**The original documents are located in Box C16, folder "Presidential Presidential Handwriting, 3/25/1975 (1)" of the Presidential Handwriting File at the Gerald R. Ford Presidential Library.**

3/25/75

Jim Cavanaugh

Do any of the proposals in current tax bill fall within RTC proposal?

If not, can it be achieved?

THE PRESIDENT HAS SEEN...

INFORMATION

THE WHITE HOUSE

WASHINGTON

February 22, 1975

MEMORANDUM FOR THE PRESIDENT

FROM: JIM CAVANAUGH

SUBJECT: New HEW Tax-Welfare Proposal

Attached is a proposal from Secretary Weinberger regarding an alternate tax reform plan that could also incorporate welfare reform. We will be studying this plan and others within the Domestic Council task force framework, working closely with your economic advisers.

The Secretary's paper describes a mechanism whereby a refundable tax credit (RTC) could be used to target a greater amount of tax relief to the low-income population than under the Administration's current tax reform program. Depending on the size of the total refund, the Secretary reports the RTC plan could cut the costs of current major welfare programs by $5 billion and could reduce the number of recipients by about 7 percent. He explains that such reductions would be possible because the burden of financing income assistance to the low-income population would be transferred to the refundable tax credit plan.

Finally, the paper also proposes ways by which the tax credit approach could offer opportunities to implement desirable structural reforms of the welfare system.

THE SECRETARY OF HEALTH, EDUCATION, AND WELFARE
WASHINGTON, D.C. 20201

FEB 14 1975

MEMORANDUM FOR THE PRESIDENT

SUBJECT: The Relation of Your Energy and Economic Proposals to The Welfare Replacement Plan

I thought you would be interested in knowing that the tax relief and cash rebate program you have proposed would decrease the incremental cost of the Income Supplement Program (which we submitted to you earlier and which will not be submitted to the Congress this year because it is a new program) from $4 billion to less than $2 billion for the tax relief part of the ISP, and by about $400 million (down to $3 billion) in the initially increased net transfer cost.

If the Congress persists in its refusal to enact the petroleum import tax refund as you submitted it, you might want to consider the possibility of recycling the revenues of that petroleum tax back through the tax system in the form of a "refundable tax credit," which would benefit non-taxpayers and could be taken by taxpayers as an option in lieu of the personal exemption proposed. This would not only start the system of requiring the filing of a tax return even by those who do not pay taxes, but the "refund" to them from the Treasury would be a first step in implementing a comprehensive income security plan. Depending on the size of this refund this method could reduce the costs of current major welfare programs by $5 billion and could reduce the number of recipients by about 7 percent since much of the burden of financing income assistance to the low income population would have been shifted over to this refundable income tax plan.

I have attached to this memo a proposal illustrating this idea, and I am sending a copy of it to Bill Seidman, Alan Greenspan and Bill Simon for their reaction.

As soon as you have concluded your consideration of the more modest changes in the present welfare programs contained in our memorandum of December 18, 1974 to you, we will, of course, proceed to draft legislation covering any of the changes you wish to have presented to the Congress.

You might also wish to consider, should you get questions at press conferences, etc., as to why you have "dropped the welfare reform plan" responding that the measures you have already submitted enable us to get started with the first stage of that program and indeed would make it far less expensive because the tax relief measures would improve the income level of a number of people to the point where they would no longer require some of the public assistance benefits, and that we have also begun using the tax system to provide assistance to the low income population.

Cap Weinberger

Secretary

Enclosure

## A PER CAPITA REFUNDABLE TAX CREDIT AS AN ALTERNATIVE TO THE PROPOSED LONG TERM TAX PACKAGE - AND ITS IMPACT ON THE WELFARE SYSTEM

### Introduction

There is likely to be considerable interest in alternatives to the President's long-term tax reduction and rebate proposal that would focus a greater share of the same total revenues on the middle and lower income populations. This paper discusses one mechanism for doing so -- the institution of a per capita refundable tax credit that could be taken at the option of each citizen in lieu of the existing personal exemption. It also indicates how such an approach offers opportunities to:

- o reduce substantially the outlays and number of recipients in the major welfare programs;
- o implement desirable structural reforms of the welfare system, including a national AFDC/Food Stamp minimum; and
- o insure that the lower income population receives sufficient net benefits at least to offset its higher energy costs.

These steps could be viewed as an end unto themselves or as a first step toward full replacement of the welfare system at a later date.

### Per Capita Refundable Tax Credit

A refundable tax credit (RTC) has the same absolute money value to each person regardless of the level of his income. However, since when used it would substitute for the personal exemption, it would be less advantageous to those who benefit more from the present personal exemption (i.e., those in higher marginal tax brackets). Thus, the benefits of a RTC are focused more on the middle and lower income population than the current Administration proposal.

Tab A describes the working of a RTC in detail and compares the distribution of benefits, by Adjusted Gross Income levels (AGI), of a \$200, \$225 and \$250 per capita RTC to the distribution of benefits under the current proposal. Table 1 of Tab A indicates, for example, that a \$225 RTC has the following characteristics for a family of four which uses the current standard deduction:

- o Families with AGI above $23,500 receive no tax reduction relative to current law. They would find it more advantageous to take the $3000 in personal exemptions (4 x $750) than the $1000 in RTC's.

- o Relative to the current proposal, families with AGI above $8,000 would receive slightly less tax reductions while those below would receive much more.

- o Families with AGI below $6,723 would receive a cash rebate because the value of their RTC would exceed their tax liability. The amount of the rebate increases as AGI decreases until it reaches its maximum of $900 at $1300 where there is no tax liability to offset any of the credit.

The total cost of this $225 RTC is $23.0 billion;* $10.0 billion in reduced tax payments, $6.75 billion in cash rebates to those with a tax liability less than the credit for which they are eligible, and $6.25 billion in cash rebates to those with no offsetting tax liability.

This and the other configurations presented in Tab A are only illustrative of the possibilities. Aspects of the current Administration proposal (such as an increase in the standard deduction and low-income allowance and/or rate changes) could be coupled together with the RTC to arrive at any desired total cost and distribution of benefits.

Impact on Welfare Programs

The impact of a RTC on current welfare programs could be substantial and desirable. The majority of welfare program recipients would have little or no tax liability to offset against a RTC and, therefore, would receive sizable cash rebates. How much better off they would be as a result depends upon the extent to which the rebate would be "counted" in determining welfare benefit levels. Fortunately, we can specify regulations so that recipient families of a given size would be better off by some predetermined amount and that any cash rebate above this amount would offset existing welfare program outlays. This has the desirable effect of simultaneously reducing welfare costs and the number of welfare recipients while increasing the purchasing power of actual or former recipients to compensate for increased energy costs.

Tab B explores in detail two alternative ways in which cash rebates could be treated by welfare programs and the respective impacts on welfare program outlays and recipients. It shows, for example, that we could specify the treatment of a $225 RTC by welfare programs in such a way as to:

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* The net cost of such a RTC actually could be as much as $5 billion less than this depending upon the degree to which welfare program outlays are offset. This is the subject of the next section.

- Insure that all individuals are better off by $100, two-person families by $200, four-person families by $300, five-person families by $350, etc.
- Reduce outlays under our major means-tested programs by $4-$5 billion (AFDC, $1.6 billion; SSI, $1.6 billion; Food Stamps, $.25-$1 billion; Medicaid, Public Housing and Veterans, approximately $.9 billion).
- Reduce by about 7% the number of recipients in the major welfare programs.

Another outcome of such an approach would be to facilitate certain modest structural reforms in current welfare programs which, while desirable in their own right, would likely be politically controversial unless done in conjunction with increasing the incomes of recipients. These reforms include averaging incomes over the past three months and requiring income reporting every three months in determining welfare benefit levels. Presently Food Stamps and AFDC look only at the current month's income and make infrequent and irregular redeterminations. These are among the major factors contributing to the high error and ineligibility rates in both programs.

Major Reform of AFDC

The integration of the RTC and the welfare system indicated in the previous section assumes that there would be no major structural changes made to the existing welfare system. However, the institution of a RTC that would provide substantial cash rebates to all AFDC families offers an opportunity to implement major reforms in AFDC -- that, in the absence of a RTC, would cost nearly $1 billion annually and increase caseloads -- while still reducing overall AFDC costs and caseloads.

More specifically, a national minimum for virtually all joint AFDC/Food Stamp recipients could be achieved by specification of how much of the income from the tax rebate is counted in low payment jurisdictions. While this additional step would, of course, result in less welfare savings in low payment states, it would achieve a long urged AFDC reform in an indirect manner that avoids the usual political confrontation between high payment and low payment states.

Implementation of this national minimum also would necessitate and facilitate certain additional, more minor AFDC reforms that should reduce, on balance, welfare expenditures and personnel and the potential for error or fraud. Finally, as part of the introduction of a RTC and national minimum the Unemployed Fathers program in AFDC could be mandated, a step less costly in the context of a rebated tax credit.

A paper at Tab C discusses these issues more fully and provides an example of how the proposal would work in a typical low payment jurisdiction. It indicates that the implementation of a combined AFDC/FS national minimum for a family of four of $3600 would result in about $200 million less welfare savings than discussed above. Approximately 30% of the AFDC caseload in the fourteen lowest payment states would be made better off.

## Conclusion

Some of the monies under the long-term tax relief and rebate program must be targeted upon the lower income population. This paper has described a mechanism by which a greater amount than is currently proposed by the Administration might be so targeted and demonstrated the unique opportunity that this would offer to implement desirable reforms and reductions in current welfare programs. The examples chosen are illustrative of the many possibilities that exist.

# THE COST AND DISTRIBUTIONAL CONSEQUENCES OF ALTERNATIVE APPROACHES TO TAX REDUCTIONS AND REBATES

## Introduction

This tab describes several tax changes which would reduce personal income taxes to compensate for the increases in prices caused by the tariff on petroleum. The distributional impact of the proposal outlined in the State of the Union Message is compared with several variants of a refundable tax credit. Each proposal is based on at least one of the following three changes in tax parameters: (1) increasing the standard deduction; (2) introducing an optional refundable tax credit in lieu of the personal exemption; and/or (3) changing marginal tax rates. Each parameter change has a different distributional impact.

- o Increasing the standard deduction raises the level of tax free income, thus eliminating all tax liability for some low-income units and reducing tax liability for all units which do not itemize. Raising the standard deduction offers greatest tax savings to non-itemizers with high incomes since they pay relatively high taxes on marginal income which becomes exempt from taxation.

- o Instituting an optional refundable tax credit in lieu of the $750 personal exemption concentrates tax relief on low and middle income units without increasing taxes for high income units. Since the tax credit is refundable, payments are made to units with small or no tax liability. Since the tax credit is optional, high income tax units who gain more from the personal exemption than from the tax credit are given the option of paying taxes according to current law schedules. Therefore, they are not made worse off by a tax credit. Tax relief to low and moderate income taxpayers decreases with income,* thus concentrating the tax expenditures on non-taxpayers and lower income taxpayers.

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* The value of the personal exemption in terms of tax reduction increases with income. The value of the tax credit does not vary with income. Therefore, the option of taking a tax credit decreases in value as income rises.

- o Reducing marginal tax rates concentrates tax relief on high income units (rate increases have the opposite impact). A rate decrease is equivalent to a tax credit for those in or above that tax bracket.* The more tax brackets with rate reductions one's income spans the larger the total tax credit.

A $200, $225 and $250 tax credit (the former with and without an increase in the standard deduction) are examined. These variants generate a wide range of options differing in amount and distribution of tax relief. The options chosen are illustrative of the general impact of tax credits. Credits can be mixed with other changes in the tax law, such as rate changes, in order to attain different distributional configuration and total cost packages.

Table 1 presents the net benefit to a four-person family which does not itemize under the President's proposal** and under the four variants of a tax credit. The net benefit is composed of tax reductions and cash rebates, shown in parentheses. Table 2 presents the costs of the options. Each option is described and analyzed in turn.

President's Proposal

As presented in the State of the Union Message, three changes would be made to the Individual Income Tax:

- o The low-income allowance would be raised from $1300 to $2000 for individuals and $2600 for couples. This would eliminate the percentage standard deduction and the maximum standard deduction. The cost would be $5.6 billion.

- o Marginal tax rates would be lowered in the first five brackets (taxable income under $6000) and raised in two brackets ($16,000 to $24,000 taxable income range). The net impact would be to reduce the total tax burden for taxpayers in all tax brackets. The cost would be $11 billion.

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* Lowering the marginal tax rate in the first $1000 bracket from 14% to 7% is equivalent to granting a $70 tax credit to all those with more than $1000 of taxable income.

** Table 1 shows tax relief to units which use the standard deduction. These numbers are not comparable to the White House background papers which seem to show tax relief weighted by the proportion of units which itemize and don't itemize in each AGI class.

- o Units with no tax liability would be eligible for an $80 per adult refundable credit. The cost would be $1.8 billion.

As Table 1 indicates, the net impact of these three changes would be to decrease taxes for all units and to give the largest absolute reductions to high income units who use the standard deduction.*
A two adult family with no income would receive $160 and a single parent family $80. Families with incomes above $8000 which use the standard deduction** would pay approximately $350 less in taxes.

Refundable Tax Credit With No Change in The Standard Deduction

Tax relief can be heavily concentrated on low and moderate income people by leaving the standard deduction unchanged. A $225 refundable tax credit with no increase in the standard deduction and no rate decrease would cost about $5 billion more than the President's package*** and only slightly more than a $200 credit with a $2000/$2600 standard deduction.

Tax relief arising from a $225 optional refundable tax credit would have the following attributes:

- o No family would pay higher taxes than under current law. Tax relief would decrease with income.

- o Low-income four-person families would pay taxes on income over $4300 but the tax credits would be greater than tax liabilities for units with incomes below $6,773. These families, therefore, would receive rebates. Families with income below $4300 would receive a rebate equal to the full credit.

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* The value of the increased standard deduction increases with marginal tax rates and, hence, with income.

** Tax units which itemize would receive tax relief only from the rate reductions. This would amount to $130 relief for units with income above $29,000.

*** When the welfare savings discussed in Tab B is taken into account, the net cost of a $225 RTC would be very nearly the same as the President's proposal.

- Relative to the President's proposal, families with AGI above $8000 would receive slightly less tax relief and those below, much greater

## Refundable Tax Credit With Higher Standard Deduction

Under this option, the standard deduction would be raised to $2600 for couples and $2000 for individuals (as under the President's proposal) but tax rates would not be altered. An optional per capita refundable tax credit which could be taken in lieu of the $750 personal exemption would be instituted. A $200 tax credit is used for illustration. This tax credit scheme would have the following attributes for a family of four:

- No family would pay higher taxes than under current law. However, units which itemize and have income above $26,000 would receive no reduction in taxes.

- Tax Relief would be concentrated on low-income families. A family of four with zero income would receive $1000 in rebates. Tax exempt income would be raised from $4300 to $5600, thus decreasing the tax liability of low-income taxpayers. Families with incomes below $2600 would receive the full $1000 credit. Above this income, tax liabilities would offset the credit such that the rebate would be zero for a family with $8600 of income.

- Families with incomes above $20,000 would receive less tax relief than they would under the President's proposal. This results from not lowering tax rates and from instituting tax credits which do not benefit high income families. High income itemizers would receive no tax relief while non-itemizers would benefit from smaller tax cuts than under the President's Proposal.

The increased standard deduction combined with a $200 credit would result in somewhat more tax relief and rebates than the President's proposal. These would be concentrated on low and middle income people and about half would be in cash rebates.

TABLE 1

NET BENEFIT FROM CHANGES IN TAX LAW
(Family of Four Which Does not Itemize)

| AGI | State of Union Proposal** | 2600 Standard Deduction: $200 Refundable Tax Credit*** | No Change in Standard Deduction: $200 Refundable Tax Credit | No Change in Standard Deduction: $225 Refundable Tax Credit | No Change in Standard Deduction: $250 Refundable Tax Credit |
|---|---|---|---|---|---|
| 0 | 160 (160)* | 800 (800) | 800 (800) | 900 (900) | 1000 (1000) |
| 1 | 160 (160) | 800 (800) | 800 (800) | 900 (900) | 1000 (1000) |
| 3 | 160 (160) | 744 (744) | 555 (555) | 655 (655) | 755 (755) |
| 5 | 58 | 548 (446) | 333 (231) | 433 (331) | 533 (431) |
| 6 | 221 | 531 (282) | 296 (47) | 396 (147) | 496 (247) |
| 8 | 351 | 487 | 232 | 332 | 432 |
| 10 | 383 | 435 | 211 | 311 | 411 |
| 12 | 362 | 340 | 164 | 264 | 364 |
| 14 | 342 | 272 | 140 | 240 | 340 |
| 18 | 360 | 200 | 50 | 150 | 250 |
| 22 | 374 | 168 | 0 | 60 | 160 |
| 26 | 358 | 192 | 0 | 0 | 40 |
| 30 | 346 | 216 | 0 | 0 | 0 |
| 35 | 364 | 234 | 0 | 0 | 0 |

* Figure in parenthesis represents cash rebate. These are included in the net benefit which is the sum of cash rebates and tax reductions. For those families with only one adult present (e.g., AFDC families) the amount of net benefit would be $80 rather than $160.

** The table is for a family which uses the standard deduction. This family benefits both from the rate reductions and the increased standard deduction. Fewer than 10% of families with AGI above $20,000 use the standard deduction. They would gain only from the rate changes. The tax relief to such families would rise from a minimum of $160 for those with no taxable income to a maximum of $210 for units with $16,000 taxable income. Due to rate increases in the higher brackets, relief would be less for higher income units, dropping to $130 for units with taxable income above $20,000 (AGI approximately equal to $27,000).

*** For those who itemize, the amount of tax relief would be that indicated under the next column to the right.

TABLE 2

COST OF CHANGES IN TAX LAW
(billion $)

| | State of the Union Proposal | 2000/2600 Standard Deduction: $200 Refundable Tax Credit | No Change in Standard Deduction: $200 Refundable Tax Credit | No Change in Standard Deduction: $225 Refundable Tax Credit | No Change in Standard Deduction: $250 Refundable Tax Credit |
|---|---|---|---|---|---|
| Total Costs | 18.4 | 24.1 | 17.5 | 23.0 | 28.6 |
| Tax Reduction | 16.6 | 11.1 | 6.5 | 10.0 | 13.1 |
| Raising SD | 5.6 | 5.6 | 0 | 0 | 0 |
| Changing Tax Rates | 11.0 | 0 | 0 | 0 | 0 |
| Allowing Credit | 0 | 5.5 | 6.5 | 10.0 | 13.1 |
| Cash Rebate* | 1.8 | 13.0 | 11.0 | 13.0 | 15.5 |
| To those with tax liability | 0 | 5.5 | 5.0 | 6.3 | 8.0 |
| To those with no tax liability | 1.8 | 7.5 | 6.0 | 6.7 | 7.5 |

* The distribution of the aggregate cash rebate between those with some tax liability and those with none is only very approximate.

# IMPACT OF THE REFUNDABLE TAX CREDIT ON THE WELFARE SYSTEM

## Introduction

The choice of an appropriate method of integrating a refundable tax credit (RTC) with the existing welfare system is dependent on the importance given to several sometimes competing objectives. For this analysis the primary objectives are threefold. First, any acceptable alternative must insure that the low-income population is rebated the increased energy taxes that it will pay. Second, the RTC should provide an opportunity to introduce several minor but desirable reforms into the welfare system. Finally, the RTC should be used to shift much of the cost and caseloads of the major welfare programs -- AFDC, SSI and FS -- onto the tax credit mechanism, and should be designed to be consistent with the longer run objective of eventual replacement of the existing welfare system. Other objectives and constraints are also important: adequacy, equity, efficiency, simplicity and overall costs.

The first section of this paper discusses two desirable reforms that would be both motivated and facilitated by a RTC plan. These reforms -- a longer and more uniform accountable period and more frequent and regular income reporting -- would increase the target efficiency of assistance dollars and reduce the opportunities for fraud and error. In addition, the RTC plan could be implemented in such a way as to establish a Federal AFDC minimum benefit level. This possibility is discussed in Tab C.

The second section of this paper explores two general integration options. The first integration option considered is the "natural" integration, which uses current rules that link the benefits of different programs. It would substantially offset public assistance payments (because of the 100 percent benefit reduction rates on unearned income that apply to AFDC and SSI), but would save a smaller proportion of the Food Stamp budget (because that program has a 30 percent reduction rate on unearned income). The second option is a slight variation of the first; it incorporates an additional offset for FS recipients not on public assistance. Under each option some portion of the tax credit is disregarded, or passed on to the recipient, in order to compensate for increased energy taxes. The disregard considered for illustration is related both to family size and to the estimated increase in energy taxes. Estimates of budget and enrollment reductions are included in these discussions and are more fully detailed in the attached tables.

## Reforms

Adoption of a reimbursable tax credit program would be accompanied by a requirement that the RTC and welfare program accountable periods be coordinated. Thus, it offers the opportunity for an independently desirable reform of income reporting and accounting practices in the welfare system.

A reimbursable tax credit would probably be paid at least quarterly to those individuals and families who have little other income and who could better use the credit if it were disbursed more frequently than annually. Eligibility for a quarterly payment would probably be based on a measure of past income and, in some cases, on expected income. The amount of any payment, however, would be fixed; it would be unrelated to income, past or future. On the other hand, most welfare programs have a prospective monthly accountable period, and benefits are based on income that must be reported only as it changes. Rational coordination of the two systems seems possible only if the accountable periods are the same, and in particular only if the welfare programs move to a quarterly accountable period. Otherwise, a tax credit payment received in the first month of a quarter could cause a reduction-- even the elimination-- of benefits in one month and yet have no impact on benefits in the other two months of that quarter.

It would be possible to require that one-third of each quarterly payment be counted for each month. However, this example of periodic income that escapes accounting in the welfare system demonstrates the desirability of longer accountable periods -- independent of the existence of a reimbursable tax credit --in order to more accurately and objectively assess a family's continuing need for assistance. A longer accountable period, combined with more frequent, regular income reporting, would serve to increase accuracy in income reporting and benefit calculations by reducing the opportunities for fraud and error. Such a move would be consistent with and supportive of the Department's "Quality Control" effort in AFDC.

While these steps constitute a relatively minor reform, and could be largely implemented by regulation, legislative change in conjunction with the proposed reimbursable tax credit plan seems preferable.

The small increases in net benefits to current assistance recipients might make more acceptable (politically) the decreases in benefits that would be faced by a minority of recipients as a result of lengthening the accountable period.

Energy Tax Rebate

In the existing welfare system, benefits are reduced when other income rises. Thus, if a RTC plan were introduced, the RTC payments would be offset to some extent by reductions in welfare benefits. Indeed, most AFDC and SSI recipients would find themselves no better off for having received the refundable credit. Therefore, in order to assure that every recipient family gets a rebate of energy taxes, the plan must include a requirement that welfare programs ignore, or disregard, at least part of the credits when they calculate benefits. A minimum disregard of $80 per adult ($160 maximum per filing unit) is necessary under any integration scheme if the President's announced commitment is to be incorporated into the alternative proposal. Above that, there may be reason to justify a higher energy-related disregard, or simply a desire to increase assistance to current welfare recipients, through the use of a higher disregard. An illustrative disregard related both to family size and to a higher estimate of increased expenditures due to the energy tax is outlined below:

| Family Size | Disregard |
|---|---|
| 1 | $100 |
| 2 | $200 |
| 3 | $250 |
| 4 | $300 |
| 5 | $325 |
| 6 | $350 |
| 7 | $375 |
| 8 | $400 |
| 9+ | $425 |

In many respects the family size conditioned disregard is more equitable. A disregard of $80 per adult would allow twice as much to a two-parent family of four as it would to a one-parent family of four, yet it is unlikely that either their needs or energy expenses are very much different. The flat rate per adult was included in the Administration proposal, however, not because it was considered the most equitable option but becasue it was considered the least difficult option to administer. The IRS judged it very troublesome to condition energy rebates on family size. But the RTC plan is more flexible and, as welfare benefits are already based on family size, the necessary disregards can better reflect the burden of the increased energy tax.

Integration Options

The impact of a RTC plan on existing welfare programs depends primarily on the way that each program treats RTC payments and the way that each program treats the benefits of other welfare programs. The RTC could be completely offset by a reduction of other benefits, thus leaving the recipient no better off at all; or the RTC could be ignored by the major welfare programs, thus giving the recipient the full benefit of the credit. The desirable outcome is probably in the middle, increasing the income of the recipient and reducing the costs and caseloads of the welfare programs. Disregards and benefit reduction rates can be used to produce the appropriate outcome.

This section outlines two integration alternatives, the advantages and disadvantages of each, and the likely impacts on welfare budgets and caseloads that they would produce. A $225 tax credit, and the family size and energy-related disregards listed above ($300 for a family of four), are used for illustration. (The tables attached to this paper include estimates of cost and caseload impact for $200 and $250 tax credit plans as well.) Estimates are based on FY75 data.

1. Natural Option

A "natural" integration would be accomplished simply by treating RTC payments in the same manner as other income is treated by welfare programs. Under existing laws and regulations, the AFDC and SSI programs would reduce benefits by the full amount of the tax credit, which would be considered "unearned income." The FS program, for which all AFDC and SSI recipients are categorically eligible, does not have differential tax rates, just a flat benefit reduction rate of 30 percent on income from all sources.*

In the absence of the special energy-related disregards discussed in the previous section, recipients of cash assistance (AFDC or SSI) thus would have the RTC fully offset. If such recipients also received Food Stamp benefits, the latter would remain unchanged as a result of the existing relationship between the cash and Food Stamp programs (the latter counts the former as income and the RTC would already have affected income as measured by the cash programs). Finally, recipients of Food Stamps only would have their RTC's offset by 30 percent. The special disregard would be added both to cash programs and to Food Stamps to pass on the appropriate increase in total disposable income to the recipients.

With this "natural" method of integration a $225 tax credit plan would reduce the budget of the three major welfare programs by $3.4 billion: $1.6B in AFDC, $1.6B in SSI, and $0.2B in FS. The number of participants in these programs would be reduced by about .5 million, .9 million and .3 million, respectively. Offsets from other programs (i.e., Medicaid, housing assistance and veterans pensions) would reduce welfare costs by another $.9 billion.*

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*The attached tables offer greater detail on the impact of the tax credit plan under alternative integration schemes.

The natural integration alternative has a number of advantages. It passes on to the recipient an increase in disposable income at the same time it substantially reduces welfare costs and caseloads. Because it requires the least change in current laws and procedures, it would be the easiest to sell politically as well as the easiest to implement administratively. Moreover, because the offsets would be heaviest on categorical cash benefits, this option would reduce the inequities of the current system by increasing the transfers to the "working poor" relative to the current welfare population.

The major disadvantages of this option follow from some of the advantages. Because the FS benefit reduction rate is relatively low, much of the potential FS offset is lost (although AFDC and SSI capture the maximum offset from the half of the FS population that also receives cash assistance). Also, because of the Federal-state cost sharing relationship in AFDC, about 44 percent of the offsets to that program would accrue to the states. (Of course, this might also be seen as an advantage of this approach.)

Natural Option with Additional Food Stamp Offset

It is also possible to treat the tax credit normally for cash assistance recipients, and, in order to reduce (or replace) more of the FS budget, implement a special treatment of the tax credit for recipients of food stamp benefits only. This would involve reducing the FS bonus by the full amount of the tax credit (minus the disregard). With a $225 credit plan, this integration option would save an additional $0.7B and reduce the FS rolls by another 1.5M.

Among the integration options considered, this option would maximize total welfare savings and total reductions in the welfare rolls. It would maintain the current relative positions of the various categorical and non-categorical welfare populations by reducing all benefits from the major programs at a net rate of 100 percent above the initial disregard.

On the other hand, this option would pass up an opportunity to foster greater equity among transfer recipients. In fact, it would create additional inequities by treating differently the incomes of persons in the same program (FS). It would also introduce special tax rates into the FS program, which, in addition to increasing administrative complexity, would contradict the logic and the principles that underlie the program (i.e., 30 percent of available income for a basic diet, versus 30 percent plus the tax credit for a basic diet). Moreover, the SSI experience indicates that it may be difficult to cash-out only part of the FS program.

## Impact of RTC Plan* on Welfare Programs
(FY 75)

| | AFDC** | SSI | FS | Medicaid | Housing | Veterans | Total |
|---|---|---|---|---|---|---|---|
| **Program Cost Reductions** (billions) | | | | | | | |
| $250 Credit | 1.80 | 1.80 | | .45 | .15 | .34 | |
| natural | | | .27 | | | | 4.81 |
| FS offset | | | 1.06 | | | | 5.60 |
| $225 Credit | 1.57 | 1.59 | | .36 | .13 | .40 | |
| natural | | | .24 | | | | 4.29 |
| FS offset | | | .97 | | | | 5.02 |
| $200 Credit | 1.33 | 1.38 | | .28 | .11 | .46 | |
| natural | | | .19 | | | | 3.75 |
| FS offset | | | .75 | | | | 4.31 |
| **Program Recipient Reductions** (millions) | | | | | | | |
| $250 Credit | .684 | 1.000 | | 1.263 | *** | NA | |
| natural | | | .363 | | | | |
| FS offset | | | 2.054 | | | | |
| $225 Credit | .502 | .900 | | 1.02 | *** | NA | |
| natural | | | .300 | | | | |
| offset | | | 1.817 | | | | |
| $200 Credit | .228 | .800 | | .771 | *** | NA | |
| natural | | | .237 | | | | |
| FS offset | | | 1.738 | | | | |

* Assumes family size - conditioned disregard as described in text, e.g., $300 for a family of four.

** Approximately 44% of AFDC savings would accrue to the states.

*** The number of subsidized units would not be affected by size of RTC.

Note: Because many recipients participate in more than one program, reductions cannot be summed over all programs to get the total number of individuals no longer receiving any of these forms of assistance.

Impact of RTC on Individual Welfare Recipients*
(increased Annual Income in Dollars)

| Programs and Family Situation | RTC $250 | RTC $225 | RTC $200 | Administration Plan $80/160 |
|---|---|---|---|---|
| AFDC (and FS) | | | | |
| Mother, 1 Child | 200 | 200 | 200 | 80 |
| Mother, 3 Children | 300 | 300 | 300 | 80 |
| SSI (and FS) | | | | |
| Individual | 100 | 100 | 100 | 80 |
| Couple | 200 | 200 | 200 | 160 |
| FS Only (natural) | | | | |
| Individual | 213 | 194 | 175 | 80 |
| 2 Parents, 2 Children | 825 | 750 | 675 | 160 |
| 1 Parent, 3 Children | 825 | 750 | 675 | 80 |
| FS Only (w/FS Offset) | | | | |
| Individual | 100 | 100 | 100 | 80 |
| 2 Parents, 2 Children | 300 | 300 | 300 | 160 |
| 1 Parent, 3 Children | 300 | 300 | 300 | 80 |

* In general, recipients would be at least this much better off; those whose RTC's take them off welfare would have an even greater increase in spendable income.

USE OF REFUNDABLE TAX CREDIT AS OPPORTUNITY FOR RESTRUCTURING AFDC

Introduction

As previously discussed, a refundable tax credit could be used to absorb much of the burden of low income assistance from the public assistance (AFDC and SSI) and Food Stamps programs. In addition, we could, as part of this shift, choose to mandate a national minimum in the AFDC program and introduce other desirable reforms into that program. This paper outlines a means by which these latter steps could be accomplished with minimal disruption of the Federal-state relationships inherent in the grant-in-aid nature of AFDC.

Description

The tax credit would displace a family's public assistance and Food Stamp bonus by an amount equal to the tax credit minus an initial disregard to offset the increased costs of energy. Total assistance (including refunded tax credits) to all public assistance/Food Stamp (FS) recipients, regardless of jurisdiction, would thus be increased by an amount equal to that disregard ($D_1$). The introduction of a refundable tax credit offers the opportunity to increase total assistance to AFDC/FS recipients in currently low payment jurisdictions by amounts even greater than $D_1$ so that all AFDC/FS recipients in those states are brought up to a national standard. This is done by adding to $D_1$ a second disregard ($D_2$) which equals the amount by which a jurisdiction's present AFDC/FS level falls below a given national standard (e.g., $3600). Table 1 displays its effect in the fourteen lowest paying jurisdictions in which the extra disregard would apply if a $3600 minimum were chosen.*

Attached to this paper is an example which shows the case of a family with no income under this proposal. For situations where the family does have other earned or unearned income, the AFDC and Food Stamp programs would reduce benefits to that family by virtue of that other income exactly as they now do. Typically such a family would continue to receive the full tax credit in cash (with the same, constant reduction in AFDC and FS as a result), but the family would, after its income had passed its appropriate standard deduction, begin to incur a Federal income tax liability. While that tax liability, of course, reduces the value of the tax credit cash transfer to the family, the liability is in turn completely offset in the AFDC computation procedure, and partially so in the Food Stamp calculation.

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* This procedure will bring total assistance in nine of the fourteen states presently below the national standard up to that standard. Actual AFDC benefits paid are so low in the five remaining states (Alabama, Arkansas, Louisiana, Mississippi, South Carolina) that the sum of a totally disregarded tax credit, appropriate Food Stamps benefits and the state's present AFDC level would still fall below the national standard.

Discussion

The principle of a national standard for assistance has been a prominent aspect of most welfare reform initiatives, especially since 1969. The reasons for a national standard are grounded in equity, adequacy, and in diminishing any incentives for movement to high payment jurisdictions. A national standard (at least for single parent families) has engendered less controversy than have other aspects of recent welfare reform plans, e.g., coverage of the working poor, cash vs. in-kind assistance and large service components. However, the problem with implementing a national standard, absent larger reform, is that it opens debate over the AFDC financing formula: should low payment or high payment jurisdictions receive the greater share of any new Federal funds? A refundable tax credit offers a rare opportunity to, in part, avoid that otherwise direct confrontation by using petroleum tax revenues to achieve the minimum. Similarly, because the refundable tax credit decreases the costs to the states, the opportunity for mandating the Unemployed Fathers program in AFDC also presents itself.

In order to implement a national AFDC/FS minimum through use of a refunded Federal tax credit, the following changes in AFDC are necessary.

-- a three month, or calendar quarter accountable period and reporting system (as was discussed in Tab B, this is a step that is necessary even without a national minimum).

-- preferably flat grants that vary only by unit size; at the very least, consolidated grants that vary by unit size and one or two other variables.

-- the elimination of any distinction between a state's "standard" (full or payment) and the actual basic benefit it pays to a family with no income.

Beyond these steps no other changes in the AFDC statute or regulations appear to be necessary. The Federal financing formula as a function of average amount paid and state per capita income, could remain unaltered, thus avoiding the debate which has impeded this step in the past.

The cost of this proposal would be somewhat under $200 million less savings in AFDC than if we chose not to adopt it in conjunction with a RTC. Approximately 30% of the AFDC caseload would be made better off as a result. (These figures do not include any mandate of the UF option.)

One criticism of this reform is that achieving a national standard in this manner changes incentives for states below the standard. After the initial savings in AFDC expenditures due to the tax credit offsets, the low payment states have an incentive not to increase AFDC levels to a new, higher level which is less than the national standard. Indeed, such an action could cost a state in increased AFDC expenditures that which it would save the Federal government in Food Stamps, and recipients would not be any better off by virtue of the state's well intentioned action. In fact, it may be necessary to legislate maintenance of present AFDC levels (after allowing the initial savings from the tax credit offset) in order to insure that low payment states do not cut back in AFDC levels at increased costs to the Federal government in the Food Stamps program. However, the costs to states to move to levels that are higher than the new national standard would be less than those they would now encounter, and would result in recipients being made better off by virtue of that state action.

## EXAMPLE

For purposes of illustration, the first method discussed in Tab B for integrating the tax credit with the welfare programs will be used here. In the case of joint AFDC/Food Stamp (FS) eligibles, the formulas for families with no income are:

- Tax Credit (TC) - "energy cost" disregard = net TC
- AFDC - 100% net TC = net AFDC
- FS - 25% net TC - 25% net AFDC = net FS

Total assistance to a family with no income will have been increased by an amount equal to the petroleum cost disregard.

Should we decide to used the introduction of a tax credit as an opportunity to mandate a national AFDC minimum, it could be easily accomplished by passing through "national minimum" disregards against tax credit payments <u>in addition</u> to the "energy cost" disregard.

Thus:

- TC - "energy cost" disregard ($D_1$) - "national minimum" disregard ($D_2$) = net TC
- AFDC - net TC = net AFDC
- FS - 25% net TC - 25% net AFDC = net FS

In this instance, total assistance to a family with no income will have been increased by an amount equal not just to the petroleum cost disregard, but by an amount which also subsumes a national minimum disregard. To arrive at the appropriate amounts for the latter figure, we would determine for each jurisdiction how much its present AFDC payment level plus the bonus value of Food Stamps at that income level falls (if at all) below whatever national standard we wish to mandate. For example, assume the following:

- Tax credit = $225/person; therefore $900/family of 4
- Petroleum cost disregard = $300 /family of 4
- AFDC payment level = $150/month for a family of 4
- Food Stamp bonus value at zero income = $1800;
  25% of net income = purchase price.

Absent a tax credit, total assistance to a family of 4 with no income equals:

| | | |
|---|---|---|
| $1800 | AFDC payment level | |
| - 0 | | |
| $1800 | AFDC benefit | $1800 |
| | | |
| $1800 | Food Stamp full bonus value | |
| - 450 | (25% $1800 AFDC) | |
| $1350 | FS benefit | $1350 |
| | Total assistance | $3150 |

If we further assume a national standard of $3600 for a family of 4 with no income, then the amount by which this jurisdiction is deficient equals $450 ($3600 - $3150). That figure than becomes the national minimum disregard for that jurisdiction. Thus:

| | | |
|---|---|---|
| $ 900 | Tax credit | |
| $-300 | petroleum cost disregard ($D_1$) | |
| $-450 | AFDC national minimum disregard ($D_2$) | |
| $ 150 | net tax credit | |
| | | |
| $1800 | AFDC payment level | |
| $-150 | 100% $150 (net TC) | |
| $1650 | net AFDC | $1650 |
| | | |
| $1800 | Food Stamp full bonus value | |
| $-413 | 25% $1650 (net AFDC) | |
| $- 37 | 25% $250 (net TC) | |
| $1350 | net FS | $1350 |
| | | |
| Tax credit (refunded) | | $1000 |
| | Total assistance | $3900 |

In this instance, the family's basic assistance level has been increased by an amount ($750) which not only subsumes the increased costs of petroleum to that family ($300), but also the amount by which it was previously deficient vis-a-vis the national standard ($450).

TABLE 1

EFFECT OF EXTRA DISREGARD TO ACHIEVE AFDC/FS NATIONAL MINIMUM IN THE APPROPRIATE STATES

| States Below $2400 AFDC | AFDC | + | Food Stamps | = | $Total_1$ | $D_2$ ($T_1 < 3600$) | Countable Tax Credit ($600-D_2$) | AFDC After Offset | + | Food Stamps | + | Tax Credit | = | $Total_2$ |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Alabama* | 1488 | | 1476 | | 2964 | 636 | 0 | 1488 | | 1476 | | 900 | | 3864 |
| Arizona | 2208 | | 1254 | | 3492 | 108 | 492 | 1716 | | 1284 | | 900 | | 3900 |
| Arkansas* | 1500 | | 1476 | | 2976 | 624 | 0 | 1500 | | 1476 | | 900 | | 3876 |
| Florida | 1812 | | 1356 | | 3168 | 432 | 168 | 1644 | | 1356 | | 900 | | 3900 |
| Georgia | 1920 | | 1356 | | 3276 | 324 | 276 | 1644 | | 1356 | | 900 | | 3900 |
| Kentucky | 2052 | | 1284 | | 3336 | 264 | 336 | 1716 | | 1284 | | 900 | | 3900 |
| Louisiana* | 1464 | | 1476 | | 2940 | 660 | 0 | 1464 | | 1476 | | 900 | | 3840 |
| Maine | 2016 | | 1356 | | 3372 | 228 | 372 | 1644 | | 1356 | | 900 | | 3900 |
| Mississippi * | 720 | | 1692 | | 2412 | 700 | 0 | 720 | | 1692 | | 900 | | 3412 |
| Missouri | 2196 | | 1284 | | 3480 | 120 | 480 | 1716 | | 1284 | | 900 | | 3900 |
| North Carolina | 2208 | | 1284 | | 3492 | 108 | 492 | 1716 | | 1284 | | 900 | | 3900 |
| South Carolina* | 1404 | | 1512 | | 2912 | 684 | 0 | 1404 | | 1512 | | 900 | | 3816 |
| Tennessee | 1584 | | 1440 | | 3024 | 576 | 24 | 1560 | | 1440 | | 900 | | 3900 |
| Texas | 1680 | | 1404 | | 3084 | 516 | 84 | 1596 | | 1404 | | 900 | | 3900 |

*See footnote in text.

NOTES TO TABLE 1

1. The table assumes a) \$225 per person rebatable tax credit, i.e., \$900 for a family of four; b) a disregard ($D_1$) of \$300 (family of four) applied against such tax credits for all AFDC/FS recipients in order to compensate for increased energy costs; c) a 100% benefit reduction rate against AFDC for non-disregarded tax credit payments; and d) that non-disregarded tax credits are treated as ordinary income for purposes of determining Food Stamp purchase prices (an approximate 25% "tax" rate in the case of families of four).

2. AFDC levels are for the "largest amount paid for basic needs" to families of four with no income in July 1, 1974.

3. Food Stamp bonus values were calculated on the basis of the schedule effective as of January 1, 1975.

4. $D_2$ means the disregard applied to the rebatable tax credits in order to raise total assistance to families in low payment jurisdictions to a national standard of \$3600 (\$3900 when the effect of $D_1$ is added).

5. Countable Tax credit means the amount of the tax credit which AFDC and FS may count for purposes of reducing benefits after both $D_1$ and $D_2$ have been applied. For example, in the case of Arizona: \$900 - \$300 ($D_1$) - \$108 ($D_2$) leaves \$492 of tax credits to be counted as income in AFDC and FS.

6. AFDC after offset shows the new, reduced AFDC payment after the tax credits have been counted.

THE WHITE HOUSE

WASHINGTON

March 25, 1975

ADMINISTRATIVELY CONFIDENTIAL

MEMORANDUM FOR: JIM CAVANAUGH

FROM: JERRY H. JONES

SUBJECT: New HEW Tax-Welfare Proposal

Your memorandum to the President of February 22 on the above subject has been reviewed and the following notation was made:

-- Do any of the proposals in current tax bill fall within RTC proposal?

If not, can it be achieved?

Please follow-up with the appropriate action.

Thank you.

cc: Don Rumsfeld