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William D. Popkin

Indiana University Maurer School of Law, popkin@indiana.edu

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THE NEGATIVE INCOME TAX: AN ALTERNATIVE SOLUTION

WILLIAM D. POPKIN*

Introduction

Professors Asimow and Klein have recently described and analyzed the accounting procedures used in several negative income tax (NIT) experiments funded by the Office of Economic Opportunity.¹ They propose that these techniques be adopted in a nationwide welfare program.² This comment will raise a number of questions about the assumptions underlying their proposed solution.

At the heart of the suggested accounting procedures is a decision to use a family's past income to determine current welfare payments.³ The period chosen is the income for the "prior month."⁴ However, two techniques are used to minimize the effect of fluctuating income on the amount of benefits. First, the income of the "prior month" is derived by averaging the income of the prior three months.⁵ High income in January can, therefore, prevent welfare payments in April because the income in March is based on the average of income for January, February, and March. Similarly, high income in March might not prevent April welfare payments since the income for March will be averaged with January and February earnings. Thus, this technique reduces the difference between welfare recipients with steady income and those with either rising or falling income.

Second, a carry forward of income is provided for twelve months whenever monthly income exceeds the amount of earnings at which welfare ceases.⁶ If monthly income of \$500 is the point at

*Associate Professor of Law, Indiana University School of Law. A.B., 1958, LL.B. 1961, Harvard University.

1 Asimow & Klein, *The Negative Income Tax: Accounting Problems and a Proposed Solution*, 8 HARV. J. LEGIS. 1 (1970) [hereinafter cited as *Proposed Solution*].

2 *Id.* 3-4, 31.

3 *Id.* 4-6.

4 *Id.* 21 (Rule 2).

5 *Id.* 21 (Rule 4).

6 *See id.* 21 (Rule 7), 24 (Rule 9), 26 (Rule 10).

which welfare ceases, for example, monthly income of \$600 in January, February, and March would reduce possible welfare payments for eleven months after March because the \$300 excess is carried forward. A carry back provision is not proposed. Thus, the carryover reduces the difference between welfare claimants with steady income and those with declining income, but not between those with steady income and those with rising income.

Welfare recipients are required to report income monthly,⁷ or every four weeks if more convenient.⁸ Businessmen, on the other hand, are allowed to report net income annually rather than monthly. In this case the income of the prior year is presumed to have been available in twelve equal installments over the twelve months beginning with the month in which the calculation is made.⁹

There are a number of difficulties with these accounting procedures which relate primarily to the treatment of declining income, the retrospective determination of income, and monthly reporting. After discussing these procedures I will comment briefly on a few of the problems posed by an alternative proposal, suggested in an earlier article,¹⁰ which utilizes a system of withholding from wages.

I. TREATMENT OF DECLINING INCOME

The decision to carry forward income rests on the assumption that it would be unfair to differentiate between welfare recipients with declining income and those with steady income.¹¹ This assumption seems questionable. A great many poor people are likely to have declining income.¹² The decline could have serious con-

⁷ *Id.* 21 (Rule 3).

⁸ *Id.* 9, n.11, 21, (Rule 2, comment).

⁹ *Id.* 21 (Rule 5), 21-22 (comment), 22-23, (Rule 6), 23, (comment).

¹⁰ Popkin, *Administration of a Negative Income Tax*, 78 *YALE L.J.* 388 (1969).

¹¹ *Cf. Proposed Solution* 10-11.

¹² I do not know how many. The image of the unemployed urban worker whose income declines because he is thrown out of a job is probably a distortion of the national picture. The majority of the poor are probably rural southerners with stable low income, rather than urban workers beset by an uncertain labor market. See generally S. MILLER & F. REISMAN, *SOCIAL CLASS & SOCIAL POLICY* 38-42 (1968). Nonetheless, the rural southerner will appear to have fluctuating income under the Proposed Solution if he is a farmer, because cash accounting is used and high receipts in one month are carried forward to later months.

sequences in that it might result, for example, in default on installment purchase contracts. Certainly it is unreasonable to expect budgeting of the earlier income for future needs at the low income levels with which we are concerned.¹³ Moreover, unemployment insurance is not an adequate solution for declining income.¹⁴ Unemployment insurance does not cover many classes of employees, including farm labor and the self-employed. Furthermore, benefits depend upon prior work history, which might be spotty for low income employees.¹⁵

The shifting three-month average device does not increase welfare benefits when there is declining income. Its moderating influence actually operates to the detriment of declining incomes: high income in the early months of the three-month period will increase the average monthly income, thereby decreasing benefits.

II. RETROSPECTIVE DETERMINATION OF INCOME

The proposed solution of Professors Asimow and Klein includes the retrospective determination of income. The purpose here is to avoid a reconciliation of welfare payments with actual income at the end of an accounting period.¹⁶ One justification for avoiding reconciliation is that a needy family is unlikely to have funds available at the end of the period when a reconciliation would be required.¹⁷ Further, even if the welfare recipient does have the surplus funds available and even if he must make a refund only

¹³ *Contra, Proposed Solution 25* (discussing unreality of carryover budgeting assumption).

¹⁴ *Contra, id.* 13.

¹⁵ Brief descriptions of unemployment insurance and the amendments made by the Employment Security Amendments of 1970, Pub. L. No. 91-373 (codified in scattered sections of 5, 15, 26, 42 U.S.C.) appear in THE PRESIDENT'S COMMISSION ON INCOME MAINTENANCE, BACKGROUND PAPERS 178 (1970) and in *Notes and Brief Reports*, EMPLOYMENT SECURITY AMENDMENTS OF 1970, 33 SOCIAL SECURITY BULL. 29 (1970). In 1966, 16.3 million wage earners and 8.7 million self-employed were not covered. *Id.* 178. Of those receiving unemployment compensation in 1961, 16 percent remained poor after receipt of benefits. THE PRESIDENT'S COMMISSION ON INCOME MAINTENANCE, BACKGROUND PAPERS 189 (1970). The 1970 amendments are expected to cover 4.75 million more workers by 1972, 33 SOCIAL SECURITY BULL. 29 (1970), although the effect on their poverty status will depend on their prior work experience and the levels of state benefits.

¹⁶ *See Proposed Solution 5.*

¹⁷ *Cf. id.*

where his income projection was not made in good faith,¹⁸ he would have to deal with a hostile administrator in proving his state of mind.

I agree that a poor family is not likely to have money available at the end of an accounting period. The very inability of the poor to save works, as I have suggested, to defeat the carry forward system. It is not quite fair, however, to say that retrospective determination of income avoids the problem of reconciliation. It does so only by disregarding it. The carry forward is, in effect, a limited and automatic reconciliation of earlier high income with subsequent low income over a twelve month period. The issue really becomes how much reconciliation is desirable and whether an administrator can be trusted to determine whether the recipients have acted in good faith when they predict their income to become eligible for welfare.

If income is low during an accounting period, the needs generated during that period should be met regardless of whether higher income was earned during earlier months. A short accounting period of one month, modified by a shifting three-month average, is not responsive enough to declining income. On the other hand, if income is higher than expected, the family should account for overpayments if it is able to do so. I suspect that a major reason for the retrospective determination of income is the opportunity it affords to pretend that overpayments do not exist. Overpayments after all are unpopular with the taxpayers. One wonders, however, whether retrospectivity will conceal this problem when the underlying facts are brought out.

The question remains, however, whether administrators will deal with overpayments in a responsible manner. The issue of a recipient's bad faith is currently relevant, for example, in federal financial assistance programs¹⁹ and in Old Age, Survivors, and Dis-

¹⁸ See *id.*

¹⁹ 45 C.F.R. § 233.20(a)(3)(ii)(d) (1971):

Where there is evidence which clearly establishes that a recipient willfully withheld information about his income or resources, such income or resources may be considered in determination of need to reduce the amount of the assistance payment in current or future periods;

This provision regulates OAA, AFDC, AB, APTD, and AABD.

ability Insurance²⁰ (OASDI). The former programs are administered by the states and OASDI by the Social Security Administration of the federal government. I suspect that the federal government is reasonable in its administration of OASDI, although I lack data to prove it. The prospective withholding system that I have suggested, however, would minimize the opportunity for bad faith. Under such a system a welfare claimant would predict whether his income would be low enough during the following year to entitle him to welfare. If his prediction renders him eligible, he receives welfare and his wages are subject to withholding at negative income tax rates. If overpayments occur, they are likely to arise from defects in the withholding system rather than from bad faith. While an overpayment might still result from bad faith if the employee does not tell his employer to withhold at NIT rates or if the employee misrepresents his wages, the proposed solution of Professors Asimow and Klein likewise presents an opportunity for bad faith: the monthly reporting system, discussed below, requires the administrator to determine whether the claimant is accurately reporting his income each month.

When the income is in the form of business profits rather than wages, problems result from the fact that it cannot be withheld, but must be predicted. The proposed solution lessens the risk of inaccurate prediction, however, by using the preceding year's income to determine the income for the year for which welfare is claimed.²¹ This considerably lessens the claimant's ability to avoid the problem of reconciliation. Furthermore, administrators under the proposed solution might still question the candor of the business applicant in reporting the preceding year's income.

III. MONTHLY REPORTING

A third element in the proposed solution of Professors Asimow and Klein is the monthly reporting requirement.²² Is it desirable to compel such frequent contact with the bureaucracy? Will an

²⁰ See 42 U.S.C. § 404(b) (1968). See, e.g., 20 C.F.R. §§ 404.506-.507, .510, .510a, .511 (1971).

²¹ See note 9 *supra*.

²² See note 7 *supra*.

employee who is paid on a daily basis lose a day's pay or perhaps his job as a result of taking time to contact the agency? The report of the recent NIT experiment in New Jersey suggests that the primary goal was to determine the effect of graduated income maintenance payments on work effort.²³ It is unclear whether there was a real evaluation of potential problems relating to administration — problems created by absence from work, by reluctance to contact the administration, and by unsympathetic exercises of discretion.²⁴ I suspect that the administrative problems which a nation-wide NIT would encounter were not dealt with in the experiment and have not received adequate testing.

A reporting system as short as a month was probably adopted to make the system responsive to changes in income, since any period longer than a month would mean unacceptable delay before the adjustment of payments at the period's end. A withholding system based on a prospective estimate of annual income would, however, be responsive without requiring monthly contact between administrators and recipients. Under such a system the full amount of welfare would be paid every month. If an employee did not have income in a particular month, there would be no withholding and hence no reduction in the level of benefits.

IV. WITHHOLDING SYSTEM

I am not suggesting that the withholding system is without difficulty. Several problems deserve consideration. First, employers might not be able to handle two different sets of withholding tables. This is especially serious in view of the kinds of employers, including homeowners with domestic help, likely to employ the poor. Second, employers might not withhold at all or might refuse to hire those who create such bookkeeping problems. There has been expansion, however, in the definition of covered employers in the closely related area of unemployment insurance to include some employers previously omitted for administrative

²³ OFFICE OF ECONOMIC OPPORTUNITY, PRELIMINARY RESULTS OF THE NEW JERSEY GRADUATED WORK INCENTIVE EXPERIMENT, 1, 26 (1970).

²⁴ See *id.* 3, 23, 26.

reasons.²⁵ Third, a large amount withheld from wages might have more disincentive effects than an equivalent reduction in welfare accompanied by higher take home pay.

Nonetheless, a withholding system deserves to be tried since it minimizes the opportunity for bad faith, allows a quick response to declining income, permits reconciliation, and limits contact with the bureaucracy. The proposed solution of Professors Asimow and Klein on the other hand, responds inadequately (either immediately or through reconciliation to the problem of declining income), presents the same potential as the withholding system for administrators to question the good faith of recipients, and requires too frequent contact with the administration.

²⁵ Employment Security Amendments of 1970, Pub. L. No. 91-373 (Aug. 10, 1970; effective after Dec. 31, 1971) §101 (a), *amending* INT. REV. CODE of 1954, § 3306(a). Generally speaking, an employer was covered only if he had four employees on a regular basis during the year. Under the new law, he is covered if he has one employee on a regular basis or if he pays \$1500 wages during a calendar quarter.

