Taxing Poor Families: The Evolution of Treatment Under the Federal Income Tax

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I. INTRODUCTION

Dramatic changes in the stance of the federal income tax towards low income individuals occurred during the history of the income tax. This article will outline the major shifts in the taxation of the poor, from the initial tax system, which included a large flat exemption and focused largely on higher income families, through a period of eroding exemptions and heavier taxation of the poor, to our current system with personal exemptions, deductions, and a negative tax via the Earned Income Credit (EIC).

The initial income tax, in 1913, taxed only relatively high income individuals.[1] In the initial income tax, flat exemption levels of $3,000 for individuals with a filing status of single and $4,000 for individuals with a filing status of married filing jointly, in addition to itemized deductions were allowed.[2] The real values of these exemption levels in 2005, based on price indices in Sutch and Carter (2006)[3] and the President's Economic Report (2006),[4] are approximately $59,000 for individuals filing as single and $78,000 for individuals filing married-jointly. Since individuals may still itemize deductions, the exemption level was even greater.[5] For

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1 Only 2% of American households paid taxes in the first several years of the income tax. W. ELLIOT BROWNLEE, FEDERAL TAXATION IN AMERICA: A SHORT HISTORY 46 (Cambridge University Press 1996). "The new tax . . . excused virtually all middle income Americans from the tax." *Id.*

2 JOSEPH A. PECHMAN, FEDERAL TAX POLICY 313 (The Brookings Institution Press, 5th ed. 1987).

3 DEP'T OF ECONOMICS, CAMBRIDGE UNIV., 3 HISTORICAL STATISTICS OF THE UNITED STATES, 3-158, table Cc1-2 (Richard Sutch & Susan B. Carter eds., Cambridge University Press 2006). [*Hereinafter* Sutch & Carter]. The figures in the text adjust values from 1913 to 2003, based on, this table.

4 COUNCIL OF ECON. ADVISORS, EXEC. OFFICE OF THE PRESIDENT, ECONOMIC REPORT OF THE PRESIDENT 2006, STATISTICAL TABLES RELATING TO INCOME, EMPLOYMENT, AND PRODUCTION 299 (2006). [*Hereinafter* ECONOMIC REPORT OF THE PRESIDENT 2006].

5 The original act allowed itemized deductions as well in addition to the personal exemption; *see* PECHMAN, *supra* note 2, at 300.

example, if in the initial tax law itemized deductions were 10 percent of income, the current value of the exemption level would be even greater: $65,000 and $87,000.[6]

Eventually, however, the income tax base broadened to include moderate and low income individuals.[7] This article first discusses the history of the income tax's treatment of low income families, and then, in light of tax developments, assesses where the tax stands today in its treatment of poor families. Attention is paid to the basic issue of whether low income families are taxed and how taxes, or subsidies, vary across family types and sizes.

There are three challenges to addressing these issues. First, should poverty be assessed on a relative or absolute basis? Second, poverty levels differ across family types. Third, should we treat the earned income credit (EIC), a refundable credit for the working poor, as a structural part of the income tax, as an offset for the payroll tax, or as a welfare program that is administered through the tax system?

The question of absolute versus relative poverty levels is a difficult one. There is a strong case for considering poverty as a relative concept.[8] Poor families in the United States are much better off than poor families in third world countries and better off than families in the past.[9] If the poverty level is treated as an absolute measure that is set and then is adjusted only for price level changes, poverty will largely disappear over time as real income rises.[10]

Whether the poverty level is treated as an absolute measure makes a great deal of difference in assessing both the past and the present taxation

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[6] To determine the exempt level with itemized deductions of 10 percent of income, income minus 10 percent of that income minus the flat exemption is equated to zero. Thus, the exempt level is the flat exemption divided by 0.9; $65,000 is $59,000 divided by 0.9.

[7] *See* BROWNLEE, *supra* note 1, at 93–94.

[8] *See* COMM. ON NAT'L STATISTICS, NAT'L RESEARCH COUNCIL, MEASURING POVERTY: A NEW APPROACH 98–99 (Constance F. Citro & Robert T. Michael eds., National Academy Press 1995). [*Hereinafter* Citro & Michael].

[9] The World Bank set the poverty level in developing countries at the equivalent of $1 per day in 1985. *See* THE WORLD BANK, WORLD DEVELOPMENT INDICATORS 1999 (1999), *available at* http://www4.worldbank.org/afr/poverty/measuring/cross_country_comparing_en.htm; while the poverty line for a single individual in the United States was $5,469 per year. *See* http://www.census.gov/hhes/www/poverty/ threshld.html. Going back to 1929, the average per capita disposal income was $6,700 per year in 2000 dollars, while the poverty threshold for a single person was $8,794 per year COUNCIL OF ECON. ADVISORS, EXEC. OFFICE OF THE PRESIDENT, ECONOMIC REPORT OF THE PRESIDENT 1974, STATISTICAL TABLES RELATING TO INCOME, EMPLOYMENT, AND PRODUCTION 238, 260.

[10] If per capita income grows at 2 percent per year, in 200 years real incomes will be $(1.02)^{200}$ larger, or 52 times larger, and the real value of a fixed poverty threshold will fall to 1/52, or to 2% of its former value. The effects of the reduction in relative numbers in poverty can be seen in the decline in the poverty share from about 23% in 1959 to 12.3% in 2006. *See* CARMEN DENAVAS-WAIT, ET AL., U.S. CENSUS BUREAU, CURRENT POPULATION REPORTS, INCOME POVERTY AND HEALTH INSURANCE IN THE UNITED STATES: 2005, 11 (2006).

of the poor. Official poverty scales used by the Census Bureau were developed in the mid-1960's and were adjusted for price changes,[11] but not real income growth. Had they been adjusted for real income growth (growth in living standards) they would be much different.[12] If poverty levels were first developed today using the methods with which they were originally developed, they would be much different as well.[13] Similarly, if we take today's poverty levels and adjust past exemption levels for real income growth, the perception of the past will be quite different.[14] For example, if we adjust the exemptions for 1913 by per capita income growth through 2005, exemption levels in 1913 are equivalent to $364,000 for individuals filing as single and $485,000 for individuals filing married-jointly, without accounting for itemized deductions and $404,000 and $538,000 when assuming itemized deductions of 10 percent. This adjustment may also provide a clearer perception of 1913 income tax's target class, which was only the wealthy.[15] There are, however, alternative ways to adjust for real income growth (such as changes in median family income) that might produce a significantly different correction.[16]

Determining how to adjust poverty levels for family size and type, referred to as equivalency scales, is also a challenge. When Congress requested a study of this issue, the report[17] suggested a quite different equivalency scale from the official poverty scales that generally makes smaller adjustments for additional children but larger ones for singles versus childless couples.[18] Citro and Michael, after reviewing a wide range of evidence, suggest that there are many problems and anomalies with the current Census Bureau poverty scales, principally inconsistencies in the cost of additional children, adults, and assumptions on the food requirements of different family members.[19] Numerous other equivalency scales, either official or proposed by academic researchers, exist.[20] The Citro and Michael study recommends an equivalency measure of the form

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[11] *See supra* note 8, at 24–25.

[12] For example, based on changes in nominal per capita output (which captures both price inflation and growth in real purchasing power) between 1959 and 2005 as reported in the ECONOMIC REPORT OF THE PRESIDENT, *supra* note 4, and using that change to multiply the poverty line for a single individual would yield an amount of $23,216, rather than the actual level of $9,973. For poverty thresholds *see* U.S. Census Bureau, Poverty, Poverty Thresholds, http://www.census.gov/hhes/www/poverty/threshld.html. (last visited Apr. 23, 2008).

[13] *See supra* text accompanying note 12. Adjusting from 2005, the poverty level in 1969 would have been $675 rather than $1,572.

[14] *Id.*

[15] BROWNLEE, *supra* note 1, at 46 (indicating that only 2% of American households paid taxes in the first several years of the income tax).

[16] *See infra* Part III.

[17] Citro & Michael, *supra* note 8, at 159–81.

[18] *Id.*

[19] *Id.*

[20] *Id.*

$(A+PK)^e$, where *A* is the number of adults, *K* is the number of children, *P* is the ratio of the cost of children to adults, and *e* is a value reflecting the benefits of economies of scale or club goods (goods that can be jointly consumed, such as a kitchen).[21] Based on their judgment from their research, they propose a value of 0.7 for P and a value of between 0.65 and 0.75 for e.[22]

The role of the EIC is also not clear. Its objectives are not clearly spelled out in the legislative history.[23] However, both Hoffman and Seidman's account and that of Jodie Allen (1999),[24] who was involved in the development of the EIC, indicate that it was the brainchild of Russell Long, then Chairman of the U.S. Senate Finance Committee.[25] Chairman Long developed the idea as an alternative, containing a work incentive, to Nixon's family assistance plan,[26]which proposed welfare payments for the working poor (a negative income tax).[27] Hoffman and Seidman also note that the EIC was explicitly introduced as a Social Security tax offset to payroll taxes.[28] In hearings in 1972, Ronald Reagan, then governor of California, proposed such a rebate,[29] and Long introduced his plan the next year as a method of relieving payroll taxes.[30] In 1972, the House of Representatives passed the Nixon proposal,[31] but the Senate Finance Committee favored Long's work bonus and the proposal stalled.[32]

Ultimately, the EIC was adopted with little debate in 1975 as part of a temporary anti-recession tax cut to stimulate the economy,[33] and was a way of extending the tax stimulus to those without income tax liability.[34] The

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[21] *See id.* at 160–62. Economies of scale refer to certain goods where the cost per person declines. For example, a larger family may buy and prepare food in bulk at a lower cost per person than would a small family.

[22] *Id.* at 161.

[23] SAUL D. HOFFMAN & LAURENCE S. SEIDMAN, HELPING WORKING FAMILIES: THE EARNED INCOME TAX CREDIT 11–16 (W. E. Upjohn Institute for Employment Research 2003).

[24] Jodie Allen, *Present at the Creation*, SLATE, Dec. 13, 1999, *available at* http://www.slate.com/id/1004162.

[25] HOFFMAN & SEIDMAN, *supra* note 23; Allen, *supra* note 24.

[26] HOFFMAN & SEIDMAN, *supra* note 23, at 12. The family assistance plan provided a flat minimum payment coupled with a work requirement.

[27] *Id.* at 13. A negative income tax results in individuals who have no tax liability under law, but receive a payment from the government based on income when filing their tax returns.

[28] *Id.* at 11.

[29] *Id.* at 12.

[30] *Id.*

[31] *Id.*

[32] *Id.*

[33] *Id.* at 13.

[34] The EIC provides a refundable credit equal to a percentage of earned income up to a maximum amount and then decreases the amount of the refund in a phase out period as earned income increases to a maximum eligible amount. *See supra* note 12.

EIC was subsequently made permanent.[35] Minor changes were later made to the EIC,[36] but it was eroded by inflation.[37] The rates were increased in 1986[38] and the tax system indexed for inflation following the general indexing of the rates and exemptions in the income tax in 1981.[39]

The general objective of tax changes in 1986[40] was to remove poor families from the income tax rolls.[41] However, the dramatic expansion of the EIC in 1990[42] and in 1993[43] moved the EIC more in the direction of a welfare program.[44] Thus, the evidence is mixed. Is the purpose of the EIC to exempt poor families from the income tax or from the income and payroll taxes? Or, is it a welfare program administered through the tax system? The case for a welfare objective is somewhat reinforced by the lack of an EIC for families without children when first instituted in 1975[45] and a much smaller EIC when the credit was granted for single individuals and married individuals without children, when expanded significantly in 1993.[46]

II. THE DEVELOPMENT OF THE INCOME TAX'S STANCE TOWARDS LOW INCOME FAMILIES

Given the rise in price levels since 1913,[47] the first income tax was clearly aimed only at high income individuals. But over time, the income tax began to cover more of the population and the adjustments for family size changed.[48] Figure 1 shows the relative importance of exemptions for single individuals, married individuals, and dependents varied over the tax

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[35] Dennis J. Ventry Jr., *The Collision of Tax and Welfare Politics: The Political History of the Earned Income Tax Credit, 1969–1999,* 53 NAT'L TAX J. 983, 996 (2000).

[36] *See id.* at 999–1002.

[37] *Id.* at 1001.

[38] JOINT COMM. ON TAXATION, 99TH CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1986, 28 (Comm. Print 1987).[*Hereinafter* EXPLANATION OF 1986 TAX REFORM ACT].

[39] JOINT COMM. ON TAXATION, 97TH CONG., GENERAL EXPLANATION OF THE ECONOMIC RECOVERY TAX ACT OF 1981, 38, 40 (Comm. Print 1981). [*Hereinafter* EXPLANATION OF 1981 ECONOMIC RECOVERY TAX ACT].

[40] *See* EXPLANATION OF 1986 TAX REFORM ACT, *supra* note 38.

[41] *Id.*

[42] Ventry, *supra* note 35, at 1004–05.

[43] *Id.*

[44] *Id.* at 1005.

[45] *Id.* at 995.

[46] *Id.* at 1004. It is interesting to note that in 1975 the House of Representatives wanted to extend the EIC to all families. *Id.* at 995. That view may, however, have reflected the fiscal stimulus aspect of the change.

[47] Based on price indices referred to in Sutch & Carter, *supra* note 3 and ECONOMIC REPORT OF THE PRESIDENT *supra* note 4, a $3,000 exemption in 1913 is the equivalent of a $59,000 exemption in 2005.

[48] BROWNLEE, *supra* note 1, at 93–94.

code's early history, with increasing importance placed on dependent exemptions. While the single individual's exemption was 75% of a married couple's exemption in 1913,[49] the 1917 law reduced the single person's exemption to 50% of the married couple's exemption[50] and by 1942 it fell to 42%.[51] Interestingly, although the income tax at that time did not affect even middle class families of the day,[52] the ratio of single people to married couples at the beginning of the income tax is very similar to the current assumptions in poverty indices (77% for the official Census Bureau scales and 62% for Citro and Michael).[53] Its subsequent values ranged between 40% and 50% for many years.[54] The 1917 law also added an exemption of $200 per dependent.[55] Over the years between 1917 and 1942–43 the share of exemptions devoted to married couples remained fairly constant, hovering around 60%, while the share for single individuals dropped from 43% to 24% with the increase from 6% to 17% of the dependent exemptions share.[56] The dependent and married couples exemptions increased to $400 and $2500 respectively in 1921, leaving the single person's exemption about 40% of the size of the couple's exemption; the single and couple exemptions increased temporarily to $1500 and $3500 from 1925–1931 before returning to the previous values.[57] Exemption levels fell during World War II to $800, $750, and $500 in 1940, 1941, and 1942–43; the couple's exemption was $2,000, $1,500, and $1,200.[58] In general the ratio of singles to married couples was in the 40% to 50% range in the early 1940s. Dependent exemptions fell to $350 in 1942–43.[59]

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[49] The single exemption was $3,000 and the married couple's exemption was $4,000. *See* PECHMAN, *supra* note 2, at 313, for the history of exemptions.

[50] *Id.* In 1917, the single exemption was $1,000 and the married couple's exemption was $2,000. *Id.*

[51] *Id.* In 1942, the single exemption was $500 and the married couple's exemption was $1,200. *Id.*

[52] BROWNLEE, *supra* note 1.

[53] Citro & Michael, *supra* note 8. The poverty level in 2006 for a single under 65 was $10,488 and the level for a married couple was $13,500, a ratio of 77%. CARMEN DENAVAS-WALT ET AL., U.S. CENSUS BUREAU, CURRENT POPULATION REPORTS, INCOME, POVERTY, AND HEALTH INSURANCE COVERAGE IN THE UNITED STATES: 2006 (2007) *available at* http://www.census.gov/hhes/www/poverty/threshld/thresh06.html. The ratio for Citro & Michael is based on their formula and is $1/(2^{07})$ or 62%.

[54] *See* PECHMAN, *supra* note 2, at 313.

[55] *Id.*

[56] *Id.*

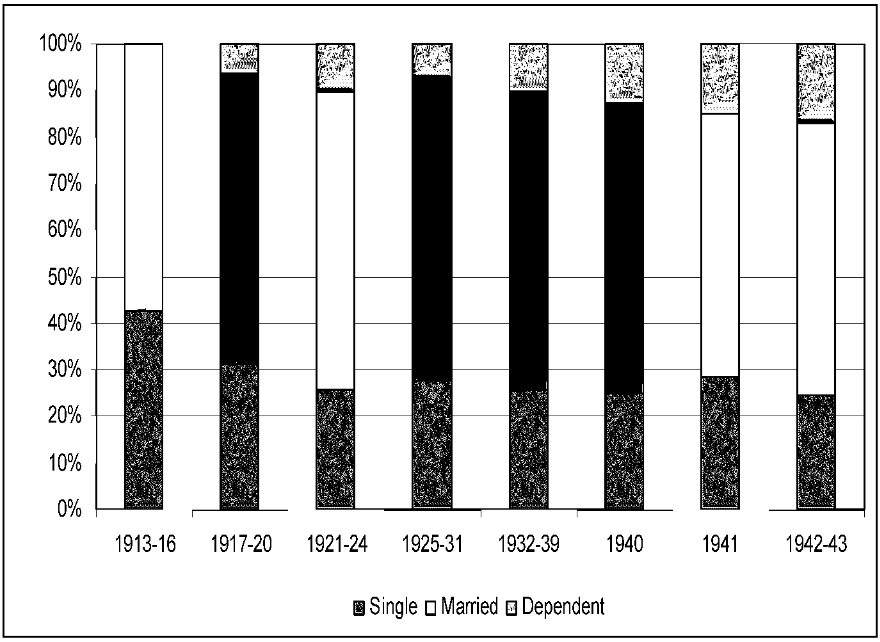
[57] *Id.*

[58] *Id.*

[59] *Id.*

Figure 1

Distribution of Exemptions through Early Tax History[60]



As revenue needs transformed the income tax into a broadly applicable tax,[61] a set of rules that was to last for the next 20 years was adopted in 1944.[62] Each person in the family had an equal exemption (set at $500 in 1944–47 and $600 for 1948–69) setting the ratio of the single exemption to married couples (without children) at 50%.[63] In 1944, the tax code also added a percentage standard deduction of 10% of income with a $500 ceiling.[64] This $500 per person exemption, contrasted with exemptions twice as large as late as 1939,[65] suggests that even without adjusting for real income growth and price levels, there was a significant move away from taxing only higher income families toward a system reaching moderate and even lower incomes.

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[60] *Id.*

[61] BROWNLEE, *supra* note 1, at 93–94.

[62] PECHMAN, *supra* note 2, at 313. For a history of standard deductions and low income allowances, as well as other provisions, *see generally* JANE GRAVELLE, CONG. RESEARCH SERV., FEDERAL INCOME TAX TREATMENT OF THE FAMILY 1–9 (2006).

[63] PECHMAN, *supra* note 2.

[64] *See* GRAVELLE, *supra* note 62.

[65] *See* PECHMAN, *supra* note 2.

Except for an increase in the personal exemption in 1948[66] these rules remained unchanged until 1964 when a small minimum standard deduction of $200 plus $100 for each dependent was allowed and the ceiling was raised to $1000.[67] The explicit object of this last change was to relieve low income individuals of tax liability.[68] At the point this legislation was being developed, poverty scales had not been developed.[69] The next change, a small increase in the personal exemption, did not come until 1970.[70] Thus we examine two years of major change, one immediately after World War II (1946) and the other in 1969, as inflation eroded exemption levels for over twenty years.

Table 1 compares the allowances in 1946 and 1969 adjusted for changes in price level through 2005 and compares them with the current poverty levels. The analysis in this and the following section will consider both absolute and relative poverty levels, both the equivalency scales (setting e at 0.7 in the Citro and Michael scale), and will examine the stance of the income tax with and without the EIC. Using the Citro and Michael scale, it will also report effective tax rates at the income levels near the poverty scale.

[66] *See id.*

[67] *See* GRAVELLE, *supra* note 62, at 3.

[68] S. FIN. COMM., REPORT OF THE REVENUE ACT, S. REP. NO. 830, at 29–30 (1964).

[69] *See* Citro & Michael, *supra* note 8, at 108–09.

[70] *See* PECHMAN, *supra* note 2.

Table 1

Poverty Levels and Exempt Levels for 1946 and 1969 in 2005 Price Levels[71]

Family Type & # Children	Official Poverty ($)	Citro & Michael ($)	Exempt Level 1946 ($)	Exempt Level 1969 ($)
Single-0	10,160	9,248	4,702	3,859
Married-0	13,078	13,078	9,406	6,861
Married-1	15,720	15,195	14,108	9,862
Married-2	19,806	17,052	22,573	12,864
Married-3	23,307	18,725	28,217	15,865

As Table 1 indicates, by the post World War II period (1946) the income tax was taxing small poor families, but not large ones. Depending on the poverty equivalence scale married couples with two or more or with three or more children had exemption levels above the poverty line.[72] For singles, exemption levels were about 40% of the poverty line, for childless married couples about 60%, and for families with one child between 75% and 80%.[73] By 1969, as inflation eroded the value of largely unchanging exemptions,[74] the situation deteriorated and the exemption level everywhere fell below the poverty line.[75] This circumstance was, indeed, a reason for expanded exemptions in the 1969 act, where a flat low income allowance of $1,100, rather than $200 plus $100 per exemption, was allowed.[76] This flat allowance provided benefits where they were most needed, in smaller families, but nevertheless was inadequate to bring the exemption level above the poverty line.[77]

The previous table focused on providing exempt levels based on an absolute poverty level, which makes no adjustments for real growth in

71 Calculations in this table are based on price indices in COUNCIL OF ECON. ADVISORS, EXEC. OFFICE OF THE PRESIDENT, ECONOMIC REPORT OF THE PRESIDENT 1991, STATISTICAL TABLES RELATING TO INCOME, EMPLOYMENT, AND PRODUCTION 290 [*Hereinafter* ECONOMIC REPORT OF THE PRESIDENT 1991] and ECONOMIC REPORT OF THE PRESIDENT 2006, *supra* note 4, 290, using the official poverty scales available at available at U.S. Census Bureau, Poverty, Poverty Thresholds, http://www.census.gov/ hhes/ www/poverty/threshld.html (last visited Apr. 23, 2008) [*Hereinafter* U.S. Census Bureau Poverty Thresholds] and Citro & Michael, *supra* note 8, at 178. Exempt levels are based on provisions of the law as reported in PECHMAN, *supra* note 2 and GRAVELLE, *supra* note 62.

72 *See supra* p. 9, table 1.

73 *See supra* p. 9, table 1.

74 *See supra* p. 9, table 1.

75 *See supra* p. 9, table 1.

76 *See* S. REP. NO. 830, *supra* note 68, at 29–30.

77 *See supra* p. 9, table 1.

incomes. In Table 2 we provide exempt levels, with adjustments made for changes in real per capita income growth, to address the relative poverty standard. Since poverty levels were set around 1965 and only adjusted thereafter for inflation, the implication is that the current 2005 poverty levels represent real 1965 levels in 2005 dollars. Therefore, we adjust 1946 exemption levels for real income growth only between 1946 and 1965. Moreover, for 1969, we reduce exemption levels to account for the fact that an income adjusted poverty level would have been larger in 1969 (in 2005 dollars).

Table 2

Poverty Levels and Exempt Levels for 1946 and 1969 with Real Income Adjustments in 2005 Price Levels[78]

Family Type & # Children	Official Poverty ($)	Citro & Michael ($)	Exempt Level 1946 ($)	Exempt Level 1969 ($)
Single-0	10,160	9,248	5,590	2,181
Married-0	13,078	13,078	11,811	3,878
Married-1	15,720	15,195	16,722	5,574
Married-2	19,806	17,052	26,835	7,270
Married-3	23,307	18,725	33,544	8,967

The income adjusted measures indicate that the 1946 tax law mostly exempted families in a relative poverty status, except for singles where exemptions were 55% of poverty and childless married couples where exemptions were 85% of the poverty line.[79] In 1969, however, the tax system was still reaching below the poverty line.[80] By this time, however, the poverty thresholds were established and recognition of the relationship between exemption levels in the income tax system and the poverty line began in the next major tax act in 1969,[81] which converted the minimum

[78] Calculations in this table are based on real incomes and population in ECONOMIC REPORT OF THE PRESIDENT 1991, 286, 321 and ECONOMIC REPORT OF THE PRESIDENT 2006, 280, 323, U.S. Census Bureau Poverty Thresholds, *supra* note 71 and Citro & Michael, *supra* note 8, at 178. Exempt levels are based on provisions of the law as reported in PECHMAN, *supra* note 2 and GRAVELLE, *supra* note 62.

[79] *See supra* p. 10, Table 2.

[80] *See id.* Note, while we use per capita income for our adjustments, alternative adjustment factors, such as median income, might produce different results, as the income distribution could easily have changed over time.

[81] JOINT COMM. ON TAXATION, 91ST CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1969, 218 (Comm. Print 1970)[*Hereinafter* EXPLANATION OF 1969 TAX REFORM ACT].

standard deduction into a flat low income allowance and raised personal exemptions.[82] According to the Joint Committee on Taxation's (JCT) explanation, the purpose was to move tax exemption levels close to the poverty thresholds.[83] A similar rationale was given for the increases in the 1971 tax revisions.[84] These exemption levels, however, related to the inflation adjusted measures of poverty and not a relative measure.[85]

The erosion of benefits from inflation coupled with periodic revisions continued in the tax law, even with the adoption of an EIC in 1975 and its expansion in 1978, until the early 1980's.[86] The 1981 legislation indexed the basic structural features of the income tax (prospectively)[87] and the 1986 legislation increased the personal exemption, and increased and indexed the EIC, which had lost significant value due to inflation, despite expansions.[88] 1988, is a good year to examine, because from that point on, basic features of the income tax that determine the exemption level (personal exemptions, standard deductions) were fixed in real terms.[89]

Table 3 shows the exemption levels and poverty scales as reported in the explanation of the 1986 legislation for several types of families. The basic objective of these legislative changes was, roughly, to exempt individuals with incomes below the poverty line from the tax.[90] This exemption did not occur, however, in the case of single individuals.[91] Two reasons were given for this exception. First, increasing the standard deduction for these individuals would increase the marriage penalty.[92] Second, the poverty thresholds do not take into account economies of scale for single individuals sharing households or for other types of support, such as assistance from family members.[93] According to the JCT explanation, two-thirds of singles with incomes of less than $10,000 are under 25, and of those between 25 and 64, a majority of these individuals share a household with others.[94]

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82 *See* GRAVELLE, *supra* note 62.
83 *See* EXPLANATION OF 1969 TAX REFORM ACT, *supra* note 81, at 218.
84 *See id.*
85 *Id.*
86 *See* GRAVELLE, *supra* note 62.
87 *Id.*
88 *Id.*
89 *Id.* Fixed in real terms means the numbers would not change in the absence of inflation.
90 *See* EXPLANATION OF 1986 TAX REFORM ACT, *supra* note 38, at 15–16.
91 *See id.*, at 16.
92 *See id.*
93 *See id.*
94 *See id.*

Table 3

Poverty Levels and Exemption Levels Before and After the 1986 Tax Revisions, for 1988[95]

Family Type & # of Children	Estimated Poverty Level ($)	Citro & Michael ($)	Exempt Level with EIC, Prior Law ($)	Exempt Level with EIC, New Law ($)	Exempt Level Without EIC, Prior Law ($)	Exempt Level Without EIC, New Law ($)
Single-0	6,024	4,745	3,760	4,950	3,760	4,950
Married-0	7,709	7,709	6,150	8,900	6,150	8,900
*H-of-H-1	7,709	6,187	8,110	12,416	4,900	8,300
Married-2	12,104	11,858	9,783	15.116	8,430	12,800
H-of-H-3	12,104	10,476	9,190	14,756	7,180	12,200

*H-of-H refers to a single head of household.

III. MOVING FROM 1986 TO THE PRESENT

Ignoring the EIC or any other changes, families in poverty with the exception of single individuals would be exempt from income tax as long as the poverty scales were on an absolute basis, because the 1986 exemption levels were indexed.[96] They would fall below it if scales were on a relative basis.[97] However, there were also two important legislative changes that affected the income tax on low income workers.

The first is the expansion of the EIC (in 1990 and in 1993), with the credit increasing from 14% in 1986 to 34% for families with one child and 40% for families with two or more children.[98] The changes in these two years heralded, one might argue, a different focus of the EIC, towards a much more significant welfare program. Clearly, it went far beyond

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[95] Calculations in this table are based on the official poverty scales, U.S. Census Bureau Poverty Thresholds, *supra* note 71and Citro & Michael, *supra* note 8, at 178, with the married couple with no children used as the reference income in Citro & Michael. Since Citro & Michael provide only a basis for relative adjustments, it must begin with an absolute number, and that number is taken from the official poverty measure. Exempt levels in the tax law are based on EXPLANATION OF 1986 TAX REFORM ACT, *supra* note 38, at 16. All amounts except the Citro & Michael numbers are taken from EXPLANATION OF 1986 TAX REFORM ACT, *supra* note 38, at 16. The Citro & Michael numbers are adjustments using a married couple as a reference income.

[96] This outcome occurs because both the poverty scale and the exemptions are increased at the same rate.

[97] Since real incomes grow over time and therefore nominal income grows faster than the price level, a relative poverty line would rise faster than the tax exemptions.

[98] CHRISTINE SCOTT, CONG. RESEARCH SERV., THE EARNED INCOME TAX CREDIT (EITC): AN OVERVIEW 23 (2008).

offsetting social security taxes, with higher rates and with differentiation across families.[99] In 1990, families with one child were differentiated from those with two or more children.[100] In 1993, along with an increase in the rate, those without children between the ages of 25 and 64 were provided a credit as well, although the 7.65% rate was much lower than the rate for families with children.[101]

The second set of legislative changes was the introduction of the $500 child credit, adopted in 1997[102] and expanded to $1,000 in 2001.[103] The credit, which was ultimately made largely refundable, removed a larger number of families that might be considered of moderate rather than low incomes from the tax roles.[104]

Table 4 displays the two poverty scales and the maximum exemption levels of income with and without the EIC, first for married couples and then for single individuals. For larger families, the exemption levels are not affected by the EIC, because at these exemption levels families have already phased out of the EIC. Based on absolute poverty levels, the current tax system exempts incomes far above the poverty line for families with children, provides exemptions below the poverty line for singles under the official scales (but not Citro and Michael), and slightly above the poverty line for married couples without children. These high levels are due to the child credit. As seen in the last column, the combination of standard deductions and personal exemptions are still fulfilling their function of, in general, exempting poverty levels (based on absolute scales).

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[99] *Id.*
[100] *Id.*
[101] *Id.*
[102] *See* GRAVELLE, *supra* note 62, at 2.
[103] *Id.*
[104] Jane Gravelle & Jennifer Gravelle, *Horizontal Equity and Family Tax Treatment: The Orphan Child of Tax Policy*, 59 NAT'L TAX J. 631, 636 (2006).

Table 4

Poverty Levels and Exemption Levels for 2005[105]

Family Type & # Children	Official Poverty ($)	Citro & Michael ($)	Exempt Level Without EIC ($)	Exempt Level With EIC ($)	Personal Exemptions + Standard Deduction ($)
Married-0	13,078	13,078	16,400	16,400	16,400
Married-1	15,720	15,195	29,586	31,703	19,600
Married-2	19,806	17,052	40,987	40,987	21,800
Married-3	23,307	18,725	52,371	52,371	25,000
Married-4	26,096	20,260	65,015	65,015	28,200
Married-5	29,229	21,687	77,660	77,660	31,400
Married-6	32,135	23,026	90,304	90,304	34,600
Single-0	10,160	9,248	8,200	9,735	8,200
H-of-H-1	13,461	12,057	23,689	27,549	13,700
H-of-H-2	15,735	14,326	33,854	34,760	16,900
H-of-H-3	18,874	16,282	46,498	46,498	20,100
H-of-H-4	22,951	18,027	59,142	59,142	23,300
H-of-H-5	25,608	19,617	69,582	69,582	26,500
H-of-H-6	28,079	21,087	73,773	73,773	29,700

The picture would look somewhat different if a relative poverty scale were used. If these scales were adjusted for the average per capita income growth since 1965, poverty levels would be multiplied by a factor of 2.3, raising the married couple's poverty level income to almost $30,000.[106] If adjusted for mean income per family, they would be increased by slightly over 68% to around $22,000 and if adjusted for median income, they would be increased by 43% to around $18,600.[107]

Table 5 shows effective tax rates for these various family types throughout the range of income, using the Citro and Michael adjustments.[108] The column headings list the reference income for a

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[105] See *supra* note 95 for an explanation of poverty scales. For tax provisions see *supra* notes 62, 98.

[106] *See* data on income and population in ECONOMIC REPORT OF THE PRESIDENT 2006, *supra* note 4, at 290, 323.

[107] *See* U.S. Census Bureau, Historical Income Tables, Families, Table F-7, http://www.census.gov/hhes/www/income/histinc/f07ar.html (last visited Apr. 24, 2008) (indicating mean family income increased by 68% from 1967–2005, while median income increased by 51%).

[108] An effective tax rate is measured as total taxes divided by total income, and thus can be negative for families receiving the negative taxes through the EIC.

married couple, with other incomes adjusted according to their equivalency scale, so that larger families would have higher incomes. They assume itemized deductions are at 22 percent of income, and incorporate personal exemptions, standard deductions, the EIC, the child credit, and the basic rate structure including the alternative minimum tax.[109]

Table 5

Effective Tax Rates under Current Law[110]

	Reference Income (Married Filing Joint No Children)							
Family	**10K**	**15K**	**25K**	**50K**	**75K**	**100K**	**250K**	**500K**
M 0	-2.87	0	3.44	8.32	9.45	11.23	**19.41**	**24.75**
M 1	-23.2	-17.94	-0.73	6.56	8.62	11.91	**21.81**	**24.93**
M 2	-33.97	-22.44	- 2.4	5.29	8.58	12.52	**23.35**	**25.04**
M 3	-31.43	-18.94	-3.47	4.28	9.04	**14.01**	**24.43**	**25.12**
M 4	-27.52	-16.33	-4.79	3.45	**10.3**	**15.46**	**24.67**	25.37
M 5	-24.47	-14.29	-6.21	**2.95**	**11.37**	**16.74**	**24.76**	25.64
M 6	-22.01	-12.65	-7.45	**3.77**	**12.22**	**17.73**	**24.84**	25.86
S 0	-6.48	-0.96	4.67	8.95	10.54	12.78	**17.78**	**24.16**
HH 1	-29.83	-22.56	-6.86	6.14	8.89	12.38	**21.28**	**24.63**
HH 2	-39.21	-27.83	-7.89	4.72	9.7	**13.6**	**23.6**	**24.86**
HH 3	-35.24	-22.27	-5.12	3.72	**11.19**	**15.69**	**24.3**	**25**
HH 4	-30.8	-18.51	-5.97	**4.87**	**12.6**	**17.64**	**24.49**	25.29
HH 5	-26.68	-15.77	-7.35	**6.34**	**13.82**	**18.94**	**24.62**	25.63
HH 6	-23.53	-13.67	-8.55	**7.39**	**15.07**	**19.88**	**24.72**	25.89

Note: Tax rates in bold indicate the alternative minimum tax applies.

Note at the lower reference incomes that the $10,000 number is slightly below the absolute poverty scale for a married couple, the $15,000 number falls between the absolute and the relative adjusted by median income, and the $25,000 level falls between the mean and per capita income adjustments. All of these levels of income could be considered to have a claim to poverty status. As this table indicates, families with children are favored at lower incomes but penalized at higher ones if the

[109] An alternative minimum tax is a tax originally intended to impose taxes on high-income individuals who have no liability under the regular income tax, requires people to recalculate their taxes under alternative rules that include certain forms of income exempt from regular tax and that do not allow specific exemptions, deductions, and other preferences. For more details *see* CONG. BUDGET OFFICE, THE ALTERNATIVE MINIMUM TAX, REVENUE AND TAX POLICY, BRIEF NO. 4 (2004).

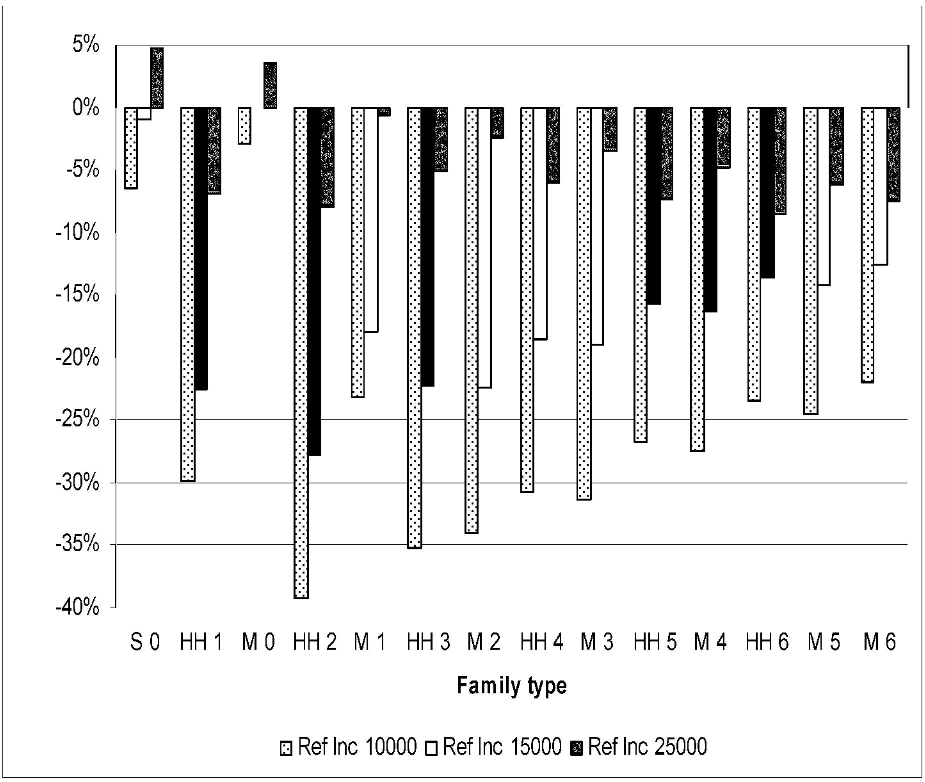
[110] This table also appears in Gravelle & Gravelle, *supra* note 104, at 636 discussing these calculations in more detail.

equivalency scale can be applied across incomes.

Figure 2 shows the variations in effective tax rates across family size for these three lower income levels, and illustrates the variations across family types.

Figure 2

Effective Tax Rates under Current Law for Lower Incomes[111]



With the exception of married couples and singles at the higher of the reference income levels, all of these lower income families are receiving a subsidy from the tax code, and at the lowest income levels, a significant one as a percentage of income.[112] These effective tax rates do, however, show some variations across types of families. At the lower income levels that would be consistent with absolute poverty scales, families with two children receive the largest subsidy, reflecting the pattern of the EIC.[113] As

[111] Based on data in Table 5, *supra* p. 15.

[112] *See id.*

[113] *See id.*

income levels rise, larger families have greater benefits due to the child credits. In all cases, however, it is the families without children that have the least favorable treatment.

It is clear that the equivalency indexes used to equate families in poverty have not been the determining factor behind the tax rules that adjust for family size. This discrepancy may simply reflect the need to have simpler rules for the tax code. It is also true that the rules to adjust for equivalency in poverty have not been explicitly applied to the EIC or the child credit, the two provisions responsible for these subsidies. To do so in theory would suggest a common EIC rate but with a rising phase-out so that families that are equivalent would have the same negative tax rate. Similarly, the child credit focuses too much on families with children and too little on those without.

IV. CONCLUSION

Do we tax or subsidize poor families and, if so, how much? As noted earlier, the answer to that question depends on both the type of family and the use of a relative or average poverty scale. Based on an absolute poverty scale, families with children receive significant subsidies and those without small subsidies. Based on a relative scale, families without children in poverty may still be paying positive taxes.

How that outcome is interpreted overall depends on the distribution of family types. Table 6 provides the distribution by income class for families headed by single individuals, married couples without children, heads of households, and married couples with children, based on data from the 2003 statistics of income.[114] These statistics suggest that families without children constitute a majority of families in the lower income levels.

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[114] *See* Gravelle & Gravelle, *supra* note 104, at 634. The sample was too small for head of household returns at higher income levels.

Table 6

Distribution of Family Types across Income Classes 2003[115]

Income Class ($ 000s)	Total Distribution (%)	Distribution within Income Classes			
		Single (%)	Head of Household (%)	Married w/ Children (%)	Married No Children (%)
<10	19.95	75.51	12.64	4.11	6.40
10-15	9.20	57.47	23.48	7.44	10.01
15-25	16.20	47.73	25.84	11.93	12.18
25-50	25.26	41.25	17.62	13.56	24.76
50-75	13.32	24.65	8.40	28.38	36.98
75-100	7.32	13.34	6.91	36.88	44.73
100-200	6.81	10.67	*	31.99	54.10
200-500	1.53	11.01	*	31.47	54.43

* Observations too small to report
Source: Internal Revenue Service Statistics of Income.

The discussion above focuses on working age families, assuming full eligibility for the EIC. Both younger and older heads of households without children are not eligible for the EIC.[116] Eliminating younger individuals would significantly change the distribution in the lowest income level. According to Weber (1998), 36% of income tax returns in 1993 with incomes under $10,000 were filed by dependents.[117] If these taxpayers are largely single, eliminating these returns would reduce the share of single returns to less than 63% (because income levels would have risen over that period, singles accounted for 71% of this class in 1993) and increase head of household returns to more than 20% of the total, married with children returns to more than 6%, and married without children

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[115] *See id.*

[116] *See id.* The EIC eligibility provisions have lower age limits for singles and upper age limits for all households.

[117] Calculated from data in Michael E. Weber, I.R.S., *The 1993 Family Cross Section File: Combining Parents and Dependents into Family Units*, STAT. OF INCOME BULL. Fall 1998, at 231, 232.

returns to more than 10%.[118] According to Sailer, Yau, and Rehula (2001), in 1998, 49% of returns with incomes below $10,000 were filed by heads of households less than 25 years old.[119] If most of these returns were also filed by singles, adjusting for this age difference would also further reduce the share of single returns in the lowest income levels.[120] Adjusting for the elderly would reduce both single returns and joint returns without children as a share; Sailer, Yau, and Rehula report that taxpayers over 65 accounted for 12% of all returns, 11% of returns under $10,000 and 19% of returns in the $10,000 to $15,000 range and in the $15,000 to $20,000 range.[121]

Even with these adjustments, single individuals and married couples without children remain a significant part of the low income working population,[122] although head of household returns are also important.[123] And despite age restrictions and relatively quick EIC phase-outs, singles are an important part of the EIC population: head of household returns account for 52.6% of returns claiming the EIC, while joint returns account for 24.7% and singles account for 22.7%.[124] Given some of the joint returns are families without children, those without children are a significant share of the EIC population.

Based on numbers of exemptions for dependents, families with children tend to have relatively few children, with the average number less than 1.8, rising with income to slightly over two at the very high income levels.[125] Families with many children are the exception rather than the rule. According to Census data, which reports a slightly larger average size (around 2), single-headed families with six children represent less than 2% of the total of these families with children, and families with six children represent less than 1% of all families with children.[126] Families with five, four, three and two children and one child represent 3%, 6%, 17%, 36%, and 38% of families with children, respectively.[127] For families receiving the EIC, 37.5% of these families claimed one child, 42.5% are claimed for two or more children, and 19.9% have no qualifying child.[128] Thus, even though the credit rate is smaller for families with one child, these families

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118 *See* Gravelle & Gravelle, *supra* note 104, at 634.

119 Calculated from data in Peter Sailer et al., I.R.S., *Income by Gender and Age from Information Returns*, STAT. OF INCOME BULL., Winter 2001–02, at 100–01.

120 *See* Gravelle & Gravelle, *supra* note 104, at 634.

121 *See* Sailer et al., *supra* note 119, at 100–02.

122 *See* Gravelle & Gravelle, *supra* note 104, at 635.

123 *Id.*

124 *Id.*

125 *Id.*

126 Calculated from data in JASON FIELDS, U.S. CENSUS BUREAU, CURRENT POPULATION REPORTS, AMERICAN FAMILIES AND LIVING ARRANGEMENTS: 2003, 3 (2004).

127 *See* Gravelle & Gravelle, *supra* note 104, at 635.

128 *Id.*

account for close to half of all credits claimed for families with children.[129] And, even though the rate for families without children is only a fraction of the rate for families with children, and phases out more quickly, these childless EIC recipients account for a fifth of families with earned income credits.[130] Thus, singles, childless couples, and families with one or two children constitute the bulk of the low income population.

While many poor families are the recipients of income tax subsidies, some of significant size, the presence of singles and childless couples among low income families and the implications of relative poverty scales suggest that one cannot positively conclude that working poor families are exempt from income tax. To remove these families from the tax rolls and provide a more significant tax subsidy would require in an increase in the EIC for those without children.

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[129] *Id.*

[130] *Id.*