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The Economics of Equivalence of Standard Tax Credits

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THE ECONOMIC EQUIVALENCE OF STANDARD TAX CREDITS, DEDUCTIONS AND EXEMPTIONS

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I. INTRODUCTION

Current tax literature is replete with comments that credits are preferable to deductions and exemptions on equitable grounds.[1] Such statements are typically based on the premise that the credit[2] in a progressive tax structure benefits all taxpayers making expenditures in equal dollar amounts.[3] The exemption[4] or deduction,[5] on the other

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1. *See, e.g.*, S. SURREY, PATHWAYS TO TAX REFORM — THE CONCEPT OF TAX EXPENDITURES 97-100 (1973); Keane, *Federal Income Tax Treatment of Child Care Expenses*, 10 HARV. J. ON LEGIS. 1, 36-38 (1972); Schreiber & Yoran, *Child Care Expenses: A Proposal for a More Equitable and Efficient Tax Treatment*, 54 TAXES 345, 349-52 (1976); Surrey & McDaniel, *The Tax Expenditure Concept and The Budget Reform Act of 1974*, 17 B.C. INDUS. COM. L. REV. 679, 713-14 (1976).

2. For purposes of this article the term "credit" refers to an amount that is subtracted directly from the tax otherwise due.

3. Understandably, if no tax liability exists the credit will not benefit the taxpayer. This has caused some commentators to propose the development of refundable credits or the use of direct expenditure programs. *See* S. SURREY, *supra* note 1, at 97-100; Surrey & McDaniel, *The Tax Expenditure Concept: Current Developments and Emerging Issues*, 20 B.C.L. REV. 225, 266-71 (1979).

hand, benefits taxpayers in proportion to their marginal tax rates, thereby economically enriching the wealthy more than the poor.[6] Unfortunately, most statements regarding the relative merits of credits, deductions and exemptions are broad generalities containing elements of both truth and error.

Congressional decisions to encourage select activities by according favorable tax treatment to certain variable expenditures are more equitably accomplished by credits than by deductions.[7] Where, however, the amount qualifying for special treatment will not vary between taxpayers, but will be universally available to all in equal dollar amount, whether Congress utilizes a credit, an exemption, or a deduction is immaterial.[8] In this instance, standard credits, exemptions, or deductions are all economically equivalent to taxpayers.

Congress failed to comprehend this point in 1976, when, in restructuring the estate and gift tax, it abandoned the simple application of a universally available deduction and created a complicated universally available credit in its stead. In so doing, Congress erroneously reasoned that the credit device would be more equitable to the low-income taxpayer than either an exemption or a deduction.[9] Although a number of commentators have supported Congress' action as a measure which is fairer to low income taxpayers,[10] this position is not supported by reason.

This article will examine the origins and the evolution of the pref-

4. For purposes of this article the term "exemption" refers to an exclusion from tax liability resulting from nonimposition of tax on the first components of the base in a progressive rate structure. The critical difference between an exemption and a deduction is that an exemption grants an exclusion from taxation at the bottom of a progressive rate structure whereas a deduction grants an exclusion from taxation at the top margin of a progressive rate structure.

5. For purposes of this article the term "deduction" refers to an amount deducted from the base before the base is subjected to taxation under a given rate structure.

6. For example, a deduction of $100 for interest paid under § 163 of the 1954 Internal Revenue Code (hereinafter I.R.C.) would save a taxpayer in a marginal 20% bracket $20 in taxes. For the same deduction, a taxpayer in a marginal 50% bracket would save $50 in taxes.

7. A number of deductions, commonly characterized as needless erosions of the tax base, are based on substantial theoretical justifications. *See* Andrews, *Personal Deductions in an Ideal Tax*, 86 HARV. L. REV. 309 (1972); Turnier, *Evaluating Personal Deductions in an Income Tax — The Ideal*, 66 CORNELL L. REV. 262 (1981).

8. If the deduction alternative is chosen, a rate structure alteration is essential to maintain economic equivalence.

9. *See infra* note 31 and accompanying text.

10. *See, e.g.*, R. CAMPFIELD, V. KIRBY, W. PEDRICK & M. DICKINSON, THE STUDY OF FEDERAL TAX LAW: ESTATE AND GIFT TAXES, 1983-1984 ¶ 11,301(a), at 105 (1983) [hereinafter cited as R. CAMPFIELD]; Piper & Fremont-Smith, *Principles for Effective Use of Marital Deductions*, 19 B.C.L. REV. 403, 406 (1978); Senzaki, *Exploring Some of the Conceptual Changes Behind the Estate and Gift Tax Provisions of the Tax Reform Act of 1976*, 10 LOY. L.A.L. REV. 785, 797 (1977). After citing the change to a credit as an equitable step benefiting low-income taxpayers, R. Campfield seems to contradict itself by equating the credit to exemptions. *See* R. CAMPFIELD, *supra*, ¶¶ 11,301(a), 11,301(c).

erence for credits over deductions and exemptions. A mathematical demonstration will then illustrate the error of applying general truisms on credits to adjustments which are universally granted to all taxpayers in a fixed dollar amount, hereinafter referred to as standard credits, deductions or exemptions.

II. Origins of the Preference for Credits as Equitable Devices

The earliest credit provision included in the Internal Revenue Code was the foreign tax credit. This credit allows individuals or corporations earning money abroad to claim all or a portion of the assessed foreign tax as a credit against the corresponding United States tax liability.[11] This and other similar credits are labeled "coordinating credits" and their existence often is predicated on equitable grounds.[12]

Professor William Vickery was the first commentator to suggest that it might be more equitable to replace an existing deduction with a tax credit. In 1948 he suggested that the deduction for charitable contributions[13] be replaced by a 25 percent credit, thereby equally benefiting taxpayers in varying tax brackets.[14] Although Vickery did not systematize his observation, for a number of years commentators reiterated his call for replacement of the charitable contribution deduction with a tax credit.[15] Over the course of the next several decades the theory behind the original Vickery observation gained substantial widespread support.

By the early 1970's, it was commonplace to encounter statements by commentators preferring credits to exemptions or deductions based upon equitable concerns.[16] These commentators generally focused their attention on personal deductions. A typical example is the following statement by Professor Murray Weidenbaum:

> Deductions are implicitly regressive, but credits need not be. In fact, credits are quite flexible from that point of view.

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11. 40 Stat. 1080 (1919).

12. *See generally* A. Tully, The Tax Credit (Special Report of the New York State Tax Comm'n, No. 15, 1948). *See also* J. Maxwell, Tax Credits and Intergovernmental Fiscal Relations 160 (1962); Tax Foundation, Inc., Tax Credits: Past Experience and Current Issues 10 (1969).

13. *See* I.R.C. § 23 (1939).

14. W. Vickrey, Agenda for Progressive Taxation 131 (1947).

15. *See, e.g.*, C. Kahn, Personal Deductions in the Federal Income Tax 87-90 (1960); Pifer, *Revitalizing the Charitable Deduction*, in Carnegie Corp. of N.Y. 1972 Annual Report 3-12 (1973); White, *Deductions for Nonbusiness Expenses and an Economic Concept of Net Income*, in Federal Tax Policy for Economic Growth and Stability 353, 364-65 (1955) (prepared for Joint Econ. Comm., 84th Cong., 1st Sess.).

16. *See supra* note 1.

> As pointed out above, the value of a deductible dollar varies with the taxpayer's bracket. Because of the progressive structure of the federal personal income tax, deductions provide proportionately larger benefits to taxpayers in upper brackets than to those in low or middle brackets. Consider a tax credit equal to a percentage of allowable expenses, the percentage being the same regardless of income. With a 50 percent credit, for example, any taxpayer giving $200 to charity, whether in a higher or lower income bracket, would have his tax liability reduced by $100. Depending on the percentage credit, such a system would reinforce the progressivity of the personal income tax, since those whose marginal rates were below the percentage credit would have their average rates reduced, while the opposite would hold for those whose marginal rates were above the percentage credit.[17]

Congress has not been persuaded by such commentators to substitute wholesale a system of credits for the prevailing deduction system. It has, however, demonstrated a growing appreciation for equitable concerns, manifested in an increased willingness to employ credits. The first indication of this tendency appearing in any legislative history occurred with the passage of the investment tax credit. In the original investment tax credit package of 1961, Congress failed to establish that its rationale for adopting the credit mechanism centered around concerns that deductions disproportionately benefit high bracket taxpayers. Nonetheless, statements in the legislative history indicating that the investment tax credit is particularly advantageous to small businesses[18] imply that this concern most likely inspired the Administration and Congress to adopt the credit mechanism.[19]

Over the last two decades, Congress has frequently opted for credits rather than deductions as a means of providing tax assistance for individuals making favored expenditures. Significant examples of such credits are the child care credit,[20] the political campaign contri-

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17. Weidenbaum, *The Advantages of Credits on the Personal Income Tax*, 42 GEO. WASH. L. REV. 516, 521-22 (1974).

18. *See* 1 *President's 1961 Tax Recommendations: Hearings before the Comm. on Ways and Means*, 87th Cong., 1st Sess. 3 (1961) (statement of President John F. Kennedy: *"Our Federal Tax System"*); *id.* at 20-27 (statement of Hon. C.B. Dillon, Secretary of Treas.).

19. *See* 2 *President's 1961 Tax Recommendations: Hearings before the Comm. on Ways and Means*, 87th Cong., 1st Sess. 951, 954 (1961) (testimony of D.T. Smith). Credits are also particularly valuable to small businesses in financing purchases of assets, a normally burdensome process for them, because a credit almost immediately reduces the direct cost of purchasing an asset. *See* S. REP. No. 1881, 87th Cong., 2d Sess. 11-12, *reprinted in* 1962 U.S. CODE CONG. & AD. NEWS 3313, 3314 (report on the Revenue Act of 1962).

20. *See* I.R.C. § 21 (West 1985).

bution credit,[21] the residential energy conservation credit,[22] and the orphan disease drug testing credit.[23] In most of these, Congress has not suggested that equitable concerns prompted its choice of the credit mechanism.[24] On at least two occasions, however, Congress did indicate that considerations of equity prompted its substitution of a credit for a preexisting deduction. It did so in 1976 when implementing the child care credit.[25] Also in that year, as part of its major estate and gift tax restructuring, Congress indicated substitution of the credit mechanism for the existing deduction system would achieve a more equitable result for low-income taxpayers.[26]

Several other significant changes, which are relevant to this discussion, were made in 1976. Prior to 1976 two separate and distinct rate structures existed for calculating the estate and gift taxes. Each system employed its own progressive rate structure which typically was not affected by gratuitous conveyances covered by its complementary counterpart.[27] In 1976 Congress replaced these two separate regimes with a unified transfer tax which cumulatively subjected all such transfers to the same progressive rate structure.[28] The rate structure was also changed to effect a diminution in aggregate tax yield. At the same time, Congress eliminated the single lifetime $30,000 gift tax deduction and the $60,000 estate tax deduction[29] and substituted a single credit which is scheduled to rise to $192,800 by 1987.[30]

A 1976 Joint Committee report indicates that Congress opted for a unified estate and gift tax credit because it believed such a device to be more favorable to low bracket taxpayers than either an exemption or a deduction. The report states:

> [S]ince the estate tax exemption under prior law was a deduction in determining the taxable estate, it reduced each estate's tax at the highest estate tax brackets. However, a credit in

21. *See* I.R.C. § 24 (West 1985).
22. *See* I.R.C. § 23 (West 1985).
23. *See* I.R.C. § 28 (West 1985).
24. *See, e.g.*, S. REP. No. 553, 92d Cong., 2st Sess. 56 (1971) (political campaign contribution credit); S. REP. No. 529, 95th Cong., 2st Sess. 30 (1977) (residential energy conservation credit); H.R. REP. No. 480, 97th Cong., 2d Sess. 13 (1982), *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 3577, 3586 (orphan drugs credit).
25. *See* STAFF OF THE JOINT COMM. ON TAX, 94th Cong., 2d Sess., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1976 124 (Comm. Print 1976).
26. *Id.* at 530-31.
27. For a comparison of the rate structure prior to 1976, compare I.R.C. § 2001, 68A Stat. 373 (1954) with I.R.C. § 2502(a)(2), 68A Stat. 403 (1954).
28. *See* I.R.C. § 2001 (1976).
29. *See* I.R.C. §§ 2052, 2521 (1975).
30. *See* I.R.C. §§ 2010, 2001 (West 1985).

> lieu of an exemption has the effect of reducing the estate tax at the lower estate tax brackets since a tax credit is applied as a dollar-for-dollar reduction of the amount otherwise due. Thus, at a given level of revenue cost, a tax credit tends to confer more tax savings on small- and medium-sized estates, whereas a deduction or exemption tends to confer more tax savings on larger estates. The Congress believed it would be more equitable if the exemption were replaced with a credit.[31]

This statement is erroneous, however, when applied to standard credits, deductions or exemptions, that is, those uniformly bestowed upon all taxpayers in equal dollar amounts.[32] In such cases, a credit is the economic equivalent of an exemption or a deduction with altered tax rates. The proof for this position is set forth in the following section.

III. Proof of Economic Equivalence of Nondiscretionary Standard Credit, Exemption and Deduction

A. *The Economic Equivalence of Standard Exemptions and Deductions*

The economic equivalence of standard exemptions and deductions will be demonstrated by use of simple but typical exemption and deduction systems, graphing the amount of tax against the net taxable estate. Utilizing the table for any exemption system demonstrates how an equivalent deduction system may be constructed, and vice versa. Next, the essential feature of such systems in terms of the graph of net tax versus net taxable estate will be described. In the following section, standard credit systems will also be shown to be equivalent to standard exemption and deduction systems.

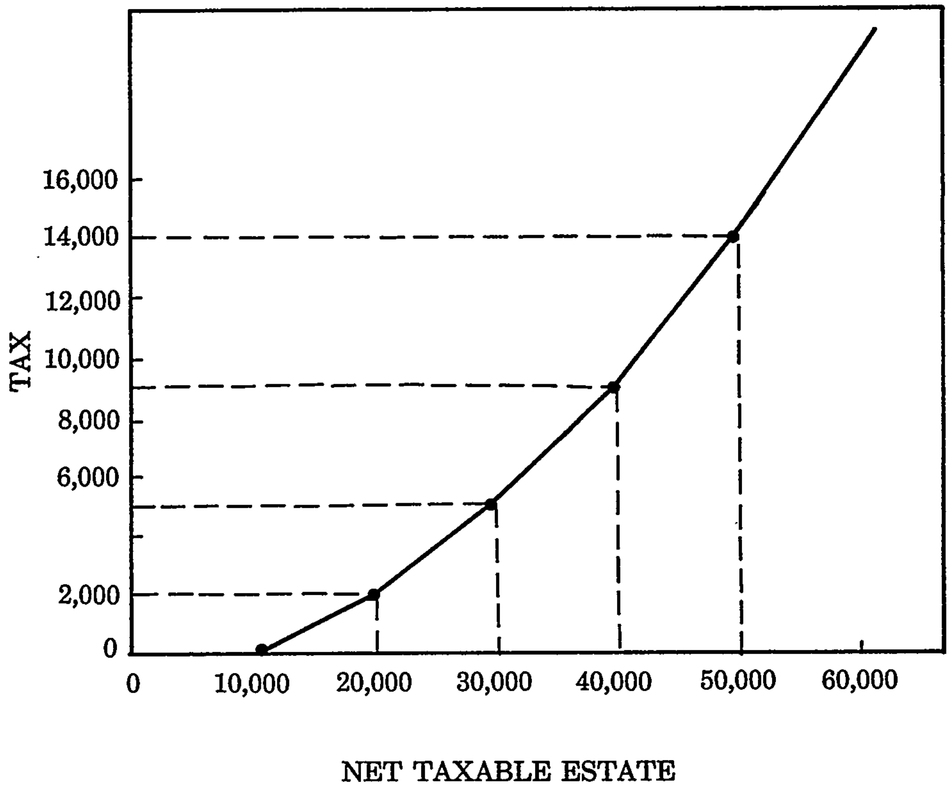
A typical standard exemption system is the following:

Net Taxable Estate	Tax
$0 to $10,000	$0
Over $10,000 but not over $20,000	20% of excess over $10,000
Over $20,000 but not over $30,000	$2,000 plus 30% of excess over $20,000
Over $30,000 but not over $40,000	$5,000 plus 40% of excess over $30,000
Over $40,000 but not over $50,000	$9,000 plus 50% of excess over $40,000
Over $50,000	$14,000 plus 60% of excess over $50,000

31. *Supra* note 26.

32. Where one is dealing with discretionary expenses, which vary in amount from taxpayer to taxpayer, the choice between a credit, deduction and exemption can be a matter of considerable equitable significance.

Plotting tax versus net taxable estate for the standard exemption system yields the following graph:



The following rate structure produces the same graph of tax versus net taxable estate if a standard deduction of $10,000 is included:

Net Taxable Estate	Tax
$ 0 to $10,000	20%
Over $10,000 but not over $20,000	$2,000 plus 30% of excess over $10,000
Over $20,000 but not over $30,000	$5,000 plus 40% of excess over $20,000
Over $30,000 but not over $40,000	$9,000 plus 50% of excess over $30,000
Over $40,000	$14,000 plus 60% of excess over $40,000

A deduction system D which is equivalent to any given exemption system E is created in the following manner:

a. The amount below which there is no tax in E becomes the amount of the deduction in D. The lowest (zero-tax) bracket of E will not appear in D.

b. The table for D is obtained by copying that of E, but subtracting the amount of the deduction from all the bracket cutoff values and from the "excess over" values in the "Tax" column.

Conversely, given the table for any deduction system D, an equivalent exemption E is constructed as follows:

a. The lowest bracket in E comprises gross estate amounts from 0 to the amount of the deduction in D. Its tax is 0.
b. The rest of the table for E is a copy of the table for D, but with the amount of the deduction added to all the bracket cutoff values and to the "excess over" values in the "Tax" column.

Standard exemption systems E and standard deduction systems D have a characteristic graph when the amount of tax, T, is plotted against the net taxable estate, x. A continuous and piecewise linear graph, one composed of straight-line segments connected at their endpoints, whose leftmost segment lies on the x-axis, results. The segments correspond to the tax brackets.

The right endpoint of the first segment corresponds to the upper limit of the zero-tax bracket in E and to the amount of the deduction D. For any other segment, the x-values of its endpoints correspond to the bracket cutoff value in E. The corresponding bracket cutoff values in D are found by subtracting the amount of the deduction.

The tax rate for any bracket, in either system, is the *slope* of the corresponding segment. The slope is defined as the difference in T-values at the endpoints of the segment divided by the difference in x-values at the endpoints. Thus, for example, the slope of the third segment in the graph above is ($5000 - $2000)/($30,000 - $20,000), which equals $3000/$10,000, or 30%.

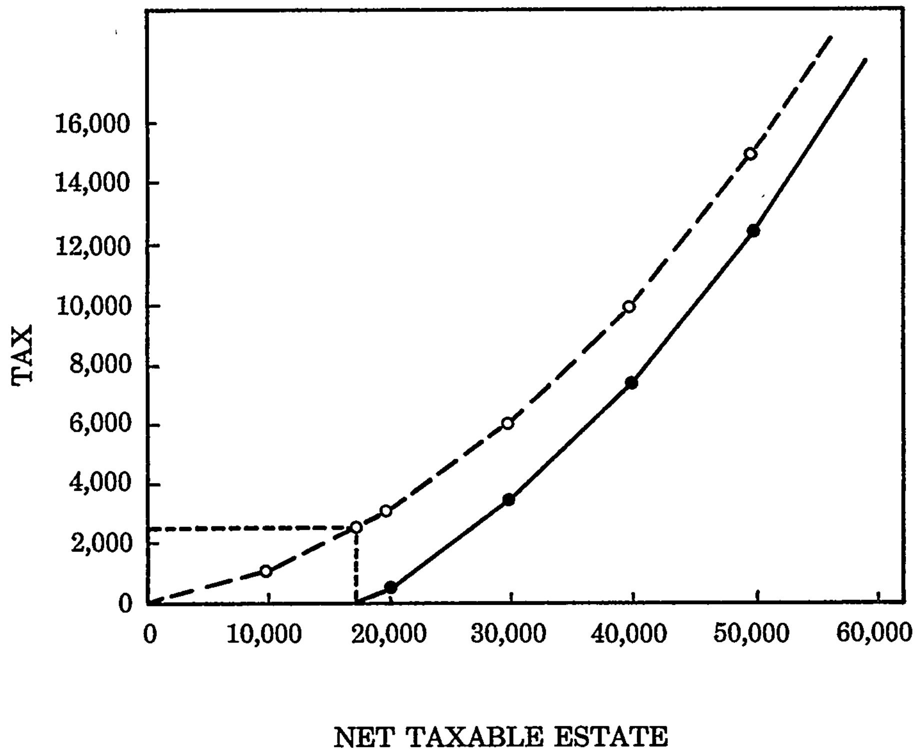
B. The Economic Equivalence of Standard Credits and Deductions

This section illustrates how any standard credit can be realized as a standard exemption system or likewise as a standard deduction system. The procedure for accomplishing this follows.

Initially consider this simple standard credit system:

Net Taxable Estate	Tax (before standard credit of $2,500)
$ 0 to $10,000	10%
Over $10,000 but not over $20,000	$1,000 plus 20% of excess over $10,000
Over $20,000 but not over $30,000	$3,000 plus 30% of excess over $20,000
Over $30,000 but not over $40,000	$6,000 plus 40% of excess over $30,000
Over $40,000 but not over $50,000	$10,000 plus 50% of excess over $40,000
Over $50,000	$15,000 plus 60% of excess over $50,000

The credit system is graphed by plotting both the before-credit tax and the net, after-credit, tax against the net taxable estate amount. The before-credit tax will be indicated by a dotted line and the net tax by a solid line. Thus, the preceding standard credit system yields a graph as follows:



The result of the net tax graphing is a continuous piecewise-linear graph whose first segment is on the x-axis. Note that this graph follows the x-axis until the point where the before-credit tax equals the credit amount. From this point on, the net tax graph continues to stay $2,500 below the before-credit tax graph. Additionally, note that the net tax graph for this credit system is identical to the graph of the following standard exemption system.

Net Taxable Estate	Tax
$ 0 to $17,500	$ 0
Over $17,500 but not over $20,000	20% of excess over $17,500
Over $20,000 but not over $30,000	$500 plus 30% of excess over $20,000
Over $30,000 but not over $40,000	$3,500 plus 40% of excess over $30,000
Over $40,000 but not over $50,000	$7,500 plus 50% of excess over $40,000
Over $50,000	$12,500 plus 60% of excess over $50,000

The graphs for the standard credit system and the standard exemption system are identical. The procedure to convert such a credit system C into an exemption system E is as follows:

a. Find the bracket B in system C in which the amount of before-credit tax equals the amount of the credit. (In the example, bracket B is $10,000 to $20,000 because the tax in that bracket ranges from $1,000 to $3,000 and thus includes the credit amount of $2,500).
b. Subtract the minimum tax for bracket B from the credit amount, divide the rate for bracket B, and add the "excess over" amount for bracket B. Call the result A. (This is the estate amount for which the before-credit tax exactly equals the credit amount). [In the example, A is (($2,500 - $1,000) ÷ 20%) + $10,000, or $17,500].
c. The zero-tax bracket in system E is for net taxable estates from 0 to amount A. The next bracket is from amount A to the upper cutoff estate value of bracket B. The tax rate for this second bracket of system E is that of bracket B, but computed on the excess over amount A. [In the example, this step produces the first two brackets of the exemption table shown].
d. The rest of the table for system E is a copy of the brackets in system C after bracket B, but with the credit amount subtracted from the minimum tax for each bracket.

C. *The Economic Equivalence of Standard Credits and Exemptions*

The federal estate and gift tax rate structure which utilizes a credit system and which will be applicable in 1987 may also be converted into an equivalent exemption system though the approach described in section B. An exemption system, which is considerably easier to apply than a credit system, would eliminate the large number of unused brackets found in the original estate and gift tax credit system. Once the exemption system has been created, the conversion to an equivalent deduction system by using the method set out in section A is easily accomplished. Finally, by employing this method, the 1987 rate structure may be converted into an equivalent rate structure for a tax system which provides a standard deduction of $600,000.

The credit system which will be effective in 1987 is as follows:[33]

Net Taxable Estate	Tax before credit of $192,800
Not over $10,000	18 percent of such amount
Over $10,000 but not over $20,000	$1,800, plus 20 percent of the excess of such amount over $10,000
Over $20,000 but not over $40,000	$3,800 plus 22 percent of the excess of such amount over $20,000
Over $40,000 but not over $60,000	$8,200, plus 24 percent of the excess of such amount over $40,000
Over $60,000 but not over $80,000	$13,000 plus 26 percent of the excess of such amount over $60,000
Over $80,000 but not over $100,000	$18,200 plus 28 percent of the excess of such amount over $80,000
Over $100,000 but not over $150,000	$23,800 plus 30 percent of the excess of such amount over $100,000
Over $150,000 but not over $250,000	$38,800 plus 32 percent of the excess of such amount over $150,000
Over $250,000 but not over $500,000	$70,800 plus 34 percent of the excess of such amount over $250,000
Over $500,000 but not over $750,000[B]	$155,800 plus 37 percent of the excess of such amount over $500,000
Over $750,000 but not over $1,000,000	$248,300 plus 39 percent of the excess of such amount over $750,000
Over $1,000,000 but not over $1,250,000	$345,800 plus 41 percent of the excess of such amount over $1,000,000
Over $1,250,000 but not over $1,500,000	$448,300 plus 43 percent of the excess of such amount over $1,250,000
Over $1,500,000 but not over $2,000,000	$555,800 plus 45 percent of the excess of such amount over $1,500,000
Over $2,000,000 but not over $2,500,000	$780,800 plus 49 percent of the excess of such amount over $2,000,000
Over $2,500,000	$1,025,800 plus 50 percent of the excess over $2,500,000.

33. *See* I.R.C. § 2001 (West 1985).

Bracket B is marked in the table. Amount A is calculated as (($192,800 - $155,800) ÷ 37%) + $500,000, which equals $600,000. Hence the table for the exemption system equivalent to the 1987 estate and gift tax credit system is as follows:

Net Taxable Estate	Tax
0 to $600,000	0
Over $600,000 but not over $750,000	37% of excess over $600,000
Over $750,000 but not over $1,000,000	$55,500 plus 39% of excess over $750,000
Over $100,000 but not over $1,250,000	$153,000 plus 41% of excess over $1,250,000
Over $1,500,000 but not over $2,000,000	$363,000 plus 45% of excess over $1,500,000
Over $2,000,000 but not over $2,500,000	$588,000 plus 49% of excess over $2,000,000
Over $2,500,000	$833,000 plus 50% of excess over $2,500,000

Applying the steps outlined in section A, the foregoing exemption system may be converted into an equivalent rate structure with a standard deduction of $600,000.[34] The table for the equivalent deduction system, allowing for a $600,000 standard deduction, is as follows:

Net Taxable Estate	Tax
$0 to $150,000	37%
Over $150,000 but not over $400,000	$55,500 plus 39% of excess over $450,000
Over $400,000 but not over $650,000	$153,000 plus 41% of excess over $400,000
Over $650,000 but not over $900,000	$255,500 plus 43% of excess over $900,000
Over $900,000 but not over $1,400,000	$363,000 plus 45% of excess over $900,000
Over $1,400,000 but not over $1,900,000	$588,000 plus 49% of excess over $1,400,000
Over $1,900,000	$833,000 plus 50% of excess over $1,900,000

The economic equivalence of the above rate structures and adjustments is demonstrated by two examples. First, applying the rate structure developed in section C to an individual who dies in 1987

34. Although the rate structure must be altered to create a standard deduction system equivalent to the standard exemption system, this would have posed no problem in 1976 when Congress was already changing the rate structure. *See* I.R.C. § 2001 (1976).

with an estate of $1,000,000, under each tax system, the decedent's estate will be required to pay an estate tax of $153,000. Under the credit system, the tax will be computed by subtracting $192,800 from $345,800. Under the exemption system, the tax is simply read from the tax table as $153,000. Lastly, under the deduction system a tax will be imposed only on $400,000 due to the $600,000 standard deduction, resulting in a tax of $153,000. Similarly, in the case of an individual with an estate of $4,000,000 who dies in 1987, a tax of $1,583,000 will be due in all cases. The credit system tax will be computed by subtracting $192,800 from $1,775,800 resulting in a tax of $1,583,000. The exemption system tax, as determined from the tax tables, will be $833,000 plus (50% of $1,500,000) or $1,583,000. Finally, the deduction system tax will be imposed on $3,400,000 ($4,000,000 - $600,000) resulting in a tax of $1,583,000 ($833,000 plus 50% of $1,500,000).

Unfortunately, when it adopted the credit mechanism in 1976 Congress did not realize that standard credits, exemptions, and deductions could each be structured to produce an equivalent benefit for all taxpayers. Lacking such knowledge, Congress imposed an unnecessarily complicated credit system upon taxpayers. A standard exemption or a standard deduction with an altered rate structure would have been more effective and easier for the average layman to understand.[35]

Although it clearly did not understand that standard credits, exemptions, and deductions were potential economic equivalents when it designed the unified estate and gift tax credit in 1976, Congress indicated in the following year that it did understand that a standard deduction was the economic equivalent of a standard exemption. In the Tax Reduction and Simplification Act of 1977, Congress decided to eliminate the existing standard deduction and substitute for it the zero bracket amount — a standard exemption.[36] Not only did Congress indicate that the change was prompted by concerns for a reduction in taxpayer compliance burdens, but it also clearly stated that it knew the new zero bracket amount was "effectively equivalent to the present law standard deduction. . . ."[37] Congress, however, still did not address the fact that a standard credit is also the equivalent of a standard exemption or deduction.

The economic equivalence of the zero bracket amount, the stan-

35. Symptomatic of this is the fact that lawyers typically explain the value of the unified credit to their clients by translating it into an exemption.

36. *See* I.R.C. § 1 (1977).

37. *See* S. Rep. No. 66, 95th Cong., 1st Sess. 52, *reprinted in* 1977 U.S. Code Cong. & Ad. News 185, 231 (1977).

dard deduction and a standard credit is demonstrated by comparing Tables A, B and C below. Table A is the tax rate structure for married couples with a zero bracket amount of $3,400, which the Code designates as applicable for taxable years beginning after 1983.[38] Table B is its rate adjusted economic equivalence in a tax system which provides a standard deduction of $3,400. Table C is its tax credit equivalence in a tax system which taxes income covered by the zero bracket amount at 10 percent and provides a $340 standard tax credit.

Table A

If taxable income is:	The tax is
Not over $3,400	No tax.
Over $3,400 but not over $5,500	11% of the excess over $3,400.
Over $5,500 but not over $7,500	$231, plus 12% of the excess over $5,500.
Over $7,600 but not over $11,900	$483, plus 14% of the excess over $7,600.
Over $11,900 but not over $16,000	$1,085, plus 16% of the excess over $11,900.
Over $16,000 but not over $20,100	$1,741, plus 18% of the excess over $16,000.
Over $20,200 but not over $24,600	$2,497, plus 22% of the excess over $20,200.
Over $24,600 but not over $29,900	$3,465, plus 25% of the excess over $24,600.
Over $29,900 but not over $35,200	$4,790, plus 28% of the excess over $29,900.
Over $35,200 but not over $45,800	$6,274, plus 33% of the excess over $35,200.
Over $45,800 but not over $60,000	$9,772, plus 38% of the excess over $45,800.
Over $60,000 but not over $85,600	$15,168, plus 42% of the excess over $60,000.
Over $85,600 but not over $109,400	$25,920, plus 45% of the excess over $85,600.
Over $109,400 but not over $162,400	$36,630, plus 49% of the excess over $109,400.
Over $162,400	$62,600, plus 50% of the excess over $162,400.

38. *See* I.R.C. § 1(a)(3) (1982). For ease of illustration the inflation adjustment authorized by § 1(f) had been ignored.

Table B

If taxable income is: (after $3,400 standard deduction	The tax is:
From 0 to $2,100	11%
Over $2,100 but not over $4,200	$231 plus 12% of the excess over $2,100
Over $4,200 but not over $8,500	$483 plus 14% of the excess over $4,200
Over $8,500 but not over $12,600	$1,085 plus 16% of the excess over $8,500
Over $12,600 but not over $16,800	$1,741 plus 18% of the excess over $12,600
Over $16,800 but not over $21,200	$2,497 plus 22% of the excess over $16,800
Over $21,200 but not over $26,500	$3,465 plus 25% of the excess over $21,200
Over $26,500 but not over $31,800	$4,790 plus 28% of the excess over $26,500
Over $31,800 but not over $42,400	$6,274 plus 33% of the excess over $31,800
Over $42,400 but not over $56,600	$9,772 plus 38% of the excess over $42,400
Over $56,600 but not over $82,200	$15,168 plus 42% of the excess over $56,600
Over $82,200 but not over $106,000	$25,920 plus 45% of the excess over $85,600
Over $106,000 but not over $159,000	$36,630 plus 49% of the excess over $106,000
Over $159,000	$62,600 plus 50% of the excess over $159,000

Table C

If taxable income is:	The tax (before a credit of $340) is:
Not over $3,400	10%
Over $3,400 but not over $5,500	$ 340 plus 11% of the excess over $3,400
Over $5,500 but not over $7,600	$ 571 plus 12% of the excess over $5,500
Over $7,600 but not over $11,900	$ 823 plus 14% of the excess over $7,600
Over $11,900 but not over $16,000	$ 1,425 plus 16% of the excess over $11,900
Over $16,000 but not over $20,200	$ 2,081 plus 18% of the excess over $16,000
Over $20,200 but not over $24,600	$ 2,837 plus 22% of the excess over $20,200
Over $24,600 but not over $29,900	$ 3,805 plus 25% of the excess over $24,600
Over $29,900 but not over $35,200	$ 5,130 plus 28% of the excess over $29,900
Over $35,200 but not over $45,800	$ 6,674 plus 33% of the excess over $35,200
Over $45,800 but not over $60,000	$10,112 plus 38% of the excess over $45,800
Over $60,000 but not over $85,600	$15,508 plus 42% of the excess over $60,000
Over $85,600 but not over $109,400	$26,260 plus 45% of the excess over $85,600
Over $109,400 but not over $162,400	$36,970 plus 49% of the excess over $109,400
Over $162,400	$62,940 plus 50% of the excess over $162,400

The economic equivalence of the three rate structures and tax systems is demonstrated by comparing the tax burdens under each of the above rate structures for two couples, one earning $30,000 and the other earning $80,000. Under Table A, the first couple will owe a total tax of $4,818 ($4,790 plus 28% of the excess over $29,900). Under Table B they will owe a total tax of $4,818 ($4,790 plus 28% of the excess over $26,500 after allowing for a $3,400 deduction). Finally, under Table C, the couple will also owe a total tax of $4,818 ($5,130 plus 28% of the excess over $29,900 minus a credit of $340). Similarly, under Table A the second couple will owe a total tax of $23,568 ($15,168 plus 42% of the excess over $60,000). Under Table

B, that couple will also owe a total tax of $23,568 ($15,168 plus 42% deduction). Finally, under Table C, they once again owe a total tax of $23,568 ($15,508 plus 42% of the excess over $60,000 minus a credit of $340).

IV. Conclusion

In recent years much attention has been focused on the fact that credits are more beneficial to low income taxpayers than are deductions. Although this position may be tenable in the case of deductions for certain discretionary expenditures, it is clearly erroneous when applied to standard tax benefits. Standard credits, exemptions, or deductions (with altered rates) are all economically equivalent. Consequently, one may be substituted for the other with no monetary difference resulting to the taxpayer. When legislating any standard credit, deduction or exemption, Congress should abandon its misconceptions of equity and focus instead upon relevant concerns such as ease of taxpayer compliance and costs of administration.