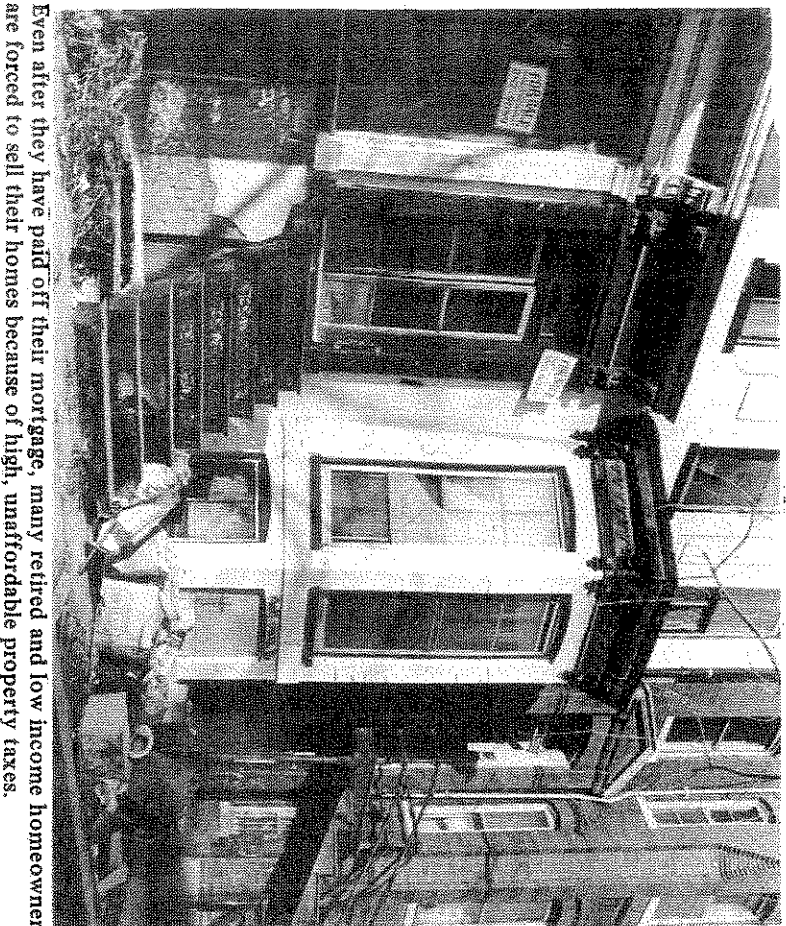


Public Citizen People & Taxes

Property Tax Reform Overdue

Tax On Wealth Needs Expansion

By Diane Fuchs



Even after they have paid off their mortgage, many retired and low income homeowners are forced to sell their homes because of high, unaffordable property taxes.

Soaring property taxes have stirred a rash of heartfelt citizen complaints over the past few years. Television documentaries have detailed cases of retired or low-income homeowners who, upon finally paying off their mortgages, are being forced to sell because they cannot afford the skyrocketing tax levies on their homes. Hundreds of grass-roots citizens groups have sprung up in protest against allegedly burdensome home property assessments. Charges that appraisers have discriminated in favor of industrial properties are hurled from coast to coast. And a recent survey shows that Americans consider the property tax — more than any other — to be the unfairiest of all taxes.

The recent outcry over property taxes stems in part from the growing share of total government spending attributable to state and local governments. As the need for local revenues has increased, inflation-caused "paper" gains in property values have been a convenient and "automatic" source of more taxes. Since 1972, the Consumer Price Index has risen by an average of 9.6% annually, and real property "values" have more than kept pace.

The Tax Reform Research Group is collecting information on state and local tax issues, and needs your help. See page 11.

The result has been substantial hikes in property tax levies, frequently on persons whose incomes have not kept up with inflation. These increases, coupled with a burgeoning tax reform movement, have focused public attention on the inadequacies of most property tax systems. This supposed tax on wealth is more and more being perceived as a harsh government interference with the ability of

See PROPERTY TAXES, page 4

Kennedy Proposes Major Tax Changes

By Richard Tomlinson

Calling for fundamental reforms but not radical changes, Sen. Edward M. Kennedy (D-Mass.) has announced a detailed plan for comprehensive reform of the federal income tax. The program, which Kennedy hopes will serve as a model for the Carter Administration's tax proposals, emphasizes the elimination of a number of tax loopholes, such as special treatment of capital gains, as a means of funding lower tax rates for individuals and corporations.

In addition, Kennedy's plan would replace several tax deductions, which tend to reduce the taxes of the wealthy to a much greater extent than the taxes of low and middle income taxpayers, with tax credits that provide the same degree of tax relief to all taxpayers. In his statement on the Senate floor, Kennedy expressed "growing opposition to proposals for the elimination of the corporate and individual income taxes by reducing the tax

See KENNEDY, page 2



Poll shows Americans like to say "Yes."

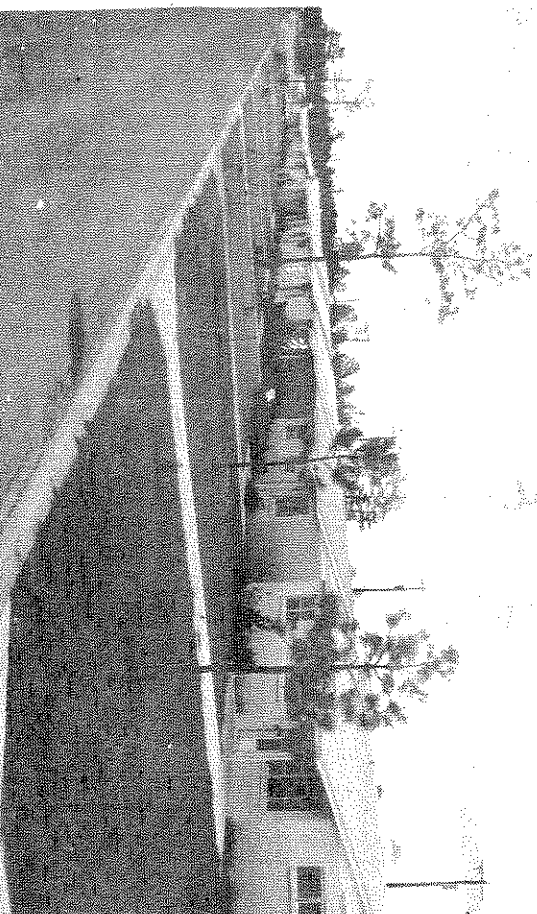
Roper Poll Has Lessons For Carter

A just released Roper survey on public attitudes towards the tax system shows, more than anything else, that Americans like to say "yes" to pollsters. In a variety of conflicting answers, large majorities of those questioned said they favored broadening the tax base, lowering rates, and making the system fairer and simpler, while at the same time they supported a laundry list of new and old special deductions and tax exemptions. One other Roper finding is also clear: most Americans have a poor understanding of the tax system.

The questions were asked of a fairly conservative (41%) to middle-of-the-road (33%) segment of the population, whose members tended to be married (70%), homeowners (66%) with children (51%). The median family income was \$14,700.

close to the national average. Sixty percent of those polled indicated they had a "not too good" or "very little" understanding of how to fill out a tax return. Newspaper accounts of the survey results have interpreted the public's seeming support of numerous tax deductions as a warning to President Carter to go slow on tax reform. In fact, however, Roper found that "the public would welcome a call for tax reform." Although the study does conclude the obvious — that "any tax reform plan that calls for elimination or reduction in deductions . . . would meet with resistance" — it interprets this to mean that tax reform proposals "will need to be accompanied by an educational program in order to achieve real public acceptance."

This is probably the key finding in See POLL, page 7



Kennedy plan for comprehensive reform would eliminate a number of tax loopholes as a means of funding lower individual and corporate income tax rates.

In This Issue

IRKSOME PROPERTY TAX - Pros and cons of one of the most some taxes to homeowners, the property tax, are debated. P.1

KENNEDY'S CUTS - Kennedy's model for federal income tax reform eliminates a number of loopholes and replaces several tax deductions with simplification measures. P.1

U.S. ROPED IN - America's answers to latest Roper tax survey raise new questions about public perception of the tax system. P.1

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BLOCK BALKS AT SIMPLE TAX RETURN - Henry Bloch testifies that IRS should leave tax return simplicity to commercial preparers. P.10

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Public Citizen People & Taxes

Public Citizen Tax Reform Research Group, P.O. Box 14198, Ben Franklin Station, Washington, D.C. 20044.

TRRG Director Robert Brandon
Production Editor Timothy Ward
Artist Barbara Sweet
Income Taxes William Pleitz
Internal Revenue Louise Brown
Staff Attorney Robert McIntyre
Production Assistants Gail Kovich
Cheryl Werner

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Plan Would Cut Deductions

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on dividends. Kennedy urged President Carter, in fulfilling his campaign commitment to a comprehensive overhaul of the nation's tax laws, "to be bold, and to encourage the Treasury, beset by lobbyists bent on retaining or winning special tax privileges, to be bold as well. . . ." Kennedy acknowledged that some of his proposals might be subject to legitimate disagreement, but stated that he hopes they will provide a "useful framework" for tax reform discussions.

The *Baltimore Sun* suggests that a major aim of Kennedy's detailed proposal is to head off plans under way within the Administration to eliminate part of the corporate income tax. Kennedy views the latest Treasury proposal for "integration" of corporate and individual income taxes as a scheme that "does little more than benefit wealthy stockholders."

It was not immediately clear how much influence the Kennedy package would have on Administration taxwriters, but according to the *Sun* some Congressional observers placed some importance on Kennedy's strong opposition to the Administration's integration proposal.

The following is a summary of the main elements of the Kennedy proposal:

Individual Income Taxation: Tax Rates

To assure that capital gains income and wage income are treated more equally under the tax code, Kennedy recommends the repeal of the preferential tax treatment of capital gains and the taxation of capital gains on property passing by death or gift. The \$16 billion in revenue savings from these changes would allow individual tax rates, which currently range from 14% to 70%, to be reduced to a range from 10% to 50%, with reductions at all intermediate levels as well. In addition, the 15% minimum tax on tax preference income would be repealed, as it would be unnecessary with closure of the remaining major tax loopholes.

Tax Shelters

Noting the failure of the 1976 Tax Reform Act to eliminate the tax shelter industry, Kennedy suggests the elimination of certain fundamental preferences, in which tax shelter deals are constructed. First, he proposes the repeal of accelerated depreciation for real estate, on the grounds that it is an inefficient and unnecessary method of inducing investment in construction of high rise office buildings, luxury apartments, beach front condominiums, and shopping centers. He emphasized, however, that low-income housing would be exempted from this change until a new federal housing program is in place to assure an adequate level of low-income housing construction.

Second, he calls for the repeal of the intangible drilling and development cost deduction, a vital component of the contemporary oil and gas tax shelter. This provision presently permits the immediate deduction of certain "intangible" drilling and development costs which are capital costs that are normally depreciated over the life of an asset in other industries. These "intangibles" deductions allow many millionaire oilmen to pay little or no federal income tax.

Finally, he proposes to give special regulatory authority to the IRS to shut down new tax shelters as they arise, rather than relying on Congress to chase tax shelter entrepreneurs. He notes that the tax shelter industry has already devised a number of new tax shelters to avoid the



Senator Edward M. Kennedy (D-Mass.)

imitations of the Tax Reform Act of 1976.

Itemized Personal Deductions

Senator Kennedy also recommends the repeal of one major deduction and the conversion of three others into tax credits. Together, these four deductions represent a substantial loss of revenues — over \$33 billion in fiscal 1977. Furthermore, these deductions are extremely inequitable, in part because they are of no benefit to the 77% of American taxpayers who do not itemize their deductions.

First, Kennedy suggests the repeal of the deduction for medical expenses, which he characterizes as an "upside down national health insurance plan." Noting that the deduction is generally available only to those who itemize deductions, he points to those who itemize deductions to high home mortgage interest payments, property taxes, that it provides no benefit to the 77% of taxpayers who take the standard deduction, and that it provides more tax relief as the income of the taxpayers rises. Kennedy labeled the current deductions the "National Catastrophic Health Insurance Plan for Upper Income Homeowners." Its repeal, however, would be phased out gradually under the Kennedy proposal to correspond with the introduction of a national health insurance program.

In a more controversial move, Kennedy proposes to substitute tax credits in place of the deductions for homeowners (on mortgage interest and property taxes) and for charitable contributions. The new tax credits would be set at amounts designed to maintain federal support at current levels — \$11 billion a year for homeowners' interest and property taxes, and \$6 billion a year for charities. Significantly, the tax credits would be available to low and middle income homeowners and charitable donors who presently use the standard deduction and who therefore get no benefit from the itemized deductions

for interest, property taxes, and gifts to charity.

Kennedy notes that the existing charitable contribution deduction is basically a federal matching grant program. Since the government's share of any grant is a function of the donor's tax bracket, the government will match a \$1 contribution of a donor in the 20% tax bracket with a \$.25 grant, whereas it will match a \$1 contribution of a donor in the 70% tax bracket with a \$2.33 grant. As a result, 50% of all charitable contributions in 1971 (\$3.5 billion) were made by the wealthiest one-half of one percent of the population, but two-thirds of this amount represented the government share.

Not only is the current deduction unfair, the constant increase in the standard deduction and the strong pressure for lower individual tax rates threaten the return charities receive through this tax break. A tax credit would end the inequity and assure that government support of charities through the tax laws does not decline.

Most reformers agree with Kennedy that the homeowner and charitable deductions are unfair, but many oppose conversion to credits as a major step away from simplification. In addition, the credit for homeowners will still discriminate against renters, and will still be more valuable to those with expensive homes.

Kennedy calls for outright repeal of the remaining personal deductions — the gasoline tax deduction, the deduction for state and local taxes (other than property taxes on homes), and the deductions for interest on consumer loans. He suggests that the revenue saved from the elimination of the deduction for state and local taxes be added to revenue sharing funds, so that state and local governments could reduce their frequently regressive taxes.

See KENNEDY, page 6

IRS Computer: Boon or Bane

By David Gersch

Proposals to revamp the Internal Revenue Service's information system using a giant new computer system known as the Tax Administration System or "TAS" should be subject to public congressional hearings, according to the Office of Technological Assessment (OTA).

OTA claims that the proposed one billion dollar computer system, which would be the largest of its kind in the world, creates the potential for dangerous abuse of taxpayer privacy and civil liberties. IRS, on the other hand, contends that the TAS is only an automated extension of established procedures and will not endanger the confidentiality of taxpayer returns. However, the increased accessibility to information afforded by modern computer technology raises difficult and important questions which merit congressional consideration. Although IRS originally resisted the idea of congressional hearings, Pat Ruttle, Assistant Commissioner at IRS, said last week that the Service was no longer adverse to congressional examination of the TAS.

Better Collection Sought

The TAS is designed to improve the collection process by compiling taxpayer information from scattered sources and consolidating it with the existing master files. This would provide the IRS local offices with quicker access to complete information on a particular taxpayer. The present system is overburdened by the close to 100 million returns filed each year by American taxpayers. As a result of this antiquated system, serious problems have developed in the collection process.

Collection Problems

Each year a growing number of people either do not file their returns or pay less than they should. Estimates of revenue lost by the IRS range from \$5.5 to \$30 billion. The TAS should provide a more efficient check of taxpayer return information and stop the loss of needed revenues. While many taxpayers instinctively feel threatened by the specter of a more efficient tax collector, the ordinary taxpayer stands to benefit. The average taxpayer already carries a disproportionate share of the tax burden. An improved

collection process could reduce his or her share of that burden.

As a result of consolidating taxpayer information IRS will more easily be able to match individual return information with related business and partnership returns. Under the current information system individuals and businesses are not cross-referenced and so matching returns is a difficult and time consuming task. The ability to match returns would particularly improve IRS capacity to monitor tax shelter partnerships.

In addition to cracking down on tax evaders, the TAS should speed up the error correction process and provide quicker distribution of refunds and bills to taxpayers. Also, the TAS could potentially "income average" all personal returns, thereby automatically extending this beneficial provision to many taxpayers who are unaware of it. The income averaging provision protects a single year of unusually high income from unduly high tax rates by averaging it with the previous four years income. The income from the exceptional year is then taxed at the rate derived from the average of the five years.

Decentralization

Currently, taxpayer master files are maintained at the National Computer Center in Martinsburg, West Virginia. It now takes over a month for information received at a regional IRS office to get into the computer and up to eight weeks to correct errors. The TAS would decentralize the existing master files to the ten regional offices around the country. Taxpayer information could then be entered in a matter of days instead of weeks.

OTA Criticism

OTA has charged that the TAS was conceived without adequate attention to issues of tax return confidentiality and broader policy questions regarding the maintenance of data banks and retrieval systems. In a lengthy, sometimes rambling report to the Joint Technology Assessment Board, OTA underscored the need for careful public and Congressional oversight of the development of the TAS, charging that IRS's interest in automating the collection process is not always compatible with the public interest in protect-



Patrick Ruttle, Assistant Commissioner at IRS
ing the privacy of taxpayer returns.

IRS Rebuttal

IRS has countered that OTA's criticism lacks specificity and that the confidentiality of taxpayer returns are legally secured by the Privacy Act of 1974 and the 1976 Tax Reform Act. IRS also stresses that the information on the master file is mainly an accounting of debits and credits of the taxpayer and does not include all the information solicited on the return form. It maintains that the information on the master file is essentially harmless and is unlikely to be abused.

What disturbs critics of the TAS is that the system as planned will accommodate more information than is currently on the master file, and that IRS has never specified exactly what information might be added to the file in the future. Members of the staff of the House Appropriations Committee point out that there is no clear blueprint of what the TAS system will actually look like once it is

put into effect.

Past Abuses

In the past, copies of taxpayer returns have been made available to several government agencies for non-tax related purposes. The now famous Church Committee Report documented the FBI's use of tax return information for the surveillance of the Southern Christian Leadership Conference and numerous individuals connected with the civil rights and anti-war movements. According to then existing IRS regulations, disclosure of return information should only have been allowed after careful scrutiny of the request. Yet, Leon Green, former Assistant Deputy Commissioner, testified that he could not recall ever questioning an FBI request for information.

It is not clear that potentially harmful information will ever be added to TAS files. The record of past abuses, however, has convinced privacy watchdogs that there must be adequate technical limits on the capability of TAS and strict legal restrictions on the disclosure of information regarding taxpayers.

New Law

IRS says that the Privacy Act of 1974 and the new regulations of the 1976 Tax Reform Act will establish sufficient safeguards against the misuse of taxpayer return information. The '76 law, section 6103 of the Internal Revenue Code, prohibits the release of return information unless IRS is specifically authorized to do so by a federal judge. But the limitations and the implementation of the law have come under criticism in the recently released report of the Privacy Protection Commission. The Commission recommends that all information retained by IRS, not just taxpayer return information, should be subject to legal restrictions against disclosure. This is because IRS has had access to information from sources other than the taxpayer when the "taxpayer has no choice but to have that other party maintain the records such as bank and credit card records." According to the Privacy Commission, such non-return information should be covered by the same legal safeguards as apply to the

Controversy is developing over the absence of public, congressional hearings for the proposed \$1 billion computer information system for the IRS.

See TAS, page 9

Property Tax Irritates Many

PROPERTY TAXES from page 1

ordinary citizens to obtain adequate shelter. Furthermore, due to the deductibility of real property taxes for federal income tax purposes, the goal of taxing wealth is being undercut, as high earners are able to avoid up to 70% of the property tax's impact.

In 1977, when Los Angeles County homes were assessed for the first time in three years, homeowners, according to *U.S. News and World Report*, received property tax bills for nearly double what they had paid previously. Similarly, in New York, the ratio of property taxes to the average homeowner's income shot up 400% in the last twenty years, and now property taxes consume 10% of some New York state homeowners' budgets. And in Washington, D.C., where housing prices are already among the nation's highest, homeowners were receiving monstrous assessment hikes this year. Average increases were 42% over previous assessments, with some homeowners bearing tax hikes of 80% and more.

Such a trend is not limited to a few major cities. The Census Bureau reports that property taxes per person in the U.S. have risen from an average \$163 per year in 1970 to \$236 per year in 1975, an increase of 52% in five years.

On the other hand, although property taxes have risen significantly in terms of dollar amounts during the past twenty years, they compare favorably to increases in other taxes. The Advisory Commission on Intergovernmental Relations has estimated that for a hypothetical family of 4 earning \$5000 in 1953 and \$12,000 in 1972, the property tax accounted for 18.6% of total tax liability in 1953, but only 16.8% in 1972. In fact, in the twenty-year period only federal income taxes grew less than the property tax as a percentage of family income.

Nonetheless, the property tax's unpopularity with homeowners continues to be

a powerful force in many jurisdictions. Much of this can be attributed to its high visibility — unlike sales and income taxes which are levied on a pay-as-you-go basis, property taxes are usually payable only once or twice a year. In addition, levies are based on subjective estimates of property values which are inevitably subject to criticism.

A more important source of unrest is the wide disparity in property tax burdens among the 65,000 different local jurisdictions. At one extreme, the typical New Jersey homeowner in 1969 paid \$626 in property taxes, while his Louisiana counterpart paid only \$79. The average income Boston homeowner paid 8.9 percent of his income in property taxes in 1971, while the figure was 2 percent in Atlanta, and only 1.4 percent in Houston.

Disparity in Tax Rates

Even more striking are the huge differences in tax rates among communities within the same local area. Thus, the owner of a \$20,000 home in the village of Wayne in DuPage County, Illinois, just west of Chicago, paid \$1005 in property taxes in 1973, while the owner of a similar home in nearby Hinsdale paid \$1565 — 56% more. In Los Angeles County, taxpayers in one plush Beverly Hills taxing district paid less than one-half the tax rate borne by homeowners in Walnut City.

In addition to these serious equality problems, there is an overriding controversy about how property tax burdens are spread among taxpayers of different wealth and income. The conventional view, at least until recently, had been that property taxes are regressive, creating greater burdens on low-income people. The leading advocate of this view is the Advisory Commission on Intergovernmental Relations, which regularly produces tables such as chart I in support of its claim.

CHART I

REAL ESTATE TAXES AS A PERCENTAGE OF FAMILY INCOME, OWNER-OCCUPIED SINGLE-FAMILY HOMES, BY INCOME CLASS AND BY REGION, 1970

Family Income	United States		North-east		North-central		South		West	
	Total	Region	Region	Region	Region	Region	Region	Region	Region	Region
Less than \$2,000	16.6	30.8	18.0	9.8	8.2	22.9				
\$ 2,000 — 2,999	9.7	15.7	9.7	5.2	12.5					
3,000 — 3,999	7.7	13.1	7.7	4.3	8.7					
4,000 — 4,999	6.4	9.8	6.7	3.4	8.0					
5,000 — 5,999	5.5	9.3	5.7	2.9	6.5					
6,000 — 6,999	4.7	7.1	4.9	2.5	5.9					
7,000 — 9,999	4.2	6.2	4.2	2.2	5.0					
10,000 — 14,999	3.7	5.3	3.6	2.0	4.0					
15,000 — 24,999	3.3	4.6	3.1	2.0	3.4					
25,000 or more	2.9	3.9	2.7	1.7	2.9					

Source: U.S. Bureau of the Census, Residential Finance Survey, 1970 (conducted in 1971). Special tabulations prepared for the Advisory Committee on Intergovernmental Relations.

The table purports to show the proportion of family income devoted to property taxes for homeowners at different income levels and in different parts of the country. It seems to indicate that, without exception, the lower the family income, the greater the share of it that goes to property taxes.

Critics of this view point out that the ACIR measures residential property taxes against the homeowner's income for a particular year only. Economists widely agree, however, that housing decisions are based on the income a family expects over the long haul — its "permanent income" — not on the income of a particular year. Adjusting for this "permanent income" concept and making other statistical refinements, Henry Aaron of the Brookings Institution found that even if one accepted the ACIR's basic premises, residential property taxes were not regressive. Instead

they were proportional, affecting people at different income levels roughly the same way. In addition, it is argued that the ACIR leaves out entirely the property taxes on commercial and industrial property, which is owned largely by the rich. The ACIR seems to assume that the property tax, like excise taxes, is passed along to consumers in the prices they pay for goods and services. Others take the view that the property tax is a tax on the owners of capital. Since property ownership is even more concentrated among the wealthy than is income, this would make the property tax decidedly progressive. This position was exploited by Joseph Pechman and Benjamin Okner of the Brookings Institution in their book *Who Bears the Tax Burden?*. Assuming that property taxes are indeed borne by the owners of capital, they found that the

continued on next page

Most Unpopular Tax

What citizens don't see they apparently don't mind is the apparent conclusion to be drawn from a public opinion survey on taxation recently released by the Advisory Commission on Intergovernmental Relations. The poll showed that the property tax is the least popular of all taxes, followed closely by the federal income tax. On the other hand, "hidden" taxes, such as state sales taxes, fared much better in the survey, although such taxes are generally considered by tax experts to be highly regressive.

When asked "which do you think is the worst tax — that is, the least fair?" thirty-three percent of those responding put the property tax at the top of their

list, while 28% picked the federal income tax. These conclusions are consistent with the results of the annual ACIR survey over the last five years, in which the property tax and the federal income tax have been consistently chosen as the two "worst" taxes.

These two taxes are the country's biggest revenue raisers, which may help explain their unpopularity, although they have gone up less than any other taxes over the past twenty years. In fact, when the data is analyzed by region the severity of a tax rather than its fairness appears to be a determining factor in its popularity. Thus, in the West, where property taxes often tend to predominate, 45% of those

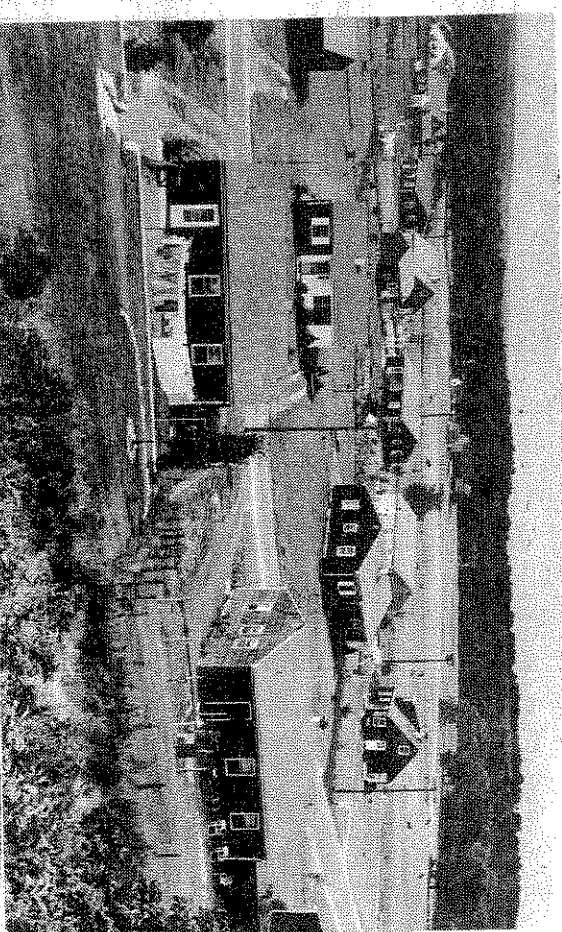
Which do you think is the worst tax — that is, the least fair?

Responses by Region

Percent of Respondents by Region

	Percent of Total		North-east		North-central		South		West	
	U.S. Public	Percent	Percent	Percent	Percent	Percent	Percent	Percent	Percent	Percent
Federal Income Tax	28	20	32	33	25					
State Income Tax	11	17	9	10	7					
State Sales Tax	17	23	15	17	15					
Local Property Tax	33	28	37	25	45					
Don't Know	11	13	8	14	7					

Source: Advisory Commission on Intergovernmental Relations, June 28, 1977.



ACIR survey shows that the property tax is the least popular tax among Americans.

polled viewed the property tax as the worst. In the Northeast, on the other hand, where there is frequently more reliance on state income and sales taxes, the response was more evenly divided.

The bottom line is that 83% of those surveyed said they are firmly in favor of holding the line on, or cutting, taxes and government services. Only 4% favored increasing services and taxes.

Another reason for the property and income taxes' unpopularity is that they have been special targets for reformers over the years, not because they are the worst taxes but because they have the

potential to be the fairest. The ACIR poll did not ask respondents to explain the reasons for their answers, which substantially reduces the validity and usefulness of the survey. Interestingly, the levels of government which rely primarily on the unpopular income and property taxes were also chosen as the most efficient spenders of tax dollars. When respondents were asked "From which level of government do you feel you get the most for your money — federal, state, or local?" 36% picked the federal government and 26% local entities. Only 20% pointed to the states.

Low-Income Relief Necessary

continued from page 4
burden by income class looked like this:

CHART II
EFFECTIVE RATES OF FEDERAL, STATE, AND LOCAL PROPERTY TAXES, 1966

Income classes in thousands of dollars; tax rates in percent	
Adjusted Family Income	Property Tax
0-3	2.5
3-5	2.7
5-10	2.0
10-15	1.7
15-20	2.0
20-25	2.6
25-30	3.7
30-50	4.5
50-100	6.2
100-500	8.2
500-1,000	9.6
1,000 and over	10.1
All classes	3.0

Source: Adapted from Joseph A. Peckman and Benjamin A. Otker, Who Bears the Tax Burden? (Washington, DC: The Brookings Institution, 1974).

Given these assumptions, a tax on property now seems a key part of a progressive tax system.

Even the new analysis is flawed, however. It still relates tax burdens solely to the taxpayer's income, reflecting the income bias that has beset tax policymakers. Economist Mason Gaffney and others argue that property tax burdens should be measured against the taxpayer's wealth, or net worth; first, because wealth represents ability to pay sometimes better than income does, and secondly, because to use the income standard is to criticize the property tax for not being what it is not — an income tax.

The permanent income approach goes somewhat in the direction of net worth. It is not clear exactly how the property tax burden would look if the taxpayer's net worth were the yardstick. Quite possibly the apparent regressivity at the lowest income levels would be eliminated, since many in these categories are older people with reduced current incomes but substantial net worths. The property tax might appear yet more progressive at other income levels too.

In any case, even if it were desirable, local governments are not about to abandon the property tax. Although steadily declining over the last six years as a percent of total state and local tax revenues (a decrease from 38% to 35%), the property tax is still the most important source of state and local funds, raising over \$50 billion annually.

Reform Steps Necessary

Therefore, the focus of tax reformers ought to be to remove the inequities in existing property tax systems, so that the tax can be made fairer and more progressive. The following steps are all important:

(1) *The property tax should be expanded, so that it covers not only "real property," such as homes and businesses, but also "intangible property," such as stocks and bonds.* Intangible property, which is primarily held by the well-off, was originally covered by most property tax systems, but this approach was abandoned almost everywhere due to administrative difficulties. A TRRG report in the October 1976 issue of *People & Taxes* explains a feasible way to reinstate intangible property within the scope of the property tax, thereby lowering the tax rate on homes substantially.

(2) *The deductibility of property taxes for federal income tax purposes should be repealed.* Currently, a high bracket taxpayer can save up to 70 cents in federal income taxes for each dollar paid in local property taxes. The average homeowner, on the other hand, gets no reduction because he or she takes the standard deduction. By eliminating the deduction for property taxes the heaviest burden of the property tax could be shifted back where it belongs — on the well-off.

(3) *Citizens groups should carefully scrutinize local property assessment rolls to insure that industrial and commercial properties are not being underassessed.* *People & Taxes* reported on some of the problems in this area in the May 1977 issue. As another example of possible abuse, a recent report prepared by the District of Columbia City Council's Department of Finance and Revenue revealed that in 1977 while half of the city's homeowners experienced a 42% increase in assessments, commercial property assessments increased by an average of only 7%.

(4) *States should adopt measures to mitigate the impact of the property tax on low and moderate income homeowners and renters.*

The first three points have been discussed in *People & Taxes* before. The remainder of this article will be devoted to analyzing various ways in which state and local governments can implement point 4.

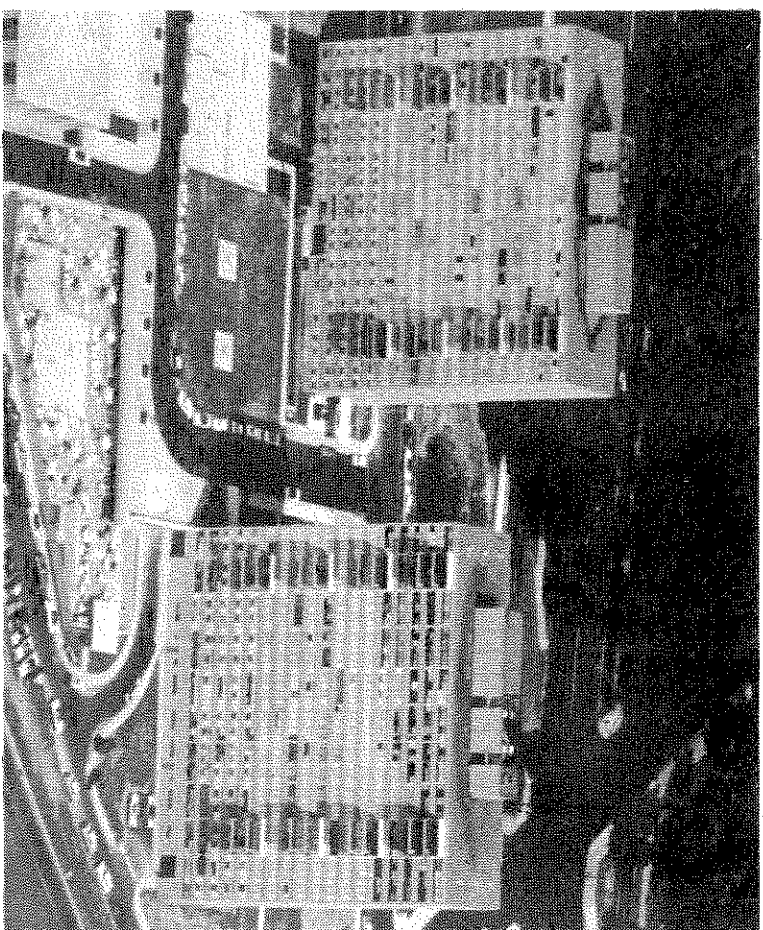
Eliminating Unfairness

Since 1970, most of the states have taken some form of action to mitigate income aspects of their property tax systems. Many of these are only stop-gap measures, but overall, according to George Peterson, a noted economist and senior researcher at the Urban Institute, "this [relief] movement may well represent the most significant change in the country's tax structure since World War II."

The most often adopted relief measures include rate freezes, limited exemptions, especially "homestead exemptions"; tax deferrals; and "circuit breakers." Some of these measures focus on particular groups of taxpayers, particularly the elderly. In fact, all 50 states and the District of Columbia either provide or authorize property tax relief for elderly homeowners. Other provisions are of more general application. Overall, it is estimated that various relief measures constitute close to \$2 billion in tax relief.

The methods with the most potential for assuring that the property tax is really a tax on wealth are the "circuit breakers" and "homestead exemption" provisions. These either limit the amount of the tax to a certain percentage of income or provide that some level of wealth will not be subject to tax.

Rate freezes and deferral provisions, on the other hand, tend to be stop-gap measures which do not adjust the structure of the property tax. Under a general freeze, localities are restricted from increasing their property tax revenues except as assessments go up. In these times of rapidly rising property values, however, such freezes have little effect on stemming taxes. Because of this, some states have adopted a freeze with more teeth by limiting the total amount of property taxes a



A drawback to the homestead exemption is that it does not affect low income renters, although as much as 15-20% of their rent may be due to property taxes passed on by their landlords.

locality can collect to what it collected the previous year, adjusted only for cost of living and population increases. Even with this additional provision, however, the freeze does nothing to correct existing imbalances in the system.

Two states — Connecticut and Minnesota — have adopted a freeze for the benefit of the elderly. Their laws limit the property tax burden to the amount paid by a homeowner in the year he or she reaches 65 years of age. Although the elderly generally tend to be a lower income group, however, across the board relief for them also benefits many well-off people. Furthermore, because high relief tends to go to those with more valuable property, even this "targeted" freeze is crude and often regressive.

Deferral programs, under which eligible homeowners (again, generally the elderly) can put off their property tax liability until they either die or sell their homes, have been adopted in a few states, but they have not been popular. Although short-term deferral for homeowners temporarily low in cash can be helpful, long-term deferral creates a number of problems while providing no real solutions. For example, large amounts of deferred

taxes may make it impossible for a person to sell a home, and if a limit is placed on the total amount which can be deferred, the problem of high taxes is only postponed.

HOMESTEAD EXEMPTIONS

A more promising form of property tax relief is to provide an exemption for a certain amount of property. Similar to the federal income tax's standard deduction and personal exemptions, this approach is consistent with the idea that only the relatively well-off should pay the property tax.

During the 30s and 40s, a variety of homestead exemption programs were instituted, usually with the stated objective of encouraging home ownership. Exemptions for veterans, for instance, flourished. Over the years, the focus of this form of tax relief has shifted toward assisting those assumed to be most harshly affected by the property tax due to low income status, primarily the elderly homeowner. More recently, a few states have extended aid to low income homeowners in general.

See **PROPERTY TAXES**, page 8

DC Aids Homeowners

The District of Columbia City Council has recently passed legislation which would grant homeowners and some renters property tax relief. The measure seeks to counteract the 30-50% average assessment hikes on the 148,000 assessed single family homes in the District.

The bill will exempt the first \$6000 of a home's assessed value. In effect, it will give each homeowner a \$109 tax reduction from his current assessment. Even with the tax cut, some homeowners will pay as much or more in property taxes this year due to the soaring assessment rates. City officials estimate that the tax breaks will add up to \$5.5 million this year in lost revenues. However, the city will recover nearly all of the funds due to the rise in assessments.

Included in the bill are additional "circuit breakers" for the elderly, disabled, and blind homeowners and renters earning less than \$20,000 in household income. The tax relief would be granted according to the level of the recipients' income. Any household earning less than \$5000 would be required to pay no more than 1% of its income in property taxes. At an income level of \$20,000, the highest percentage of income required for payment of the property tax is raised to 2.5%.

Councilman Marion Berry (D-at large) introduced an amendment which would grant relief to the residents of the District's 66 cooperatives. The amendment which was adopted by the council would give a 12% tax break to residents of cooperatives, which the owners of the cooperatives would divide up among the owners residing in the individual apartments.

Plan Preys On Preferences

KENNEDY from page 2.

The \$750 Personal Exemption

Kennedy also proposes the replacement of the \$750 personal exemption with a tax credit in the range of \$200-250, depending on the revenues available. He notes that a tax credit is worth more to low and middle income families than a tax deduction. For instance, the \$750 deduction under current law brings a tax savings of \$525 for persons in the top 70% bracket, but a saving of only \$105 for persons in the bottom 14% bracket. A tax credit, however, would provide the same relief to all taxpayers.

Tax Treatment of the Family

Kennedy would restructure the "tax treatment between single persons and married couples" with a new rate schedule which would treat the two partners in a marriage as if they were a single individual. This is a somewhat strange approach, since one would have thought that the goal ought to be to equalize the tax treatment of single persons and married individuals. Already, under current law, a married person pays a heavier tax on his or her share of the family income than does a single person with the same income. Kennedy's proposal would exacerbate this problem, although he would then partially correct it by providing a special tax credit for two-earner couples.

Kennedy would also convert the current \$750 deduction for dependents to a refundable \$200-250 child allowance credit. This is the equivalent of a flat grant to all families with children.

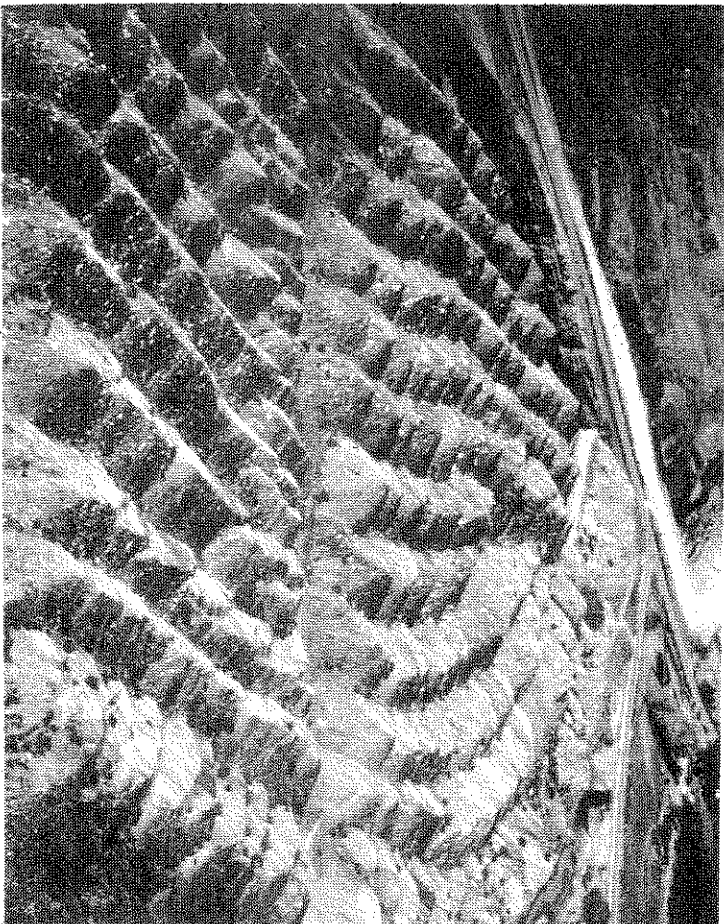
Other Individual Changes

Other individual income tax reforms proposed by Kennedy include: a federal interest rate subsidy to encourage state and local governments to issue taxable bonds instead of tax-exempt bonds; repeal of the exclusion for interest on industrial development bonds; and the institution of withholding on interest and dividends to close the gap between amounts paid and amounts reported for tax purposes.

Corporate and Business Taxation:

Investment Stimulants

To spur "capital formation," Kennedy makes four proposals — increase the deduction for net capital losses; make the investment tax credit refundable; provide an additional incremental investment credit of 5% for investment exceeding the average investment of the three prior years; and reduce the top corporate tax



Kennedy recommends complete repeal of all percentage depletion allowances for mineral exploration and development.

rate from 48% to 45%.

In line with the present rule which taxes only one-half of net capital gains, capital losses may be deducted up to a maximum deduction of \$3000, on a total loss of \$6000. With the elimination of special capital gains treatment, Kennedy suggests that net capital losses be deducted in full up to a maximum limit of \$9000 each year. According to many economists, such liberal loss deduction rules may in fact provide more potent incentive to risk-taking than the existing preferential treatment of capital gains.

The proposal would also expand the 10% investment tax credit for purchasing new equipment, adding an extra 5% to the credit for purchases in excess of average investment over the prior three years and making the credit refundable. Increases in the investment credit have been opposed by many tax reformers, who feel that the credit is mainly a giveaway to businesses for doing what they would have done anyway. Making the credit refundable would mean that many well-off taxpayers not only would be able to pay no tax on substantial incomes, but also frequently could even receive a check back from the government. For example, if the investment credit had been refundable last

year, President Carter not only would have owed no tax on his \$52,000 income, but would have received a refund of several thousand dollars from the Treasury!

Kennedy also would extend the investment credit to tax-exempt organizations, so that they too could receive government checks.

Kennedy also suggests a reduction in the nominal corporate tax rate from the current 48% to 45%. Coupled with the increased investment credit, this could reduce the *actual* corporate rate to even less than the current 25%.

Repeal of Tax Preferences

To provide partial funding for the expansion of the investment tax credit, the reduction in the corporate tax rate, and the increased deduction for net capital losses, Kennedy suggests repealing a number of business tax preferences that survived the Tax Reform Act of 1976. First, he advocates repeal of the asset depreciation range (ADR) system of depreciation. Traditionally, the law only permitted deductions for depreciation to be taken over the actual life of asset, but ADR permits a business to reduce artificially the expected useful life of its assets and then take depreciation deductions based

on the shorter life. A Library of Congress study found this accelerated depreciation rule to be a highly wasteful method of inducing capital formation, producing far less in capital investment than is lost by the Treasury in revenues.

The oil depletion allowance was partially repealed in 1975, but percentage depletion for other minerals has remained in effect. Kennedy recommends finishing the job begun in 1975 by completely repealing all percentage depletion. This recommendation was also made recently by the National Commission on Supplies and Shortages, which found the deduction to be an inefficient method of encouraging exploration for and development of natural resources.

The special 30% rate of tax on capital gains made available to corporations would be repealed under the Kennedy plan. This is in line with the proposed repeal of the capital gains preference for individuals and the reduction to the top corporate tax rate to 45%. The timber industry has relied on this tax preference in a special way and has deferted it as a parallel to the percentage depletion deduction made available to other natural resources. With the repeal of percentage depletion for minerals, this purported justification of the preferential gain rate for timber no longer makes any sense.

In addition, Kennedy proposes to require large farm corporations (gross sales of more than \$2 million) to use the accrual accounting method that is required of all other comparable businesses. This change would allow only small, family farmers to make use of the cash method of accounting. (See "The Great Chicken Debate," *P&T*, June 1977, p. 4.)

Tightening of Expense Account

Living Rules

To curtail tax subsidized "expense account living," Kennedy proposes denial of deductions for business meals, yachts, country clubs, tickets to sporting events, theaters, and similar entertainment, and the first class portion of airfare. Moreover, he suggests that deductions for travel away from home should be limited to the government *per diem* amount. Although these expense-account deductions involve a relatively small amount of tax revenue, Kennedy said, "there are few more vivid symbols of the disgrace of our current tax laws than the martini lunch, the first class fare, and the front row seat."

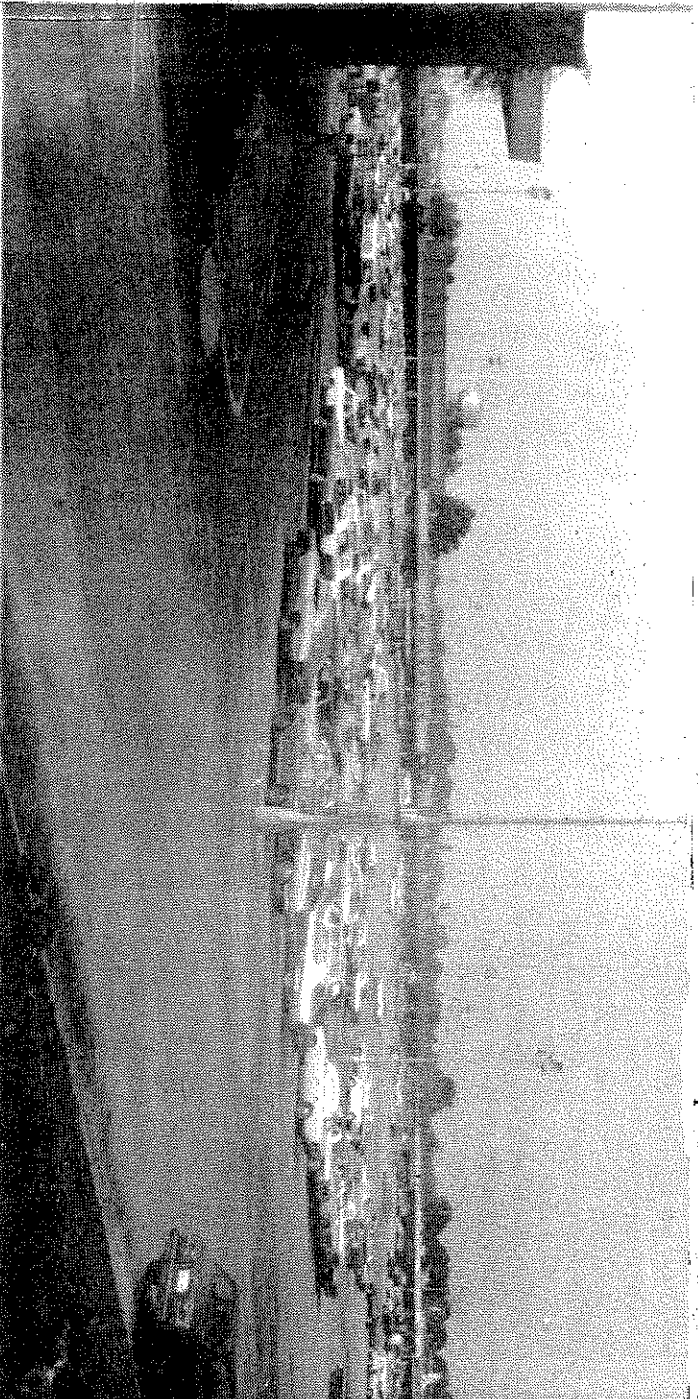
Repeal of DISC

The export subsidy DISC is probably the least justifiable of all tax preferences in the tax code, according to Kennedy. Many studies have revealed its inefficiency as a means of increasing exports and its irrelevancy in a world of fluctuating currencies. Kennedy recommends this tax preference to be repealed gradually over a 10 year period.

Other proposed tax reforms in the business and corporate area include the repeal of the tax deferral on earnings of U.S. controlled foreign subsidiaries and the repeal of the exclusion for income earned abroad by U.S. citizens.

Wealth Transfer Taxation

In the estate tax area, Kennedy called for a series of improvements in the measure passed by Congress in 1976, including a freeze on the estate tax exemption at the current \$120,000 level, rather than the \$175,000 level now scheduled for 1981, and a closing of the loopholes in the "generation skipping" tax enacted in 1976.



Kennedy proposes repeal of accelerated depreciation for real estate, on the grounds that it is an inefficient and unnecessary method of inducing investment in construction of high rise office buildings, luxury apartments and shopping centers.

Birds Of A Feather

Simplicity And Fairness

After some sixty odd years of amending and tinkering with our tax system, adding complexity at every turn, attention is finally being turned toward tax simplification. Shamed and appalled by the "Lawyers and Accountants Relief Acts" enacted as the Tax Reform Acts of 1969 and 1976, Congress, reformers, and practitioners are resolved that future tax reforms must also remove some of the horrendous complexity of the tax system.

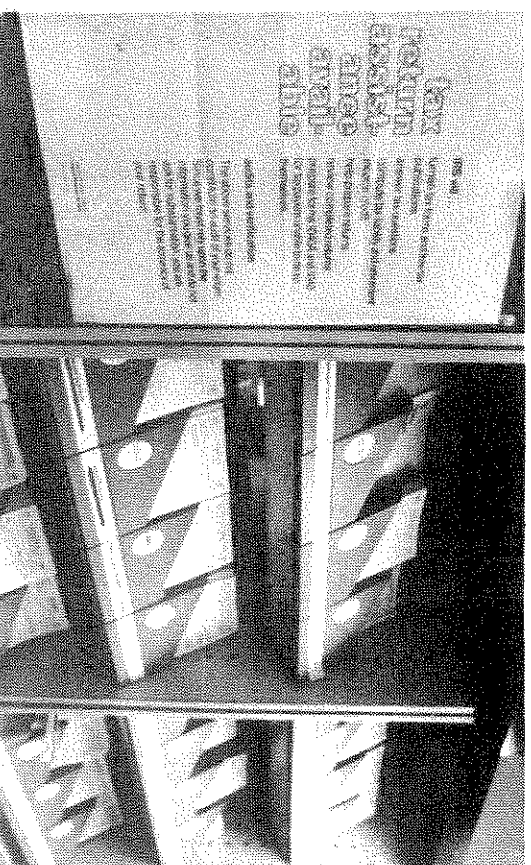
ITEM: The tax treatment of insurance companies has become so complex that virtually no one understands it. The Internal Revenue Service apparently has no full-time insurance experts, but is instead forced to hire outside counsel to audit an insurance company. The Supreme Court had two cases involving insurance companies this term, deciding both of them against the government. In one, the dissenting Justice complained that the Court had opened a "truck-hole" in the law; in the other, a public interest tax lawyer told the Court that the briefs for both the government and the taxpayer had totally missed the point. Virtually no one knows if the complainers are right. On the other

side, lawyers for insurance companies bemoan the fact that, even when they think they understand an issue, they are unable to explain their position to IRS attorneys. The result is a system which no one understands, which is probably unfair, which Congress is afraid to amend, and which Ralph Nader characterizes as "essentially unenforceable."

ITEM: Although 77% of all taxpayers now take the standard deduction and could fill out a short tax form in a matter of minutes, 40 million Americans found it necessary to seek the assistance of a professional tax preparer last year, in hopes of finding "loopholes" or in fear of making mistakes.

ITEM: A law professor at Hofstra University asked his class of over 100 law students studying the federal income tax to attempt to calculate the earned income credit for a sample taxpayer. Although the credit is available only to low income families who are likely to be poorly educated, only half the law students successfully computed the proper credit.

ITEM: The error rate on tax returns is skyrocketing. Recent figures show that at



Because of the complexity of the tax code, 40 million Americans had to seek the assistance of professional tax preparer services to fill out their returns.

best only 1 out of 2 taxpayers avoid mistakes on their returns. Professional preparers did just as poorly: surveys in California and New York showed virtually a 100% error rate on moderately difficult sample returns. Even the IRS has trouble: it's personnel avoided mistakes on only 21% of middle income returns in a 1972

49% Favor Fairness 26% Favor Simplicity

What's The Difference?

POLL, from page 1

the study, and one which President Carter ought to pay careful attention to. When the pollsters conducted their own "mini-education program," asking the overwhelming majority who had voted for at least one of an array of proposed new deductions whether they would give them up in favor of simplification and lower tax rates, a large majority favored the broad-based tax reform. Part of this may have been just semantics. Roper notes that "buzz words," such as "tax reform" and "loopholes," seem to "turn people on and off." In addition, however, the results indicate that for the President's tax reform plans to be successful he must explain to the public how eliminating special provisions in the tax laws will lower most people's taxes.

Press stories have quoted the survey for the proposition that the public is not particularly entranced with tax simplification, a key goal announced by President Carter. This is based on a very misleading Roper question, which asked respondents which they thought was more important — "changing the tax laws to make them fairer, or simplifying the tax return forms and instructions?" Not surprisingly, a plurality (49%) favored fairness, while 26% thought simplicity was more important, and 17% rated the two equally. But Roper's conclusion that "tax reform is called for by a two to one margin" over simplification is nonsense, because for the average taxpayer the two go hand in hand. Eliminating special provisions in the tax laws would both improve equity and reduce complexity.

The study belittles the public's knowledge about the amounts of tax paid by persons in different income classes, and, in fact, from a third to a half of those polled couldn't even make a guess. However, even the most seasoned tax professionals have trouble estimating effective tax rates, and only recently did the Treasury Department begin publishing

reasonable reports on high income taxpayers. Even these reports have a number of deficiencies, because they fail to take account of some forms of tax-exempt income.

In fact, the public's estimates for taxes paid by persons earning \$25,000 or less were extraordinarily accurate, a fact which the pollsters partially fail to note, due apparently to their own ignorance. Furthermore, although the public's guess that the average taxpayer earning over \$50,000 pays only 13% is somewhat low, it is well within the range paid by high income people. For example, 10% of those earning over \$50,000 per year pay less than 15% in federal income taxes, and effective rates on people earning over \$200,000 range from zero to 58%. Thus, the 64% of the public who felt the tax system is either somewhat (34%) or quite (30%) unfair were right when they pointed the finger at high earners paying too little, although some people with high incomes obviously do pay their fair share.

This ought to be another lesson to President Carter: Any tax reform plan which does not assure that all high-income persons bear their share of the tax burden will be perceived as unfair by the public. Special exceptions going, for example, to oilmen will tend to undercut public support for the President's package.

A survey which asks people for "gut reactions" to questions on a subject they admittedly know little about clearly has to be interpreted with several shakers of salt. The Roper poll is nevertheless valuable in alerting the President to the importance of educating and involving the public concerning his tax reform plans. Without this effort, tax reform will again be torpedoed by special interests, who have so successfully utilized the public's lack of awareness in the past.

Summary of Some of the Results of the Roper Poll

Understanding of tax forms:

Very well — 10%.
Fairly well — 27%.
Not too well — 19%.
Very little — 41%.
Don't know — 2%.

Fairness of the tax system:

Quite fair — 3%.
Reasonably fair — 27%.
Somewhat unfair — 34%.
Quite unfair — 30%.
Don't know — 5%.

Which is more important, deductions or simple forms and lower rates? (asked only of those who favored specific new deductions):
Simplicity and lower rates — 58%.
Deductions — 33%.
Don't know — 9%.

Broadening the tax base (less tax exempt income) and lowering rates:
In favor — 48%.
Opposed — 29%.
Don't know — 23%.

Specific base broadening plan versus current law:
Broadened base — 36%.
Current law — 54%.
Don't know — 11%.

Tax credits substituted for deductions:
In favor — 42%.

Opposed — 41%.
Don't know — 17%.

Estimated tax rates (approximate actual rates in brackets):

\$10,000 — 10% [9%].
\$15,000 — 12% [11%].
\$25,000 — 12% [14%].
\$50,000 — 12% [19%].
\$100,000 — 13% [27%].
\$200,000 — 13% [32%].

sample.

Simplification of our tax system is so long overdue that some reformers are starting to put it even before fairness as the primary goal of reform. Luckily, however, fairness and simplicity tend to go together in a large number of cases.

There are four primary goals which simplification measures should serve:

(1) Tax forms should be easier to fill out.

(2) Tax considerations should be less of a factor in day-to-day transactions, thereby simplifying life.

(3) The tax system should be made more understandable to the average taxpayer. This should increase respect for and compliance with the tax laws.

(4) The Internal Revenue Code should be easier for the experts to understand, and easier for IRS to enforce.

To serve all these goals, as a general rule means elimination of special deductions and tax expenditures. Happily, elimination of these also leads to greater fairness in the tax system. This is for three reasons:

(1) The benefits of tax expenditure deductions are skewed towards the well-off, since deductions only benefit the 23% who itemize, and the amount saved by a deduction is dependent upon a taxpayer's marginal rate bracket.

(2) Many of the tax expenditure items are only available to middle and upper income people. Homeowner deductions, for example, benefit less than 20% of the citizenry. Capital gains exclusions and state and local bond exceptions only help those with a lot to invest.

(3) Even the few tax expenditures in the form of a credit tend to benefit a particular group, at the expense of everyone else, with little strong social policy reason for doing so (e.g., the child care credit).

An example of how this works are the homeowner deductions for mortgage interest and property taxes. Only a minority of taxpayers owning homes actually benefit from these deductions. Virtually all homeowners, however, have to calculate their tax returns two ways to see if they are better off itemizing or taking the standard deduction.

The effects of these deductions are manifestly unfair. For top bracket homeowners, each dollar in deductions can save 70 cents in taxes — in other words, the government will pay close to 70% of their housing costs. For mid-bracket taxpayers the subsidy is less, and for the majority of homeowners, who take the standard deduction, it is zero. The top 15% of

See SIMPLIFY, page 11

'Circuit Breakers' Aid Poor

PROPERTY TAXES from page 51

The amounts exempted vary from \$1000 in Indiana to \$20,000 in Hawaii. As of November of 1975, there were 39 mandated homestead exemption programs in 23 states. Some programs, such as in Montana, simply reduce the assessed value of the home of those who qualify by 50% no matter what the assessed value of the property is. In other states, such as New Jersey, eligible homeowners are given an across the board flat dollar reduction in their tax bills.

Although the homestead exemption theoretically ought to be geared to wealth rather than income, few states have across the board exemptions. Instead, most programs are limited to certain groups (e.g., the elderly and the disabled) and more than half incorporate household income ceilings. Only a few have set asset levels.

The targeting by income level has tended in practice to be rather crude, although this is not inherent to the measure. Thus, most putatively income-related programs aid the wealthy elderly as well as the impoverished. Even programs which do impose income limits are faulty, in that they tend to take an all or nothing approach, granting full relief for persons below a certain income level and nothing to those above it.

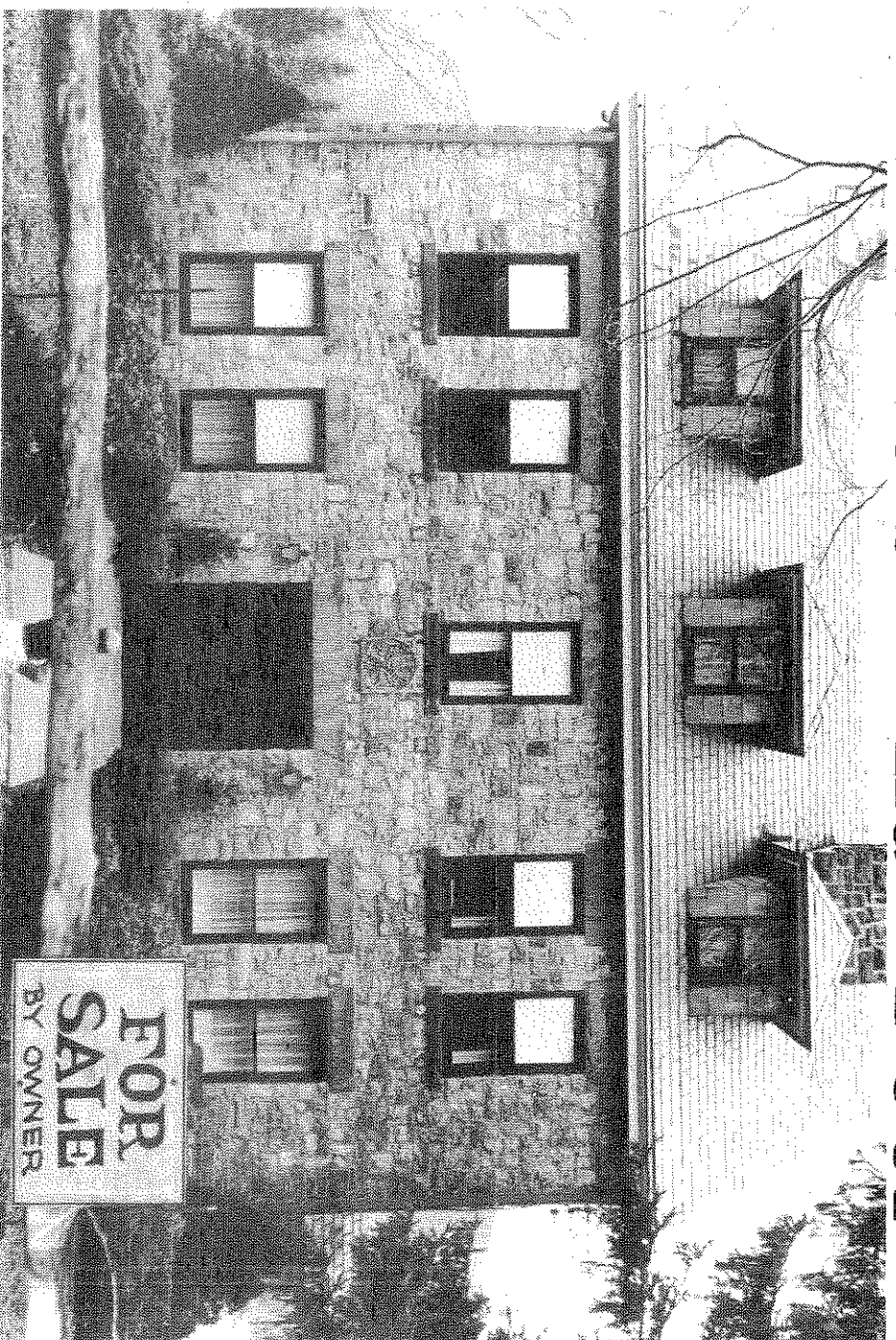
Drawbacks

Even if these problems were corrected, there are some serious drawbacks to the homestead exemption as a means of shifting the tax burden away from low income households.

Most important is the fact that it is difficult to give any of the benefits to low income renters, although as much as 15-20% of their rent may be due to property taxes passed on by their landlords.

Other problems include the fact that state set exemptions may be either too meagerly or too generous depending upon the locality a homeowner lives in. Finally, attempting to provide an across the board standard deduction for wealth taxation may be more than many localities can afford, yet the selective relief now granted tends to be unfair.

Overall, the homestead exemption appears to be a theoretically sound means of reforming property taxes. Until state and local governments can afford to apply fair exemptions generally, however, its potential may go unrealized.



Deferral programs under which eligible homeowners can put off paying their property tax until they either die or sell their homes create a number of problems and have not been popular.

CIRCUIT BREAKERS

Circuit breakers provisions are fast becoming the most popular means of granting property tax relief. Geared totally to a family's income rather than its wealth, the measures can insure for both homeowners and renters that property taxes do not eat up more than a certain percentage of family income. Like a fuse or circuit breaker in an electric system, the property tax circuit breaker cuts in when taxes exceed a certain level and either forgives or refunds the excess.

The circuit breaker approach was first initiated in Wisconsin in 1964. It took three years before a second state (Minnesota) tried it, and by 1970 only four states had adopted it. Since then, however, twenty-one additional states have enacted circuit breaker legislation. The recent speed of adoption has been so great that the 1976 statistics upon which this count is based may already be substantially outdated.

The basic idea behind the circuit breaker is that tax burdens exceeding a prescribed percentage of household income are excessive and all or part of this excessive tax burden should be rebated.

The original circuit breaker in Wisconsin and most of those that followed early on were restricted to the low-income elderly. Currently, however, 7 states have programs covering all low-income households and many of these programs now cover both homeowners and renters. Although there are almost as many formulas for circuit breaker relief as there are programs, the approaches fall into two basic categories: the "threshold approach" and the sliding-scale or "percentage of tax liability" approach. Both rest on the ability to pay.

Threshold Approach

* Under the threshold approach, an acceptable tax burden is defined as some fixed percentage of household income (different percentages may be set for

various income levels). Any tax above this amount qualifies for relief. For example, if the threshold is set at 5%, the "acceptable" tax burden for a family with \$8000 of income is \$400 (.05 times \$8000). If this family's actual property tax bill is \$500, it qualifies for a \$100 rebate (\$500 actual tax minus \$400 acceptable tax).

Sliding-Scale Approach

* Under the sliding-scale approach, no threshold is defined. Rather, a fixed percentage of property tax (whether that tax is high or low) is rebated for each eligible taxpayer within a given income class; this formula returns higher percentages of the tax bill as income declines. For example, if the rebate percentage for families in the \$7500-\$10,000 income range is 15%, the family in the previous example having \$8000 income and a \$500 property tax bill qualifies for a \$75 rebate (15% times \$500).

One feature of the sliding-scale approach is that it grants relief to all low-income families, whether or not they spend a certain "minimum" on property taxes. This also means that relief goes to families in areas where taxes are relatively low, as well as to those in high-tax districts. Under the "threshold" approach, on the other hand, people in high tax areas will garner the lion's share of the rebates, since more of them will pay property taxes in excess of the "threshold" limit. Of course, some would contend that low-income families paying more than the limit are exactly the ones who need relief.

In practice, most states have extended circuit breaker relief primarily to the elderly, although on equity grounds there is no clear justification for limiting tax relief to persons on the basis of age — or any other physical characteristic. Presumably this is done to restrict coverage to those groups most likely to need tax relief. However, one of the biggest theoretical advantages of the circuit breaker is that relief can be targeted to those who actually need relief rather than having to rely on often inaccurate assumptions about the

By deducting their property tax liabilities from their federal income taxes, high bracket taxpayers can save up to 70 cents for each dollar paid in local property tax. Average homeowners, however, get no reductions because they take the standard deduction.

continued on next page

FBI, S.S. Taboo For TAS

TAS from page 3

disclosure of return data.

In addition, the Privacy Commission suggests that IRS's interpretation of the new

law may be "inconsistent with the spirit and substance of the 1976 restrictions." According to the Commission, IRS's temporary regulations implementing the new law seem to "provide an easy way to avoid the Tax Reform Act's restrictions on the disclosure of tax data for non-tax criminal law enforcement."

Linkage

One issue on which both sides agree is that the TAS should legally be prevented from linking up with other data retrieval systems such as the FBI National Crime Information Computer or the Social Security information system. The potential linkage of computer systems has been one of the major fears of TAS critics. But IRS agreed that there ought to be federal legislation prohibiting such linkages.

Budget Status

Neither the House nor the Senate Appropriations Committees are rushing to pass judgement on the TAS. Both Committees have expressed a concern about the lack of details in the TAS proposal. And both Committees seem inclined to wait until an Office of Management and Budget study, due this summer, and two General Accounting Office reports, due in late fall, are released. GAO has

already released a study focusing primarily on the physical security of the TAS system. The new reports will be devoted

to privacy issues and to a cost-benefit analysis of the proposed system. The Committees are especially awaiting the OMB report which is expected to reflect the position of the Carter Administration, not just on the TAS but on general policy questions concerning privacy and computer technology.

IRS's need to replace its existing system is unquestioned. Also unquestioned is the need to create a more efficient collection process. Previously, however, Congress has been willing to allow IRS to dictate its needs to the taxpayers. But, with the implementation of advanced computer information technology, Congress must take more care in the oversight of systems such as TAS. The rationale for intensive scrutiny of the TAS has been supplied in the Privacy Commission Report: "The fact that tax collection is essential to government justifies an extraordinary intrusion on personal privacy by the IRS, but it is also the reason why extraordinary precautions must be taken against the misuse of the information the Service collects from and about taxpayer."

The rationale for the intensive scrutiny of the TAS is that due to the extraordinary intrusion into personal privacy to make accurate collections, "extraordinary precautions must be taken against the misuse of the information..."

Property Tax

continued from page 8

needs of the elderly, the handicapped, the widowed or veterans. At least 7 states do in fact provide relief for all low income people. Nineteen of the twenty-five states include renters as well as homeowners within their circuit breaker programs, on the assumption that landlords shift forward to tenants their property taxes and that equity requires that renters be afforded relief. Since, overall, renters are more likely than owners to have low incomes, providing relief to renters would seem to be an essential part of a comprehensive circuit breaker program.

In those states that provide relief to renters, most define their property tax equivalent as approximately 20% of rent (generally adjusted to subtract extras

such as utilities and furnishings). All of the states with circuit breakers put an upper limit on the amount of relief that can go to any one taxpayer, by setting a ceiling on either the amount of credit or rebate, the dollar amount of the property tax that can be considered, or the amount of assessed value on which tax qualifying for relief can be based.

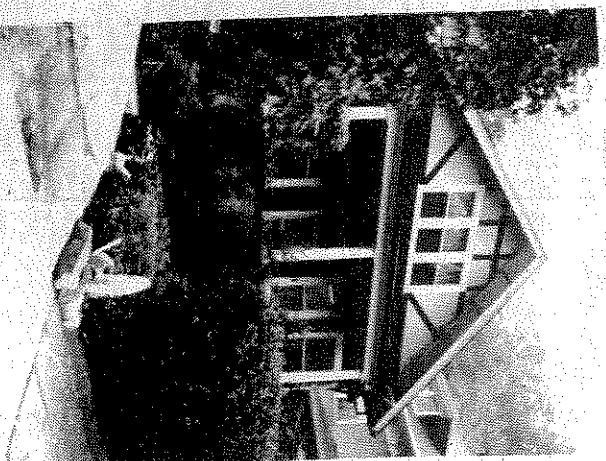
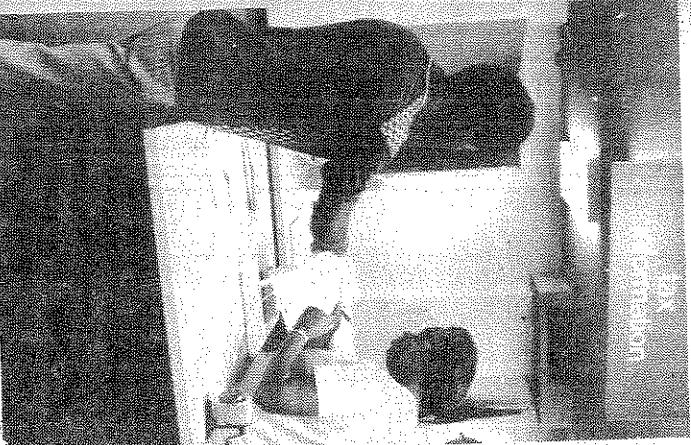
Overall, circuit breakers are generally very effective relief mechanisms for those at whom they are aimed. When broadly targeted for all low-income people, the program helps to make tax burdens proportional or progressive in relation to household income and thus effects a very positive reform.

Conclusion
Even the best kinds of property tax

reform are dependent on two other considerations to be successful. First of all, property tax relief must be paid for, and unless care is taken it could result in either serious retractions in public services or increased use of regressive taxes such as sales taxes. If this happens, any relief granted will be nullified by the negative effects. A promising approach has been proposed in California, under which low-income property tax relief would be financed by increased progressivity in the state income tax (see *P&T*, July 1977).

Second, citizens must take action to assure that local assessors are competent and honest. A theoretically perfect system will still be unfair unless properly administered.

Citizens must take action to assure that local assessors are competent and honest for reform to work.



H&R Block Opposes Taxpayer Aids

H&R Block, the country's largest commercial tax preparer, has a new addition to its "17 reasons" why taxpayers should pay to use its services. At hearings held on July 26, Henry Bloch told the Ways and Means Oversight Subcommittee that he opposes simplifying the tax laws and improving IRS's help for taxpayers. "Self interest aside," said Bloch, whose company prepared over 10 million tax returns this year, "we believe IRS should leave tax return preparation to private industry."

Bloch's viewpoint was sharply criticized by Subcommittee member Richard Gephardt (D-Mo.), who told Bloch that one of the primary goals of Congress ought to be to improve the system so that average taxpayers are capable of filling out their own returns. "In a way," he told Bloch, "we ought to be trying to put you out of business."

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Many of the other witnesses before the Subcommittee also disputed Bloch's recommendations. Robert McIntyre of the Tax Reform Research Group, for example, proposed expanding IRS taxpayer assistance, including simplifying the procedures whereby taxpayers can have the Service fill out their returns. Currently, only about 1% of taxpayers request IRS to complete their tax forms for them, although in the mid 50s the figure was close to 40%. "We have no objection to taxpayers consulting commercial preparers if they want to," said McIntyre, "but tax-

payees should not be forced to use outside help, and they should be able to understand their own tax returns, for which they alone are ultimately responsible."

When Gephardt quizzed McIntyre about Bloch's recommendations, McIntyre compared the problems taxpayers have with the current system to "a dread disease set loose on the country by the government. Now, the government has the antidote, but Bloch's suggestion is that it shouldn't use it, but should instead let private industry muddle around and see if they can find a cure."

So far, private tax preparers have done a rather poor job in assisting average taxpayers. Recent surveys in New York and California showed serious mistakes by commercial preparers in virtually every attempt they made to fill out "model" returns. (See the March and May 1977 issues of *P&T*.) In 1972, IRS statistics showed that commercial preparers made substantive errors in three-quarters of the middle-income returns they completed.

Bloch alleged that for the tax system to be fair it has to be too complex for the average taxpayer to understand. This contention is disputed by many tax reformers, who feel that a much fairer system would be attained by removing the complex layers of special provisions in the current tax code.

The Tax Reform Research Group also called for a program to make legal services available to low and moderate income taxpayers dealing with IRS audits, appeals, and collections. Because the amounts in dispute are typically only \$100-300 for people in these groups, it does not make financial sense to hire a private attorney. The Tax Group recommended that the Legal Services Corporation make tax help available to low and moderate income taxpayers at little or no cost, and also suggested that IRS encourage law schools to set up programs to allow law students to provide taxpayer assistance. The Tax Group receives "hundreds of letters from anguished taxpayers each year," said McIntyre, "but as of now there is rarely anyone to whom we can refer the taxpayer that we have any confidence will solve the problem."



Bloch alleged that for the tax system to be fair it has to be too complex for the average taxpayer to understand. As more people seek the aid of professional tax preparers every year it seems we have reached that high complexity level already and the system does not seem to be fair.



Representative Richard Gephardt (D-Mo.) to Henry Bloch of H & R Block -- "In a way, we ought to be trying to put you out of business."

The Oversight Subcommittee will the hearings, as to ways in which the tax make recommendations to the Ways and system can be made more responsive to Means Committee and the IRS, based on the average taxpayer.

A Comment

In Defense Of Double Taxation

The present treatment of corporate profits--taxing them once when earned by the corporation and again when realized by shareholders as dividends or as capital gains on the sale of stock--makes no sense in a world with no tax preferences. In the simple case, with no preferences and 100% distribution, \$100 in corporate profits results in about \$75 in tax for a 50% bracket shareholder. This is unfair and illogical, and either full or partial integration of the corporate and personal income taxes would be an improvement.

We do not, however, live in a preference-free world. If our tax system must serve the two goals of providing corporate "incentives," while at the same time taxing shareholders at their nominal tax rates, the present "double taxation" approach is the only efficient and fair one. When preferences are included in our calculations, "double taxation" is really "two-step" taxation.

An example can make this clear. Assume that preferences reduce the effective corporate rate to about 25%, and that the shareholder we are considering

is in the 50% rate bracket. Assume our goal is to continue the lower corporate rate, which the corporation attains by engaging in socially beneficial activities such as investment in new machines. Assume our second goal is to assure that the shareholder really pays 50%. Partial integration fails badly to satisfy these two goals. Thus, if the corporation earns \$100 its after-tax profit is \$75. If it distributes half and retains half, the shareholder will get \$37.50, on which he or she must pay a tax of 50% x \$50 = \$25, reduced by a \$12.50 tax credit to \$12.50. Later, the shareholder will have to pay tax on the \$37.50 in retained earnings (e.g., when the stock is sold), but assume that deferral reduces the effect of this later tax to zero. Therefore, on the \$100 in corporate earnings, the shareholder ultimately gets \$67.50, the government, \$32.50. This is much less than the \$50 which the government should get if the shareholder is to be taxed fairly.

The result under present law is much better. Assume again \$100 in corporate profits and a 25% corporate tax. On a distribution of \$37.50, our 50% See **DOUBLE TAX**, page 11

Social Deductions Unfair

page 7
7% of this \$11

the deduction so that all profits. This but only with expenses subsidy at grant the simple of the to beneficiaries, as would be capable es total s. This, of lification.

other individuals to the same ons are unfair

Although repeal of tax expenditures is the most important step toward simplification.

The move toward simplification of the tax return process ought to enable taxpayers to fill out their own tax returns in a matter of minutes.

and complex and should be eliminated.

cation, other steps also ought to be taken to improve the system.

Copy Tax Concept

DOUBLE TAX from page 10

shareholder pays a tax of \$18.75. The realized \$37.50 is eventually realized by the shareholder, and counting deferral jobs essentially untaxed. Therefore, the shareholder nets \$56.25, the government, \$43.75. Although still less than the 50% rate we seek, this is far preferable to partial integration. A slight reduction in preferences, raising the effective corporate rate to 33%, achieves a near-perfect result.

Furthermore, because the corporation receives the full benefit of the

els, the unfairness is even less.

preferences under the present system, "incentives" are maximized. Some would argue that partial integration calculated on the "exact" method reduces preferences, and therefore incentives, by half.

Therefore, if the Carter tax plan is really to be based on a tripod of goals—equity, simplicity, and incentives—the Administration should hesitate before switching to a partial integration method of taxing corporate profits. Measured by all three elements of the tripod, the present system is preferable. (Requiring shareholders to "gross-up" dividends as does partial integration, obviously adds complexity to the tax laws.) If integration is to be proposed, then the incentives leg of the tripod ought to be abandoned as the least important of the three.

For example, many employers fail to include taxable fringe benefits on their employees W-2 forms. This leads many taxpayers either to think these benefits are non-taxable or to forget about them, thereby underpaying their tax. Even when taxpayers know that the benefits should be included, they are discouraged from reporting them because no tax has been withheld and by the feeling that "nobody else does it." There is a major equity problem here as well, since substantial fringe benefits tend to be concentrated on high income employees.

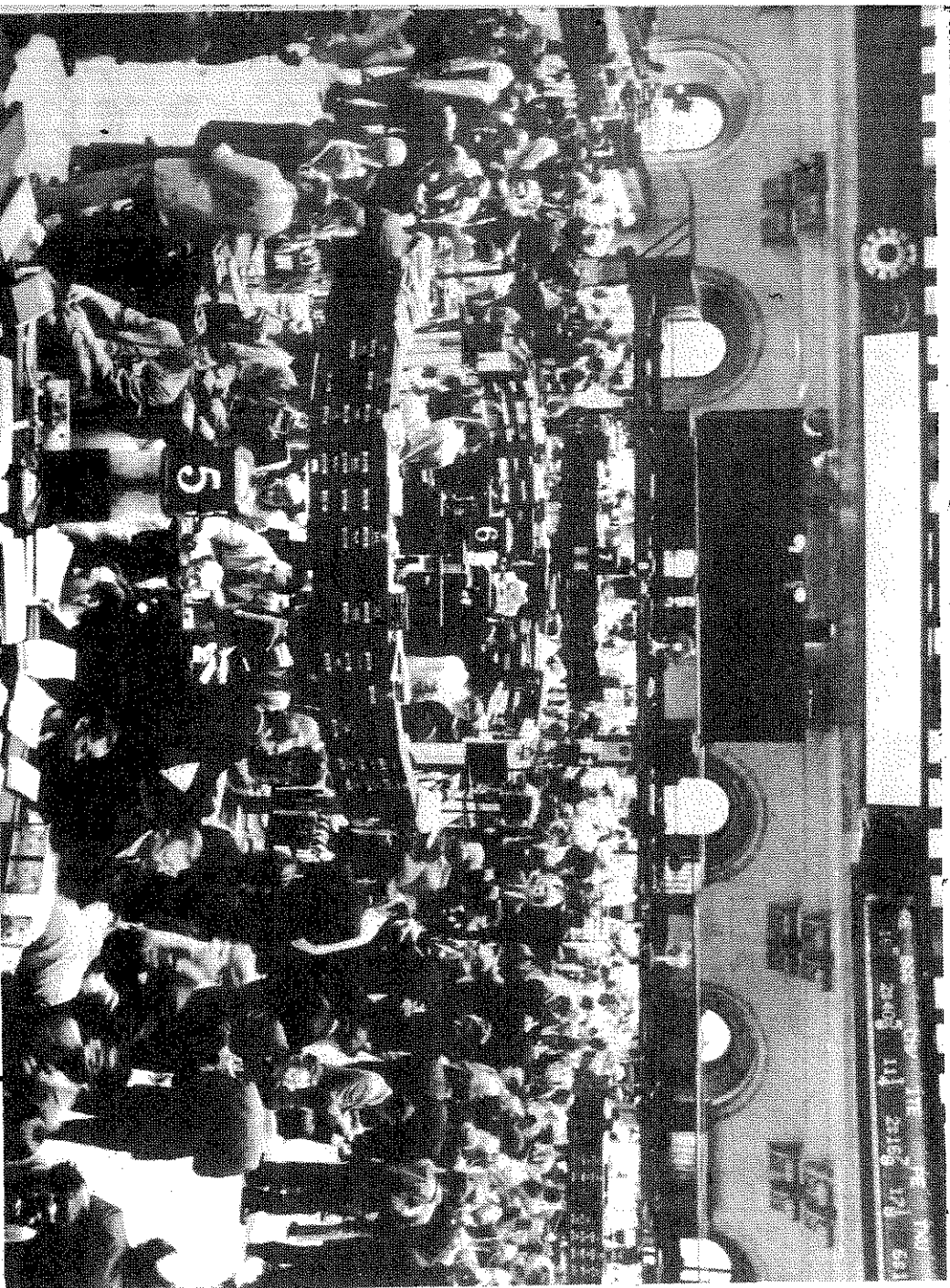
For the same reasons, withholding and W-2 forms should be extended to dividend and interest income. This would both simplify tax return preparation and enhance the fairness of the system.

The instructions to the tax forms should be improved. A problem frequently encountered by average taxpayers is that they cannot glean from the forms and instructions the basic principles or rules with regard to a tax provision. Instead, the IRS instructions tend to list the technical conditions for a deduction or to give examples of what is and is not covered by the provision. The result is that taxpayers are forced to spend hours analyzing provisions which are irrelevant to them, and they often come away with no sense as to why or why not they qualified for a deduction.

For example, tens of millions of taxpayers annually scrutinized the "earned income credit" to see if they are eligible. Many erroneously take it not realizing that it is only available to families with dependents. Conversely, many eligible persons fail to take advantage of the credit because the technical instructions scare them away.

The tax forms and instructions are a marvelous opportunity to educate the public about tax policy, but so far they have not been utilized. Most taxpayers, when told the general scope and purpose of a provision, will find it easier to deal with, and have increased respect for the system.

Many stockholders are concerned about corporate income being taxed once as corporate income and then again when dividends are paid out to shareholders as income to shareholders. However, they don't seem upset by all the loopholes in the tax code that they often take to effectively reduce or eliminate their "normal" tax burden.



People & Taxes

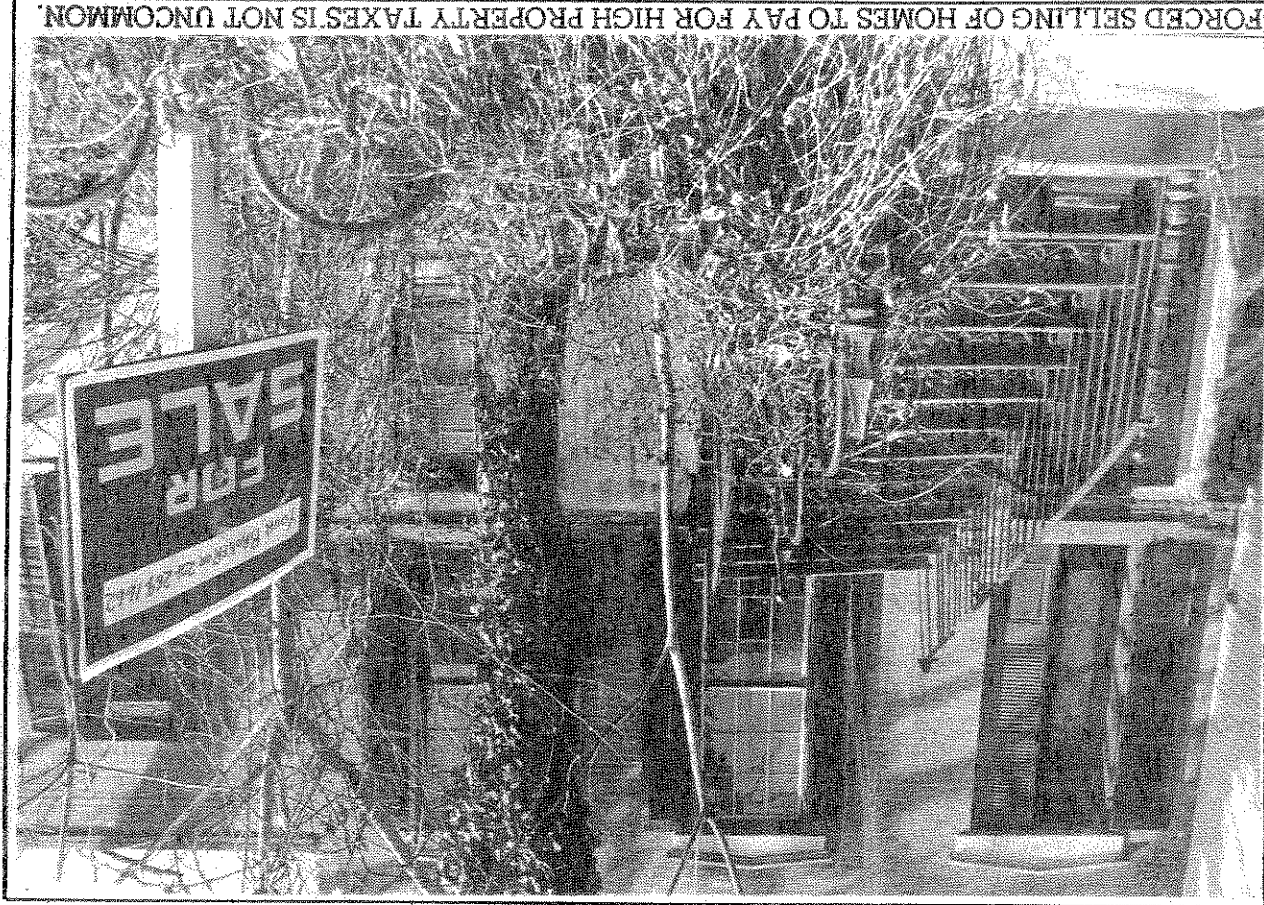
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AUGUST 1977

Good Tax System: Simple And Fair



FORCED SELLING OF HOMES TO PAY FOR HIGH PROPERTY TAXES IS NOT UNCOMMON

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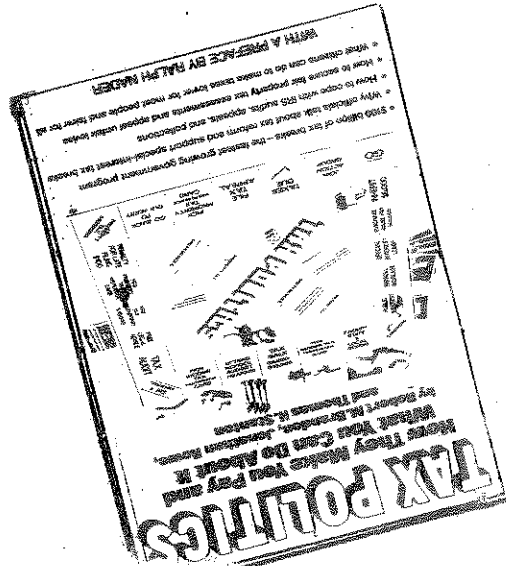
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