

An hourglass-shaped graphic with a globe of the Earth inside. The top bulb is dark blue, and the bottom bulb is light blue. The hourglass is centered on the page.

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*Additional Standard Tax Deduction for the Elderly: A
Description and Assessment*

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Abstract. An additional personal exemption for elderly taxpayers was enacted by the Revenue Act of 1948 (P.L. 80-471). The rationale for the provision was to accord the elderly tax relief because the elderly had small incomes and are unable to adjust their incomes in response to increases in the cost of living since they no longer work. Congress attempted to target the tax benefit to low- and moderate-income elderly individuals by substituting an additional standard deduction for the personal exemption amount in the Tax Reform Act of 1986 (P.L. 99-514). The additional standard deduction for both the elderly and the blind is projected to cost \$9 billion in lost tax revenue over the next five years and fails to meet the economic tests of horizontal and vertical equity among taxpayers. The provision could be corrected with alternative policies. If Congress wanted the provision more focused to benefit lower-income elderly, then it could be converted to a tax credit with a phaseout range.

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CRS Report for Congress

Additional Standard Tax Deduction for the Elderly: A Description and Assessment

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Summary

An additional personal exemption for elderly taxpayers was enacted by the Revenue Act of 1948 (P.L. 80-471). The rationale for the provision was to accord the elderly tax relief because the elderly had small incomes and are unable to adjust their incomes in response to increases in the cost of living since they no longer work. Congress attempted to target the tax benefit to low- and moderate-income elderly individuals by substituting an additional standard deduction for the personal exemption amount in the Tax Reform Act of 1986 (P.L. 99-514).

The additional standard deduction for both the elderly and the blind is projected to cost \$9 billion in lost tax revenue over the next five years and fails to meet the economic tests of horizontal and vertical equity among taxpayers. The provision could be corrected with alternative policies. If Congress wanted the provision more focused to benefit lower-income elderly, then it could be converted to a tax credit with a phaseout range.

This report will be updated as warranted by future developments.

Brief Summary of Current Law

Tax laws provide certain allowances for the elderly. Among the most important is the availability of an additional standard deduction amount allowed for those age 65 years or older. Other special tax allowances are included in other provisions of the law,¹ such

¹ For more information on the provisions available to aged taxpayers, see the U.S. Department of Treasury, Internal Revenue Service's annual publication entitled *Older Americans' Tax Guide* (continued...)

as the preferential tax treatment accorded Social Security and railroad retirement benefits and the favorable tax treatment accorded long-term care expenses.² Only the additional standard deduction amount for the elderly, however, is reviewed in this report.

Present law provides that individuals are entitled to claim a standard deduction amount rather than itemize deductions. In tax year 2008, the standard deduction amounts that taxpayers may deduct from their income are \$5,450 if single; \$8,000 as head of household; or \$10,900 if married and filing jointly. In 2008 the additional standard deduction is \$1,050 for each qualifying taxpayer filing a joint return who is 65 or older or blind. The deduction rises to \$1,350 if the taxpayer is single or head of household and 65 or older and blind. If taxpayers are married and both spouses are 65 or older or blind, an additional \$2,100 is allowed on a joint return. If both spouses are 65 or older and blind, an additional \$4,800 is allowed on a joint return. These amounts are adjusted annually for inflation. The additional standard deduction amount is not allowable for a dependent who is 65 years old or blind.³

Legislative History and Rationale

In the past, the advocates of special tax provisions for elderly taxpayers have justified tax concessions based on need. They argued that the elderly have small incomes and are unable to adjust their incomes in response to increases in the cost-of-living since they no longer work. Thus, it is no surprise that legislative history indicates that the underlying basis of the special tax concessions for the elderly is need: that older persons are not as well off as younger persons who are still working.

At the introduction of the provision for an additional personal exemption in the 1947 tax bill (which was later vetoed), the House Ways and Means Committee and the Senate Committee on Finance recognized these considerations in their reports on the bill. In the Revenue Act of 1948 (P.L. 80-471), the additional personal exemption was proposed again based on these considerations. Both the House Ways and Means Committee and the Senate Committee on Finance reported that:

There is a very heavy concentration of small incomes among persons in this age group reflecting the fact that the group as a whole is handicapped in an economic, if not in a physical sense. Persons in this age group suffered with unusual severity as a result of the rise in the cost of living and the increase in taxes which occurred during the war, as well as the additional price increases of the immediate post-war period. Unlike younger persons, the bulk of those over 65 could not compensate for these

¹ (...continued)

(Publication 554) available free from your local IRS service office or on the web at [http://www.irs.gov/pub/irs-pdf/p554.pdf], visited January 19, 2005.

² For more information on this provision, see U.S. Congress, Joint Committee on Taxation, Description of Federal Tax Rules and Legislative Background Relating to Long Term Care, JCX-18-01, 107th Cong., 1st sess. (Washington: GPO, 2001) 9 p. [http://www.house.gov/jct/x-18-01.pdf], visited January 19, 2005.

³ For more information on statutory marginal tax rates, personal exemption and standard deduction amounts, see CRS Report RL30007, *Individual Income Tax Rates: 1989 through 2007*, by Gregg A. Esenwein.

changes in prices and taxes by accepting full-time jobs at prevailing high rates of wages.⁴

Along with the addition of an extra personal exemption for the elderly, the 1948 act increased the personal and dependency exemption amounts from \$500 to \$600 per person. The Senate committee report noted that in 1947 dollars, income after taxes had declined from an average of \$1,285 in the first quarter of 1946 to \$1,188 in the fourth quarter of 1947. The extra personal exemption for the elderly was incorporated unchanged in the Internal Revenue Code Act of 1954 (P.L. 83-591). As the personal and dependency exemption amounts increased over the years, so too did the amount of the additional exemption accorded the elderly. The exemption amount increased from \$625 in 1970 to \$1,080 in 1986.

A comprehensive revision of the income tax code was made with enactment of the Tax Reform Act of 1986 (P.L. 99-514). The revision was designed to lead to a fairer, more efficient, and simpler tax system. In order to lower tax rates, the act broadened the tax base by removing the preferential treatment of certain classes of income and expenditures (e.g., capital gains, two-earner wage deduction, personal interest deductions, etc.). This act also repealed the dividend exclusion, the political contributions credit, and the provision for income averaging. Both the personal exemption amount and the standard deduction amounts were raised, thus reducing the number of taxpayers who would find it advantageous to itemize their income tax deductions.

Further, the act repealed the additional personal exemption amount for the elderly and/or blind and in its place instituted an extra standard deduction amount for both elderly and/or blind taxpayers. This additional standard deduction amount was combined with the increased standard deduction provided by the 1986 Act.⁵ As noted earlier, both the standard deduction and additional standard deduction amounts (for elderly and/or blind taxpayers) are indexed for inflation.

Higher income taxpayers are more likely to itemize their deductions than lower and moderate income taxpayers, who are more likely to use the standard deduction. Thus, a personal exemption has greater value for higher income taxpayers than an additional standard deduction amount. All taxpayers can use a personal exemption whereas an additional standard deduction can be used only by those who forgo itemizing deductions.⁶ In the 1986 tax act, Congress was attempting to target tax benefits to lower and moderate income elderly and blind taxpayers by substituting an additional standard deduction amount for the additional personal exemption amounts permitted those groups under prior law.

⁴ U.S. Congress. House. Committee on Ways and Means. *Revenue Act of 1948, Report to Accompany H.R. 4790*, 80th Cong., 2nd session, H.Rept. 1274. Washington: GPO, 1948, p. 20. And also U.S. Congress, Senate, Committee on Finance, *Revenue Act of 1948*, 80th Cong., 2nd session, S.Rept. 1013, Washington: GPO, 1948, p. 21.

⁵ The higher standard deduction amounts were effective one year earlier (1987) for elderly or blind individuals.

⁶ The 1986 Act provided that beginning in 1988, the personal exemption is reduced (or phased out serially) for high-income taxpayers. The phaseout levels are adjusted for inflation.

Assessment

It may be that the elderly have been singled out for special tax treatment because Americans can relate to — and are related to — the aged. Tax benefits are frequently available to taxpayers' parents and grandparents and are viewed as one method of enabling relatives to remain independent. Further, younger taxpayers may see this tax benefit as one that they will enjoy in future years. Thus, to the extent that the current benefits will be available to them, they are likely to be supportive of such tax advantages. To the extent that benefits remain the same over generations, any advantages to those now elderly compared with those who are young now (but who will be elderly later) are small.

As noted earlier, advocates for the elderly justify special tax treatment based on need. They argue that the elderly face increased living costs primarily due to inflation. For example, the elderly are frequently faced with increased medical costs that have risen faster than prices on many goods and services.⁷ While facing these increasing costs, the elderly often have age-related physical attributes that give rise to a diminished ability to work.

Nevertheless, the premise underlying the original rationale for the provision no longer holds true. The argument was that the elderly were faced with inflation while their incomes were held flat. Since 1975, Social Security benefits are adjusted annually for cost inflation. Further, to protect the elderly from high medical costs, the federal government has established the Medicare Program. Thus, while it is still true that many elderly individuals have low incomes, it is no longer true that the elderly have the highest rate of poverty. Indeed, more children are found to live in poverty than the aged.⁸ Because the provision is not precisely targeted at need, these changing characteristics of the elderly mean that many who are not poor receive the benefit.

Although not all who qualify for the benefit are needy, it is true that not all the elderly who are needy can claim the benefit of the additional standard deduction since low-income elderly individuals, who would already be exempt from tax without the tax incentive, receive no benefit. Thus, while these individuals are the most in need of financial assistance, they receive no benefit from the tax concession. Additionally, the provision does not benefit those elderly taxpayers who itemize deductions (such as those with large medical expenditures in relation to income). Moreover, the value of the additional standard deduction amount is of greater benefit to higher rather than lower income taxpayers (in those cases where the taxpayer does not itemize).

Another targeting issue is presented by those who are not elderly themselves, but provide care for older persons. As previously mentioned, a taxpayer who supports an elderly dependent may not claim the additional standard deduction amount. Many believe that a taxpayer who must incur additional expenses for an elderly dependent has as much justification to claim the additional standard deduction amount as that dependent.

⁷ Note that benefits under Medicare are not taxed.

⁸ See U.S. Department of Commerce. A Joint Project Between the Bureau of Labor Statistics and the Bureau of the Census. *Current Population Survey, Annual Demographic Survey, March Supplement*. [http://ferret.bls.census.gov/macro/032004/pov/new01_100_01.htm], visited January 19, 2005.

As noted previously, the tax benefit is currently more accurately targeted at need than before the TRA86 changed the extra personal exemption to an extra standard deduction amount. Low-income taxpayers most frequently use the standard deduction while higher income taxpayers are more likely than low-income individuals to itemize deductions. This is because higher income taxpayers are more likely to own their homes and therefore claim mortgage interest and property tax deductions. Additionally, higher income taxpayers may also owe state income taxes that are deductible in determining federal taxable income. Conversely, it is true that many of our elderly have paid for their homes, and thus, no longer have mortgage interest deductions. However, in general, it remains true that as an additional standard deduction amount, this tax benefit for the elderly is more likely to go to lower or moderate income elderly taxpayers than would an itemized deduction. Unfortunately, statistics are not available that separate those who claim that the age deduction versus those who claim that the blindness additional standard deduction amount. Presumably, most qualify based on age but there are no precise data.

Even if the tax provision were more precisely targeted and it was only available to the needy, it could still be criticized on equity grounds: it discriminates against other needy taxpayers. One notion of fairness is that the tax system should be based on one's ability-to-pay and that ability is based upon the income of taxpayers — not age.⁹ Thus, the provision of an “extra” standard deduction amount for age “violates” the principle of “horizontal” equity: since people with equal incomes will not pay equal taxes if one is young and the other elderly. Further, the original rationale for the provision (as cited earlier in this report) noted that the elderly were “handicapped in an economic, if not in a physical sense”. Thus, as but one example, other taxpayers with disabling conditions may be in as much need of tax relief. For, just as the elderly are faced with diminished earning capabilities so too are many disabled persons due to their individual impairments. Further, like many elderly, many disabled taxpayers have low incomes.

Congress may review alternatives that would improve the targeting of the provision. The availability of this provision was founded on the taxpayer having attained 65 years of age. In the intervening years, life expectancy has increased. The Social Security program recognized this fact and provided that future retirees will receive full benefits but only at higher age levels. One alternative would be to raise the eligibility age. For example, the Census Bureau reported that total money income of the elderly declines when those between the ages of 65 to 74 years old are compared with those 75 years and over.¹⁰ Thus, to return the program to its original rationale (need and the inability to compete financially with taxpayers still working), age could be correlated to the poverty level to determine a more advanced age at which to provide this tax benefit.

Options for Change

⁹ Vertical equity is the relative tax burden borne by individuals at different income levels. Vertical equity requires that taxpayers with large incomes pay more in taxes than taxpayers with smaller income.

¹⁰ See U.S. Department of Commerce. A Joint Project Between the Bureau of Labor Statistics and the Bureau of the Census. *Current Population Survey, Annual Demographic Survey, March Supplement*. [http://ferret.bls.census.gov/macro/032004/perinc/new04_001.htm], visited January 19, 2005.

As previously noted, the value of the additional amount is greater for higher rather than lower income taxpayers. If Congress wanted the provision more focused to benefit lower income elderly then it could be converted to a tax credit with a phase-out range. For example, the dependent care tax credit amount decreases as income rises. The credit might be made unavailable to higher income taxpayers such as is done in the case of the tax credit for the elderly and permanently and totally disabled. Another alternative would be to investigate a change from a tax-based program to a grant program. Under a grant program, the revenue costs are known and benefits precisely targeted with conclusive rules and regulations. It may be noted, however, that a grant results in taxable income to the recipient unless specifically excluded by statute.

Demographic trends are such that with the nation aging it may be that this tax expenditure could grow in size. The Joint Committee on Taxation estimated that the revenue cost over the five fiscal years of 2007-2011 at \$8.9 billion for those who use the additional standard deductions available to the elderly and blind.¹¹

¹¹ U.S. Congress, Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2007-2011*, JCS-3-07, (Washington: GPO, 2007), p. 35.