600	36,633
1999	8,113	12,700	22,984	28,203	30,950	37,033
2000	8,274	12,950	23,380	28,682	31,350	37,483
2001	8,862	13,400	25,979	31,738	38,100	45,000
2002	9,156	13,850	27,371	33,209	38,850	45,850
2003	9,286	15,600	29,870	39,700	49,416	59,133
2004	9,480	15,900	30,424	40,100	49,866	59,633
2005	9,701	15,000	29,984	36,170	42,599	50,466
2006	9,932	15,850	30,769	37,047	43,600	51,516
2007	10,179	16,400	31,508	37,874	44,450	52,466
2008	10,423	16,950	32,844	39,544	45,816	53,883
2009	10,703	18,000	34,217	41,257	49,283	58,116
2010	10,955	18,400	35,768	43,833	54,100	64,366
2011	10,844	17,000	30,131	36,716	39,642	45,133
2012	11,092	17,350	30,788	37,498	40,444	45,683
2013	11,375	17,800	31,529	38,374	41,362	46,533
Tax at poverty threshold:						
1996	140	0	-1,989	-2,650	-2,058	-1,586
1997	124	0	-2,052	-2,741	-2,135	-1,652
1998	111	0	-2,134	-2,857	-2,241	-1,751
1999	125	0	-2,160	-2,882	-2,253	-1,752
2000	155	0	-2,166	-2,883	-2,233	-1,760
2001	62	0	-2,667	-3,778	-3,427	-3,148
2002	36	0	-2,919	-4,144	-3,788	-3,503
2003	51	0	-2,959	-4,185	-3,820	-3,530
2004	54	0	-3,024	-4,283	-3,910	-3,613
2005	56	-59	-3,341	-5,007	-4,798	-4,632
2006	59	-55	-3,420	-5,114	-4,899	-4,729
2007	61	-53	-3,488	-5,224	-5,005	-4,830

TABLE 13-25 -- TAX THRESHOLDS, POVERTY LEVELS, AND FEDERAL TAX AMOUNTS FOR DIFFERENT FAMILY SIZES WITH EARNINGS EQUAL TO THE POVERTY LEVEL, 1995-2012-continued

Measure and year	Family size 1	2	3	4	5	6
2008	64	-127	-3,556	-5,553	-5,328	-5,148
2009	62	-128	-3,686	-5,696	-5,465	-5,281
2010	67	-133	-3,780	-5,842	-5,605	-5,417
2011	175	0	-2,858	-3,811	-2,968	-2,297
2012	185	0	-2,930	-3,906	-3,042	-2,354
2013	188	0	-3,003	-4,003	-3,117	-2,411
Payroll tax at poverty threshold:						
1996	624	808	966	1,217	1,432	1,604
1997	639	827	988	1,245	1,465	1,641
1998	649	839	1,004	1,265	1,488	1,666
1999	663	858	1,026	1,292	1,521	1,703
2000	685	887	1,060	1,336	1,572	1,760
2001	705	912	1,091	1,374	1,617	1,810
2002	716	927	1,108	1,396	1,643	1,840
2003	733	948	1,133	1,428	1,680	1,882
2004	749	968	1,158	1,459	1,717	1,923
2005	766	991	1,186	1,494	1,758	1,968
2006	785	1,016	1,215	1,531	1,802	2,017
2007	805	1,042	1,246	1,569	1,847	2,068
2008	825	1,068	1,277	1,609	1,893	2,119
2009	846	1,094	1,309	1,649	1,940	2,172
2010	867	1,122	1,341	1,690	1,989	2,227
2011	889	1,150	1,375	1,732	2,039	2,282
2012	911	1,178	1,409	1,776	2,089	2,340
2013	934	1,208	1,445	1,820	2,142	2,398
Combined tax at poverty threshold:						
1996	764	808	-1,023	-1,433	-625	18
1997	763	827	-1,064	-1,496	-669	-11
1998	760	839	-1,130	-1,592	-753	-85
1999	788	858	-1,134	-1,590	-732	-49
2000	841	887	-1,105	-1,547	-661	0
2001	767	912	-1,576	-2,404	-1,810	-1,337
2002	753	927	-1,811	-2,748	-2,145	-1,664
2003	784	948	-1,826	-2,757	-2,140	-1,648
2004	803	968	-1,866	-2,824	-2,193	-1,690
2005	822	933	-2,155	-3,514	-3,040	-2,663
2006	845	961	-2,205	-3,583	-3,098	-2,711
2007	866	988	-2,242	-3,655	-3,158	-2,762
2008	890	941	-2,279	-3,944	-3,435	-3,029
2009	908	966	-2,377	-4,047	-3,525	-3,109
2010	934	989	-2,438	-4,152	-3,616	-3,190
2011	1,064	1,150	-1,483	-2,079	-930	-14
2012	1,096	1,178	-1,520	-2,131	-953	-14
2013	1,122	1,208	-1,558	-2,183	-975	-13
Combined tax at poverty level as a percent of poverty level:						
1996	9.4	7.7	-8.1	-9.0	-3.3	0.1
1997	9.1	7.7	-8.2	-9.2	-3.5	-0.1
1998	9.0	7.7	-8.6	-9.6	-3.9	-0.4
1999	9.1	7.7	-8.5	-9.4	-3.7	-0.2
2000	9.4	7.7	-8.0	-8.9	-3.2	0.0

TABLE 13-25 -- TAX THRESHOLDS, POVERTY LEVELS, AND FEDERAL TAX AMOUNTS FOR DIFFERENT FAMILY SIZES WITH EARNINGS EQUAL TO THE POVERTY LEVEL, 1995-2012- continued

Measure and year	Family size					
	1	2	3	4	5	6
2001	8.3	7.7	-11.1	-13.4	-8.6	-5.7
2002	8.0	7.7	-12.5	-15.1	-10.0	-6.9
2003	8.2	7.7	-12.3	-14.8	-9.7	-6.7
2004	8.2	7.7	-12.3	-14.8	-9.8	-6.7
2005	8.2	7.2	-13.9	-18.0	-13.2	-10.4
2006	8.2	7.2	-13.9	-17.9	-13.2	-10.3
2007	8.2	7.3	-13.8	-17.8	-13.1	-10.2
2008	8.2	6.7	-13.7	-18.8	-13.9	-10.9
2009	8.2	6.8	-13.9	-18.8	-13.9	-10.9
2010	8.2	6.7	-13.9	-18.8	-13.9	-11.0
2011	9.2	7.7	-8.2	-9.2	-3.5	0.0
2012	9.2	7.7	-8.3	-9.2	-3.5	0.0
2013	9.2	7.7	-8.3	-9.2	-3.5	0.0

Note- Tax law for future years are those in effect as of July 2003.
Source: Congressional Budget Office

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