

HJR

70

**STATE OF ALASKA
1992 LEGISLATIVE SESSION**

Revision Date: _____ Department Affected: Legislature
 Title: Amend Internal Revenue Code BRU: _____
 Sponsor: Rep. Leman Component: _____
 Requestor: _____ COMPONENT SERIAL NO.

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EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 93	FY 94	FY 95	FY 96	FY 97	FY 98
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	-0-					
CAPITAL	-0-					
REVENUE	-0-					
FUND SOURCE:						

FUNDING: (Thousands of Dollars)

GENERAL FUND	-0-					
FEDERAL FUNDS	-0-					
OTHER	-0-					
FUND SOURCE:						
TOTAL	-0-					

POSITIONS:

FULL-TIME	-0-					
PART-TIME	-0-					
TEMPORARY	-0-					

Estimate of current year impact: _____

ANALYSIS: (Attach a separate page if necessary.)

Prepared By: [Signature] Phone: 465-3732
 Division: House Health Education and Social Services CMTE Date: 1/21/92
 Approved by Commissioner: _____ Date: 1/21/92
 Agency: _____



REPRESENTATIVE LOREN LEMAN West Anchorage

3111 C Street Anchorage, AK 99503 561-7614 During Session: P.O. Box V Juneau, AK 99811 465-2095

M E M O R A N D U M

DATE: March 31, 1992

TO: Senator Arliss Sturgulewski, Chairman
Senate Health, Education and Social Services Committee

FROM: Representative Loren Leman *Loren*

SUBJECT: Request for Hearing
HJR 70: Increase Personal Exemption and Provide
Parental Child Care Exemption

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Please schedule HJR 70 for a hearing by the Health, Education and Social Services Committee at your earliest convenience.

HJR 70 requests the IRS to allow a parental child care exemption for the services of a parent who stays at home to care for at least one child under the age of 13, and to increase the personal exemption for a child under 18 by at least \$500.

This is a pro-family proposal that has bipartisan support in our Legislature and in Congress. It has a zero fiscal note.

It passed the House without opposition. I urge its swift passage through the Senate.

Attached are the following:

- Fiscal Note
- Sponsor Statement
- Backup Information

Attachments



REPRESENTATIVE LOREN LEMAN West Anchorage

411 C Street Anchorage AK 99503 561 7611 During Session P.O. Box A Juneau AK 99811 465 2095

SPONSOR STATEMENT

DATE: March 26, 1992

BY: Representative Loren Leman *Loren*

SUBJECT: HJR 70: Resolution Urging Congress to Amend the Tax Code

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The tax burden for working and middle class families, especially young families, has grown heavier over the past 40 years. Although they disagree on methodology for change, President Bush and Congress agree that something needs to be done. Families with children are overtaxed and need a break from the inflation-driven tax increases that have fallen disproportionately on them.

HJR 70 urges Congress to promote parental child care and increase the personal exemption for children by amending the Tax Code. This is a pro-family proposal that has bipartisan support in Congress.

One element of this resolution is a parental child care exemption for the services of a parent who stays at home to care for at least one child under the age of 13. The increase in spendable income would be a big help to many families.

Current tax law allows for a credit of a portion of up to \$4,800 to offset expenses for child care services provided by others. However, no deduction or credit is allowed for parents who surrender opportunities for a second income outside the home by staying at home to care for their own children.

During the last thirty years, we have seen tremendous changes in the composition of our families. These changes have certainly influenced nearly every element of society. Although some of these developments may be largely a result of a changing culture, many recent studies demonstrate the close relationship they have with the absence of parents from the home.

A second element of this resolution is an increased personal exemption for children. President Bush proposed an increase of \$500 in this exemption during his State of the Union address. Other proponents of tax reform in Congress have suggested even more significant changes.

Helping parents give their children a better life by allowing them to keep more of their earnings is one of the best things we can do to strengthen families. Families, after all, are the most basic structure of society and their protection should be the highest objective of social policy.

Passage of HJR 70 will show the Legislature's support for this protection. Concerns raised about this resolution have been addressed during the committee process.



POLICY INSIGHTS

The Tax Cut Families Need

During his long tenure on Capitol Hill, Rep. Dan Rostenkowski (D-IL), chairman of the House Ways and Means Committee, has been fairly consistent in favoring high taxes. It is therefore not without significance that during the past holiday season, the door to Mr. Rostenkowski's congressional office was decorated with Christmas greetings and wishes for a happy new year and "a tax cut in 1992."

When even Dan Rostenkowski is campaigning for a tax cut, it is obvious that sentiment for tax reduction is strong. It is equally clear, given Mr. Rostenkowski's powerful position as head of the Ways and Means Committee, that tax reduction is a real possibility in this session of Congress.

Rostenkowski is one of at least a half dozen major Democratic congressional figures with tax relief plans to offer. They are joined by just as many Republican tax cut proposals. Remarkably, there is a common thread among the many plans that have been proposed. Democrats and Republicans alike seem to agree that families with children are over-taxed and need a break from the inflation-driven tax increases which have fallen disproportionately on their shoulders over the past generation.

The tax climate that enabled families to prosper in the 1950s was so favorable to child rearing that most families with children in that era were virtually exempt from federal income tax. The value of the personal exemption was so high, relative to wage levels, that the exemptions alone eliminated tax liability for families with two or more children and incomes near the national median. Moreover, payroll taxes in those days were so low that most ordinary workers who had growing families were able to take home virtually all of the money they earned.

Real wage levels rose through the fifties and sixties, and their higher incomes pushed many families into tax-paying brackets. But still, the effective tax rates paid by families with children were quite

low until the rapid inflation of the late sixties and the seventies artificially eroded the value of the personal exemption. By the mid eighties, most of the real-dollar increase in federal taxation had been concentrated on those wage earners who were trying to raise children.

In the tax reform of 1986, this problem received some attention with the doubling of the personal exemption. It was evident that the exemption had by then lost most of its significance. At a pre-inflation level of just \$1050 per person, it simply failed to shelter a sufficient amount of earned income from taxation to provide for the basic subsistence of families. By doubling the personal exemption, Congress took a step towards repairing this inequity. But the bigger exemption was not enough to solve the financial squeeze imposed on families by excessive taxation.

Working class and middle class families feel that they are simply falling behind, and not without reason. Real wage levels for men under forty, especially for men with no more than a high school education, are actually lower than they were in the early seventies. Thus, the fathers of young families are actually earning less than their own fathers did. But this is just the beginning of the problem. The cost of housing and health care — elements which tend to loom much larger in the budgets of families with children than among those without children — have far outstripped inflation. As a consequence, home ownership seems out of the financial reach of a growing segment of the population, while the rapidly rising cost of health insurance — or worse yet, the threat of an uninsured illness — further erodes the purchasing power of an ordinary worker's earnings.

Yet even as the cost of living has been rising for young families, their tax burden has grown heavier. Not only are the effective income tax rates higher than a generation ago, but the payroll tax rate, which

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"With a national election looming, widespread discontent within his own party over his failure to keep the now-infamous 'no new taxes' campaign pledge, and a faltering national economy, the President has come to recognize tax relief for families as a pressing national priority."

This issue of **POLICY INSIGHTS** was written by Michael Schwartz, Director of the Free Congress Foundation Center for Social Policy.

falls most heavily on lower-income workers because not one cent of earned income is exempt from it, has more than doubled since the mid-sixties. Most families with children now pay more in payroll taxes than in federal income taxes.

This financial squeeze is one of the main reasons why more mothers have been forced into the workforce. Married women with children are more likely to hold a job outside the home than are either unmarried women or married women without children, even though almost everyone would agree that the responsibility of raising children is such that a lower rate of employment would be expected among this group. Obviously, perceived financial necessity is a significant factor in driving up employment rates among married mothers. Yet much of the additional gross family income generated by second jobs is dissipated in high taxes and the additional expenses entailed in having both parents in the labor force.

The public debate over child care in the late 1980s helped to focus public attention on the issue of overtaxation of families, and members of Congress in both Houses and both parties have gotten the message.

Plans Now on the Table

Among the many tax reduction proposals offered in Congress in 1991, nearly all include some provisions for easing the tax burden on middle-income families. Several of them are specifically targeted to aiding families in meeting the financial cost of raising children. For example, Sen. Lloyd Bentsen (D-TX) has proposed a non-refundable tax credit of \$300 per child. He was outbid by Sen. Bill Bradley (D-NJ), who proposes a refundable \$350 per child credit. Sen. Bob Kasten (R-WI), whose bill is co-sponsored by Rep. Vin Weber (R-MN) in the House, matches Bentsen's \$300 per child credit, but raises it to \$1000 per child for children under six years of age. Sen. Dan Coats (R-IN) recommends, instead of a tax credit, an increase in the personal exemption for dependent children from \$2150 to \$3500, which translates into a tax savings of about \$200 to \$400 per child. In addition, the Coats bill calls for a tax credit of \$500 for preschool children. The Coats bill is sponsored by Rep. Frank Wolf (R-VA) in the House, where it has gained the co-sponsorship of an absolute majority of the entire House membership. Other tax cutting proposals, including some aimed at reducing payroll tax rates, are not specifically targeted to families with children, but would produce similar effects in assuring more take-home pay for working parents.

This immense burst of tax-cutting initiatives in Congress indicates that a consensus is emerging, a consensus which crosses party lines and which is gaining in force. Standing against that consensus has been a cadre of key Bush Administration figures, led

by budget director Richard Darman and Treasury Secretary Nicholas Brady, who have resisted tax reduction proposals.

But in his State of the Union address, President Bush finally broke with his advisors on this point. On January 28 he added the weight of his office to the emerging congressional majority in favor of tax relief for families. With a national election looming, widespread discontent within his own party over his failure to keep the now-infamous "no new taxes" campaign pledge, and a faltering national economy, the President has come to recognize tax relief for families as a pressing national priority.

Fundamental Criteria

Clearly, however, this is just the beginning rather than the end of the debate. Congress and the President must reach an agreement on the specific tax revision which will be of greatest benefit to families and which will contribute to economic recovery. It seems that four principles should guide them in their efforts to reach a solution.

- 1. The tax cut should be targeted directly to families with children. A more general tax cut would dilute the benefits to families with children. Fiscal responsibility places a limit on the amount of revenue which the Treasury can forego, and as far as possible the tax reductions should go to families with children. Such families, frankly, got short shrift in the 1986 tax reform and the inequities that have gradually crept into the tax code over the past generation are far from remedied. Moreover, strengthening the financial position of families with children will marginally ease the burden on the nation's social service structures, and, in general, families are far more effective in caring for the needs of children than even the best of social service programs.

This is a point on which President Bush and most congressional leaders appear to be in general agreement. Those who favor more general tax relief have a certain political advantage, since there would be no immediate gain for the majority of taxpayers in tax relief targeted to children. Nonetheless, maximizing tax relief for families will produce the greatest social benefits, both in the short run and in the long run.

- 2. The tax cut should be non-refundable. This is a point on which President Bush is at odds with at least some of the Democratic advocates of tax reduction, although Senator Bentsen favors a non-refundable credit. A refundable per-child tax credit would amount, in effect, to a welfare supplement and create a greater disincentive to work for poor families, as well as exorbitant marginal taxation for those families who increase their earnings. This problem is

already the one major difficulty with the earned income tax credit, which is the only refundable credit against personal income taxes.

- 3. The tax cut must be large. A cut which adds an insignificant amount to the disposable income of families is simply wasted effort. Here President Bush's proposed increase of \$500 in the personal exemption for dependent children is weak in comparison with most of the proposals offered in Congress. Under the President's plan, the actual per-child tax advantage to families would be in the range of just \$75 to \$140 — far below the amounts envisioned in the congressional plans. Tax breaks so small will not be enough to give hard-pressed families a sense of greater security. Under most of the congressional plans, which provide per-child tax breaks ranging from \$300 to \$1000, it is possible to foresee parents reducing their work hours in order to spend more time with their children or having the confidence to make major purchases. The President's proposal is not large enough to offer such incentives.
- 4. The tax cut should not be limited to the poor. While the working poor are obviously in need of assistance, middle class families are also suffering a serious financial squeeze. The old definitions of material comfort no longer apply. A household income of \$50,000, in a two-earner family with children and a mortgage, is simply not a definition of affluence. Many families in these circumstances are just getting by, with no ability to set aside savings. Fortunately, despite the potential for election year demagoguery, there appears to be a reasonable level of consensus between the President and congressional leaders of both parties, so there is a possibility for real tax reduction and not simply income redistribution.

While there is a good chance that whatever emerges from the deliberations between Congress and the White House will embody these four principles, there is not yet agreement on the means by which the tax cut can be implemented. One distinction is that some proposals call for tax credits, while others offer deductions or increases in the personal exemption for dependent children. The credit mechanism is more egalitarian, in that the same dollar amount of tax savings is offered per child, regardless of family income. This is, in fact, nothing other than a family allowance, which has been popular in many European countries through most of this century.

An increase in the personal exemption for dependent children has the conceptual advantage of protecting a certain minimum level of earnings from taxation. These tax-exempt earnings are supposed to be roughly approximate to bare subsistence. This embodies the principle that citizens will be taxed

only on that portion of their earnings which exceeds the essentials of survival. This is a sound principle and, as long as the personal exemption is indexed for inflation, it offers a systemic assurance that families will not be taxed into utter dependency.

Another question that could be explored is the possibility of combining some reform of the personal income tax with tax reductions channelled through the payroll tax. As noted, this tax is regressive and, for most families, more burdensome than the income tax. A per-child reduction in the payroll tax rate would not only give workers with dependent children more take-home pay, but would also provide such workers with a slight marginal advantage in the labor market, thereby tending to reduce unemployment among the heads of families. Moreover, since the Social Security trust fund, which is currently running an enormous surplus in revenues over outlays, is off-budget, this might be a convenient mechanism for keeping the tax cut within budgetary guidelines.

Some other tax reforms outlined by President Bush deserve comment. His proposal that withdrawals be permitted without penalty from IRAs for home purchases, education and medical expenses is one which will help families. It is also a feature of the tax reform package proposed by Senator Bentsen, so there is reason to believe that it could form part of a bi-partisan tax relief program.

The President's proposed tax credit of \$5000 for the purchase of a first home would be beneficial in many ways, and could play a key role in economic recovery. It is worth noting, however, that currently first-time home buyers are less likely to be married couples than are second-time purchasers of homes. Home ownership is vital to family stability, and this tax credit might help reverse the recent trend towards lower level of home ownership. This tax credit, however, is not family-specific, but one which will be of benefit to large numbers of single persons who have not yet formed families.

Helping parents give their children a better life by allowing those parents to keep more of what they earn may be the single best thing Congress and the Administration can do this year to strengthen families now and to invest in the future. Families, after all, are what societies are made of, and the protection of families should be the highest objective of social policy. □

For More Information:

For more information on this topic, contact Michael Schwartz at the Free Congress Foundation, at (202) 546-3000. For more information on receiving POLICY INSIGHTS, contact Paul Gannon at (202) 546-3000.

"Helping parents give their children a better life by allowing those parents to keep more of what they earn may be the single best thing Congress and the Administration can do this year to strengthen families now and to invest in the future."

From Department of Treasury
FAMILY TAX ALLOWANCE

Current Law

In general, a taxpayer is allowed a personal exemption for himself, his spouse, and for each dependent. Personal exemptions are allowed as deductions in computing taxable income. The amount of each personal exemption is \$2,300 for taxable years beginning in 1992.

In general, a child age 18 or under qualifies as a dependent if the taxpayer furnishes over half the child's support. A "child" includes a child by blood, an adopted child, a stepchild, and a child placed with the taxpayer by an authorized placement agency for legal adoption. In addition, a child who is a member of the taxpayer's household and lives with the taxpayer during the entire taxable year may be considered the taxpayer's "child." The amount of the personal exemption is indexed for inflation. Personal exemptions are phased out for high-income taxpayers.

Reasons for Change

Taxpayers incur significant costs in rearing children. An increase in the personal exemption for dependent children is a simple and effective way to decrease the financial burden on families.

Proposal

The proposal increases the personal exemption for dependent children age 18 and under at the end of the taxable year by \$500 per child. This amount would be indexed for inflation. The proposal is effective October 1, 1992.

Effects of Proposal

Under the proposal, the personal exemption for dependant children age 18 or under at the end of the taxable year will increase by \$500 per child. For taxable years beginning in 1992, the increase will be prorated.

Revenue Estimate

	Fiscal Years						
	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1992-97</u>
	(Billions of dollars)						
Family tax allowance:	0	-4.4	-4.6	-4.7	-5.0	-5.2	-23.8