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The Rationale of the Personal Exemptions

Although the protection of some minimum standard of living has long been widely accepted as the primary reason for personal exemptions in an income tax, the actual role the exemptions play today is wider and more complex than this. Only a small part of the aggregate dollar amount of the exemptions now goes to persons who are thereby excluded from income tax. We estimated that the exemptions of such persons in 1964 approximated $15.2 billion, or only about 15 per cent of that year's total, whereas those of taxable persons aggregated $88.3 billion.[1] In altering the exemption levels from time to time, Congress has not been sensitive to fluctuations in living costs. A review of the development of the income tax in Great Britain and the United States indicates that various other objectives besides the protection of a minimum standard of living have played a considerable and at times a decisive part in determining the character and level of the personal exemptions.

In examining the rationale of the exemptions we shall organize the discussion around the four principal functions (briefly noted in Chapter 2) that they appear to serve in the present United States income tax: excluding the poor, providing an allowance for the essential living expenses of all taxpayers, providing additional allowances for those with dependents and those who are aged or blind, and supplying a significant graduation of effective tax rates in the lower of taxable income groups. Although primarily concerned with the present exemptions in the United States, we shall find it revealing to make liberal references at various

[1] The estimating procedure we followed is described in C. Harry Kahn, *Personal Deductions in the Federal Income Tax*, New York, NBER, 1960, Appendix A.

points to earlier British and American thought and practice and to those of some other countries.

A. EXCLUDING THE POOR

1. *Equitable, Economic, and Social Considerations*

There is nowadays general acceptance in principle that a comprehensive or global income tax—one applied to the total of a person's income from all sources—should exclude from tax persons with incomes less than or only large enough to maintain the minimum socially acceptable standard of living. Such persons may be said to lack the ability to pay an income tax except at the cost of impairing their health or their economic efficiency and the welfare of their children. Apart from any equitable or humanitarian considerations, the support of at least some minimum standard of well-being for the poor and their children has commanded increasing governmental attention in recent years because such a policy is believed to possess high value for society. The health and education of the poor and their children are important for the nation's economic efficiency, the national defense, the reduction of crime, intelligent voting, and the fuller development of human talents in all fields.[2] Large public expenditure programs are being undertaken for the underprivileged on such grounds, among others, as we noted in Chapter 2. The exclusion of the poor from income tax may be supported on the same grounds.

The same considerations, it may be noted, support an exclusion level that varies with the number and even the ages of a person's dependents. They argue also against any but moderate effective tax rates for taxable persons with incomes not far above the exclusion limits.

Economists of earlier generations emphasized various more technical considerations in favor of excluding the poor. Adam Smith and many members of the Classical school of economists who followed him argued that direct taxes upon the wages of lower-paid workmen, as well

[2] See Harold M. Groves, *Federal Tax Treatment of the Family*, The Brookings Institution, 1963. pp. 11–12, 24; "Toward a Social Theory of Progressive Taxation," *National Tax Journal*, March 1956, pp. 27–34; Elmer D. Fagan, "Recent and Contemporary Theories of Progressive Taxation," *Journal of Political Economy*, August 1938, pp. 457–497.

as taxes on the goods that they buy, are bound to be shifted to consumers and landlords in large part through a resulting rise in money wages.[3] The effects of such taxes were bad, moreover, Smith held:

> If direct taxes upon the wages of labour have not always occasioned a proportionable rise in those wages, it is because they have generally occasioned a considerable fall in the demand for labour. The declension of industry, the decrease of employment for the poor, the diminution of the annual produce of the land and labour of the country, have generally been the effects of such taxes. In consequence of them, however, the price of labour must always be higher than it otherwise would have been in the actual state of the demand: and this enhancement of price, together with the profit of those who advance it, must always be finally paid by the landlords and consumers. . . .[4]

John Stuart Mill favored excluding the poor for a different reason. Contending that equal treatment of all taxpayers is the best principle of taxation, and that "equality in taxation means equality of sacrifice," Mill held that the sacrifice imposed by a tax which absorbs funds needed for the taxpayer's subsistence is "incommensurably" greater than that imposed by one which merely cuts into superfluities.[5] He did not believe, however, that the rule of equal sacrifice demands progressive taxation at income levels above subsistence requirements, holding the case for progression on this ground to be "too disputable altogether, and even if true at all, not true to a sufficient extent to be made the foundation of any rule of taxation."

Since the latter part of the 19th century the exclusion of the very poor from income tax found support in nearly all the different varieties of the equal and minimum sacrifice criteria of taxation. An income tax that forced the very poor to do without some necessities clearly imposed heavier sacrifices upon them than upon any persons who were left with spendable income beyond their minimum needs. Essentially the same implication remained when the concept of absolute equality of sacrifice came to compete with those of equal proportional and equal

[3] Adam Smith, *The Wealth of Nations,* Edwin Cannon, ed., Modern Library Edition, New York, 1937 (text copied from 5th ed., 1789), pp. 815 ff.; Richard A. Musgrave, *The Theory of Public Finance,* New York, 1959, Chapter 5.

[4] *Ibid.*

[5] John Stuart Mill, *Principles of Political Economy,* Ashley ed., London, 1921, pp. 804 ff.

marginal sacrifice.[6] The last concept was favored by some, including Edgeworth and Pigou, who judged equal marginal sacrifice to be the best criterion, not on ground of equity, but because it tended to promote maximum economic welfare by entailing the least aggregate sacrifice.[7]

On the other hand, those opposed to excluding even the lowest income groups from income tax argue that expenditures for the support of the government are as much a part of the necessary outlays of the individual as any other expense.[8] Moreover, it has been urged that the exemption of any considerable class of individuals is especially dangerous in a democracy with universal suffrage because those who have the power to influence public expenditures by their votes are more likely to be extravagant and irresponsible in exerting this influence if they do not share in the costs.[9] While conceding "a slight degree of strength" to the latter consideration, Seligman observed that practical experience with the general property tax, from which the very poor are largely exempt, did not support it.[10]

It may be noted that, although the costs of government are indeed a necessity for the community as a whole, the legislature is free to allocate these costs among individuals in ways it deems best. Indirect taxes exact some contribution from even the poorest, while the graduated rates of the income tax as determined from time to time by the legislature exact different proportions of private incomes at different income levels for governmental support. Hence there is no contradiction between exempting the very poor from income tax and holding that

[6] F. Y. Edgeworth, *Papers Relating to Political Economy,* London, 1925, Vol. II, pp. 100 ff.; Henry Sidgwick, *The Principles of Political Economy,* London, 1883, p. 562; Alfred Marshall, *Principles of Economics,* 8th ed., London, 1930, p. 135, Note 1; T. N. Carver, "The Minimum Sacrifice Theory of Taxation," *Political Science Quarterly,* Vol. 19, No. 1, March 1904, pp. 66–79.

[7] Edgeworth, *Political Economy,* p. 117; and A. C. Pigou, *A Study in Public Finance,* 3rd ed., London, 1951, p. 61; Richard A. Musgrave, *Public Finance,* p. 98.

[8] Gustav Cohn, *The Science of Finance* (translated by Thorstein Veblen), Chicago, 1895, pp. 327–330; Antonio de Viti de Marco, *First Principles of Public Finance* (translated by Edith Pavolo Marget), London, 1936, pp. 284 ff.; Senator Henry Cabot Lodge, *Congressional Record,* Vol. 50, pp. 3839–3840.

[9] Cohn, *The Science of Finance, loc. cit.*

[10] E. R. A. Seligman, *The Income Tax,* New York, 1911, p. 28 ff.

the costs of government are a necessary expense for individuals in the aggregate.

2. *Exemptions as an Offset to Other Taxes*

The exclusion of the lowest income groups from the income tax, as well as increases in the exclusion limits and concessions in the tax rates on the smaller of taxable incomes, have been supported also as offsets to the disproportionately heavy weight imposed upon these groups by indirect taxes: import duties, manufacturers' excises, and wholesale and retail sales taxes. Although such indirect taxes are collected from a relatively small number of importers, manufacturers, and dealers, they tend to be borne by the mass of the population in the form of higher prices for the taxed articles. In recognition of this fact, the British Chancellor of the Exchequer in 1872 increased the allowance on small incomes "in order to counterbalance the pressure of indirect taxes on small incomes." [11] Similarly, when the first American income tax measure under the 16th Amendment was being considered, Representative Cordell Hull, one of the principal authors of the Act, and others recognized a valid relationship between the weight of indirect taxes and the exemption levels: they combined their position in favor of high personal exemptions with one of opposing any but a gradual substitution of income taxes for customs and other indirect taxes.[12]

Exemptions favoring the lower income groups have been used to a limited extent in other taxes, such as the homestead exemption from the property tax, the exemption of food from the sales tax in some states, the selection of luxury or nonessential goods for various federal excise taxes, and the specific exemptions under the estate, gift, and inheritance taxes of the federal and state governments. The last-named, like income taxes, are direct taxes and therefore lend themselves more readily than indirect taxes to recognition of differences in the personal circumstances of taxpayers.

But special allowances for the lower income groups have not been of substantial importance in indirect taxes. While so-called luxuries have sometimes been singled out for taxation or for especially high

[11] *Minutes of Evidence,* Royal Commission on the Income Tax, Appendix No. 7 (a), p. 51.

[12] *House Ways & Means Committee Report No. 5,* 63rd Congress, 1st Session, p. XXXVII, 1913.

tax rates, excise and sales taxes do not yield large revenues unless applied to goods and services in wide use. In fact, excise taxes on necessities such as salt, and general turnover and "value-added" taxes have been chosen deliberately in various countries because of their universal application and their great revenue yields; and the same is true of the retail sales taxes now levied by more than four-fifths of the state governments in the United States. Many articles that are taxed by the federal government on the ostensible ground that they are luxuries, or at least nonessentials, such as tobacco, liquor, and automobiles and their components, are actually purchased largely by persons with modest incomes.

Unless accompanied by special administrative devices, it would be difficult to frame and administer excise taxes in ways that would take account of differences in the incomes and family responsibilities of the final purchasers. Imagine, for example, the difficulty of attempting to exempt the lower income groups from the existing manufacturers' excise tax on cigarettes, automobiles, or tires, while imposing it on these goods when made for others; and the greater difficulty of allowing for variations in family size in connection with such taxes. At the manufacturers' and wholesale levels, which produce most of the revenue raised by federal excise taxes, the final purchasers are not known, for the taxes are collected mainly from firms that sell their goods to dealers rather than to consumers.

Experience with the use of food-purchase stamps during the Great Depression and since, and with rationing coupons during World War II, led to the suggestion that excise taxes might conceivably be adapted to the differential treatment of persons through the distribution to eligible individuals of tax-paid stamps covering different amounts of purchases of goods subject to certain excise taxes.[13] Such a scheme might be applied, for example, to persons on relief and to others with very small incomes, in connection with the general and selected retail sales taxes levied by state and local governments, or in connection with a federal retail sales tax. It is even possible to conceive of rebates of portions of the federal customs duties and manufacturers' excise taxes for certain classes of final purchasers by an extension of the exemptions

[13] See W. L. Crum, John F. Fennelly, and Lawrence H. Seltzer, *Fiscal Planning for Total War,* New York, NBER, 1942, p. 239.

now permitted under certain of these excises for state and local governments and their instrumentalities. But all such schemes must contend with the evasions that are possible because most goods are readily transferable from one person to another. In general, except when combined with some such rationing system as indicated above, excise taxes offer limited opportunity for exempting or granting other preferential tax treatment to persons with small incomes and those with relatively large families.

Despite the prominence of individual and corporation income taxes, particularly in the tax revenues of the federal government, and of the property tax in those of local governments, a total of $32.9 billion, or 23.7 per cent of the aggregate tax revenues of the federal, state, and local governments in the fiscal year 1965, was raised by general or selected sales and gross receipts taxes and customs duties.[14]

The payroll income tax that is levied for social security and medicare on the income from personal services of employees and the self-employed also imposes a relatively heavier current tax burden on the lower than on other income groups because the tax applies neither to income from property nor (in 1967) to the amount of anyone's wages and salaries in excess of $6,600. It is true that the proceeds of this tax, as well as of the equal rate levied on employers, are segregated for the benefit of the aged, permanently disabled, and their survivors, most of whom have small incomes, and that employees and the self-employed can look forward to participating in the benefits ultimately. But the current impact of the tax upon those who pay it is not significantly different from that of the income tax. The 1967 F.I.C.A. tax rate of 4.4 per cent took more than the federal income tax from married couples with two dependent children and incomes of up to about $4,500 derived

[14] U.S. Bureau of the Census, *Government Finances in 1964–65,* Series GF-No. 6, Washington, D.C., revised, February 1967, Table B. The statistics relate to governmental fiscal years which ended June 30, 1965, or at some date within the twelve previous months, except that they include those of the state governments of Alabama and Texas and school districts in those states for the fiscal year which ended at the end of September and August 1965, respectively. While some of the state and local government sales and excise taxes are deductible for the federal income tax by individuals who itemize their deductions, a large proportion is not, and in no case are they deductible by persons claiming the standard deduction, including the minimum standard deduction.

entirely from wages and salaries, assuming the couples used the minimum standard deduction.

3. *Administrative Reasons Formerly Favored Exempting the Poor but Are Now of Small Importance*

Practical considerations favored the exclusion of the lowest income groups in the early years of the income tax, both in Great Britain and the United States. One such consideration was the administrative problems and disproportionate costs of collecting income taxes from millions of poor persons, many of them farmers, with scanty cash resources and even scantier habits of bookkeeping. The income tax was difficult to administer at first even when much of the population was excluded from it, for enforcement machinery was meager, traditions of taxpayer compliance had yet to be established, and few taxpayers kept adequate records. William Pitt explained the financially disappointing results of the primitive income tax that he introduced in Great Britain in 1798 as due to "shameful evasion or rather scandalous frauds." [15]

Fear of the administrative difficulties of a mass income tax was prominent in the United States in 1913, when the first income tax measure under the 16th Amendment was under consideration. Congressman Cordell Hull, who, as previously noted, was one of the principal authors of the measure, argued strongly in favor of high personal exemptions on administrative grounds. He urged that the income tax "must first be understood by the people and become adjusted to the intricate business conditions of the country before its administration could be expected to prove entirely convenient and satisfactory." To have low exemptions, he argued, "might result in the breakdown of its administration." [16]

The force of the practical considerations that influenced the provision of personal exemptions in the earlier years of the income tax was reduced substantially by various subsequent developments: the collection of income tax at the source on wages and salaries through compulsory withholding by employers (which began in 1943 in the United States and as early as 1803 in the United Kingdom), the increase in

[15] Quoted in *Minutes of Evidence,* Royal Commission on the Income Tax, London, 1919, Appendix I, p. 1.

[16] *Congressional Record,* Vol. 51, Appendix, p. 102.

the relative importance of wage and salary income as compared with income from self-employment, the related decline in the proportion of farmers in the population, the widespread adoption of standard accounting practices, the greater abundance of written records, greater familiarity with and respect for the law on the part of the taxpayers, the development of more adequate enforcement machinery, and the widespread acceptance of progressively graduated tax rates as against a standard proportional rate as "just" or "equitable."

Nevertheless, the question continues to be raised from time to time whether administrative considerations alone do not even now justify a substantial rise in the level of the minimum taxable income, or, alternatively, greatly simplified tax provisions for low income groups. In a paper submitted to the Joint Committee on the Economic Report in November 1955, Thomas C. Atkeson, formerly assistant to the Commissioner of Internal Revenue, noted the following facts about the disproportionate administrative burden that he attributed to tax returns with adjusted gross income of under $2,500 in 1952: While providing only 5.2 per cent of the total income tax liability, they accounted for 38 per cent of all returns, 28 per cent of all exemptions, 43 per cent of returns claiming refunds on account of excessive tax withheld from salaries, 50 per cent of returns reporting annuities, 19 per cent of returns claiming a medical deduction, 26 per cent of returns reporting income or loss from sole proprietorships, and 20 per cent of returns reporting income or loss from partnerships. The under $2,500 group was responsible for more than one-third of the Revenue Service's total costs other than for auditing, and for more than one-third of employers' administrative costs on account of taxes.[17]

While the foregoing figures seem impressive, similar figures suggesting disproportionate administrative costs could be cited for the tax returns supplying the bottom 10 per cent of income tax revenues even if the exemption levels were raised substantially. The fact is that to achieve effective enforcement of the income tax, whatever the exclusion levels, it is necessary to require tax returns from all persons with incomes close to those levels, many of whom will be found to have

[17] Thomas C. Atkeson, "The Economic Costs of Administering Special Tax Provisions," in *Federal Tax Policy for Economic Growth and Stability,* Washington, 1955, pp. 276–286.

little or no tax liability. As far back as 1930, when a tax return was not required of individuals with gross incomes of less than $5,000 or net incomes of less than $3,500 if married or $1,500 if single, some 45 per cent of all individual returns were nontaxable, and 78 per cent of the total number of returns supplied only 2.1 per cent of the individual income tax revenues (*Statistics of Income,* 1930, Table 3).

Low exemption levels and changes in them from time to time are not likely to encounter serious administrative difficulties under current conditions. They can be readily incorporated in the tax tables used by most taxpayers and in those used for withholding purposes by employers. Moreover, since tax returns are now required of all persons under 65 years of age with gross incomes of $600 or more, and $1,200 if older, regardless of the amounts of the personal exemptions (a requirement that could be retained), changes in the exclusion or exemption levels would no longer cause millions of persons to be withdrawn from or added to the tax-return population as was true during the 1920's.

4. *Payroll Income Taxes Without Exemptions*

Instead of using personal exemptions to reduce the number of taxpayers, simplified administration of an income tax for the lower income groups might be sought by eliminating the exemptions altogether and levying a low flat rate of tax, largely collected by withholding on the part of employers. This is the method used in the payroll income taxes levied by several hundred local governments in the United States, and, as previously noted, by the employee taxes levied under the federal social security and railroad retirement tax acts for old age and survivors' insurance and medicare. Such taxes differ from global or comprehensive income taxes in that they are generally limited to a single type of income—that from personal services. Because of the relatively low rates of these taxes, the usual considerations in favor of personal exemptions are commonly regarded as less compelling. The social security employee and self-employment taxes, moreover, may be regarded for the most part as forced contributions to an individual's retirement needs—forced savings—rather than as pure taxes; for they are subject to ordinary income tax in the year in which they are withheld, while the retirement and other benefit payments are exempted from income tax when received. About 700 local governmental units,

ranging from small school districts to a number of large cities, mostly in the states of Ohio, Pennsylvania, Michigan, and Kentucky, were levying so-called "municipal income taxes" in 1964, nearly all by means of a flat-rate payroll income tax without personal exemptions and with property income excluded.[18]

Despite the predominant absence of allowances for dependents and, most commonly, the exclusion of income from property, the flat-rate income taxes levied by various local governments in the United States offer several advantages over the usual practical alternatives—increases in general property tax rates or in sales taxes. They are paid only by individuals with income, though only on income from personal services, and in proportion to the amount of taxed income, regardless of how that income is spent or invested. Thus they avoid discriminating against the particular kinds of goods and services covered by a sales tax, or the kinds of property, notably real estate and business inventories, that usually suffer disproportionately from property taxes. The revenues from income taxes are more responsive than those from property taxes to rising prices. Sales and other excise taxes, because they tend to be borne in proportion to expenditures on the taxed articles, fall with special severity upon those who, because of illness or age, are living on past savings or on charity, and upon those with large families; and, more broadly, upon those whose consumption requirements absorb their entire incomes.

These relative attractions of an income tax without exemptions or graduated rates, as compared with increases in sales or property tax rates, are mainly responsible for the spread in recent years of municipal income taxes in the United States. But when income taxes are levied at substantial rates, as at the federal or state level, the case for special treatment for the lowest income groups and for those with dependents has generally prevailed against the administrative simplicity of avoiding personal exemptions.

[18] Because the Kentucky Constitution prohibits local governments from taxing income, the local income taxes in that state are legally defined as occupational license taxes, though levied as a percentage of earned income. For a good summary of the fiscal importance and geographical distribution of municipal income taxes, see Advisory Commission on Federal Intergovernmental Relations, *Tax Overlapping in the United States,* 1961.

B. A UNIVERSAL EXEMPTION FOR ESSENTIAL LIVING COSTS

1. *The Idea of Allowing for Necessities*

In contrast to the view that the personal exemptions should be confined to the poor, is the view that they should be allowed at all income levels. The latter view has traditionally been based on the ground that an income tax is properly levied only on income in excess of subsistence or other requirements—variously termed "clear income," "surplus income," or "dispensable income." [19] In the United States, this view was reflected in the early Civil War income tax acts, as well as in subsequent income tax laws. Referring to the personal exemption provided under the income tax acts of 1862 and 1864, the Commissioner of Internal Revenue declared, "It is, of course, the purpose of the law to exempt so much of one's income as was demanded by his actual necessities." [20] More generously, in the Congressional debates on the bill that became the Revenue Act of 1913, the personal exemptions were conceived as amounts to be exempted from all incomes in order to protect a "proper standard of living." [21]

A superficially plausible basis for a universal personal exemption—applicable to those who remain subject to tax after the very poor have been excluded, and exclusive of allowances for dependents, age, and blindness—is that some personal consumption expenses are also, in a sense, costs of earning income, and a universal personal exemption serves as an allowance for such expenses. These might be said to include the minimum amounts "necessary" for food, clothing, shelter, and other essential maintenance costs. They may also be thought to include some other expenses, such as costs of getting to and from work. Train, bus, and subway fares, and automobile expenses incurred in traveling to and from work are not at present allowed as deductible

[19] Adam Smith, *Wealth of Nations;* Gustav Cassel, "The Theory of Progressive Taxation," *Economic Journal,* Vol. 11 (1901), p. 481; U.S. Treasury Department, Division of Tax Research, *Individual Income Tax Exemptions,* 1947, p. 47; Walter J. Blum and Harry Kalven, Jr., *The Uneasy Case for Progressive Taxation,* Chicago, 1953, pp. 90 ff.; E. R. A. Seligman, *The Income Tax,* p. 21.

[20] *Annual Report of the Secretary of the Treasury for 1866,* p. 32.

[21] *Congressional Record,* Vol. 50, p. 3851.

expenses in the federal income tax because, presumably, they are occasioned by the taxpayer's free decision to reside at a distance from his work. Nevertheless, in many communities, particularly in the larger cities, a significant amount of such expense is now unavoidable. A factory or office worker who rides a bus to and from work five days a week for 50 weeks at 25 cents a trip pays out $125 a year in such fares. A universal personal exemption may be regarded as a practical means of taking account of the fact that a limited amount of "consumption expenses" of this and some other kinds are comparable to the deductible expenses allowed in arriving at the net income of a business enterprise or a piece of real or personal property. Logically such an allowance might be better termed a deduction, needed to arrive at "clear" or taxable income, but long usage has given it the designation of personal exemption.

2. *Illusory Nature of Allowance for Necessities*

Although a modest universal allowance of this character seems to be a reasonable provision, it does not actually serve as a real concession to the taxpayer (except to those whom it excludes from tax), for an equal allowance for all is a special allowance for none. What everyone appears to gain from a universal allowance must be made up by higher tax rates on the taxable portion of incomes. If the present exclusion from tax for those with very low incomes were provided in some other manner, as by an express exclusion limit restricting the tax to those with incomes above it, the universal personal exemption for taxpayers on their own accounts could be eliminated, and bracket tax rates correspondingly reduced, without the taxpayer being worse off than before. Similarly, an increase in the exemption to $800 or even $1,000 for the taxpayer proper (ignoring for the present the exemptions for dependents, the aged, and the blind) would not benefit him if Congress adjusted the bracket rates upward in such fashion as to raise an unchanged amount of income tax revenue from each of the remaining taxable income classes; and it would increase his tax burdens if Congress raised his tax rates sufficiently to make up for the revenues lost from persons newly excluded from the income tax.

Of course, with a progressively graduated structure of tax rates, the present uniform exemption of $600 produces a greater absolute tax reduction for incomes subject to higher bracket rates than for those

subject to lower ones: e.g., the $600 exemption cuts the tax by $114 for an income lying wholly within the 19 per cent bracket, but by $300 for one that lies to the extent of $600 or more in the 50 per cent bracket. Hence, if the tax rate schedule is regarded as fixed independently of the personal exemptions, an equal absolute exemption at all income levels gives a greater tax concession to those with larger than to those with smaller incomes.[22]

But examination of the Congressional committee hearings on income tax changes over a long period of years clearly shows that, in considering any proposed schedule of bracket rates of tax, Congress regularly pays close heed to the combined effects of the proposed bracket rates *and* the proposed personal exemptions upon the total or effective tax rates *on incomes both before and after the exemptions.* In consequence, Congress may be said to choose deliberately the effective tax rates on incomes in the light of the exemptions. So far as concerns the large proportion of total personal exemptions going to taxpayers on their own accounts, therefore (about 60 per cent of the total number of exemptions in recent years, if all spouses filing joint returns are regarded as taxpayers), the apparent allowance for personal maintenance provided by the personal exemption may be regarded as only nominal: Congress may be presumed to have chosen the combination of personal exemption and bracket tax rates which produced the level and distribution of tax burdens that it sought.

The view has been advanced from time to time that, far from being confined to the lowest income groups, the personal exemptions should be greater for larger than for smaller incomes, perhaps being fixed at a constant percentage of income, such as 10 per cent. The ground offered for this view is that "necessary" consumption expenditures tend to rise with income—that costlier shelter, clothing, and other components of consumption are in some measure essential for earning larger incomes or, at any rate, are in fact required by custom on the part of those enjoying larger incomes. A position akin to this was taken by Gustav Cassel, who urged that "indispensable income increases with to-

[22] At the same time, however, the equal exemption constitutes a declining proportion of income as income rises, and in this sense represents a *relatively smaller* concession to bigger incomes than to lesser ones. It is because of this effect that an equal personal exemption at all income levels contributes to the progressivity of the effective tax rates.

tal income because luxuries for the lower income groups become necessities for the upper income groups." [23] However, Cassel thought that the amount of "indispensable" income increases more slowly than individuals' total incomes.

It is doubtless true that for many taxpayers the present amount of the personal exemption on their own accounts is smaller than the total of personal maintenance expenses (exclusive of tax deductible expenses) that they find useful or even essential in earning their incomes. The ways in which taxpayers dispose of their incomes often contribute materially to the amounts they earn: by facilitating useful contacts with business associates and customers and by promoting their physical fitness. Expenditures for roomier and fashionably located living quarters, costlier food and clothing, club dues, and even vacations may in these ways contribute to income directly or indirectly. It is probably also true, in a general way, that such expenses tend to rise with incomes over a considerable range, at least for incomes derived from personal services.

But there are significant differences among taxpayers. For some, such expenditures are motivated *primarily* by the desire to increase income, though they also bring consumption satisfactions. For others, they may have the same favorable effects upon income even though they are motivated entirely by consumption satisfactions. And still other taxpayers make similar expenditures without either striving to increase their incomes thereby or in any measure achieving this result. It would be extremely difficult to discriminate with nicety among them. A blanket personal exemption rising mechanically with income would attempt to avoid this difficulty by ignoring all such differences. Unless offset by higher tax rates, however, it would be the equivalent of a tax cut at all income levels, with the amount of tax reduction varying directly with the size of a person's income. A taxpayer with a substantially larger income than another would gain more, both because his exemption would be greater and because it would be from a higher tax bracket.

Two observations suggest themselves in this connection. First, unless the distinction between consumption and the costs of earning income is narrowly rather than generously drawn, a large part of all in-

[23] Gustav Cassel, "Theory of Progressive Taxation," *Economic Journal*, Vol. II (1901), p. 481.

come could be plausibly regarded as costs of earning it, leaving little "clear income" available for partial diversion to public use by the income tax. Even the saved portion of most individual incomes can be regarded as a kind of cost—a depreciation and retirement provision for meeting the taxpayer's needs when he retires.

Second, unless Congress chose to reduce the revenue yield and to alter the distribution of the burden of the income tax by this means, no real gain to the middle and upper income groups might well result. The nominal concession in the form of reductions in taxable incomes would have to be accompanied by roughly offsetting increases in tax rates for each income group to avoid a reduction in revenue, an increase in the effective tax rates on the lower taxable income groups, or some other alteration in the distribution of income tax burdens among the income classes. On the other hand, if Congress actually desired to make allowances for the living expenses of taxpayers in rough proportion to the size of their incomes, at the cost of smaller revenues or higher tax rates on small incomes, it could approximate this result without altering the nominal personal exemptions merely by reductions in the bracket rates applicable to medium and larger incomes.

The foregoing considerations provide strong support for the view that if any allowance at all is made through a personal exemption for the maintenance needs of the taxpayer proper, it should be restricted, as at present, to a modest amount that does not vary with income; and that allowances for expenditures that partake of the nature of both production costs and consumption uses of income should be dealt with on an individual basis, as at present, giving rise to negative items in arriving at taxable income to the extent that carefully devised rules and administrative scrutiny justify.

C. EXEMPTIONS FOR DEPENDENTS, THE AGED, AND THE BLIND

1. *Universal Exemptions for Dependents*

The most cogent reason for not confining the personal exemptions to the very poor is to take account of varying family responsibilities at other income levels. At the lower end of the income scale, the same

income that could support a single person in tolerable comfort might leave a large family well below the poverty line. Allowances for the greater minimum requirements of a man with a dependent wife and children than of a single person could conceivably be confined to those with small incomes, as was the practice in Great Britain for many years. But differences in family responsibilities create variation in economic well-being at every income level.[24] A married couple without children or other dependents may live much more affluently, by common standards, on an income of $7,500 a year than a couple with three or four children and the same income. Even at substantially higher income levels, taxpayers with smaller families are reasonably presumed to be better off economically than those with the same income but larger families. By providing allowances for dependents at all income levels, the law may be said to seek a more equitable tax treatment *at each income level* between persons with unequal family responsibilities.

Nevertheless, no allowances were made for a wife or children in the Civil War Income Tax Act of 1863. Such allowances were absent from the British income tax for more than a century following 1806. An allowance for children—but only if there were five or more!—had been made in the British Income Tax Act of 1798, but was discontinued in 1806 and not restored until 1909. The Chancellor of the Exchequer in 1848, referring to this discontinuance and the absence of the allowances in the income tax act of 1842, said "the exemption was taken away, as it was found that it led to great . . . fraud." [25] Exemptions for children were also absent from the first three years, 1913–16, of the present series of U.S. income tax laws enacted after the 16th Amendment, doubtless because the $4,000 exemption for married couples was deemed enough to cover children as well.

Allowances for dependents are now nearly universal in graduated income taxes. Although children are doubtless a source of satisfaction to most parents, the public also has an interest in their health and upbringing. Since the children of today are the citizens of tomorrow, virtually all countries have assumed a considerable degree of respon-

[24] See Carl S. Shoup, "Married Couples Compared with Single Persons Under The Income Tax," *Bulletin of the National Tax Association*, February 1940, pp. 130–135; Paul Strayer, *The Taxation of Small Incomes*, New York, 1930.

[25] *Minutes of Evidence of the Royal Commission on the Income Tax*, London, 1920, Appendix No. VII (e), p. 59.

sibility for their education and well-being at public expense. Measures reflecting the acceptance of such public responsibility include not only the provision of publicly supported educational and health services, but federal aid to dependent children in the United States and, as we have seen, universal family allowances in Canada, the United Kingdom, Sweden, and a number of other countries. In rearing children, parents may be said to provide economic and other services of considerable public importance, some allowance for which in the income tax is widely accepted as reasonable. Allowances for other dependents may be justified on the ground that the taxpayer is assuming the burden of supporting persons who might otherwise require some measure of public support.

Several objections have been raised from time to time against personal exemptions for dependents. One holds that the support of dependents is an optional form of consumption from which the taxpayer derives substantial satisfactions, and for which, therefore, he is not entitled to tax concessions.[26] Gary Becker has explored the concept that parents decide upon the number of their children and the amounts they spend on their maintenance and education in somewhat the same way as if children were durable consumer goods. Besides the well-known positive correspondence between cyclical movements in income and fertility, he found other statistical support for the view that the number of children desired is directly related to income.[27] A second objection is that those with larger families make greater demands upon publicly provided services, notably for education, health, and recreation; and hence are already receiving more favorable treatment on the side of public expenditures.

A view urged by Professor Harold Groves is that allowances for dependents are needed at the lower end of the income scale to help preserve the amenities of a civilized society, but that they do a disservice at the upper end of the income scale because they reduce the effectiveness of a graduated income tax in combating the concentration of economic power in families.[28]

[26] See Henry C. Simon's *Personal Income Taxation,* Chicago, 1938, Ch. VI; Gary S. Becker, "An Economic Analysis of Fertility," in *Demographic and Economic Change in Developed Countries,* Princeton University Press for NBER, 1960, pp. 210 ff.

[27] Becker, *loc. cit.*

[28] *Federal Tax Treatment of the Family,* pp. 12 ff.

Allowances for dependents are scarcely necessary in the highest income brackets, though it is doubtful that they add significantly to the concentration of economic power. At the maximum bracket rate of 70 per cent in 1967, applicable to taxable incomes over $200,000 for a married couple filing a joint return, the allowance of $600 for each dependent child saved the couple $420 in income tax—a tiny fraction of their income.

Granted that the allowances are unnecessary and possibly even harmful at very high levels of income, are they so in the important range of incomes between these and the lowest brackets? It may be argued in their favor, as previously indicated, that such allowances permit a more equitable treatment of taxpayers with equal incomes but unequal family responsibilities—say, between a childless couple and one with four dependent children—in a range of incomes covering an important fraction of the taxpaying population. About 43 per cent of all taxable returns in 1965 reported adjusted gross incomes of $5,000 to $10,000, about 57 per cent, $5,000 to $15,000, and 60 per cent, $5,000 to $20,000 (Table 21). Moreover, the distribution of dependents among taxpayers in these income groups is highly uneven. In 1963, the latest year for which detailed tabulations are available in this respect, taxable returns with adjusted gross incomes of $5,000 to $15,000, for example, which totaled somewhat over 27 million, included 9 million with no dependents, over 5 million with one, nearly 6 million with two, a little under 4 million with three, a little less than 2 million with four, and nearly 2 million with five or more (Table 22). The objective sought by dependent allowances in some or all of such income groups is to distribute the tax burden to be levied on each group somewhat in favor of taxpayers with more dependents and against those with fewer, not to reduce the burden on any group as a whole, though the attainment of the latter result in practice will depend in part upon the number and distribution of the exemptions in each income group.

It has sometimes been suggested that exemptions for dependents should be greater for larger than for smaller incomes on the ground that equal absolute amounts of exemption at all income levels do not differentiate adequately between small and larger families in the middle and upper income groups. Exemptions that make appropriate allowances at $5,000 of adjusted gross income for the greater requirements of couples with four children than for childless couples,

TABLE 21

Number of Returns and Number of Exemptions by Type of Exemption and Adjusted Gross Income Classes, 1965

Adjusted Gross Income Classes (thousand dollars)	Number of Returns (1)	Total Number of Exemptions (2)	Number of Exemptions for Taxpayers (3)	Exemptions for Taxpayers Age 65 or Over: Number of Returns (4)	Exemptions for Taxpayers Age 65 or Over: Number of Exemptions (5)	Exemptions for Blindness: Number of Returns (6)	Exemptions for Blindness: Number of Exemptions (7)	Exemptions for Taxpayers' Dependents: Number of Returns (8)	Exemptions for Taxpayers' Dependents: Number of Exemptions (9)
Grand total	67,596,300	190,741,281	107,625,130	6,149,876	7,926,201	104,471	107,195	31,597,067	75,082,758
Taxable returns, total	53,700,794	153,203,616	87,914,437	3,290,127	4,056,593	59,998	61,769	26,995,134	61,170,816
Under 1	552,583	552,583	552,583	–	–	–	–	–	–
1 under 2	4,487,369	4,877,238	4,658,740	93,582	93,582	7,378	7,378	124,103	124,103
2 under 3	4,325,234	6,506,297	5,238,032	335,421	336,228			782,976	925,472
3 under 4	5,047,285	10,170,911	6,980,638	450,394	522,177	4,000	4,000	1,671,824	2,664,095
4 under 5	5,201,239	12,984,896	7,944,443	459,343	564,186	6,467	7,275	2,300,972	4,468,992
5 under 6	5,201,624	14,811,560	8,528,838	377,735	477,858	11,620	11,765	2,718,267	5,793,099
6 under 7	5,378,580	17,466,412	9,426,340	320,128	409,436	6,317	6,317	3,280,865	7,624,319
7 under 8	4,928,047	17,261,172	9,021,324	229,351	297,764	4,619	5,281	3,264,425	7,936,802
8 under 9	4,125,098	14,994,493	7,752,774	177,366	226,679	4,982	4,982	2,834,144	7,011,291
9 under 10	3,377,613	12,545,338	6,428,451	129,446	166,071			2,377,360	5,949,583

10 under 15	7,695,823	28,269,086	14,882,806	346,197	451,039	8,125	8,227	5,345,094	12,927,014
15 under 20	1,756,955	6,501,091	3,390,628	136,721	183,391	2,873	2,924	1,200,031	2,924,148
20 under 50	1,389,340	5,363,660	2,665,081	180,431	251,558	2,966	2,966	950,377	2,444,055
50 under 100	188,276	733,143	358,527	39,565	56,067	472	472	120,595	318,078
100 under 500	43,713	158,693	81,584	13,684	19,518	168	171	23,143	57,420
500 under 1,000	1,391	4,930	2,535	512	702	8	8	677	1,685
1,000 or more	624	2,113	1,113	251	337	3	3	281	660
Nontaxable returns, total	13,895,506	37,537,666	19,710,694	2,859,751	3,869,606	44,473	45,427	4,601,932	13,911,940
No adjusted gross income	397,372	1,113,395	661,048	85,569	114,177	–	340	146,012	337,830
Under .6	4,180,301	5,267,762	4,509,726	230,524	287,933	3,954	3,954	230,777	466,150
.6 under 1	2,653,940	4,089,457	3,063,889	299,691	380,011	3,386	3,386	327,467	642,170
1 under 2	2,810,755	8,272,490	4,391,473	1,222,918	1,545,213	10,995	11,286	1,136,072	2,324,518
2 under 3	1,803,471	7,084,570	3,179,342	638,327	949,233	14,340	14,340	1,115,491	2,941,655
3 under 4	991,446	4,972,582	1,863,405	237,224	365,069	6,254	6,917	744,457	2,737,191
4 under 5	566,356	3,406,720	1,092,567	82,890	134,399	3,464	3,464	479,637	2,176,290
5 or more	491,865	3,330,690	949,244	62,608	93,571	1,739	1,739	422,019	2,286,136
Returns under 5	33,017,350	69,298,900	44,135,885	4,135,881	5,292,209	60,580	62,340	9,059,788	19,808,467
Returns 5 under 10	23,473,737	80,274,708	42,052,897	1,290,839	1,663,520	29,012	29,820	14,876,281	36,528,472
Returns 10 or more	11,105,211	41,167,673	21,436,348	723,156	970,472	14,879	15,035	7,660,998	18,745,819

SOURCE: *Statistics of Income*, 1965, Table 19.

TABLE 22

All Returns: Number of Returns by Number of Taxpayers' Dependents, by Adjusted Gross Income Classes, 1963

Adjusted Gross Income Classes (thousand dollars)	Number of Returns (1)	Number of Returns by Number of Taxpayers' Dependents								
									Eight or More	
		One (2)	Two (3)	Three (4)	Four (5)	Five (6)	Six (7)	Seven (8)	Number of Returns (9)	Number of Exemptions (10)
Grand total	63,943,236	10,450,963	9,441,622	6,026,074	3,066,044	1,376,153	590,376	252,534	183,715	1,620,845
Taxable returns, total	51,323,221	9,153,096	8,226,859	5,012,936	2,351,213	933,370	336,080	123,681	67,072	572,981
.6 under 2	5,778,408	242,723	–	–	–	–	–	–	–	–
2 under 3	4,785,696	896,447	333,883	29,321	–	–	–	–	–	–
3 under 4	5,282,080	1,020,495	691,354	289,028	21,155	–	–	–	–	–
4 under 5	5,686,287	1,108,878	867,517	497,307	268,807	45,557	33,960	–	–	–
5 under 6	5,617,112	1,102,411	1,020,315	666,205	314,802	136,326		24,352	–	–
6 under 7	5,390,530	1,085,727	1,115,411	729,894	364,403	167,026	69,125		16,893	136,827
7 under 8	4,517,117	888,696	981,128	673,142	346,816	149,567	59,579	23,156		
8 under 9	3,524,119	678,823	799,760	552,429	269,000	119,938	45,418	22,305	11,653	99,366
9 under 10	2,643,623	557,909	581,621	384,655	193,003	84,879	36,428	17,319	11,022	94,688
10 under 15	5,651,184	1,142,883	1,302,750	812,092	383,778	152,262	62,887	23,989	17,704	155,019

15 under 25	1,692,939	307,709	384,845	258,600	127,030	51,273	17,710	7,619	5,953	52,875
25 under 50	592,854	93,779	120,869	98,413	49,923	21,408	8,713	3,875	2,934	26,006
50 under 100	131,971	21,915	23,308	18,912	10,807	4,375	1,917	939	780	7,017
100 under 500	28,146	4,521	3,958	2,869	1,633	730	331	123	129	1,150
500 under 1,000	804	117	108	46	45	22	7	3	3	25
1,000 or more	351	63	32	23	11	7	5	1	1	8
Nontaxable returns, total	12,620,015	1,297,867	1,214,763	1,013,138	714,831	442,783	254,296	128,853	116,643	1,047,864
No adjusted gross income	431,992	55,807	46,202	28,373	17,968	6,794	3,240	1,155	1,216	11,043
Under .6	3,951,204	127,030	72,799	33,855	20,656	8,680	5,638	1,909	1,794	16,158
.6 under 2	4,467,375	877,018	537,882	245,862	112,943	62,748	21,906	8,242	11,124	102,786
2 under 5	3,394,879	223,368	530,202	675,025	521,999	320,027	164,416	66,564	43,781	389,005
5 or more	374,565	14,644	27,678	30,023	41,265	44,534	59,096	50,983	58,728	528,872
Returns under 5	33,777,921	4,551,766	3,079,839	1,798,771	963,528	443,806	197,178	77,870	57,915	518,992
Returns 5 under 10	22,046,821	4,325,233	4,522,718	3,033,911	1,526,980	701,168	301,176	137,872	97,618	852,929
Returns 10 or more	8,118,494	1,573,964	1,839,065	1,193,392	575,536	231,179	92,022	36,792	28,182	248,924

NOTE: Detail may not add to total because of rounding.

See text of source for description and limitations of the data and explanation of classification and terms.

SOURCE: *Statistics of Income*, 1963, Table 22.

for example, may be too small to reflect the differences in requirements between families of these two sizes at income levels of $10,000 or $20,000. The Colwyn Commission in Great Britain commented on the desirability of varying the allowances for dependents with the size of income, within limits, on this ground.[29]

Such a variation in the personal exemptions could be achieved by establishing the exemptions for dependents as a percentage of income, perhaps with upper and lower limits. The objective would not be to reduce the net tax burden on larger incomes as compared with smaller ones, but to redistribute the tax burden at each income level in favor of those with larger families. Although the personal exemptions would be made larger for dependents in families with larger incomes than for those in families with smaller ones, the relative net tax burdens on incomes of different size could be maintained substantially unchanged by appropriate adjustments in the bracket tax rates. In other words, what each upper income group as a whole appeared to gain from the larger exemptions would be nullified by appropriate increases in bracket rates, but taxpayers with larger families in each upper income group would gain relative to those with smaller families in each group.

As elsewhere in the tax law, considerations of this kind must be weighed against those of simplicity and public understanding and acceptance. The interrelations of the bracket tax rates with the personal exemptions are only vaguely understood by many. To grant larger personal exemptions to taxpayers with larger incomes than to those with smaller ones would doubtless appear unjust to many persons, even though the bracket rates were so adjusted as to cause the distribution of tax liabilities among the different income groups to remain substantially unchanged. Many persons would continue to judge the fairness of the exemption provisions solely by their direct comparative treatment of taxpayers with different amounts of income, without regard to the structure of bracket rates. Moreover, it may be contended that the law already favors larger as against smaller incomes in the allowances for dependents because the equal absolute allowance results in a larger absolute tax reduction for incomes subject to higher than to those subject to lower marginal tax rates. The opposing contention is that

[29] *Report of the Committee on National Debt and Taxation* (Cmd. 2800, London, 1920), paragraphs 358 and 1014. See also Henry Simons, *Personal Income Taxation, Chicago,* 1938, p. 137.

the equal absolute allowance is a declining fraction of adjusted gross income as the latter rises, and that, in any event, the bracket tax rates have presumably been established in the light of, among other factors, the effects of the exemptions upon tax liabilities in the various income groups.

The direct or indirect provision of larger tax allowances for dependents as the size of income increases has been opposed, in part, by the same considerations that have been advanced against any allowances for children, except at low incomes—considerations that were noted previously. Among them, special emphasis has been placed by some upon the great importance in a political democracy of combating concentration of economic power in families.

2. *The "Double Exemption" for a Dependent Child with Income*

Since 1954, a taxpayer has been allowed a full exemption of $600 for each of his children under 19 years of age, and for each of those 19 or over who are still attending school regardless of the amount of the separate income received by such children, provided only that the taxpayer contributes more than one-half of their support. If the child is 19 or over and not a student, the exemption is allowed only if the child has less than $600 gross income and the taxpayer contributes more than one-half of his support. Since an exemption of $600 is also given to each child who receives income reportable for income tax purposes, the objection has been made that a double exemption is granted, in effect, for such children.[30] An example cited is that of an individual who provides more than one-half of the support of his son who is attending college and who earns $1,000 during the year, but requires $2,100 for living expenses. Besides his other exemptions, the father obtains an allowance of $600 for his son as a dependent, and the son is also permitted an exemption of $600 on his own return. In contrast, if the son has no income, only one exemption is allowed. This type of treatment, it is objected, "increases the exemption from $600 to $1,200 for those who are least entitled to it." [31]

An alternative treatment that is employed in some countries is to add the dependent's income to that of the taxpayer in the latter's return.

[30] Joseph A. Pechman, "Individual Income Tax Provisions of the 1954 Code," *National Tax Journal,* March 1955, p. 126.

[31] *Ibid.*

This was the situation in the United States as respects the earned income (but not property income) of minor children prior to 1944, except that the earnings were not taxable to the parent if he could prove that they belonged to the child under state law.[32]

Neither alternative is free from objection. To require a taxpayer to add the income of his dependent children to his own in arriving at his taxable income and tax liability would subject the income of the dependent, however small, to the taxpayer's highest bracket tax rate. It would imply that the taxpayer actually controls the disposition of each dependent's income, and that such income reduces, dollar for dollar, the demands on the taxpayer's own income for the dependent's support. There are, doubtlessly, instances in which this is true. But a much more common situation in the United States is that of a teen-aged youngster who earns additional spending money by delivering newspapers or by other part-time employment, often during the summer vacation, and who has his own uses for his earnings. An attempt by the parent to seize the earnings or to closely control their disposition would be likely to be resisted or to reduce or eliminate the dependent's incentive for the part-time employment.

Similar objections may be raised against withdrawing a dependent's exemption from a taxpayer in any year in which his child's income reaches $600, if the taxpayer supplies more than one-half of the child's support. In addition, a fixed limit such as $600 or even $1,000 has the objection of creating an abrupt increase in tax liability for the parent whenever the dependent's income reaches or exceeds it. Prior to 1954, when Congress eliminated the $600 gross income test for determining the dependency status of children, many newspapers regularly cautioned taxpayers at the beginning of each summer that if they allowed any of their children to earn $1 more than $599 during the summer vacation, the taxpayer would lose an exemption worth at least $120 in tax to him (the amount payable at the first bracket rate, which was 20 per cent at that time) on the addition of $600 to the parent's taxable income. The effective marginal rate of tax on the last dollar of a dependent child's $600 income became no less than 12,000 per cent! The need to choose (when, indeed, the parent had a true choice) between allowing a son or daughter of high school or college age to earn an additional amount

[32] U.S. Treasury Department, Bureau of Internal Revenue, *Supplement to Regulation 111, Income Tax,* 1946, sec 29.51–3.

that would transgress the $599 limit, at a tax cost to the parent of $120 or more, and forceably preventing the child from doing so, seemed irrational to many parents and aroused considerable resentment and complaint. It was in response to such complaints that the $600 gross income test of dependency of children was eliminated.

Nearly all the children involved in the "double exemption" may be divided into three groups: (1) grammar school and intermediate school pupils whose part-time employment seldom contributes materially to their parents' disposable income and whose earnings are often too sporadic and too small to become a matter of record; (2) many high school and college students who are partly self-supporting and partly supported by their parents; and (3) grammar school, high school, and college students with property or earned income of their own in excess of $900 annually ($600 personal exemption and $300 minimum standard deduction) who nevertheless receive more than one-half of their support from their parents.

With respect to the first group, the small sums involved, the difficulties of record-keeping and of enforcing reporting, and the less than equal addition to the parents' disposable income can be cited in support of excluding the youngster's income from that of his parents.[33] For all three groups, the double exemption could be avoided by depriving a dependent child of the personal exemption and standard deduction or other exclusion limit allowed all other income recipients, but this remedy may be viewed as inequitable to the child.

With respect to the second group, the underlying difficulty is that the position of adolescent and somewhat older children who are partly self-supporting is one in which the facts of life do not lend themselves to perfectly neat and logical classifications. A high school or college student who pays for a part of his support with income from part-time employment is actually both a dependent and independent in some degree. He pays an income tax on his own account, if his income exceeds the effective exclusion limit, even though his parents contribute more than one-half of his support. He is apt to bridle at close application of pa-

[33] It was estimated in a recent study that only 6 per cent of spending units have children who earn income. Two-thirds of these children had incomes of less than $500 a year; the remaining third was about equally divided between those with incomes of $500 to $1,000 and those with larger incomes. James N. Morgan, Martin H. David, Wilbur J. Cohen, and Harvey E. Brazer, *Income and Welfare in the United States,* New York, 1962, p. 140.

rental authority over his earnings. He regards some, much, or all of his earnings as his own to dispose of; and, in fact, his earnings only rarely reduce in full the necessary outlays of his parents for his support. If he is a college student, he commonly resides outside of the family home. What many regard as a merit of the present tax treatment is that it avoids impairing the incentives of teen-age and older dependent children to obtain gainful employment, and avoids punishing their parents taxwise when they do so. The so-called "extra" exemption for such dependents may also be regarded as having the related merit of enlarging the effective exemption for large numbers of older children, particularly college students, beyond the amount allowed for infants and small children; though it should be emphasized that this enlargement is inequitable relative to the treatment of older children without income.

The double exemption appears to be most questionable with respect to the third group—children whose own incomes from property or personal effort are sufficient for their support but whose parents choose to support them in whole or in part, much or all of the child's income being saved and invested. A formal defense of the present treatment of this group might be made on the ground that parents who fulfill their legal or moral obligation to support their minor children are entitled to a dependent exemption, while children with income should not be denied the same personal allowances for income tax purposes as other recipients of income. And while the dependent exemption is also extended to parents who support a child beyond his minority if he is continuing his education, this extension reflects a deliberate decision of Congress to encourage continued education in this manner.

But the dependency in many of these cases is unreal, reflecting only the parents' voluntary decision to employ their own funds for the child's support. These cases include both small children and college students with ample property income of their own, commonly derived from securities or other assets received as gifts or bequests from relatives, including gifts from the parents themselves. It is also unreal in instances in which the child's earned income is ample for his support.

The low level of the present effective exclusion limit under the income tax perhaps contributes to the liberality of the present treatment with respect to dependents with income; an income of $900 a year is commonly not enough to free a child from dependence upon his parents or guardian for the major part of his support, particularly if the

child is attending college away from home, and this consideration may influence some legislators.

It must be acknowledged, then, that the present treatment leaves some problems unresolved. It is unduly favorable to the parents of the young man or woman who earns enough for his support, or who has an ample property income of his own—perhaps acquired through gifts of securities from his parents—but who is supported in college by his parents, his own income being saved and reinvested. It also favors parents of dependent children whose earned or property income is spent in whole or part for the latter's support, if the amount so spent is less than one-half of the total used for this purpose. Parents whose dependent children have no income of their own receive only the same dependent exemption as the former. At the same time, the present treatment is perhaps hard on some parents who supply a substantial sum, though less than one-half, towards the support of a child with a part-time job while he is in college. Their contribution to his support may well be greater than the amount spent on a young child in the same or a different family. Is it entirely consistent to allow an exemption of $600 for an infant, but to refuse the dependent's exemption to parents who, with difficulty and sacrifice, scrape together $1,000 a year to help meet the $2,200 annual expenses of a partly self-supporting college student? In qualification of this example, it should be added that parents who would contribute close to one-half of a child's support are apt to add a few dollars in order to claim the exemption or to rely upon imperfect law enforcement in claiming it.

Although, on balance, the "double exemption" errs on the side of undue and uneven generosity in all three categories, the administrative difficulties, inequities, and undesirable effects upon incentives of readily apparent alternative treatments for the first two categories appear to have made the present treatment more generally acceptable than its predecessors or other alternatives thus far advanced. For the third category, in which the dependent status depends upon a voluntary decision not to use the dependent's income for one-half or more of his support, the case for the present treatment appears to be questionable.

3. *The Additional Exemption for the Aged and the Blind*

Since 1948 the aged and the blind have been allowed an extra exemption of $600 each. A sighted single person 65 years old or more

thus has a personal exemption of $1,200; a married couple, both of whom are 65 or over, a total exemption of $2,400; a blind person under 65 years of age, $1,200; a blind person 65 or over, $1,800; and an aged couple, both of whom are blind, $3,600. No additional exemption is allowed for a dependent who is blind or for one who has attained the age of 65.

The aged, of course, are far more numerous than the blind. There were 7.9 million exemptions claimed for age on returns filed for 1965, but only 107 thousand for blindness (Table 21). Thus the extra exemption for the aged potentially removed a little more than $4.7 billion from the category of taxable income in 1965, and that for the blind, about $64 million.

THE AGED. The presumptive basis for the additional exemption for the aged is that they incur extra expenses and hence require a larger income than other taxpayers for the same standard of living. While this may be the fact, it is difficult to find evidence to support it. The equivalent income scales developed by the United States Bureau of Labor Statistics for families of different sizes, ages, and composition (which are summarized in another connection in Table 35) point to the contrary for single persons aged 65 or over, and for aged individuals living in two- and three-person families. Reflecting the greater requirements of older than of younger *children,* these scales indicate that families of four or more persons headed by an aged individual require somewhat larger incomes than similar-sized families whose head is under 35 years of age, but smaller incomes than similar-sized families whose head is 35 to 65 years old.

That an elderly retired couple requires a distinctly smaller annual income than younger and active couples in order to achieve a level of living comparable to the "modest but adequate" standard developed by the Bureau of Labor Statistics for a city worker's family is indicated by a parallel study of the former's needs undertaken by the Bureau at the request of the Social Security Administration.[34] The average cost of the elderly couple's budget for goods, rent, and services in twenty large cities and their suburbs in the autumn of 1959 was $2,793. In contrast, a couple, the husband of which was between 35 and 55 years of age,

[34] Mollie Orshansky, "Budget for an Elderly Couple," *Social Security Bulletin,* December 1960.

would have required $3,406, or about 21.9 per cent more for goods, rent, and services; and, in addition, would have incurred other expenses, such as income taxes, social security taxes, and employment expenses, all of which are absent from the budget of the retired elderly couple.

The State of New Jersey has found that the requirements of adults receiving public assistance varied directly with their degree of activity, being greater for those undertaking strenuous activity than for those undertaking minimal activity; the aged do not commonly fall in the group undertaking strenuous activity.[35]

In support of the extra exemption for the aged, it has been argued that at any given income level, the aged have less resilience to financial reverses than other taxpayers; they lack the time and ability to recoup losses; and their employment opportunities are limited. Pechman has objected that the ordinary personal exemptions and the graduated income tax rates already differentiate between the taxpaying abilities of individuals with different incomes, and that it would be impossible to take account in the income tax of all the different groups of taxpayers who are handicapped in one way or another.[36] Related to this objection is the fact that, on the one hand, the extra exemption favors one class of low-income receivers, the aged, over all others; while on the other hand, it gives an unnecessary tax privilege to the well-to-do among the aged, and one that increases with the amount of income.

Another objection often made is that the extra exemption does nothing for the millions of aged persons whose tax-accountable incomes do not extend beyond the ordinary exemptions and standard deduction. It is, of course, an inherent limitation of income tax concessions that they cannot provide relief for those who are not subject to the tax. Effective help for the very poor must take the form of positive additions to their incomes either by the direct provision of public facilities and goods and services or by money payments, such as are being made to the needy aged and certain other categories of economically disadvantaged persons under the federal-state assistance program established by the social security laws. In addition to those of the aged who depend for their sup-

[35] Gertrude Lotwin, *A State Revises Its Assistance Standards,* Public Assistance Report No. 37, Social Security Administration, U.S. Department of Health, Education, and Welfare, 1959.

[36] Joseph A. Pechman, "Erosion of the Individual Income Tax," *National Tax Journal,* March 1957, pp. 19–20.

port upon such assistance, other aged persons who benefit not at all or little from the double exemption are those retired persons whose principal source of income consists of OASI or railroad retirement benefit payments, which are excluded by law from gross income. Testifying before the House Ways and Means Committee in 1959, Professor Eveline M. Burns of Columbia University observed that 58 per cent of the aged in 1958 were deriving the major part of their retirement income from OASI and that the proportion is expected to rise to 75 per cent by 1970.[37] In 1957 the median amount of income from other sources of the retired OASI beneficiaries was only $595 for those with such other income and $158 for the group as a whole.[38]

The fact that the extra exemption does little or nothing for the majority of the aged is not necessarily a strong argument against it, however. Assuming that Congress desires to make income tax concessions to the aged, it may sensibly provide different methods for different groups among them, fully recognizing that one or more of the methods will be available in only limited degree, if at all, to the majority. And, in effect, this is what it appears to have done. The greater part of the aged above the poverty line—those who do not receive direct assistance on account of need—are relieved of income tax on all or most of their income by the exclusion from gross income of OASI and similar pension payments, as well as by the ordinary personal exemptions and personal deductions. Those whose incomes are not chiefly derived from OASI or similar pensions or from earned income, but who receive investment income, are given a tax credit on such retirement income, which has the effect of wiping out income tax liability on the first $1,524 of the taxable amount of such income for a retired single individual of 65 or more.[39] Aged persons who do not qualify for tax relief in either or both of these ways, as well as some who do, get it through the extra personal exemption. These persons include those with otherwise taxable earned income, business profits, and capital gains, as well as some others.

[37] "Taxation of the Aged: Retirement Income Credit and the Like," *Tax Revision Compendium,* p. 553.

[38] *Ibid.*

[39] The amount of income eligible for the tax credit is reduced by the amounts of pensions excluded from gross income and, for retired persons between 62 and 72 years of age, by 50 per cent of earned income above $1,200 but not above $1,700, and by 100 per cent of earned income above $1,700.

The danger of a variety of concessions aimed at different segments of the aged population is that of excessive overlapping of benefits in some cases. The extra personal exemption is of value not only to the aged with otherwise taxable earned income, business profits, and capital gains, but also to those with substantial amounts of investment income who in addition benefit from the exclusion of OASI and similar pensions from gross income. Eligibility for the investment credit is strictly circumscribed, but the extra exemption provides an additional tax concession for the beneficiaries of this credit if their incomes are large enough.

In 1965, besides those of the aged whose gross incomes from taxable sources were too small to require them to file income tax returns, nearly one-half of the exemptions claimed for age on taxable and nontaxable returns were claimed on returns with no tax liability (Table 21). Of the 4 million exemptions for age on taxable returns, 63 per cent were on returns with AGI of $5,000 or over, and 24 per cent on returns with AGI of $10,000 or over. These figures indicate that significant amounts of the extra exemption go to relatively well-to-do persons for whom the extra exemption has added value because their marginal tax rates are higher than those of persons with smaller incomes.

While no support for an extra exemption for the aged can be found in the available statistics of the relative living costs for aged and younger families, it remains true that sentiment in favor of preferential tax treatment of the aged is nearly worldwide and is reflected in the income tax provisions of many countries. By definition, the aged have relatively few years to live. It is a fact of common observation that many, if not most, of them suffer from various aches, ills, and other physical impairments that take away some of the zest and joys of ordinary living. Collectively the aged are the old parents of us all, a relationship that influences our attitudes. Whatever the balance of logical considerations, the provisions for a modest amount of extra tax-free income to enable the aged to add somewhat to the comforts of their declining years is clearly in keeping with a strong and widespread sentiment; but whether the extra exemption is the most appropriate means to provide it is debatable.

In deference to this sentiment, but with the aim also of eliminating both the unequal tax value of the extra exemption for different amounts of income and the complexity and restricted scope of the retirement income credit, President Kennedy proposed the substitution for both of

these provisions of a $300 tax credit for persons aged 65 or more.[40] This credit was to be applicable regardless of the source of income, except that it would be reduced by a sum equal to one-half of social security and railroad retirement benefits received multiplied by the taxpayer's highest bracket rate. It would have reduced the tax liabilities of most older taxpayers, including the employed, but would have increased those of the aged in the middle and upper income brackets. The $300 tax credit would have been equal to the tax saving from the extra exemption at a bracket rate of 50 per cent, with nothing further allowed for those who had previously benefited also from the retirement income credit. It would have eliminated all income tax liability for aged persons with incomes of $2,900 or less if single, and about $5,800 or less if married couples.

As in the case of the allowance for children and other dependents, the implicit rationale of the extra exemption as against a tax credit is one that stresses horizontal rather than vertical equity: the tax value of the allowance is assumed to be properly greater at larger than at smaller incomes because the allowance is granted for the greater needs or disabilities of an aged person as compared with a younger one *with the same income*. On the other hand, the implicit rationale of the tax credit stresses vertical equity: the allowance should have the same tax value at all levels of income because the aged person with a larger income is at least no more disadvantaged than one with a smaller income.

Congress took no action on President Kennedy's proposal, but the subject is still under study by the Treasury Department and the House Committee on Ways and Means.

THE BLIND. The exemption for the blind is granted not only for total blindness—when the taxpayer cannot distinguish light from darkness—but for partial blindness of such a character that central visual acuity does not exceed 20/200 in the better eye with correcting lenses or the widest diameter of the visual field subtends an angle no greater than 20 degrees. As previously noted, the exemptions for the blind are far less numerous than those for the aged.

The presumptive basis for the extra exemption for the blind is that they need a larger income than other taxpayers to maintain any given standard of living. The available evidence, though scanty, lends some

[40] *President's 1963 Tax Message,* Jan. 23, 1963, pp. 12–13.

support to this presumption. In the State of New Jersey, which has published its monthly allowances for the personal and household needs of various categories of individuals and families receiving public assistance, the needs of blind adults are recognized as significantly greater than those of other adults in similar family units, as may be seen in Table 23. Thus the monthly allowances for blind adults capable of moderate activity and responsible for marketing and food preparation are a little over 25 per cent larger in two-person families than the allowances for other adults in two-person families who are capable of moderate activity.

No doubt there are various other categories of taxpayers who are seriously handicapped by physical, mental, or emotional disabilities that entail extra expenses to maintain the same standard of living as nonhandicapped taxpayers with equal incomes, and for whom a similar tax

TABLE 23

Total Monthly Allowance for Personal and Household Needs of Blind and Other Adults Receiving Public Assistance, New Jersey, 1959 [a]

(dollars)

	Number of Persons in Family					
Activity	1	2	3	4	5–6	7 or More
1. *Blind Adults Responsible for Marketing and Food Preparation*						
Minimal	72.70	61.40	57.10	52.90	52.10	51.00
Moderate	79.40	67.60	63.20	58.60	57.90	56.70
Strenuous	89.30	76.70	71.60	66.50	65.80	64.60
2. *Blind Adults Not Responsible for Marketing and Food Preparation*						
Minimal	64.80	54.40	50.70	47.10	46.30	45.20
Moderate	70.70	59.90	56.10	52.20	51.50	50.30
Strenuous	79.00	67.50	63.20	58.80	58.10	56.90
3. *Other Adults*						
Minimal	58.80	48.40	44.70	41.10	40.40	39.20
Moderate	64.70	53.90	50.10	46.20	45.50	44.30
Strenuous	73.00	61.50	57.20	52.80	52.10	50.90

SOURCE: Gertrude Lotwin, *A State Revises Its Assistance Standards*, Public Assistance Report No. 37, Social Security Administration, 1959, p. 38.

[a] If those receiving public assistance are also gainfully employed $4.50 is added to the monthly total in each case.

concession might therefore be justified. Perhaps the best explanation for the absence of special tax treatment for the other categories of seriously handicapped taxpayers is twofold: (1) the difficulty of identifying and obtaining easy yet adequate proof of many other handicaps, and (2) the long tradition, extending over many centuries, of special sympathy for the blind.

As between an exemption and a tax credit, the competing considerations are similar to those noted for the aged.

4. *Allowance for Working Wives*

Although both spouses who file a joint return are technically taxpayers under present law, most wives fall into one of two classes: (1) those who are dependent upon the husband for support in the sense that their contribution to the family income consists wholly or mainly of their personal services in housekeeping, child care, and general operation of the household, and (2) those who have outside employment and contribute money earnings towards the family support, though the husband is also gainfully employed. The value of the services that a housewife contributes to her own home is not included in taxable income, but if she obtains employment outside the home, her entire money income becomes subject to tax. There is no recognition that a portion of her earnings must usually be spent for transportation and other employment expenses, and, in many instances, another portion for a part-time or full-time maid to perform some of the housekeeping and child care services that she herself formerly provided. In some cases, a portion of the extra income is also absorbed by greater resort to purchased laundry services, eating in restaurants, and renting living quarters in buildings where various housekeeping services are provided. Even when little of the wife's earnings is spent in these ways, the diversion of her time and energy to employment outside of the home is likely to cost her husband and herself significant sacrifices of comfort and convenience. Some husbands of working wives have made remarks substantially like the following: "A man who has a working wife has only half a wife. He does not get all the comforts and conveniences that are provided by a wife who spends her time taking care of her home and family, and to get some of them he must pay extra for them. Therefore, he and his wife should properly be given a larger personal exemption than the man whose wife is also his housewife."

These considerations may be summarized by saying that a part of the working wife's additional money income is merely a substitute for income previously enjoyed in the form of her own tax-free services to the household; that the net gain to the family is smaller than is indicated by the added money income, for the latter is partly offset by the loss of the housewife's services at home and by additional expenses incurred to replace some of these services and for transportation and other employment-related costs.[41] To allow working wives a deduction for actual expenses attributable to their employment would not fully meet the problem of equal tax treatment of working wives and housewives because the families of the former do not always replace all the household services that they previously received tax-free, services that other households continue to receive tax-free. On the other hand, it would clearly be impractical to attempt to provide such equality by including the value of a housewife's services to her own household in income for tax purposes.

Besides the question of equity, there is that of incentives. A wife with two children who contemplates taking a job at $4,000 a year to supplement the $8,000 earned by her husband might calculate as follows in 1967: "Our income taxes will be raised from $772 to $1,512, assuming we take the standard deduction. A maid to care for my two small children and do the cooking and housework will cost at least $35 a week plus about $15 for her food, or a total of about $2,500 a year. Transportation, the extra cost of eating lunch at a restaurant, and social security tax for the maid would add about $250 more to our expenses. Our net gain in income after these extra expenses and taxes, and without counting my own social security deduction, would be about $500 a year. It just doesn't pay."

A widely applicable deduction for the actual extra expenses of working wives would be difficult to frame and administer with precision because some of the principal items of expense, such as domestic service, restaurant eating, etc., are also important forms of personal consumption for housewives and working wives alike. Faced with this problem, yet convinced that such expenses are comparable for some taxpayers to ordinary business expenses,[42] Congress, in the Internal Reve-

[41] See Joseph A. Pechman, "Individual Income Tax Provisions of the 1954 Code," *National Tax Journal,* March 1955, pp. 120–122.

[42] *House Committee on Ways and Means,* Report No. 1337, 83rd Congress, 2d

nue Code of 1954, and in somewhat liberalized form in the Revenue Act of 1964, went only so far as to provide a highly restricted nonbusiness deduction for child care expenses actually incurred by a very limited category of persons "for the purpose of enabling the taxpayer to be gainfully employed." [43]

But the broader question whether all working wives should be given a somewhat larger personal exemption or other allowance than housewives as an offset against the direct and indirect costs incident to their employment has thus far been answered in the negative. Great Britain meets the problem in a way that applies to all working wives and that avoids the need of distinguishing between ordinary and extra expenses: by reducing the taxable income of a married couple, when the wife is gainfully employed, by 7/9 of her earned income or £140 ($336), whichever is less. A similar allowance in the United States could take the form either of a special personal exemption or deduction proportioned to the wife's earned income up to a stated maximum.

D. THE EXEMPTIONS AND TAX PROGRESSION

An income tax that is designed, together with other objectives, to exclude persons with small incomes in order to protect a minimum standard of living must also deal with incomes somewhat larger than the mini-

Session, p. 30, and U.S. Senate, *Report of the Committee on Finance,* to Accompany H.R. 8300, Senate Report No. 1622, 83rd Congress, 2d Session, p. 22.

[43] The deduction may be claimed only for a dependent who is a son or daughter (or stepson or stepdaughter) of the taxpayer and who is under age 13, or for a dependent who is physically or mentally incapable of caring for himself. For working wives the deduction is available only if the combined adjusted gross income of wife and husband (who must file a joint return) does not exceed $7,000. If their income exceeds this amount, the allowable deduction is reduced. An exception to this rule provides that the income limitation does not apply if either spouse is incapable of self-support because mentally or physically defective. No income limitation applies to single women, women who are divorced or separated, or in some cases deserted, and widows and widowers, having one or more eligible dependents. The maximum deduction is $600 for one eligible dependent, $900 for two, and $1,000 for three or more. Under the more restrictive provisions in force in 1960, only 244,000 taxable returns claiming the deduction were filed for that year, and these included only 117,000 joint returns by married couples.

mum but not large enough to bear a heavy tax without encroaching on the minimum. This problem is met in the present income tax systems of the United States and various other countries by the personal exemptions in conjunction with a graduated structure of income tax rates. However substantial the bracket tax rates in the first few brackets of taxable income, the exemptions permit the effective tax rates to begin at only a small fraction of income before the exemptions, and to rise as the exemptions become a diminishing proportion of the taxpayer's total income.

Other motives are, of course, primarily responsible for the widespread use of progressively graduated tax rates in the present-day income tax. At the same time, however, the fact is that the personal exemptions in the United States provide all or a large part of all the graduation in effective rates for an important range of incomes from the lowest of taxable levels to well above, and modify the graduation at all levels for differences among taxpayers in family responsibilities, age, and blindness.

The great extent to which the progression of effective tax rates in the lower taxable income groups is derived from the personal exemptions and standard deduction rather than from bracket rate graduation is illustrated in Table 24. In the upper portion of that table, the effective tax rates in 1967 for married couples with two dependents and various selected incomes are compared with what they would be if all graduation in bracket rates were abolished and all taxable income were subject only to the 1967 first bracket rate of 14 per cent. It will be observed that for adjusted gross incomes of $5,000 or less, virtually all of the existing progression would remain, and that for incomes between $3,000 and $10,000, more than four-fifths of the entire progression would remain. For joint returns with more than four exemptions, the influence of the exemptions is, of course, even more pronounced. For larger incomes, however, the effects of eliminating bracket rate graduation would become increasingly marked. In the lower part of the table, where the same comparison is made for persons with only one exemption, the contribution of the exemptions and standard deduction to rate progression may be seen to be very much smaller. This results both from the smaller absolute amounts of income removed from the taxable category by the exemption and from the steeper graduation of bracket rates for single persons—the width of each tax bracket being only one-half that of joint returns.

Since each personal exemption removes $600 from otherwise taxable

TABLE 24

Contribution of the Personal Exemptions and the Standard Deduction to the Progression of Effective Tax Rates, 1967

(actual tax liability in 1967 as percentage of selected adjusted gross incomes compared with that if all taxable income had been subject only to the first bracket rate of 14 per cent)

Adjusted Gross Income (dollars)	Tax Liability as Per Cent of AGI [a]	
	Actual 1967	At Flat 14 Per Cent
A. *Married Couple with Two Dependents*		
3,000	0.0	0.0
3,500	2.0	2.0
4,000	3.5	3.5
5,000	5.8	5.6
7,000	8.6	7.8
10,000	11.1	9.2
14,000	12.2	9.5
20,000	14.6	10.2
B. *Single Person*		
3,000	11.0	9.8
3,500	11.8	10.2
4,000	12.5	10.5
5,000	13.4	10.9
7,000	15.2	11.4
10,000	17.4	11.8
14,000	18.6	11.3
20,000	22.5	11.5

NOTE: Tax liabilities are calculated after allowance for personal exemptions and the standard deduction (the minimum standard deduction or 10 per cent standard deduction, whichever result in a smaller tax) for incomes of $10,000 and under. For incomes over $10,000, a nonbusiness deduction equal to 15 per cent of adjusted gross income (approximately the average in these income groups in recent years) is assumed.

[a] Rounded to nearest one-tenth of 1 per cent.

income, the present personal exemptions contribute to progression because they constitute a bigger fraction of smaller than of larger incomes for taxpayers of each exemption status. The distribution of income and of exemptions among the various income groups is also such as to cause the actual personal exemptions on taxable returns to constitute a shrinking proportion of the aggregate adjusted gross income of the various income-size groups when the latter are arranged in the order of increasing size, as is done for 1965 in Table 25. It will be observed that of the aggregate of adjusted gross incomes under $1,000 on taxable returns, 63.7 per cent was removed from taxable income by the personal exemptions, a fraction that declined without interruption to 18.5 per cent for adjusted gross incomes of $10,000 to $15,000, 3.5 per cent at $50,-

TABLE 25

Personal Exemptions as Percentage of Adjusted Gross Income on Taxable Returns, by Income Classes, 1965

Adjusted Gross Income Class (thousand dollars)	Exemptions as Percentage of Adjusted Gross Income
Under 1	63.7
1–2	44.1
2–3	35.9
3–4	34.5
4–5	33.3
5–6	31.1
6–7	30.0
7–8	28.1
8–9	25.7
9–10	23.5
10–15	18.5
15–20	13.1
20–50	8.1
50–100	3.5
100–500	1.3
500–1,000	0.3
1,000 and over	0.1

SOURCE: *Statistics of Income*, 1965, Table 7.

000 to $100,000, and to small fractions of 1 per cent above $500,000.

The actual progression of income tax liabilities and of effective tax rates (tax liability as a percentage of adjusted gross income) in 1967 for single persons, married couples, and couples with two and four dependent children, respectively, is shown for selected incomes in Tables 26 and 27. The difference between the tax liabilities and effective rates for single persons and married couples with dependents is striking. Married couples not only have the great bulk of dependent exemptions, but the rise in their tax liabilities and effective tax rates as incomes increase is also slowed by income-splitting. The difference in tax liability in 1967 between a single person and a married couple with four dependent children, assuming the standard deduction, was: $587 at $5,000 adjusted gross income; $856 at $10,000; $1,888 at $20,000; $4,944 at $40,000; $10,630 at $100,000; $16,138 at $200,000; and $16,610 at $500,000 (Table 26). Below about $12,000 of AGI, the greater part of these differentials was produced by the personal exemptions and standard deduction; above, by income-splitting. As between childless married couples and couples with dependent children, however, the difference in tax liability in the middle and upper income ranges has remained relatively small. The tax liability of a married couple with four dependent children in 1967 was less than that of a childless married couple by: $417 at $5,000 of adjusted gross income; $456 at $10,000; $600 at $20,000; $960 at $40,000; $1,392 at $100,000; $1,632 at $200,000; and $1,680 at $500,000. The differences between the effective tax rates of single persons and married couples without children are most pronounced between about $15,000 and $50,000 (Table 27).

Although personal exemptions and other concessions for small incomes are nowadays recognized as important means of graduating the effective tax rates, it is interesting to note that they were long accepted as innocuous or even desirable during a period when formal graduation of income tax rates, as contrasted with a single proportional rate, was heatedly opposed as dangerous and dishonest. Replying in 1806 to a member of Parliament who had suggested higher rates on larger than on smaller incomes, Lord Henry Petty declared:

> Of all the dangerous doctrines that could possibly be held out in a legislative assembly, there was not one that could possibly be more mischievous in its tendency than that of equalising all ranks of society by reducing the higher orders to a level with those of a different class, and depriving them

TABLE 26

Progression of Tax Liabilities for Selected Incomes and Family Sizes, 1967

(dollars)

Adjusted Gross Income (dollars)	Single Person	Married Couple	Married Couple with Two Dependent Children	Married Couple with Four Dependent Children
700	0	0	0	0
1,000	14.00	0	0	0
1,500	85.00	0	0	0
2,000	161.00	56.00	0	0
2,500	242.00	126.00	0	0
3,000	330.00	201.00	2.00	0
3,500	414.50	275.00	70.50	0
4,000	500.00	354.00	140.50	0
4,500	585.50	426.00	215.00	14.50
5,000	671.00	501.00	290.00	84.00
6,000	866.00	658.00	450.00	230.00
7,000	1,064.00	829.00	603.00	386.00
8,000	1,280.00	1,000.00	772.00	552.00
10,000	1,742.00	1,342.00	1,114.00	886.00
12,000	2,078.00	1,600.00	1,342.00	1,114.00
14,000	2,606.00	1,974.00	1,710.00	1,446.00
16,000	3,190.00	2,360.00	2,084.00	1,820.00
18,000	3,823.00	2,785.00	2,485.00	2,194.00
20,000	4,498.00	3,210.00	2,910.00	2,610.00
30,000	8,480.00	5,768.00	5,372.00	4,988.00
40,000	12,980.00	8,996.00	8,504.00	8,036.00
50,000	17,772.00	12,764.00	12,188.00	11,645.00
75,000	30,806.00	23,651.50	23,015.50	22,379.50
100,000	44,782.00	35,544.00	34,848.00	34,152.00
200,000	104,070.00	89,564.00	88,748.00	87,932.00
300,000	163,570.00	148,640.00	147,800.00	146,960.00
400,000	223,070.00	208,140.00	207,300.00	206,460.00
500,000	282,570.00	267,640.00	266,800.00	265,960.00
600,000	342,070.00	327,140.00	326,300.00	325,460.00
700,000	401,570.00	386,640.00	385,800.00	384,960.00

NOTE: Tax liabilities are calculated after allowance for personal exemptions and the standard deduction (the minimum standard deduction or 10 per cent standard deduction, whichever results in a smaller tax) for incomes of $10,000 and under. For incomes over $10,000 a nonbusiness deduction equal to 15 per cent of adjusted gross income (approximately the average in these income groups in recent years) is assumed.

TABLE 27

Income Tax Liability as a Percentage of Adjusted Gross Income, Selected Income and Family Sizes, 1967

Adjusted Gross Income (dollars)	Single Person	Married Couple	Married Couple with Two Dependent Children	Married Couple with Four Dependent Children
700	0	0	0	0
1,000	1.4	0	0	0
1,500	5.7	0	0	0
2,000	8.0	2.8	0	0
2,500	9.7	5.0	0	0
3,000	11.0	6.7	0.1	0
3,500	11.8	7.9	2.0	0
4,000	12.5	8.8	3.5	0
4,500	13.0	9.5	4.8	0.3
5,000	13.4	10.0	5.8	1.7
6,000	14.4	11.0	7.5	3.8
7,000	15.2	11.8	8.6	5.5
8,000	16.0	12.5	9.6	6.9
10,000	17.4	13.4	11.1	8.9
12,000	17.3	13.3	11.2	9.3
14,000	18.6	14.1	12.2	10.3
16,000	19.9	14.8	13.0	11.4
18,000	21.2	15.5	13.8	12.2
20,000	22.5	16.0	14.6	13.0
30,000	28.3	19.2	17.9	16.6
40,000	32.4	22 5	21.3	20.1
50,000	35.5	25.5	24.4	23.3
75,000	41.1	31.5	30.7	29.8
100,000	44.8	35.5	34.8	34.2
200,000	52.0	44.8	44.4	44.0
300,000	54.5	49.5	49.3	49.0
400,000	55.8	52.0	51.8	51.6
500,000	56.5	53.5	53.4	53.2
600,000	57.0	54.5	54.4	54.2
700,000	57.4	55.2	55.1	55.0

SOURCE: Table 26.

of every comfort which they had a right to expect from their exalted situations.[44]

The chairman of the Select Committee of Parliament in 1861 opposed a graduated income tax as partaking of the "errors of Socialism." Even John Stuart Mill, testifying before this committee, spoke of "the small amount of justice that there is in the theory of the graduated income tax, which appears to me to be otherwise an entirely unjust mode of tax, and, in fact, graduated robbery." [45] Nevertheless, these gentlemen and most of their supporters did not oppose personal exemptions and other concessions for the lower income groups, allowances that made it feasible to subject a portion of their income to the standard rate of tax. In fact, such allowances largely escaped criticism in Great Britain until about 1863 and thereafter, when the range of incomes for which tax abatements were made was materially broadened.

[44] Quoted in "Historical Note on the Graduation of the Income Tax" submitted by the Board of Inland Revenue to the Royal Commission on the Income Tax, *Minutes of Evidence,* Appendix No. 7 (2), 1919.

[45] *Ibid.*