Volume Title: The Personal Exemptions in the Income Tax

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Volume Publisher: NBER

Volume ISBN: 0-870-14482-0

Volume URL: http://www.nber.org/books/selt68-1

Publication Date: 1968

Chapter Title: Sketch of the Legislative History of the Personal Exemptions in the United States

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Chapter URL: http://www.nber.org/chapters/c1148

Chapter pages in book: (p. 38 - 57)

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Sketch of the Legislative History of the Personal Exemptions in the United States

A review of the legislative history of the personal exemptions in the United States indicates that, although the cost of living (in a general undefined way) and administrative considerations have always received Congressional attention in determining the amounts of the personal exemptions, revenue needs have commonly played the strongest role.[1] On the whole, however, changes in the personal exemptions have been relatively infrequent except during wartime.

THE CIVIL WAR THROUGH WORLD WAR II

1. *The Civil War Period*

In the very first federal income tax to go into effect, that of 1862, when collection machinery had to be hastily improvised, the heavy revenue needs of the Civil War led Congress to set the personal exemption at $600, both for excluding persons with incomes of this amount or less and as a deduction from otherwise taxable income, but without additional allowance for married couples and dependents. This level was continued until 1869, when the exemption was raised to $2,000, and when provision was made for cessation of the tax in 1872. A new

[1] Cf. Paul Strayer, "The Significance of Exemption and Deductions for Low-Income Taxpayers," *Federal Tax Policy for Economic Growth and Stability*, Joint Committee on the Economic Report, 84th Congress, 1st Session, 1955, p. 339, and J. P. Crocket, *Federal Tax System of the United States*, New York, 1955, p. 22.

income tax, levied at 2 per cent on the taxable income of individuals and corporations, was enacted in 1894. It was ruled unconstitutional by the Supreme Court in the following year on the ground that it was a direct tax, which was required by the Constitution to be apportioned among the states according to their populations.[2]

2. *Revenue Act of 1913*

The 16th Amendment authorized a federal income tax without apportionment among the states, and the first income tax measure (1913) was enacted as Section II of an "Act to Reduce Tariff Duties and to Provide Revenue for the Government and Other Purposes." Its revenue objective was only $70 million—the amount needed to offset concurrent reductions in import duties.[3] Hence Congress could afford to give sympathetic consideration to the concern of the principal author of the Act, Representative Cordell Hull—that there would be administrative difficulties in starting the tax with low exemptions and mass coverage. As a result, it gave a liberal interpretation to the "standard of living" that was to be protected against the tax.[4] Said Senator John Sharp Williams: "The House framed its bill upon the theory that $4,000 was a reasonable amount, in its opinion, for an American family to live upon, with a proper standard of living, and that a sum below that ought not to be taxed." [5]

As finally enacted, the Revenue Act of 1913 exempted the first $3,000 of income of a single person and the first $4,000 of a married person; it made no allowance for other dependents. In 1916, the married person's exemption was extended to other heads of families. As in all subsequent years down to 1934, the personal exemptions were allowed for normal tax only, not for surtax. Most taxpayers did not feel this restriction because the surtax did not apply to incomes under $20,000 until 1917, and to incomes under $5,000 until 1934.

3. *World War I*

In 1917, driven by the revenue needs of World War I, Congress reduced the exemptions of married persons and heads of families by one-

[2] *Pollock* v. *Farmers Loan and Trust Co.*, 157 U.S. 429; 158 U.S. 601 (1895).

[3] Roy G. and Gladys C. Blakey, *The Federal Income Tax*, New York, 1940, pp. 76, 103.

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

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

half, and of single persons, by two-thirds—to $2,000 and $1,000, respectively. The impact of this sharp drop was somewhat softened by the introduction of an exemption, then termed a credit, of $200 for each dependent against the income otherwise subject to normal tax.

4. *The 1920's*

With the beginning of an eleven-year period of budget surpluses in 1920, increases in the level of the personal exemptions competed with other forms of tax reduction for the favor of Congress. In 1921, Congress raised the exemptions for married couples (and for heads of families) from $2,000 to $2,500 for those with net incomes not in excess of $5,000, and increased the credit for each dependent from $200 to $400. At the same time it reduced normal tax rates and the maximum surtax rates.

In 1924, as budget surpluses continued, Congress made extensive reductions in income tax rates. A credit for earned income of 25 per cent of the normal tax on such income was introduced, but changes in the personal exemptions proper were limited to adding $500 to the $2,000 exemption of married couples with net incomes in excess of $5,000, thereby bringing up their exemption to the same level as that for taxpayers with incomes of $5,000 or less. In the Revenue Act of 1926, applicable to 1925, Congress raised the personal exemptions from $2,500 to $3,500 for married couples and heads of families and from $1,000 to $1,500 for single persons. These levels were retained until 1932. Normal taxes and surtaxes were also reduced in 1926, the maximum surtax rate being cut in half, to 20 per cent.

5. *The Great Depression*

In 1932, near the bottom of the Great Depression, Congress reacted to the budgetary deficits in orthodox fashion by seeking increased revenues. The personal exemptions were reduced to $2,500 and $1,000 for married and single taxpayers, respectively, and sharp increases were made in normal and surtax rates. The exemption levels established in 1932 remained in effect for eight years.

6. *World War II*

In 1940, to help finance the greatly enlarged expenditures for national defense that were stimulated by the outbreak of World War II, Congress lowered the personal exemptions to $2,000 and $800. In 1941, defense needs were even greater, and the exemptions were reduced to

$1,500 and $750. In 1942, following America's entrance into World War II, they were lowered further to $1,200 and $500, and the credit for each dependent was cut from $400 to $350. For 1943 the regular income tax was supplemented by a flat rate tax of 5 per cent on what was specially defined as Victory Tax net income. For this purpose, each taxpayer was allowed a specific exemption of $624 plus a credit of 25 per cent of the tax for a single person, 40 per cent for a married person, and 2 per cent for each dependent, subject to the limitation that the tax credit could not exceed $100 for each dependent or $500 for any other one person. For a joint return, the specific exemption of $624 was enlarged by the spouse's income up to $624. Victory Tax revenues totaled $2.3 billion, and those of the regular individual income tax $12 billion. In 1944 and 1945, no exemptions for spouses or dependents were allowed for purposes of the normal tax.[6]

THE PER CAPITA SYSTEM

The present system of uniform per capita exemptions was initiated in 1944 as part of a program to overhaul income tax administration. The growth in the number of taxable individual returns from 3.9 million in 1939 to more than 40 million in 1943 had created strong pressure for simplified administrative procedures. The adoption of a flat $500 exemption for each person covered by an income tax return, whether husband, wife, single person, or dependent, was believed to facilitate the construction of simple tax tables for the use of taxpayers with incomes under $5,000 and of employers. Actually, the uniform per capita exemption was not established in full until 1946. In 1944 and 1945 it was made applicable only to the surtaxes, which began at 20 per cent of the first $2,000 of surtax net income; it was not applicable to the 3 per cent normal tax. For the latter, as previously noted, no allowance was made for dependents in 1944 and 1945: the taxpayer was allowed a flat exemption of $500, except that if he filed a joint return, the exemption was enlarged by the amount of his spouse's income up to $500.

By raising the surtax exemption for each dependent from $350 to $500, while reducing the surtax exemption of a married couple from

[6] Except that on a joint return a taxpayer's exemption was enlarged by the amount of his spouse's income up to $500.

$1,200 to $1,000, as well as by removing the requirement that a dependent be under 18 years of age or incapable of self-support, the 1944 Act was expected to impose a "lesser burden on the taxpayers with a large family and a greater burden on the taxpayers with a smaller family." [7] That this purpose was abundantly realized is indicated by a comparison of the exemption figures for 1943 and 1944. The exemptions allowed for dependents rose from $11.5 billion to $20.0 billion, while total personal exemptions rose by only $4.3 billion (Table 17).

The 1944 Act also included other notable changes: the adjusted gross income concept, which, by distinguishing nearly all business deductions from nonbusiness deductions, approximated net income in an economic sense, was adopted; the tax credit for earned income was eliminated; a generally applicable optional standard deduction was provided; the withholding system for the current collection from employers of tax liabilities of employees on wages and salaries was greatly expanded; and a current payment system for other kinds of income was established.

EXEMPTION INCREASE A BIG PART OF THE 1948 TAX CUTS

The $500 per capita exemption level, adopted for the surtax in 1944 and extended to the normal tax in 1946, remained in effect until 1948, a year in which a budget surplus of $8.4 billion prompted Congress to enact tax reductions estimated at $5 billion. Somewhat more than 40 per cent of the aggregate reduction was produced by enlarging the personal exemptions.[8] To provide "relief from the present high cost of living," the per capita exemption was raised to $600, and an additional exemption of the same amount was provided for age (65 and over) and for blindness.[9] The optional standard deduction was also liberalized, with the equivalent effect of further enlarging the exemptions for most taxpayers. This was done by raising the maximum standard deduction from $500 per return to $1,000 for both single persons and for mar-

[7] *House Ways & Means Committee Report No. 1365,* 78th Congress, 2nd Session, p. 5.

[8] *Annual Report of the Secretary of the Treasury,* 1948, p. 53.

[9] *House Ways & Means Committee Report No. 1274,* 80th Congress, 2nd Session, p. 3. The new $600 exemption for the blind replaced a special $500 *deduction* introduced in 1943.

ried couples filing joint returns (the limit of $500 was retained for separate returns of married couples), and the previous ceiling of 10 per cent of adjusted gross income was retained for all returns. Substantial additional cuts were made in the effective tax rates by lowering all bracket rates, and by allowing married couples filing joint returns to compute their tax liability as if their combined incomes were divided equally between the spouses. Income-splitting doubled the maximum amount of a married couple's income that was taxable at the first bracket tax rate and at each higher bracket rate. It therefore reduced the degree of progression of effective tax rates. Changes made in the rates and other provisions of the estate and gift taxes reduced their revenue yield by an estimated $250 million a year.

INCOME-SPLITTING FOR MARRIED COUPLES

Although responsible for less than one-sixth of the tax cuts made in 1948,[10] the provision of income-splitting for married couples merits special attention here because it introduced a basic change in the treatment of family income and because the form in which it was adopted provided more favorable tax treatment for married couples than for single persons. Whereas the personal exemptions were the sole means whereby differences in marital status had been previously recognized, income-splitting now introduced differences in effective tax rates as between married and single persons that far outweighed the effects of the personal exemptions for taxpayers in the upper income groups.

Unlike the situation in Great Britain, where the separate incomes of spouses have always been taxed as one, married couples in the United States have had the option of reporting and being taxed on their individual incomes either jointly or separately. Separate returns offered tax economies if a portion of the combined income was thereby prevented from falling into a higher tax bracket. While offering no tax advantage to a couple whose combined income fell wholly within the first bracket, separate returns offered increasingly substantial tax savings to those with larger incomes.

[10] On a basis measured by the estimated annual loss of revenue, and assuming personal income at $200 billion (the Department of Commerce estimate for 1948 was $208.7 billion); see *Annual Report of the Secretary of the Treasury*, 1948, p. 53.

Prior to the changes made by the Revenue Act of 1948, each spouse could report separately only the income *legally* attributable to him. This created inequalities in the tax treatment of many married couples with equal combined money incomes. Couples living in states with community-property laws, under which all or a part of a couple's income is legally regarded as divided equally between the spouses, were automatically enabled to divide at least a portion of their incomes for income tax purposes. In other states, couples with income from securities and other property, including partnership interests in business enterprises, could do so to the extent that the legal ownership of the income-yielding properties was divided between the spouses. But income earned by either spouse from personal services could not be legally attributed to the other except in community-property states.

The sharp rise in tax rates brought about by World War II increased the tax advantage enjoyed by married couples in the middle and upper income groups who could lawfully divide their incomes for tax purposes over those who could not. Between 1945 and 1947, five states—Oklahoma, Oregon, Nebraska, Pennsylvania and Michigan—newly adopted community-property laws.[11] Added to the eight original states whose community-property laws antedated the 16th Amendment—Louisiana, California, Texas, New Mexico, Arizona, Idaho, Nevada, Washington—the new adoptions brought nearly one-third of the population of the continental United States under community-property law. It seemed only a question of time before many other states would be moved to take the same action to enable their married citizens automatically to split income for purposes of the federal income tax. Congress adopted optional income-splitting for all as a means both of meeting this problem and of reducing the effective level and rate of progression of tax rates for married taxpayers with incomes above $2,000.

Unlike mandatory joint returns which, in the absence of offsetting rate adjustments would increase taxes for many and reduce them for none, the equal division of income between spouses for the purpose of income tax assessment reduces taxes substantially for many and raises them for none—assuming an unchanged rate schedule.

As incorporated in the Revenue Act of 1948 and subsequent revi-

[11] Pennsylvania's law was declared unconstitutional by its Supreme Court in November 1947; the other four states repealed their community-property laws soon after the passage of the Revenue Act of 1948.

sions, the split-income provision retains the right of husbands and wives to file separate or joint returns, but permits automatic income-splitting only to those who file joint returns. Since an equal division of income between the spouses usually minimizes tax liability, the provision eliminated nearly all incentives for separate returns except those made for reasons other than tax economy.[12] Whereas separate returns of married couples had constituted more than 18 per cent of all taxable returns in 1946, they had fallen to 4.2 per cent by 1965.

By permitting married couples filing joint returns to calculate their tax liability as if only one-half of their income was earned by each spouse, Congress went farther in two respects than the mere elimination of inequalities in the tax treatment of various married couples: (1) it materially reduced the degree of progressivity of the effective tax rate structure, and (2) it materially changed the relative tax treatment of single individuals and married couples. The effective tax rate brackets for couples filing joint returns became twice as wide as before and twice as wide as those for single individuals, *viz.:* the first bracket rate of 20 per cent became applicable to the first $4,000 instead of the first $2,000 of taxable income on joint returns, the second bracket rate of 22 per cent to the income between $4,000 and $8,000, instead of from $2,000 to $4,000, etc. Since joint returns accounted for about 70 per cent of the total adjusted gross income on taxable returns in 1948 (and nearly 80 per cent in 1965), to a considerable degree the effect of the split-income provision was to reduce tax liabilities for married members of the middle and upper income groups and to reduce the degree of progressivity of the effective tax rate structure.

This effect was at the heart of much of the controversy that pre-

[12] The principal situation in which separate returns may still offer a tax advantage is one in which the spouses have approximately equal incomes and each has an excess of capital losses over capital gains. In such cases, separate returns will enable each spouse to offset up to $1,000 of net capital loss against ordinary income—a combined offset twice as large as would be possible on a joint return. Another situation is one in which the *disallowed* portion of medical expenses—3 per cent of adjusted gross income—would be sufficiently larger with a joint than with separate returns to more than offset the saving in taxes from the lower marginal bracket rate that might be applicable to the joint return. Several other but rarer circumstances in which separate returns may reduce the aggregate tax liability of husband and wife are cited in Stanley S. Surrey and William C. Warren, *Federal Income Taxation,* Brooklyn, N.Y., 1955, p. 898, footnote 47.

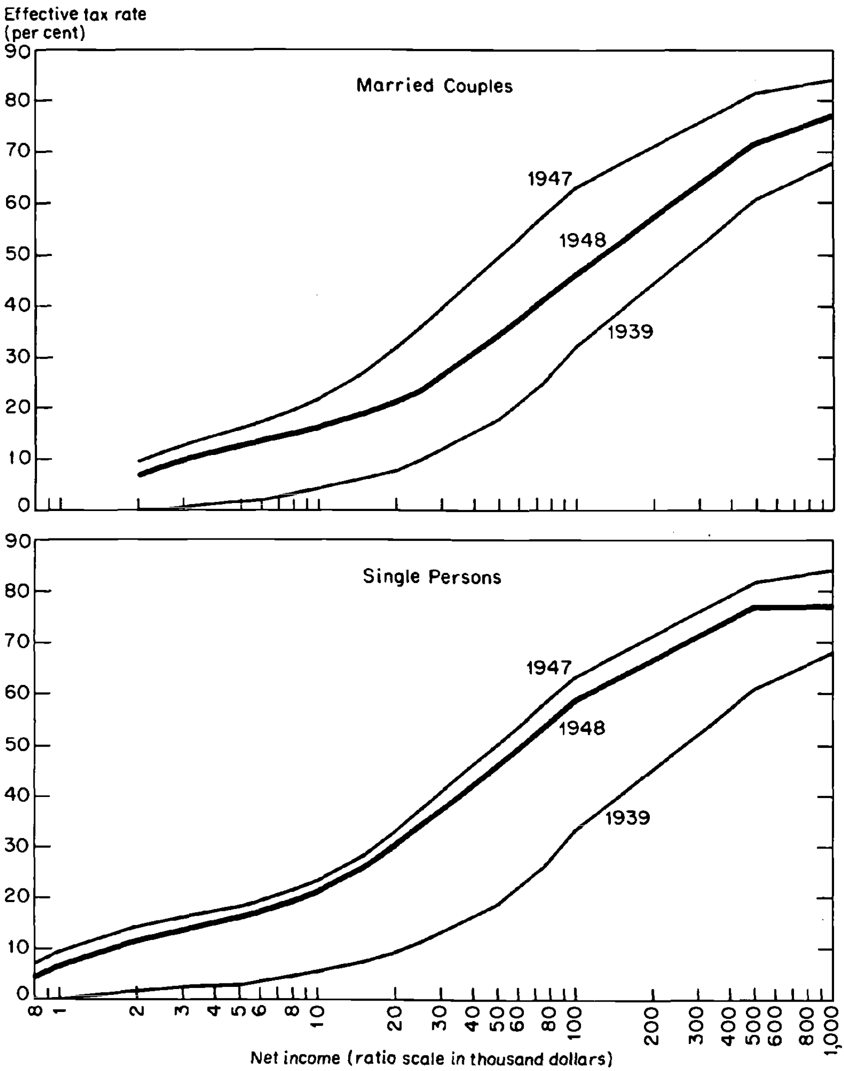
ceded and, for a time, followed the change. But the intention of Congress to reduce the level and degree of progression of income tax rates, whether by this or other means, was clear and pronounced; it was demonstrated by other parts of the Revenue Act of 1948, which included reductions in all the bracket rates and a 20 per cent increase in the per capita personal exemptions. The aggregate cuts in the effective tax rates for joint returns were substantial, particularly in the middle and upper brackets, though they accomplished only a partial retracement of the sharp wartime increases that had taken place since 1939 (see Chart 1 and Table 6); the cuts for single persons were much less marked. With nearly 80 per cent of all adjusted gross income on taxable returns now reported on joint returns, it is reasonable to suppose that the joint-return rate schedule is closer than the single-person rate schedule to the rates that would now be imposed by Congress if the split-income provision did not exist.

The great majority of married couples did not benefit at all or benefited little from income-splitting at first because their combined taxable incomes fell entirely within the first, or between the first and second, brackets. With the division of the previous first bracket into four separate ones by the Revenue Act of 1964, the tax benefits of income-splitting were extended to all joint returns reporting taxable incomes of more than $500. At the same time, the general cuts in bracket rates in that Act shrank the absolute tax-reducing value of income-splitting for middle and upper income groups, though leaving the value substantial. Whereas the maximum difference between the tax on a married couple and a single person under the rates in force between 1954 and 1963 was $25,180, reached at a taxable income of $400,000, the maximum under the 1965 rates is $14,510, reached at a taxable income of $200,000.

The reasonableness of an income-splitting provision that creates such a wide difference between the effective tax rates applicable to married couples and those applicable to single persons with equal taxable incomes is disputed by scholars, though there appears to be little dispute among legislators. This differential treatment was not essential to the removal of the main tax incentives for filing separate returns by spouses; that could have been accomplished by any rate schedule with tax brackets one-half as wide for separate as for joint returns of married couples.

CHART 1

Level and Progression of Effective Tax Rates Resulting from 1948 Income Tax Changes Compared with 1939 and 1947: Single Persons' and Married Couples' Tax Liability as a Percentage of Net Income
(adjusted gross income less nonbusiness deductions)



SOURCE: Table 6.

TABLE 6

Tax Liability as a Percentage of Selected Net Incomes, Single Persons and Married Couples Without Dependents, 1939, 1947, and 1948

	Married Couples			Single Persons		
Income	1939	1947	1948	1939	1947	1948
$ 525					0.9	
600					3.2	
800					7.1	4.2
900					8.4	5.5
1,000					9.5	6.6
2,000		9.5	6.6	1.6	14.3	11.6
2,500		11.4	8.6			
3,000	0.3	12.7	10.0	2.3	16.2	13.6
5,000	1.6	16.0	12.6	2.8	18.4	16.2
6,000	1.9	17.4	13.6	3.6	19.5	17.3
8,000	3.1	19.7	15.1	4.7	21.5	19.3
10,000	4.2	21.9	16.2	5.6	23.5	21.2
15,000	6.2	27.0	18.9	7.4	28.5	26.0
20,000	7.9	32.0	21.2	9.2	33.2	30.4
25,000	10.0	36.3	23.5	11.2	37.5	34.4
50,000	17.7	49.6	34.4	18.7	50.3	46.4
75,000	25.0	57.5	41.4	26.0	58.0	53.6
100,000	32.5	63.1	46.4	33.4	63.5	58.8
500,000	60.8	81.5	71.9	61.0	81.6	77.0
1,000,000	67.9	84.0	77.0	68.0	84.0	77.0
5,000,000	75.8	85.5	77.0	75.8	85.5	77.0

SOURCE: *Annual Report of the Secretary of the Treasury*, 1950.

As it stands, the income-splitting provision presents aggravated problems in the cases of single persons with dependents.[13] Congress made concessions for a limited category of such single persons, called "heads of households," in 1951 by giving them a separate rate schedule incorporating approximately one-half the benefits of income-splitting. In 1954, widows and widowers with dependent children were given the same rate status as married couples for two years after the death of the spouse, and the heads-of-household category was enlarged to include single persons who support one or more parents in

[13] See Joseph A. Pechman, "Income-Splitting," *Tax Revision Compendium*, Committee on Ways and Means, Washington, 1959, pp. 474–486.

a separate home. These concessions do nothing, however, for other single persons who contribute to the support of dependents. Even where there are no dependents, the question remains whether the rate differences between single persons and married couples are not too great. It may be noted that no change in income-splitting would be needed to ease the relative tax treatment of single persons if Congress should decide to do so. As Pechman has pointed out, a separate rate schedule could be established for single persons containing rates or brackets more favorable to them in any desired degree than the present ones, just as a separate rate schedule now exists for heads of households.[14]

DEFEAT OF TAX CREDITS AS SUBSTITUTE FOR THE EXEMPTIONS

The tax reductions of 1948 were strongly opposed by President Truman and Secretary of the Treasury Snyder on the ground that a balanced budget with a surplus for debt reduction was needed to combat the then-prevailing inflationary pressures. Asserting that "the $500 per capita exemption system would endanger the health and living standards of large segments of the population if retained for many years," the Administration proposed the addition of a $40 *per capita* tax credit, instead of an increase in the exemptions, as a means of giving immediate relief to the lower income groups, and proposed to recoup the resulting loss in revenue by an increase in taxes on corporate profits.[15] It was estimated that the $40 tax credit, together with the $500 personal exemption would be the equivalent of more than a $700 per capita exemption at the bottom of the income scale, and would concentrate 93 per cent of the resulting income tax reduction among individuals with incomes under $5,000.[16] About 13.3 million of the 52.1 million taxpayers would have been altogether freed from tax, it was estimated.

The tax credit would have had the same absolute tax-reducing value

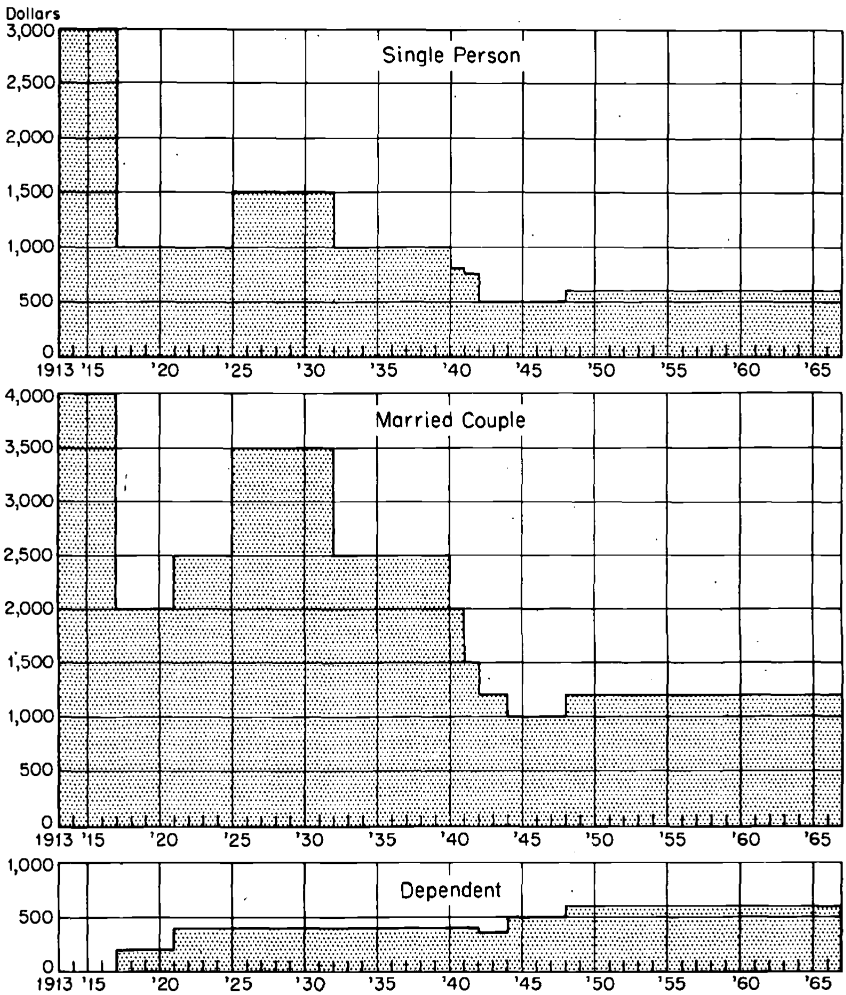
[14] *Ibid.*, pp. 485–486.

[15] *Annual Report of the Secretary of the Treasury,* 1948, pp. 50 ff., and Statements of the Secretary of the Treasury Snyder before the House Ways and Means Committee and the Senate Finance Committee on H.R. 4790, reproduced as Exhibits 27 and 28, respectively, in this *Annual Report.*

[16] *Annual Report of the Secretary of the Treasury,* 1948, pp. 302, 319.

CHART 2

Personal Exemptions in Federal Individual Income Tax, 1913–66



NOTE: For periods indicated, personal and dependent exemptions have applied as follows:

1913–34: Exemptions for normal tax only (surtax began at specified amounts of net income).

1934–43: Exemptions for both normal tax and surtax (1934–40 surtax began at $4,000 of surtax net income).

1944–45: Exemptions of $500 per capita for surtax only; for normal tax, the taxpayer was allowed a flat $500 exemption plus his spouse's income up to $500 if joint return filed.

(Note continued on page 51.)

to the remaining taxpayers with larger incomes as to those with smaller incomes and the same number of exemptions: married couples with two children, for example, would have received the same tax credit of $160 regardless of the size of their incomes. The enacted increase of $100 in per capita exemptions, on the other hand, had a tax-reducing value that varied with the highest bracket rate of the taxpayer, being worth $50 multiplied by the number of his exemptions to a man in the 50 per cent bracket, and $20 multiplied by the number of his exemptions to a man in the 20 per cent bracket. The Revenue Act of 1948 was passed over the President's veto.

CHANGES IN EXEMPTION LEVELS RELATED TO BUDGET SURPLUSES AND DEFICITS

A conspectus of the levels of the personal exemptions since 1913 is given in Chart 2 and Tables 7 and 8. Two high plateaus stand out: 1913–16 and 1925–31. In the first of these periods, a married couple with or without dependents could have an adjusted gross income as high as $4,210, and a single person $3,157, without liability for income tax (Table 8). In the second, the levels of adjusted gross income that could be reached without liability for income tax were $4,526 for married couples with two dependents, $3,684 for married couples without dependents, and $1,578 for single persons. An abrupt decline from the first plateau was occasioned by World War I, and a more gradual descent from the second, by the Great Depression and World War II. World War I brought these figures down to $2,526 for married couples with two dependents, $2,105 for married couples without dependents, and $1,052 for single persons. The Great Depression and World War II brought them down to a low of $2,222 for married couples with two dependents, $1,111 for married couples without dependents, and $556 for single persons. And just as each reduction in the level of the exemptions for single persons and married couples was occa-

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1946–47: Exemptions of $500 per capita for both normal tax and surtax.

1948–65: Exemptions of $600 per capita: prior to 1954 as a credit against net income for both normal tax and surtax; since 1954 as a deduction in computing taxable income. Since 1948 additional $600 exemptions allowed taxpayer and his spouse for old-age (65) and/or blindness.

SOURCE: Treasury Department.

TABLE 7
Personal Exemptions Since 1913

Year	Amounts of Exemption [a] (dollars)		
	Single Person	Married Person or Head of Household [b]	Each Dependent
1913–16	3,000	4,000	–
1917–20	1,000	2,000	200
1921–24	1,000	2,500 [c]	400
1925–31	1,500	3,500	400
1932–39	1,000	2,500	400
1940	800	2,000	400
1941	750	1,500	400
1942–43 [d]	500	1,200	350
1944–47 [e]	500	1,000	500
1948–	600	1,200	600

[a] Prior to 1934, allowed for normal tax only. For 1934 through 1943 and for 1946 and subsequent years, allowed for both normal tax and surtax. For 1944 and 1945, allowed for surtax only; for normal tax, each taxpayer was allowed a flat exemption of $500, plus his spouse's adjusted gross income up to $500 if a joint return was filed. From 1948 on, an additional exemption of $600 each allowed for taxpayers and their spouses aged 65 or more, and for the blind.

[b] From 1916 to 1944, the personal exemption allowed to married persons was also allowed to heads of households; prior to 1916, the latter were treated as single persons.

[c] For net incomes not exceeding $5,000 in 1921–23; above this figure the personal exemption for married persons was $2,000 in 1921–23, and was raised to $2,500 in 1924.

[d] Applicable only for the purpose of computing regular tax liability. For the Victory Tax, which was a 5 per cent tax on specially defined income, and effective only for 1943, each taxpayer was allowed a specific exemption of $624 plus a credit of 25 per cent of the tax for a single person, 40 per cent for a married person, and 2 per cent for each dependent, with the limitation that the tax credit could not exceed $100 for each dependent and $500 for any other person. For a joint return, the Victory Tax exemption of $624 was increased by the other spouse's income up to $624.

[e] In 1944–45 these exemptions were allowed only against surtax; for normal tax the exemption was $500 for each taxpayer, with no allowance for dependents, except that for a joint return, it was enlarged by the amount of the spouse's income up to $500.

TABLE 8

Maximum Adjusted Gross Income Receivable Without Incurring Liability for Income Tax, by Years Since 1913
(dollars)

Year	Single Person	Married Couple	Married Couple with Two Dependents
1913–15	3,157	4,210	4,210
1916	3,157	4,210	4,210
1917	1,052	2,105	2,526
1918–20	1,052	2,105	2,526
1921	1,052	2,631	3,473
1922–23	1,052	2,631	3,473
1924	1,052	2,631	3,473
1925–27	1,578	3,684	4,526
1928–31	1,578	3,684	4,526
1932–33	1,052	2,631	3,473
1934–35	1,169	2,923	3,859
1936–37	1,169	2,923	3,859
1938–39	1,169	2,923	3,859
1940	935	2,339	3,274
1941	789	1,578	2,421
1942–43	526	1,263	2,000
1944–45	556	1,111	1,111
1946–47	556	1,111	2,222
1948–63	667	1,333	2,667
1964–	900	1,600	3,000

SOURCE: These amounts were derived by adding the relevant personal exemptions and standard deduction for years beginning with 1944; for prior years they are the sum of the personal exemptions, credit for dependents, and earned income credit in years in which these were applicable, plus an allowance of 5 per cent of the total for nonbusiness deductions. The figures represent the maximum amounts that could be received without incurring liability for either normal tax or surtax (the Victory Tax, which was in effect only for 1943, is disregarded). No allowance is made for small differences arising from the use by many taxpayers of the simplified tax tables, nor for the option allowed taxpayers since 1954 to round their tax calculations to the nearest whole dollar, nor for the extra exemption or deduction allowed for age or blindness, nor for the possible effects of tax credits for retirement and dividend income.

sioned by a severe budget deficit, so the three times when the levels were raised were times of budget surpluses. The amount of the exemption for dependents, however, has sometimes been increased or maintained unchanged at the same time that the exemptions for others were being reduced—the purpose being to temper the effects upon large families of the reduced exemptions of parents.

STABILITY OF THE EXEMPTION LEVELS SINCE 1948

Despite wide changes in revenue needs in both directions, the levels of the personal exemptions have remained unchanged since 1948, except for the indirect increase accomplished for most small incomes through the minimum standard deduction enacted in 1964.

In 1950–51, the Korean War led to a major increase in federal taxation—an estimated $14.7 billion at 1951 income levels, of which all but $1.1 billion came from increased taxes on individual and corporation incomes.[17] In recommending that the exemptions not be lowered at that time, President Truman conceded that the rise in the cost of living had made the existing $600 per capita exemption less generous than the $500 level in effect during World War II.[18] The Consumer Price Index of the United States Bureau of Labor Statistics had risen by 48 per cent between 1944 and 1951. Moreover, the resulting shrinkage in the effective value of the personal exemptions was compounded by a sharp increase in the tax rate applicable to the first bracket and by smaller increases in the other brackets. The starting rate prior to the Korean crisis (on the first $2,000 of taxable income of a single person and $4,000 of a married couple) had been 16.6 per cent. Under the Revenue Act of 1951 it became 22.2 per cent.

Again, when a major program of tax reduction (estimated at $7.4 billion at 1954 income levels) [19] was enacted in 1954 to accompany a planned decline in military spending, the personal exemptions were once

[17] *Annual Report of the Secretary of the Treasury,* 1951, pp. 44 ff.

[18] Message to the Congress, February 2, 1951, House Document No. 53, 82nd Congress, 1st Session.

[19] *Annual Report of the Secretary of the Treasury,* 1954, pp. 43 ff. About two-thirds of the estimated revenue reduction was attributable to measures nominally enacted in 1951, the effective date of which had been deferred until January 1, 1954. The tax reductions of 1954 were partly offset by an increase in social security taxes.

more left unaltered. As in 1950–51, a change in the tax rate applicable to the first bracket of taxable income—a decrease from 22.2 to 20 per cent—was chosen to accomplish an important part of the desired alteration both in total tax liabilities and in those of the lowest of the taxable income groups.

It is significant that the combination of the wide coverage of the income tax at the current exemption levels and the substantial first bracket tax rate, enabled Congress to alter individual income tax liabilities materially in opposite directions in 1950–51 and in 1954 without changing the level of the personal exemptions.

During this period, there appeared to be a growing acceptance of the view, in principle at least, that fiscal policies should be designed to promote economic stability by countercyclical variations in taxation and public expenditures. Through its public hearings and its reports to Congress, the Joint Congressional Committee on the Economic Report, created under the Employment Act of 1946, called wide attention to the important possibilities of both restrictive and expansionary fiscal policies as counterforces, respectively, against inflation and depression. Nevertheless, the major tax increases occasioned by the Korean War were largely supported on the traditional grounds of the need to balance the budget, though strong emphasis was also laid on the anti-inflationary contribution of increased taxation. Similarly, the important tax reductions of 1948 and 1954 do not appear to have been motivated by anticipations of the economic recessions of 1948–49 and 1953–54. Subsequently, however, the possible relationship of the tax reductions to the mild character and brief duration of these two postwar recessions received considerable notice.[20] And temporary alterations in the level of the personal exemptions for anticyclical purposes were among the expedients proposed in public discussion in more recent business recessions.

Finally, in 1963, President John F. Kennedy expressly proposed a major reduction in taxes for the deliberate purpose of stimulating the economy: to reduce unemployment and increase the nation's rate of economic growth. In the face of continuing budget deficits, he proposed

[20] Among others, see Alvin H. Hansen, "Brief Note on the Role of Consumption in the 1954–55 Recovery," *The Review of Economics and Statistics,* November 1955, pp. 424–425; Bert G. Hickman, "The Contraction of 1953–54," *The Review of Economics and Statistics,* February 1958, pp. 36–48, and accompanying comment by Alvin H. Hansen.

net reductions aggregating $10.2 billion annually in individual and corporation income tax rates. In his message to Congress of January 24, 1963, he declared:

> Originally designed to hold back war and postwar inflation, our present income tax structure now holds back consumer demand. After the Korean conflict, the outburst of civilian demand and inflation justified the retention of this level and structure of rates. But it has become increasingly clear—particularly in the last five years—that the largest single barrier to full employment of our manpower and resources and to a higher rate of economic growth is the unrealistically heavy drag of Federal income taxes on private purchasing power, initiative, and incentive. Our economy is checkreined today by a war-born tax system at a time when it is far more in need of the spur than the bit.

After more than a year of committee study and debate, Congress enacted income tax reductions expected to total $11.7 billion annually at 1964 levels of income, to take effect over a two-year period.

Again, a change in the level of the personal exemptions proper was rejected as a means of implementing the desired alteration in tax liabilities. Instead, as noted previously, a new minimum standard deduction was introduced, at an estimated revenue cost of $320 million, as a means of giving additional tax relief to taxpayers with the smallest incomes.[21]

The stability of the exemption levels since 1948, in the face of wide changes in both directions in the amount of revenue sought, is not difficult to understand. Even seemingly modest changes in the amount of the present type of per capita exemption produce such widespread and pronounced effects that they do not lend themselves readily to highly selective or discriminating use. For example, if Congress had desired in 1960, in recognition of the rise in the cost of living since 1948, to raise by $100 per capita the minimum amount of income that could be received without liability for income tax by those at the lower end of the income scale, it would have found that a uniform increase of $100 in the per capita exemptions would have gone far beyond its aim. The loss in tax revenues, assuming no other changes, would have been great —about $3.4 billion—yet we estimate on the basis of the 1961 tax returns that less than 14 per cent of the reduction in tax liabilities would

[21] *Report of the Committee on Ways and Means to Accompany H.R. 8363,* Washington, 1963, p. 24.

have gone to those with adjusted gross income under $3,000, while 58 per cent would have gone to those with adjusted gross income of $5,000 or more. In short, enlarging the present type of per capita exemptions would have produced tax reductions that were differently distributed and more widespread than those intended.

For somewhat similar reasons, but also in the interests of public understanding, frequent alterations in the exemption levels for short-term countercyclical purposes are less appealing than changes in rates. Steady exemption levels are readily understood as an integral component of the income tax, one that provides a deduction from otherwise taxable income for the taxpayer's minimum family responsibilities. Frequent alterations in these levels would be likely to be mistakenly interpreted by many as directed primarily at upward or downward adjustment in the taxes levied on the lowest of taxable income groups. Their wide and complex effects upon tax liabilities and effective tax rates are far less likely to be understood than those of direct changes in bracket rates. And ease of understanding is important for the purpose of maximizing taxpayer compliance and goodwill. Finally, as Vickrey has emphasized, changes in bracket tax rates are more readily reversible than changes in the exemption levels.[22]

The indirect increase in effective personal exemptions at the lower levels of income that was accomplished by the introduction of the minimum standard deduction in the massive tax cuts of 1964 avoided the more diffused, less widely understood, and possibly less reversible results of a rise in the nominal per capita exemptions; the major part of the tax cuts was accomplished by overt reductions.

[22] William Vickrey, "Adjustment of Income Tax Schedules for Small Incomes," in *Federal Tax Policy for Economic Growth and Stability,* Joint Economic Committee, 84th Congress, 1st Session, Washington, 1955, pp. 347 ff.