Brandeis Graduate Journal
2004, Volume 2
http://www.brandeis.edu/gradjournal
All Rights Reserved

# Conceptions of Fair Tax Policy: A Review of the Jobs and Growth Tax Relief Act of 2003

Debra Rahmin Silberstein
Heller School for Social Policy and Management
Brandeis University

> "Tax revision should never be made the football either of partisan or class politics but should be worked out by those who have made a careful study of the subject in its larger aspects…."
>
> U.S. Secretary of the Treasury, Andrew Mellon - 1924

Tax policy should reflect our country's core values – fairness, equity and equal opportunity. Yet our collective definition of fairness and equity, like our Constitution, continues to evolve. Perhaps this evolution caused the Internal Revenue Code to grow to two volumes of more than 2,500 pages and five volumes of Federal Tax Regulations 1994 with almost 6,500 pages.[1] As our country has grown, so has the complexity of our tax code. Adding to the complexity of the most recent tax law changes are uncertainty and instability because most changes terminate or sunset in or before 2010. President Bush, like all his predecessors, uses "tax fairness" as one goal of the tax policy changes. However, our newest tax law is not fair; the "expanded" child tax credit omitted 12 million children; the failure to index the alternative minimum tax to inflation will result in the encroachment of this tax on middle class married taxpayers[2]; and projections of the impact of the new law show reduced long-term economic growth.[3]

An empirical review of the new law indicates bias and benefit to the wealthy. This paper will highlight certain provisions of our newest tax law and identify different concepts of fairness relative to tax policy.

## I. Historical perspective

A review of the formative years of U.S. tax policy beginning in 1789 shows the changing of concepts of fairness over time, the increasing complexity of our tax laws and the increasing reliance on non-elected representative experts in creating tax policy. Tariffs, the primary means of federal finance in 1789, constituted 90% of federal tax revenues between 1789 and 1815.[4]

---

[1] Hall, Robert E. & Rabushka, Alvin, *The Flat Tax*, at p. 5 (2d ed., Hoover Institution Press 1995).

[2] Leonard Burman et al., *The AMT:Projections & Problems*, *Tax Notes*, THE BROOKINGS INSTITUTION, July 7, 2003 ("Because the AMT prohibits deductions for dependents, 64% of married couples with children will face the AMT, 97% among those couples with income between $75,000 and $100,000."), *available at* http://www.brookings.edu/views/articles/gale/20030707.htm.

[3] William G.Gale, *Short-term Stimulus, Long-Term Growth and JGTRRA*, Testimony to United States Senate, Democratic Policy Committee (June 9, 2003), http://www.brookings.edu/views/testimony/gale/20030609.htm.

[4] Brownlee, W. Elliot, *Federal Taxation in America – A Short History*, at p. 16 (Woodrow Wilson Center Press 1996).

State and local governments relied primarily on property tax revenues. Tariffs, excise taxes and property taxes are relatively simple administratively, yet are highly regressive, causing individuals with "lower incomes [to be] taxed at higher rates than those with higher incomes".[5]

Evolving notions of fairness culminated in the first U.S. income tax in 1861. The "first U.S. tax was a low, simple tax, with a large exemption".[6] This tax was not graduated and imposed a 3% rate on all incomes above a personal exemption of $800. This tax was the earliest American example of an income tax known as a "flat tax", one of horizontal equity. Horizontal equity means that "people under similar circumstances should bear similar tax burdens".[7] Tax rates became graduated, as they are today, taxing lower incomes at a lower percentage and higher incomes at a higher percentage. This concept of tax fairness, one of vertical equity is known as "ability to pay" tax policy.

As the two-party political system grew, so did ideological conflict between horizontal and vertical equity. As our country grew so did our reliance on the income tax and other forms of tax revenue. As taxes increased, so did complexity and the use of major loopholes in tax policy (in the form of exemptions, deductions and exclusions). Empirical research indicates public support for taxation appears greatest during times of crisis, economic or military. The last two decades, however, have been periods of increasing anti-government and anti-tax sentiment.

Tax policy changes often occur where revenue is needed for war purposes, military spending, to minimize economic stress, and for desirable programmatic changes, such as Social Security and Medicare. World War I sedimented our income tax system. Then U.S. Treasury Secretary Andrew Mellon increased the influence of the U.S. Treasury and the administrative bureaucracy to enforce, collect and clarify tax policy. In 1913 only .4 percent of the population filed tax returns.[8] In 1914 (after World War I began) the tax base was expanded by reducing the large exemptions. The political climate favored "ability to pay" tax policy. This was a period of highly progressive taxation, anti-special privilege, and breaking up wealth concentration. Taxation was embraced as a tool to achieve social justice.

Tax policy during this period was often called "soak the rich" income taxation. Income taxation was transformed from an "experimental" "tentative" tax to the "foremost instrument of federal taxation".[9] President Wilson also imposed the first significant tax on corporate profits which aroused much hostility in the business community. Wilson's tax policy included the sale of war bonds to middle class Americans to reduce consumption and increase savings. The Treasury administration developed (and appears to have retained) significant autonomy.[10]

In 1921 Republicans assumed control of the presidency and Congress. Tax reform and reduction became a priority. Redistributional politics were attacked. Substantial tax reductions to corporations and wealthy individuals were granted. The excess profits tax was abolished. "In response to intense lobbying…a wide range of special tax exemptions and deductions" were enacted. Preferential taxation of capital gains occurred during this time.[11] These "amounted to new expenditure programs by creating pockets of privilege within the tax code."[12]

---

[5] *Id.* at 25.
[6] *Id.* at 10.
[7] Hall, Robert E. & Rabushka, Alvin, *The Flat Tax,* at p. 27 (2d ed., Hoover Institution Press 1995).
[8] *Id.* at 21
[9] Brownlee, W. Elliot, *Federal Taxation in America – A Short History*, at p. 51 (Woodrow Wilson Center Press 1996).
[10] *Id.* at 57.
[11] *Id.* at 60.
[12] *Id.* at 60.

 This article © 2004 Debra Rahmin Silberstein

The Great Depression produced further changes and philosophical shifts in tax policy. President Hoover's goal of "short-term" economic stimulation and revenue growth through tax cuts and increases in the public works budget created huge deficit spending. Bush's tax plan under JGTRRA appears similar in philosophy to Hoover's plan. In response to the huge deficits, the 1932 Revenue Act increased top marginal tax rates for individuals from 25 to 63 percent. Our next President, Roosevelt, favored "ability to pay" taxation.[13] Roosevelt was successful in increasing income tax progressivity in the Revenue Acts of 1935 and 1937. Effective rates on the wealthy would soon exceed World War I levels.[14]

The payroll tax enacted in 1935 as a part of the Social Security system was regressive, offsetting the progressiveness of Roosevelt's income tax policy.[15] Then U.S. Secretary Henry Morgenthau "conducted a war against tax loopholes and evasion".[16] "The Roosevelt administration did not redistribute income through taxation to any great extent, but overall, the tax system had become somewhat more progressive."[17] The federal government's revenue capacity was significantly enhanced during this period.

"World War II produced a mass-based income tax."[18] The Revenue Reform Act of 1941 lowered exemptions and increased tax rates on the upper middle class.[19] One important tax policy change was the new system of "collection at the source", withholding taxes through payroll deductions.[20] Between 1939 and 1945 the number of income taxpayers increased from 4 million to 43 million.[21] Federal income tax collections from 1939-1945 increased from $2.2 billion to $35.1 billion.[22]

Post World War II tax policy was very much influenced by Keynesian economics. Tax policy "de-emphasized progressive taxation and promoted capital investment for wealthy taxpayers and corporations."[23] Economic growth through tax reduction and flatter (more horizontal) tax rates became common goals of both political parties. Nevertheless, top marginal tax rates remained relatively high (over 90% for individuals and from 52-77% for corporations).

Tax expenditures, such as the mortgage interest deduction which began in 1913, grew significantly in the 1960s and 1970s as a mechanism to achieve social policy objectives. Unfortunately, these tax expenditures are not highly visible to the public and often act to sediment existing inequalities. They are tools used by individuals and groups with economic power that make our "fair tax" policy a fictional symbol of equity.

Kennedy supported economic stimulative tax policies, corporate and personal income tax cuts, capital gain reduction, the investment tax credit and accelerated depreciation.[24] Kennedy's

[13] Brownlee, W. Elliot, *Federal Taxation in America – A Short History* (Woodrow Wilson Center Press 1996).
[14] Thorndike, Joseph J. & Ventry, Dennis J., Jr., *The Ongoing Debate Tax Justice*, (The Urban Institute Press 2002).
[15] Brownlee, W. Elliot, *Federal Taxation in America – A Short History*, at p. 82 (Woodrow Wilson Center Press 1996).
[16] Thorndike, Joseph J. & Ventry, Dennis J., Jr.., *The Ongoing Debate Tax Justice,* at p. 34 (The Urban Institute Press 2002).
[17] Brownlee, W. Elliot, *Federal Taxation in America – A Short History*, at p.82 (Woodrow Wilson Center Press 1996).
[18] Thorndike, Joseph J. & Ventry, Dennis J., Jr., *The Ongoing Debate Tax Justice* (The Urban Institute Press 2002).
[19] Brownlee, W. Elliot, *Federal Taxation in America – A Short History* (Woodrow Wilson Center Press 1996).
[20] *Id.* at 94.
[21] *Id.*
[22] Brownlee, W. Elliot, *Federal Taxation in America – A Short History* (Woodrow Wilson Center Press 1996).
[23] Thorndike, Joseph J. & Ventry, Dennis J., Jr., *The Ongoing Debate Tax Justice,* at p. 35 (The Urban Institute Press 2002)
[24] Thorndike, Joseph J. & Ventry, Dennis J., Jr.., *the Ongoing Debate Tax Justice,* at p. 45 (The Urban Institute Press 2002).

 This article © 2004 Debra Rahmin Silberstein

Revenue Act of 1964 reduced tax rates by an average of 20%. Thus commencing a period of tax reduction, which has not stopped (barring a period in the early 90s when the highest income taxpayers saw their tax rates increase twice with OBRA 90 and OBRA 93). The Tax Reform Act of 1969 reduced the maximum rate on wage and salary income to 50%. In the Economic Recovery Act of 1981 (ERTA), Reagan undertook a "massive reduction in taxes".[25] "ERTA reduced the role of the income tax for the nation's revenue system for the first time since the Great Depression."[26] The Tax Reform Act of 1986, under President Reagan, lowered the top rate to 33% and simplified the rate schedule to 3 brackets, broadening the tax base and lowering marginal rates.[27]

With two decades of tax cuts, increases in government spending and an economic recession, President Bush, focusing on deficit reduction, agreed to increase tax rates on the highest incomes through OBRA 90.[28] President Clinton also focused on the need for deficit reduction, and, as a part of OBRA 93, added two new tax rates on the highest incomes, increasing income tax progressivity. A period of sustained economic growth followed. Daniel Ventry Jr. points out that reform in this period, 1964-1999, was not the result of crisis (war or economic depression) but "reflected changes within the economics profession and its influence within the tax policymaking process".[29] Others note a growing anti-government movement which began in the late 70s and has built momentum through the 1990s.

## II. Introduction to JGTRRA

On May 28, 2003, President Bush signed a $350 billion tax-cut bill into law. The bill, Jobs and Growth Tax Relief Reconciliation Act of 2003 ("JGTRRA")[30] passed the House (231-200) and the Senate (51-50) on May 23, 2003.[31] The President's initial proposal was for a $726 billion tax cut over ten years. JGTRRA, in part, amends The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA").[32] Provisions relative to the Child Tax Credit, the Standard Deduction and the Marriage Penalty, Capital Gains, and Dividends are reviewed and their fairness assessed.

JGTRRA is the third significant tax cut President Bush signed into law. The President's intent was to "increase tax fairness" and "encourage enterprise" by allowing "the typical American family of four [to] be able to keep at least $1,600 more of their own money."[33] Reports do not yet indicate an economic boost from these cuts. Bush remains hopeful and claims

---

[25] Brownlee, W. Elliot, *Federal Taxation in America – A Short History* (Woodrow Wilson Center Press 1996).
[26] *Id.* at 17
[27] Thorndike, Joseph J. & Ventry, Dennis J., Jr., *The Ongoing Debate Tax Justice,* at p. 45 (The Urban Institute Press 2002).
[28] Brownlee, W. Elliot, *Federal Taxation in America – A Short History*, at p.82 (Woodrow Wilson Center Press 1996).
[29] *Id.* at 52
[30] *Jobs and Growth Tax Relief Reconciliation Act of 2003*, Pub. L. No. 108-27, 117 Stat. 752 (codified as amended in scattered sections of 26 U.S.C.).
[31] Prior to signing the bill, President Bush criticized it for being too small to significantly help the economy. Judy Keen, *Politics behind Bush's Tax Reversal*, USA TODAY, May 23, 2003. "Why the reversal? Political reality intervened. Moderate Republicans in the Senate would not vote for more than $350 billion, and Bush decided that any tax cut is better than no tax cut." *Id.*
[32] *Economic Growth and Tax Relief Reconciliation Act of 2001*, Pub. L. No. 107-16, 115 Stat. 38 (codified as amended in scattered sections of 26 U.S.C.).
[33] *The President's Agenda for Tax Relief* at 1, http://www.whitehouse.gov/news/reports/taxplan.html.

 This article © 2004 Debra Rahmin Silberstein

that the recent rise in the stock market shows increasing investor confidence. Others acknowledge that a short-term economic boost is likely but remain skeptical about the impact of the tax cuts on long-term growth.[34]

*a. The Child Tax Credit*

Currently, an individual is allowed a $600 tax credit for each qualifying child.[35] JGTRRA increases this tax credit to $1,000 for 2003 and 2004.[36] In 2005 the child tax credit will return to lower levels set by EGTRRA:

| Year | Child Tax Credit |
|---|---|
| 2005-2008 | 700 |
| 2009 | 800 |
| 2010 | 1,000 |
| 2011 | 500 |

The effective date of the $1,000 child tax credit for 2003 and 2004 is December 31, 2002. JGTRRA provides that in July 2003 (and not later than October 2003), taxpayers whose 2002 tax returns claimed a child tax credit will be advanced an amount on their 2003 child tax credit.[37] [38] The "advanced payments" are estimated to "result in checks of up to $400 per eligible child to be sent to 25 million households in early July".[39] The legislative intent behind the advance is to promote economic recovery by encouraging taxpayers to spend this advance shortly after receipt.[40] In response to recent criticism that JGTRRA has not had the promised positive impact on the economy, a White House spokeswoman pointed to the fact that these advance payment checks had not yet gone out to provide the desired effect.41 Others claim JGTRRA is merely a short-term stimulus and that other policy options such as "progressive tax cuts, increased federal spending or transfers to the states, and extension of unemployment benefits" would provide the a better stimulus with "lower long-term cost" and "more equitable distribution of benefits".[42]

As evidence of the complexity of our tax legislation, even to our experts, just days after JGTRRA passed, our legislators "discovered" that 6.5 million low-income families or 12 million children were "unintentionally" omitted from this benefit. Those omitted include families (including military personnel with children) with incomes between $10,500 and $26,000. These families pay payroll tax, but not federal income tax. While Democrats are working hard to expand this credit to the 6.5 million low-income families, Republicans cite concern about the

[34] William G.Gale, *Short-term Stimulus, Long-Term Growth and JGTRRA*, Testimony to United States Senate, Democratic Policy Committee (June 9, 2003), http://www.brookings.edu/views/testimony/gale/20030609.htm.
[35] A qualifying child must be under 17. A qualifying child is a son, daughter, stepson, stepdaughter, a descendant of any of the previous, or an eligible foster child for whom the individual is able to claim a dependency exemption. (defined in I.R.C. § 24(c)).
[36] Jobs and Growth Tax Relief Reconciliation Act § 101(a).
[37] *Id.* at § 101(b) (adding I.R.C. § 6429).
[38] "Advance payments are to be made in a similar manner to the advance payment checks issued by the Treasury in 2001 to reflect the creation of the 10-percent regular income tax rate bracket." *Tax Complexity Analysis by the Joint Committee on Taxation*, LEXIS NEXIS, at 25 (2003).
[39] *Jobs and Growth Tax Relief Reconciliation Act of 2003, Special Report,* CCH TAX BRIEFING, May 28, 2003, at 6.
[40] *Id.*
[41] Danial Altman, *Jobless Rate Hits 6.4%, Highest Level in 9 Years*, N.Y. TIMES, July 4, 2003.
[42] William G.Gale, *Short-term Stimulus, Long-Term Growth and JGTRRA*, Testimony to United States Senate, Democratic Policy Committee (June 9, 2003), http://www.brookings.edu/views/testimony/gale/20030609.htm.

 This article © 2004 Debra Rahmin Silberstein

additional cost. To date, no expansion of the child tax credit has occurred with Republicans claiming the Medicare legislation must take priority.[43]

b. The Marriage Penalty

Touted as an equitable change to tax policy, Marriage Penalty Relief was a part of EGTRRA. JGTRRA accelerated the Marriage Penalty Relief provisions of EGTRRA. The "Marriage Penalty," a popular term, describes an increased tax on married couples. President Bush's Agenda for Tax Relief claims, the Marriage Penalty is a "burden" because "the marriage tax contradicts our values and any reasonable sense of fairness."[44]

Current tax law provides individual filers with a standard deduction of $4,750, married taxpayers filing jointly $7,950, and married taxpayers filing separately $3,975.[45] By marrying, a working individual potentially loses $775 of the standard deduction that was available before marriage. The penalty only applies to married taxpayers taking the standard deduction and not taxpayers who itemize deductions.

JGTRRA attempts to correct this "inequity" by increasing the standard deduction available to married couples filing jointly to $9,500 for 2003 and 2004.[46] In addition, married individuals filing separately may take the same standard deduction as single individuals during 2003 and 2004 (effectively eliminating the category of married individuals filing separately for this period).[47] Approximately three million taxpayers will benefit by the increased standard deduction. [48]

JGTRRA also accelerates EGTRRA's provisions for expanding the 15% tax bracket for married couples filing jointly. Under JGTRRA, the 15% bracket "is increased to twice the width of the 15-percent regular income tax rate bracket for single returns for taxable years beginning in 2003 and 2004 only."[49] Under EGTRRA (existing law), this increase to double the width of the 15% regular income tax rate would not occur until 2007 and would be repealed in 2010. Under JGTRRA, after 2004, the tax rate tables follow EGTRRA and are repealed in 2010.[50]

The Internal Revenue Code needs to be looked at in totality to determine whether exemptions, exclusions or deductions exist to offset the alleged "Marriage Penalty." For example, the child tax credit, the ability to roll over a deceased spouse's retirement assets, and the unlimited tax-free gifting provisions for spousal transfers provide substantial tax benefits to married persons. One might also examine whether the marriage penalty relief accrues to primarily white middle class persons and whether non-white working people receive the same level of benefit from JGTRRA.

*c. Individual Tax Rate Reductions*

(i) The 10% Bracket

Again, accelerating EGTRRA's tax relief JGTRRA increases the taxable income levels falling under the 10% bracket. Relief is temporary and only applies in 2003 and 2004. Current

[43] *Democrats Urge Bush to Press hard on Tax Credit*, N.Y. TIMES, June 26, 2003.
[44] *The President's Agenda for Tax Relief* at 2 and 3, http://www.whitehouse.gov/news/reports/taxplan.html.
[45] IRC § 63(c).
[46] Jobs and Growth Tax Relief Reconciliation Act § 103.
[47] *Id.*
[48] Matthew Bender, *The Jobs and Growth Relief and Reconciliation Act of 2003 an Analysis*, LEXIS NEXIS, July 2003 at 7, http://www.lexisone.com/news/library/taxact03.pdf.
[49] *Id.*
[50] What will happen in 2010 depends on future tax legislation; however, any provisions in EGTRRA expire in 2010.

 This article © 2004 Debra Rahmin Silberstein

law sets the 10% tax bracket at $6,000 for single individuals and $12,000 for married individuals filing jointly. EGTRRA scheduled this amount to increase starting in 2008 to $7,000 for single individuals and $14,000 for married individuals filing jointly. Under JGTRRA, these higher income levels receive 10% income tax treatment in 2003 and 2004. After 2004 and before 2008, the income under the 10% bracket will return to prior levels. After 2010, the 10% bracket will fall out of the tax rate table.

(ii) The 15% Bracket

This bracket remains unchanged by JGTRRA except to the extent that the 10% bracket has expanded making the 15% bracket start at a higher income level.

(iii) The 28%, 31%, 36%, and 39.6% Brackets

These tax brackets, effective before EGTRRA, were to be reduced over a six year period by EGTRRA, to 27%, 30%, 35%, and 38.6%. In 2006 the rates were scheduled for further reduction to 25%, 28%, 33%, and 36%. In 2010 rates will return to pre-EGTRRA levels. JGTRRA makes what was to be effective in 2006 effective for 2003 until 2010. The new tax brackets for ordinary income, effective December 31, 2002, are 10%, 15%, 25%, 28%, 33%, and 36%. The 28%, 31%, and 36% brackets decreased by 3%, and the 39.6% bracket decreased by 3.6%. The highest income taxpayers are getting the greatest income tax relief. It is noteworthy that the highest rates are almost as low as they were under the Tax Reform Act of 1986 when the top rate was set at 33%.

As an example of one complication caused by JGTRRA, in 2003 the tax bracket changes will result in "overwithholding".[51] For instance, since the 10% bracket in the beginning of the 2003 applied only to the first $6,000 of income and now applies to the first $7,000 of income, many individuals will have too much tax withheld from their paychecks. This will result in a refund after filing 2003 tax returns. "Congress intends that taxpayers who have been overwithheld as a consequence of these amendments should be able to obtain a refund of this overwithholding through the normal process of filing an income tax return, and not through the payor."[52]

*d. The Alternative Minimum Tax*

The Alternative Minimum Tax ("AMT") is "the excess (if any) of the tentative minimum tax for the taxable year, over the regular tax for the taxable year."[53] The AMT uses a different income definition, allowable deductions and rate structure.[54] For example, the AMT does not allow deductions for dependents.[55] The AMT applies to both individual (non-corporate) and corporate taxpayers. The AMT first took effect in 1970. It was enacted to capture a small minority of high income taxpayers who were able to escape the regular income tax.

There is serious concern that the AMT will apply to millions of new taxpayers in the middle-income range at some point in the future.[56] Burman, Gale and Rohaly project 33 million

[51] Matthew Bender, *The Jobs and Growth Relief and Reconciliation Act of 2003 an Analysis*, LEXIS NEXIS, July 2003 at 10, http://www.lexisone.com/news/nlibrary/taxact03.pdf.
[52] *Id*. at 10-11.
[53] IRC § 55(a).
[54] Len Burman et al., *The AMT: Projections and Problems*, TAX NOTES, July 7, 2003.
[55] *Id.*
[56] *Jobs and Growth Tax Relief Reconciliation Act of 2003, Special Report,* CCH TAX BRIEFING, May 28, 2003, at 7.

 This article © 2004 Debra Rahmin Silberstein

taxpayers will be affected by the AMT by 2010. This would be an increase of 1 million taxpayers from 1999. The expansion of the AMT will occur, in part, because the tax was not indexed to inflation. There is also concern that many individual taxpayers will see their taxes increase after JGTRRA by way of the AMT.[57] The AMT is known to be "one of the most complicated tax provisions to comply with".[58] JGTRRA has increased exemption amounts so that a single filer is exempt with income of $40,250 and married filers are exempt with income up to $58,000.[59] But the increased AMT exemption only applies in 2003 and 2004. Experts remain concerned about the unintended AMT tax burden on millions of taxpayers previously out of its reach.[60]

*e. Capital Gains Rates*

Most capital gain is not taxed as ordinary income and is subject to its own rate table. Short-term capital gain, gain from an asset held for less than one year, is taxed as ordinary income.

JGTRRA reduced the capital gains tax rates by 5% cutting the maximum rate from 20% to 15% and the 10% rate for lower income taxpayers to 5%.[61] The reduced rates apply to long-term capital gain (gains derived from assets held one year or longer) and for "both regular tax and AMT purposes."[62] The lower rates were effective immediately, as of May 6, 2003. In 2008, the 5% rate for low-income taxpayers drops to zero for one year only. Effective January, 2009, pre-JGTRRA rates of 20 and 10 percent return.[63] Certain assets such as "collectibles" remain subject to the 28% maximum rate.[64]

Under prior law, property held for five years or longer was subject to an 18% or 8% tax on capital gain, depending on the individual taxpayer's income level. Many taxpayers relied on the five-year holding period category and timed sale transactions accordingly, only to find that under the newer law no sale would have been necessary.[65] [66] It is speculated that these taxpayers may be able to rescind the election of the deemed sale.[67] This is another example of the challenges in our tax code.

The capital gains tax reductions made by the Taxpayer Relief Act of 1997 (TRA 97) resulted in a "flood of revenue" due to the then stock market boom. Today, there is "little unrealized gain waiting to be freed by the 15 percent rate".[68] While empirical research often emphasizes the "potentially large response elasticities to capital gain reductions" evidence shows that few taxpayers realizing capital gain are utilizing avoidance strategies (changes in the law) the

---

[57] *Id.*
[58] Len Burman et al., *The AMT: Projections and Problems*, TAX NOTES, July 7, 2003.
[59] The previous exemption amounts were $35,750 for single filers and $49,000 for married filers.
[60] *Jobs and Growth Tax Relief Reconciliation Act of 2003, Special Report,* CCH TAX BRIEFING, May 28, 2003, at p. 7.
[61] IRC §1(h)(1)(C).
[62] *Jobs and Growth Tax Relief Reconciliation Act of 2003, Special Report,* CCH TAX BRIEFING, May 28, 2003, at p. 2.
[63] *Id.*
[64] *Id.*
[65] *Id.* at 3.
[66] The deemed sale was of any appreciation that occurred before 2001, therefore a tax on that gain was taxed, and was supposed to subject any post 2001 appreciation to the new rate if held for five plus years. *Id.*
[67] *Jobs and Growth Tax Relief Reconciliation Act of 2003, Special Report,* CCH TAX BRIEFING, May 28, 2003, at p. 2.
[68] *Id.*

 This article © 2004 Debra Rahmin Silberstein

empirical theorists would predict.[69] Tax avoidance planners are contemplating transferring appreciated assets to children over 13 (children are taxed at their own, often reduced, tax rate) to further reduce the capital gains tax. "Savings in 2008 could be dramatic using this technique".[70] This temporary reduction in capital gains tax, for the most part, applies to individuals who have been able to attain assets through savings.

Some assessment is necessary to determine who this tax change impacts and how. It does not appear to be consistent with President Bush's goal of "lowering barriers to the middle class".[71] In fact, this cut appears to further sediment wealth inequalities by allowing the wealthy (defined as those who have been able to accumulate assets and realize gain) another tax avoidance mechanism.

It is noteworthy that the "spread between the highest tax bracket rate and the capital gains tax rate" pre-EGTRRA was 18.6% (38.6%-20%) and is now 20% (35%-15%) making realization of capital gain more valuable than short term gain or ordinary income.[72]

*f. Treatment of Dividends*

Generally under current law, dividends are treated as ordinary income and top bracket taxpayers could pay as much as 38.6% on dividends received.[73] Many argue that this is unfair and double taxation, because dividends are taxed first as corporate profits and income, and second, upon distribution, to shareholders at the individual level.

The double taxation of dividends was a particular bête noire for President Bush. Earlier drafts of Bush's tax reform agenda included tax-free treatment of dividends at the individual level.[74] JGTRRA represents a compromise between tax-free treatment and the double taxation of dividends. Under JGTRRA, dividend income received "from a domestic or qualified foreign corporation will be taxed at a maximum rate of 15% for most taxpayers."[75] Lower income taxpayers will pay a dividend income tax of 5%. These reduced rates, again, are temporary. The 15% rate "sunsets" in 2009. The 5% rate sunsets in 2007 and is "0" in 2008. Higher JGTRRA rates will be in effect in 2009.[76]

The sunset dates complicate the tax relief. Determination of what constitutes "qualified dividend income" to be taxed as capital gain is expected to create new rules and regulations for both corporations and shareholders.

---

[69] Slemrod, Joel B., *Does Atlas Shrug? The Economic Consequences of Taxing the Rich* (Harvard University Press 2000); Alan J. Auerback, Leonard E. Burman and Jonathan M. Siegal, *Capital Gains Taxation and Tax Avoidance:New Evidence* from Panel Data at 386.

[70] *Jobs and Growth Tax Relief Reconciliation Act of 2003, Special Report,* CCH TAX BRIEFING, May 28, 2003, at p. 2.

[71] *The President's Agenda for Tax Relief* at p. 2, http://www.whitehouse.gov/news/reports/taxplan.html.

[72] *Jobs and Growth Tax Relief Reconciliation Act of 2003, Special Report,* CCH TAX BRIEFING, May 28, 2003, at p. 2.

[73] Hall, Robert E. & Rabushka, Alvin, The Flat Tax at p. 5 (2d ed., Hoover Institution Press 1995).

[74] H.R. REP. NO. 108-37, at 6 (2003), *reprinted in* 2003 WL 1335789 (Leg.-Hist.) (that the elimination of the double taxation of corporate earnings would accommodate President Bush's plan for growth and jobs).

[75] *Jobs and Growth Tax Relief Reconciliation Act of 2003, Special Report,* CCH TAX BRIEFING, May 28, 2003, at p. 2.

[76] *Id.*

 This article © 2004 Debra Rahmin Silberstein

To be considered "Qualified dividend income":

- The source of the dividend must be a domestic corporation or a qualified foreign corporation[77];
- The stock on which the dividend was issued must be held "for more than 60 days during the 120-day period beginning 60 days before the ex-dividend date"[78];
- "The taxpayer is [not] obligated to make related payments with respect to positions in substantially similar or related property."[79]

Qualified dividend income specifically excludes:

- "Dividends received from an organization that was exempt from tax under IRC Section 501 or was a tax-exempt farmers' cooperative [see IRC § 521] in either the taxable year of the distribution or the preceding year"[80];
- "Dividends received from a mutual savings bank that received a deduction under IRC Section 591"[81];
- "Deductible dividends paid on employer securities [see IRC § 404(k)]"[82];
- "[A]ny amount the taxpayer takes into account as investment income for purposes of determining the amount of deductible investment interest [see IRC § 1(h)(11)(D)(i)]."[83]

Dividend reduction provides much greater benefits to higher income taxpayers. For example, pre-JGTRRA law would impose a tax on $100,000 dividend income (assuming highest rate 38.6) of $38,600. Under JGTRRA, the tax liability is $15,000, a tax reduction of $23,600. For a taxpayer in the 10% bracket JGTRRA would reduce the tax on $100 dividend income from $10 to $5.[84] Again, Bush's plan appears to benefit the wealthy and conflicts with his stated goal of making "life better for average men, women and children."[85]

Of note, dividends paid into a "tax free fund" such as 401Ks, IRAs do not qualify for the new reduced tax rate. The rationale is that no taxes are due as these dividends are paid into tax-free funds. To the extent tax policy influences behavior, people may save less for retirement, particularly older persons, as they will be likely to pay income tax on their retirement assets soon and there is less current benefit to utilizing these retirement savings devices, 401Ks, IRAs. If their tax bracket is greater than 15%, utilizing these deferred income tax retirement devices could cost them more in income tax.

---

[77] "A 'qualified foreign corporation' is an entity incorporated within a U.S. possession or is eligible for the benefits of comprehensive U.S. tax treaty. However, dividends paid by a foreign company that is not 'qualified' are eligible for the lower rates if the stock of the corporation is traded on an established U.S. equities market." *Id.*

[78] Matthew Bender, *The Jobs and Growth Relief and Reconciliation Act of 2003 an Analysis*, LEXIS NEXIS, July, 2003 at p. 19, http://www.lexisone.com/news/nlibrary/taxact03.pdf.

[79] *Id.*

[80] *Id.* at 19-20.

[81] *Id.* at 20.

[82] *Id.*

[83] *Id.*

[84] *Jobs and Growth Tax Relief Reconciliation Act of 2003, Special Report,* CCH TAX BRIEFING, May 28, 2003, at p. 4.

[85] The President's Agenda for Tax Relief at 1, http://www.whitehouse.gov/news/reports/taxplan.html.

 This article © 2004 Debra Rahmin Silberstein

## III. Conclusion

The examples outlined from JGTRRA, the Child Tax Credit, Marriage Penalty Relief, Individual, Capital Gain and Dividend Income Tax reductions appear to benefit, in a big way, the wealthy. The slivers thrown lower income taxpayers are relatively small compared to the benefits provided higher income taxpayers. The changes increase complexity in the tax code and instability in planning, a technique often used to benefit the wealthy. Bush's plan does not appear to address the structural problems in our economy, i.e. provide job skills, job training, job growth and opportunity to Americans who need the most help. Recent reports indicate that our economy continues to lose jobs and "a stubbornly weak labor market continues to defy all expectations of a rebound".[86] JGTRRA is projected to worsen growing income inequality. A 2003 Federal Reserve Study showed a 19.3% increase in pre-tax incomes of the top 10% of Americans between 1998 – 2001 compared to an 11.9% increase for the rest of Americans.[87] "The new tax provisions will raise the after-tax income of Americans making more than $1 million by 4.4 percent while raising the average American's income by only 1.8 percent. More than 70 percent of households will receive $500 or less."[88]

Bush's tax policy under JGTRRA continues our trend toward tax reduction. It also fuels anti-tax and anti-government sentiment. Other presidents combined tax reduction with true reform. TRA 86 simplified the tax code, minimizing brackets. The Revenue Act of 1964 significantly reduced tax rates, with the purpose of achieving long-term economic growth. JGTRRA is complex and confusing. The omission of 12 million families from the Child Tax Credit was politically embarrassing. The pending encroachment of the AMT on middle class taxpayers must be addressed soon. Tax rates will change much too frequently through 2011 for anyone other than a tax expert to keep track of. Bush's focus on short-term economic stimulus is shortsighted (as was Hoover's tax policy in the early stages of the Great Depression) and will leave our nation with significant deficits. Tax relief to the wealthy in the form of reduced tax rates (on income, dividend and capital gain) was not tied to long-term growth or job development. Bush laid the groundwork for increased disparity in income and wealth accumulation. If history gives us any answers, Bush has also set the stage for the pendulum to swing toward "ability to pay" taxation and for true fairness and equity in tax policy.

---

[86] Robert Galvin, *U.S. Employers Continue to Cut Jobs*, BOSTON GLOBE, August 2, 2003.

[87] Steven Rattner, June 19, 2003, www.newsday.com, citing an analysis by the Tax Policy Center of the Brookings Institution and the Urban Institute.

[88] Steven Rattner, *Bush Tax Policy Makes Inequality a Way of Life*, NEWSDAY, June 19, 2003 (citing an analysis by The Tax Policy Center of the Brookings Institution and the Urban Institute) *available at* www.newsday.com.

 This article © 2004 Debra Rahmin Silberstein